

Chemical companies sift through their portfolio

"Activities that are reasonably stable or benefit from the crisis are coming to the market" -
Uncertainty about valuations

The chemical industry is struggling with weak demand from important customer sectors such as the automotive industry and suffering from the fall in raw material prices. This is slowing down M&A activity in the industry. Nevertheless, portfolio streamlining is continuing - especially in weatherproof activities.

From Sabine Wadewitz, Frankfurt

Börsen-Zeitung, August 22, 2020

The chemical industry is far away from big deals. However, possible attractive takeover targets are being discussed independently of the Corona crisis. For example, the Swiss specialty chemicals group Clariant is named as a candidate, especially since it is difficult to assess what plans the Saudi Arabian majority shareholder Aramco is pursuing with its involvement after a new chemical giant has emerged in the Middle East with the acquisition of Sabic.

In the current year, the larger transactions in the petrochemicals sector to date have also been put on the rails. The Austrian oil and gas group OMV is diversifying and increasing its share in the plastics company Borealis to 75% for 4.7 billion dollars. The British chemicals supplier Ineos puts a total of 5 billion dollars on the table to acquire further parts of the petrochemicals of the oil company BP - this time the global acetyl and aromatics business.

The transaction comes as no surprise, as Ineos has already emerged from a management buy-out of former BP petrochemical assets in Antwerp. In 2005, Ineos then acquired Innovene, a petrochemical company that also emerged from the BP Group, for \$9 billion. Since then Ineos has already been producing at BP sites in neighbouring plants. But the acquisition could not be completed in one go. The most recent deal is also taking place in several stages. BP is also considering selling the German company DHC Solvent Chemie, which produces solvents from mineral oil.

Martin Bastian, chemicals expert at investment bank Houlihan Lokey, does not see the fact that there are two major deals in the petrochemical sector this year as a trend: "These are two companies in different situations that have suffered more recently. The end markets for many petrochemical products have collapsed - visible in the example of the automotive industry as an important customer group for manufacturers of precursors for plastics.

Oil price collapse slows down

In a similar situation, he sees the South African company Sasol, which years ago launched a huge investment to build a chemical complex for the production of ethylene with an ethane cracker in the USA and now has to bear the increased burden of debt due to the corona crisis, out-of-control construction costs, low oil prices and weaker demand. Completion has also taken considerably longer than planned.

Due to the high level of debt resulting from the additional costs, Sasol, an oil and chemical company from Johannesburg, is now trying to sell a minority stake because liquidity or a low level of debt is needed, explains Bastian. "The transaction was born out of this special situation, which has been significantly exacerbated by Corona". When the company planned the investment, the price of oil was around 60 dollars, but today the project is of course paying off differently. In July, Sasol announced that it was selling the world's largest oxygen production facility in South Africa to Air Liquide for half a billion dollars.

Large parts of the chemical industry are affected by the fall in oil prices due to high price and margin pressure. At best, specialty companies can maintain prices to their customers. "Also, for liquidity reasons, chemical companies are currently postponing major investment projects for the time being, while smaller suppliers are temporarily halting some projects, even though production facilities are already 70% complete. This group could also be forced to cut back or delay necessary digitization projects, says Bastian.

With a view to future M&A transactions, he believes that the sale of group units that are coming through the crisis well is on the horizon. "Activities that are reasonably stable or profit from the crisis are coming onto the market. Bastian refers, for example, to the Danish company Chr. Hansen, which put its Natural Colours division with colorants for the food industry in the shop window in early July. DSM had paid 16 to 17 times the Ebitda for similar activities. The Swiss company Lonza intends to put its specialty chemicals business up for sale. This business was added to the portfolio in 2011 with the acquisition of the US biocide manufacturer Arch Chemicals - at that time the largest takeover in the company's history for Sfr1.6 billion. In November 2019, Air Liquide had already begun to sell its subsidiary Schülke & Mayr, a manufacturer of disinfectants and impregnating agents, together with the financial investor EQT. In April, the deal was closed - for 900 million euros. Clariant has put the pigments business in the showcase, which is expected to be valued at 800 to 900 million sfr.

Under investment pressure

Evaluation multiples have gone up for industrial chemicals and specialties. "In volatile times, it is pointless to talk about multipliers," says Bastian. This is because the adjustments accumulate in the profit expectations for the businesses up for sale. "This makes it a question of perspective. It happens that the buyer announces a transaction to his shareholders with an Ebitda multiple of 8, the seller puts it at 10.

In the short and medium term, he believes that there will be a serious discussion about how the effects of Corona can be reflected in the figures. Valuations are also being driven up because private equity companies are urgently looking for takeover targets to spend their money. "Where the pressure to invest is greatest, a higher price is sometimes paid."

The strategists may be more disciplined, but anyone who trades with an EBITDA multiple of over 16 or 17, for example, and makes a buy below that, will have made a good deal in mathematical terms. "But this is a snapshot and carries depreciation risks in the future if the market turns or the acquisition does not meet expectations," warns Bastian.