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Chemicals M&A Review

theValenceGroup

IN THIS ISSUE

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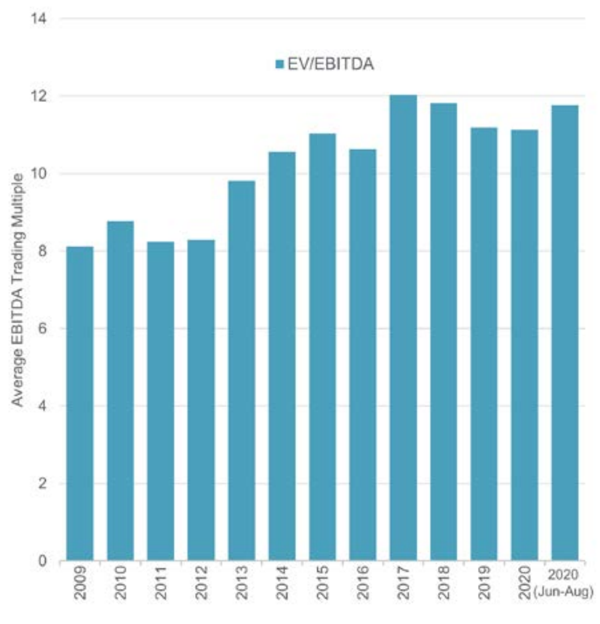
Highlights

- V-shaped recovery in chemical M&A transaction volumes with a return to recent high levels
- High-tier specialty chemical companies valuations continue to rise and now approaching 20x EBITDA
- Valence indices show share prices gains with many sub-segments outperforming global stock markets
- Chemical company profits rebound and could drive valuations further into 2021

Chemical Companies Valuations and Profits

For obvious reasons we decided not to publish a newsletter earlier in the year. It would have been perhaps foolish to opine on how chemical companies, valuations and M&A would perform during a pandemic, especially as timescales and impacts on economies was so hard to understand, let alone predict. Now that we appear to have passed the first phase of the crisis and we have observed chemical company Q2 results, forward visibility is hopefully a little clearer and our outlook is based on more solid ground.

Figure 1: Chemical Company Trading Multiples



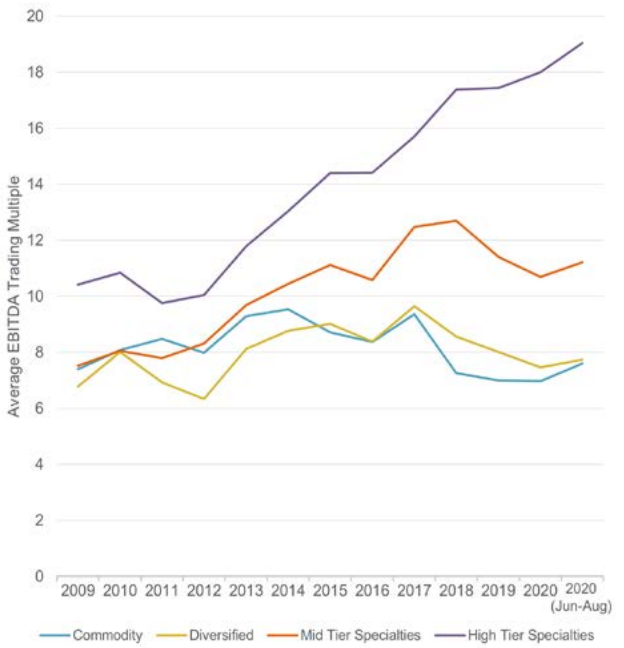
The Valence Group and CapIQ analysis based on 90 mostly European and North American chemical companies.

Certainly the doomsday scenarios from some forecasts have not come to pass for the chemical industry. Some sectors have performed admirably with strong profitability, despite general GDP declines. In particular, electronic chemicals, food related products, products related to home improvements and of course, biocide related products for both consumer and industrial sanitisation have all outperformed. Other segments closely related to aerospace and auto production have seen significant revenue falls of up to 20-30% in Q2, including engineering plastics, composites and industrial coatings.

However, despite some significant revenue impacts, profits have generally remained relatively strong across chemicals, partially supported by lower raw material and other costs. The result has been a much stronger chemical company performance in 2020 H1 than originally feared and, combined with the general uptick in the stock markets globally, has seen valuations remain at pre-Covid-19 levels. As shown clearly in Figure 1, valuations in 2020 have not fallen noticeably. EBITDA multiples have remained at about 10x EBITDA for 2020 as a whole and the last three months have seen valuations rise above 2019 levels.

As you would expect, this averaging masks the underlying dynamics. There has been a “flight to quality” or rather a move towards more stable earnings. Figure 2, show the valuations across the different sectors of the chemical industry.

Figure 2: Trading Multiples by Chemical Segment



The Valence Group and CapIQ analysis based on 90 mostly European and North American chemical companies.

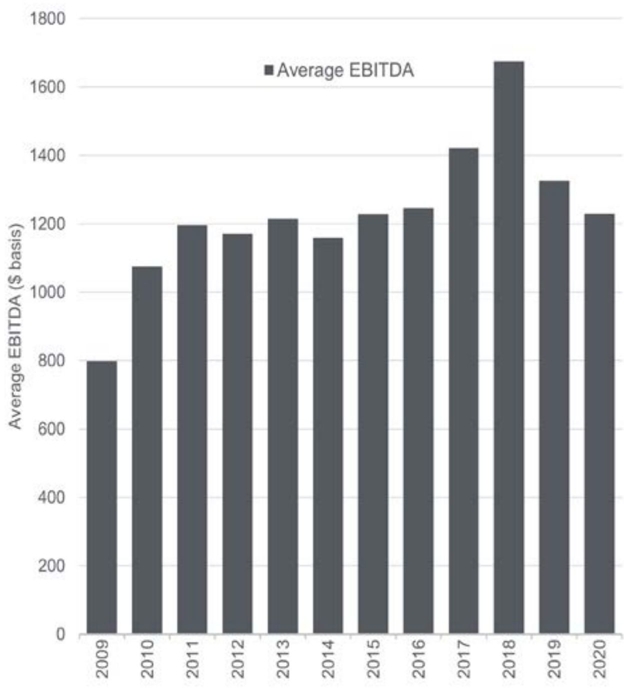
Most apparent is the huge increase in valuation in high tier specialty chemicals – this includes segments such electronic chemicals, food ingredients and personal care chemicals. This almost doubling of EBITDA multiple in the last 10 years has been driving much of the chemical company valuation increase in the last few years and during the Covid-19 crisis.

With high end specialty chemicals continuing to grow, consolidate and expand through M&A, this will underpin chemical company valuations as a whole. The so-called mid-tier specialties in areas such as adhesives, coatings and polymer additives have also seen valuations rise over the last 10 years.

But without doubt, the relatively stagnant valuation levels of commodity, intermediates and diversified chemicals has been just as important in determining the dynamics of the chemical industry.

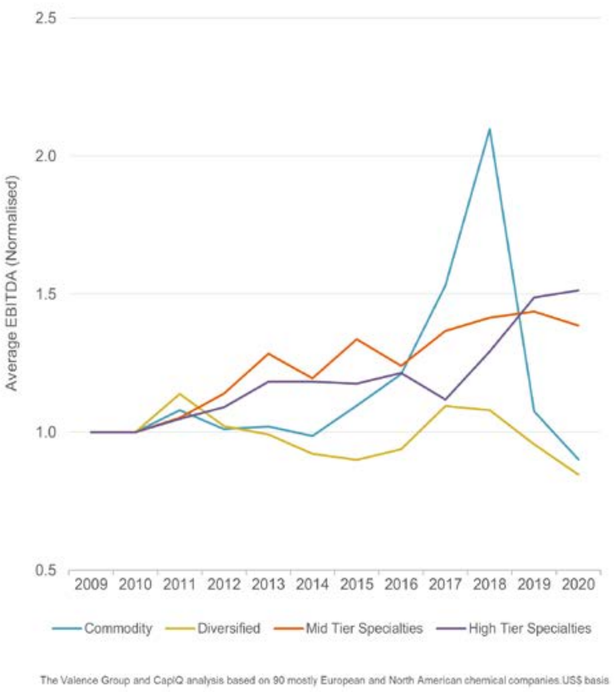
The question of profitability and stability is often cited as the key to valuation. In fact, as outlined in previous newsletters, future profit growth is the key determinant of valuation. This is starkly demonstrated in Figures 3 and 4 where average profit is shown for the different segments.

Figure 3: Chemical Company Average EBITDA



The Valence Group and CapIQ analysis based on 90 mostly European and North American chemical companies.

Figure 4: Chemical Company Profits by Chemical Segment



The high tier specialties have shown stable and consistent profit growth and this has been reflected in the increasing valuation. For commodities and diversified chemicals, the declining profits have directly translated into lower trading multiples. This is hardly surprising and the recent stock market valuations across the Nasdaq and S&P have underlined that rising profits or growth prospects are the driver of valuation – even if this is concentrated in only a few sectors or even companies.

Simply put, valuations in chemicals are following the profit curve. If, as seems likely, this growing disconnect between valuations of many specialty chemical sectors and much of the upstream and more intermediates parts of the chemicals chain continues, we could see a fracturing of the chemical industry. As downstream, more market facing chemical companies keep expanding their presence and profits (while in parallel valuations continue to rise), it will become much more challenging for diversified or commodity companies to acquire these businesses. Valuations and acquisition prices will stretch balance sheets and be more difficult to justify to shareholders. The result will be that the chemical industry will be split into two. The implication for larger, lower valued companies is that a strategic push to move further downstream or into higher growth more market/product focused areas will be imperative over the next years.

Simply waiting for a cyclical upturn or geographic expansion, although beneficial, is not a long term strategy and further repositioning and acquisitions are imperative. Companies such as DSM have already successfully embarked on this strategy but we would now expect other companies to follow suit.

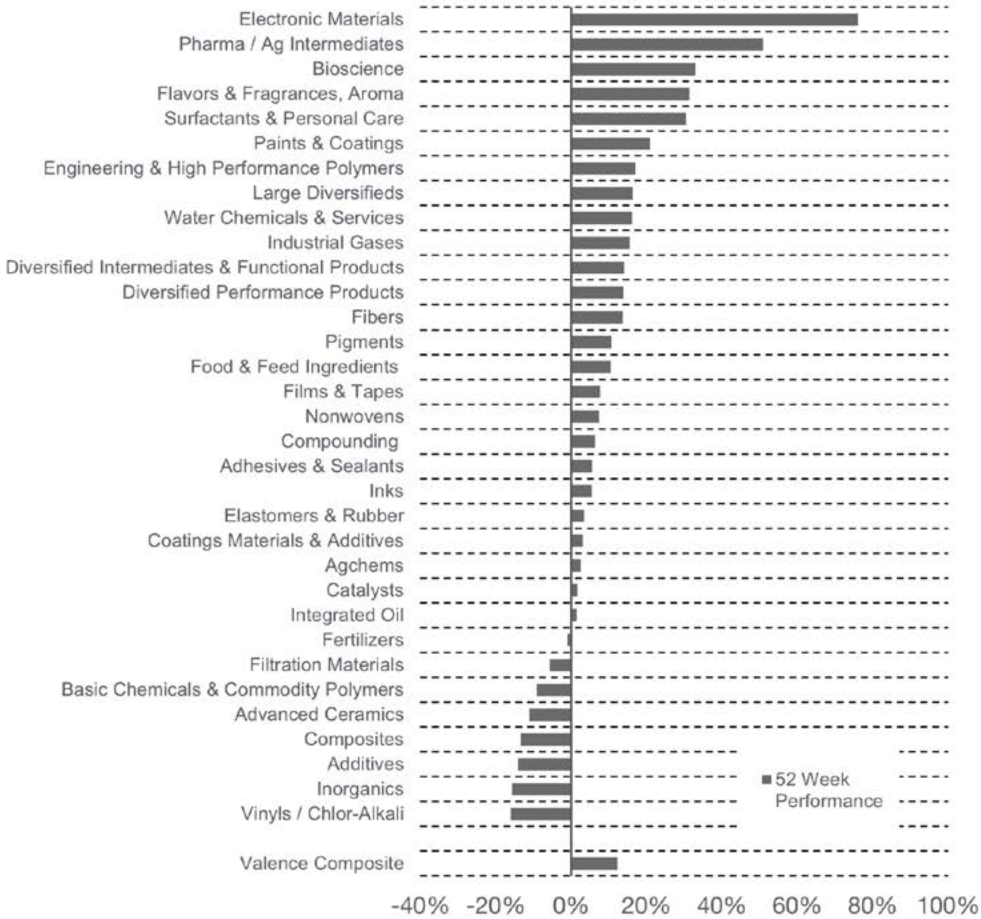
The next few years will likely see an acceleration of this portfolio realignment as companies realise the need to maintain growth and profit stability.

Valence Indices - Chemicals & Materials

On a more detailed sub-segment level, it almost goes without saying that share prices have been on a rollercoaster ride over the last 12 months. Prices across all markets have been impacted by the challenging economic situation resulting from the Covid-19 crisis.

Chemical sub-segments have been no exception but, mirroring the broader economy, the chemicals industry has been impacted to varying degrees. Indeed certain sub-sectors have outperformed the wider market even registering significant gains over the last 52 weeks. The Valence Indices follow the share price movements of c. 230 chemicals and materials companies and are categorised into c. 30 different sub-sectors. Each of the sub-sectors is comprised of companies which predominantly compete in those products or end markets or alternatively have larger more diversified portfolios. Therefore they are an excellent benchmark of both the chemical industry stock performance and also investors view of the outlook for specific sub-segments. Most strikingly, as shown in Figures 5 & 6, the Valence Indices show huge differences across sub-sectors.

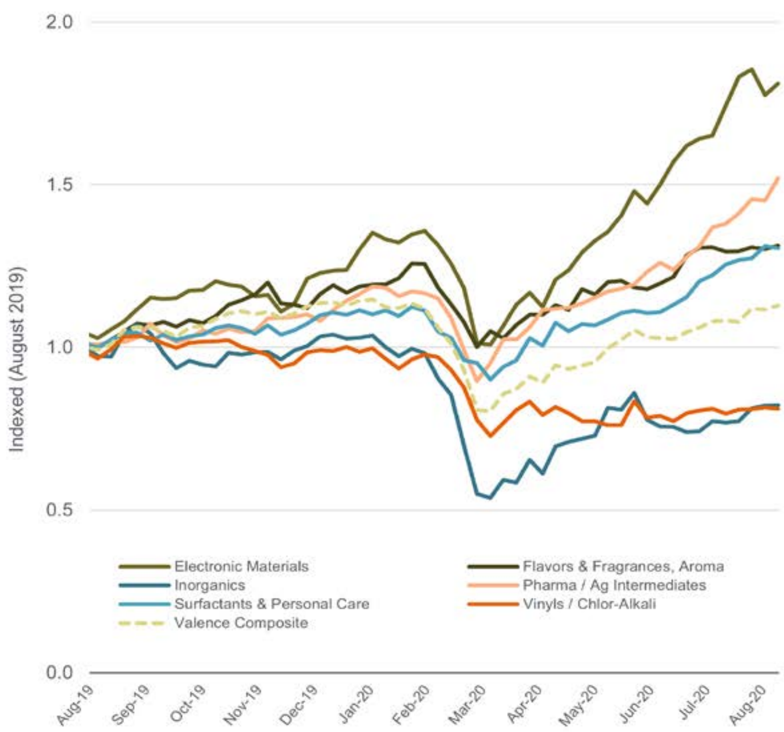
Figure 5: Valence Chemical Indices by Sub-Segment – 52 Week



The Valence Group and CapIQ analysis

Although there was the collapse in prices in mid-March as global markets fell, the subsequent development has been very different depending mainly on the end market dynamics. As expected many of the sub-sectors have seen losses over the past year, largely driven by the recent downturn in end market demand since the end of Q1 2020. Generally, the more commodity focused segments have seen the greatest losses, of c. 10-20%, while more specialized or "functional" type portfolio companies have been impacted less e.g. Compounding and Catalysts. Those with a more commodity centered portfolios have also been hit by oil prices and resulting lower product selling prices and the potential impact on profits. Remarkably some of segments have chalked up strong gains including Electronic Materials and Pharma / Ag Intermediates. In the context of the current markets, the Electronic Materials index in particular has seen almost spectacular growth over the last year. This is partly attributed to the continuing consolidation in the sector, strong results in Q1 for several companies and perhaps the broader Nasdaq favouring electronics stocks. Whether the product portfolio of electronic chemical companies, where profit growth is derived from new products, will be sufficient to support this current share price appreciation remains to be seen.

Figure 6: Selected Valence Chemical Indices – Last 52 weeks



The Valence Group and CapIQ analysis

The stock appreciation of other sectors such as Pharma / Ag Intermediates and Water and Chemical Services is more straightforward. The demand for pharmaceuticals from more basic products such as paracetamol, as well as a range of newer more sophisticated actives, has risen on the back of increasing consumer purchasing and healthcare providers stockpiling. For Water and Chemical Services, many of these companies are also involved in disinfection which only adds to the stability and growth of these companies.

Those segments with less cyclical exposure appear to have had this reflected in their stock prices, with limited movement over the last 12 months. Examples include Surfactants & Personal Care which has continued to perform strongly and Food & Feed Ingredients which have been resilient.

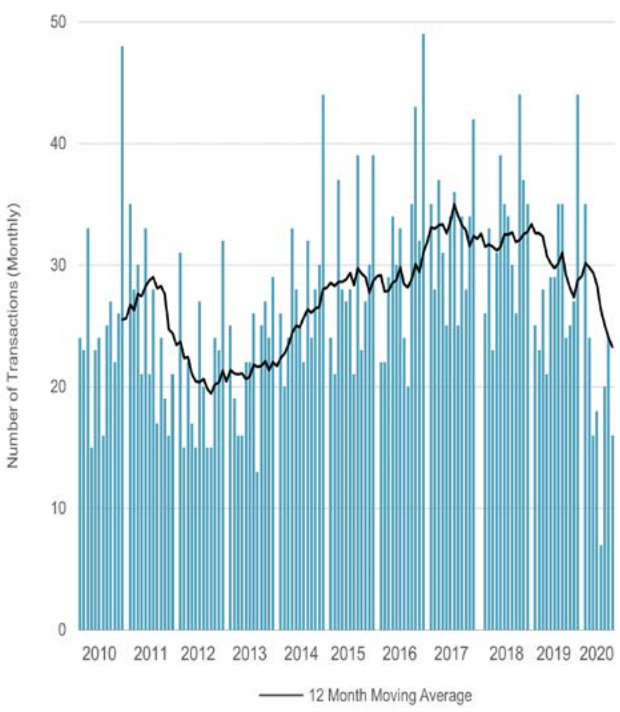
It is no surprise that businesses most affected in the last months are those linked to automotive, construction & aerospace. Chlor-vinyls, composites & inorganics have all seen declines since the beginning of the year of up to 40% (Figure 6). Unless the auto or aerospace sector starts to show growth again, it is difficult to see how many of these sectors will be able to reach pre-Covid-19 levels in the near to mid-term.

Amongst all the recent declines, there is one “stand-out” sub-sector which at first glance appears at odds with the general trends: the rise of the Nonwovens index. The rapidly growing demand for PPE (Personal Protection Equipment), especially for face masks, has resulted in a boom in demand in a sub-sector not normally known for high growth. Perhaps as the market evolves in parallel to the global pandemic, other sub-sectors will rise more strongly as demand shifts to other products. Nobody would have predicted the recent surging demand for polycarbonate and PMMA sheet, disinfectants and nonwovens even a few months ago.

Volumes of M&A and Outlook

Predictably M&A volumes fell from late February, first with Chinese M&A deal flow declining followed by Europe and the US. In May 2020, when all regions were either under lockdown or just emerging, the number of announced transactions fell to an all-time low, registering only seven chemical deals (>$10m). In fact the average number of deals from March-May was the lowest we have recorded. Figure 7 shows monthly chemicals deal volumes since 2010.

Figure 7: Monthly Chemicals M&A Volumes



The Valence Group and CapIQ analysis

All of this was hardly unexpected, but more surprising has been the strength of the recovery since early June this year. Chinese transactions started to pick-up in early June and since late June both the US and Europe have witnessed increased deal flow. Volumes are now at pre-Covid levels and despite a summer break in August, there are signs the transactions are again increasing and businesses are being brought to market.

The larger question remains whether this deal volume can be maintained. Certainly some of the transactions we see now are delayed from earlier in the year which will inevitably decline as the year progresses. But we believe there are several fundamental industry dynamics that will underpin M&A volumes in the short- medium term as Covid plays out. Specifically:

1. Integrated oil majors realigning portfolios: BP's recent divestment of its chemicals business to Ineos is the most obvious example but other oil majors are now also preparing businesses for divestment
2. Companies taking advantage of the Covid induced spending shift: Companies in areas such as home improvement and electronic chemicals will take advantage of the current situation. Henkel's recent acquisition of the Momentive Sealants business is a prime example
3. Further investment in less cyclical businesses: Chemical companies have been impacted by the volatility in areas such as auto related plastics, oil and gas chemicals and even high end composites for aircraft. The result will be both divestment of cyclical businesses and acquisition of more resilient chemicals in downstream areas
4. Asian acquirers: There has been recent strong interest from buyers in Japan, South Korea and S.E. Asia to diversify downstream and also acquire strategic footholds in Europe/North America
5. Acceleration of the on-going portfolio realignment and consolidation in the chemical industry
6. Companies using highly valued stock to finance deals

All of these factors combined with a potentially improving economic backdrop will spur M&A volumes in the next 6-18 months. Rising profits across many sub-segments and increased debt availability will also boost the demand for acquisitions. ***The Valence Group analysis and intelligence indicate a significant number of chemical business divestments are set to be launched in September/October.*** Therefore we expect Q4 2020 will see M&A volumes returning to levels of the last few years and valuations remaining robust.

Piper Sandler acquired the preeminent chemicals M&A firm, The Valence Group, on April 3, 2020. The Valence Group is a specialist investment bank offering M&A advisory services exclusively to companies and investors in the chemicals, materials and related sectors.

The Valence Group team includes a unique combination of professionals with backgrounds in investment banking, strategic consulting and senior management within the chemicals and materials industries, all focused exclusively on providing M&A advisory services to the chemicals and materials sector.

MOMENTIVE
jointly owned by
KCC SJL PARTNERS
is selling its
Consumer Sealant business to
Henkel
The Valence Group acted as
Financial Advisor to Momentive

CLARIANT
has sold its
Masterbatches business to
PolyOne
The Valence Group Issued a
Fairness Opinion to Clariant

INDORAMA VENTURES
has acquired the
Integrated Oxides and Derivatives
Businesses of
HUNTSMAN
The Valence Group acted as
Financial Advisor to Indorama Ventures

synthomer
has acquired
OMNOVA SOLUTIONS
The Valence Group acted as
Financial Advisor to Synthomer

ARKEMA
has acquired
ArrMaz
from
GOLDEN GATE CAPITAL
The Valence Group acted as
Financial Advisor to Arkema

INEOS
has acquired the
Ashtabula, OH Titanium
Dioxide plant of
TRONOX
The Valence Group acted as
Financial Advisor to INEOS Enterprises

SK CAPITAL
has acquired the Performance
Products and Solutions Division from
PolyOne
The Valence Group acted as
Financial Advisor to SK Capital

CPS PERFORMANCE MATERIALS CORP
a portfolio company of
ARSENAL CAPITAL PARTNERS
has acquired
GEO SPECIALTY CHEMICALS
The Valence Group acted as
Financial Advisor to CPS/Arsenal

GOLDEN GATE CAPITAL
has acquired
ActiveMinerals INTERNATIONAL, LLC
from
MERIT CAPITAL PARTNERS
The Valence Group acted as
Financial Advisor to Golden Gate

INEOS
has acquired the Composites
business and German BDO plant of
Ashland
The Valence Group acted as
Financial Advisor to INEOS Enterprises

Charlesbank CAPITAL PARTNERS LLC
has sold
PLASKOLITE
to
PPC Partners
The Valence Group acted as
Financial Advisor to Charlesbank

DUNES POINT CAPITAL
has sold
MILLER
to
HUBER
The Valence Group acted as
Financial Advisor to Dunes Point Capital

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INEOS
has sold its
Melamines & Paraform businesses to
prefere resins
The Valence Group acted as
Financial Advisor to INEOS Enterprises

The Carlyle Group GIC
have acquired the
Chemicals business of
AkzoNobel
now known as
Nouryon
The Valence Group acted as
Financial Advisor to Carlyle

Solenis
a portfolio company of
Clayton Dubilier & Rice
has merged with the
Paper and Water
Chemicals business of
BASF
The Valence Group acted as
Financial Advisor to Solenis

ChemicaInvest
a joint venture of
DSM CVC Capital Partners
has sold
FIBRANT
to
HSC
The Valence Group acted as
Financial Advisor to ChemicaInvest

US Silica
has acquired
EP Minerals
a portfolio company of
Golden Gate Capital
The Valence Group issued a
Fairness Opinion to the
Board of Directors of U.S. Silica

SK Capital
has acquired the
Fire Safety and Oil Additives
businesses of
ICL
The Valence Group acted as
Financial Advisor to SK Capital

ITAÚSA
has sold
Elekeiroz
to
H.I.G. Capital
The Valence Group acted as
Financial Advisor to Itaúsa

EP Minerals
a portfolio company of
Golden Gate Capital
has acquired the
Bleaching Clay and Mineral
Adsorbents business of
BASF
The Valence Group acted as
Financial Advisor to Golden Gate

Archroma
a portfolio company of
SK Capital
has been recapitalized
The Valence Group issued a
Fairness Opinion to SK Capital

Quaker
has acquired
Houghton
from
Gulf
The Valence Group has issued a
Fairness Opinion to the
Board of Directors of Quaker

NMC
New Mountain Capital LLC
has partnered with
Gelest
The Valence Group acted as
Financial Advisor to New Mountain

Niacet
has been sold to
SK Capital
The Valence Group acted as
Financial Advisor to Niacet

Rockwood Thebe
have sold
Safripol
to
KAP
The Valence Group acted as
Financial Advisor to Safripol

Evonik
has acquired the
Huber
The Valence Group acted as
Financial Advisor to Evonik

INEOS
has sold its Expandable
Polystyrene business to
synthos
The Valence Group acted as
Financial Advisor to INEOS

eurazeo
has acquired
novacap
a portfolio company of
ARDIAN
The Valence Group acted as
Financial Advisor to Eurazeo

Arsenal Capital Partners
has sold
ROYAL ADHESIVES & SEALANTS
to
AMERICAN SECURITIES
The Valence Group acted as Financial Advisor to Arsenal

nubiola
has been sold to
FERRO
The Valence Group acted as Financial Advisor to Nubiola

INEOS SOLVAY
has sold certain Chlorvinyls businesses as a remedy to secure European Commission approval of INOVYN, their planned PVC JV, to
INTERNATIONAL CHEMICAL INVESTORS GROUP
The Valence Group acted as Financial Advisor to INEOS and Solvay

DSM
has sold, via a JV with a critical offtake contract, a collection of businesses to
CVC Capital Partners
The Valence Group acted as Financial Advisor to DSM

DOW
has sold its Sodium Borohydride business to
Vertellus
a portfolio company of
WIND POINT PARTNERS
The Valence Group acted as Financial Advisor to Dow

cbpe capital
has sold
Warwick Chemicals
to
Lubrizol
The Valence Group acted as Financial Advisor to CBPE

Arsenal Capital Partners
a portfolio company of
ACCELLA POLYURETHANE SYSTEMS
has sold its Plastisols business to
PolyOne
The Valence Group acted as Financial Advisor to Accella/Arsenal

HSC CORPORATION
(Zhangjiagang, China)
has been sold to
CYG
ChangYuan Group
(Shenzen, China)
The Valence Group acted as Financial Advisor to HSC

Permira
has acquired
CABB
from
Bridgepoint
The Valence Group acted as Financial Advisor to Permira

canexus
has been sold to
CHEMTRADE
The Valence Group acted as Financial Advisor to Canexus

TESSENDERLO GROUP
has sold its Compounds business to
MITSUBISHI CHEMICAL
The Valence Group acted as Financial Advisor to Tessenderlo

KENNAMETAL
has acquired
Deloro Stellite
from
DUKE STREET
The Valence Group acted as Financial Advisor to Kennametal

CYTEC
has sold its Building Block Chemicals Division to
H.I.G. CAPITAL
The Valence Group acted as Financial Advisor to Cytec

Niacet
has acquired ChemSolutions B.V. from
Kemira
The Valence Group acted as Financial Advisor to Niacet

IGM RESINS
has been sold to
Arsenal Capital Partners
The Valence Group acted as Financial Advisor to IGM Resins

PolyOne
has sold its 50% ownership interest in SunBelt Chlor Alkali Partnership to
Olin
The Valence Group acted as Financial Advisor to PolyOne