Transformations to spark M&A

Chemical companies are accelerating portfolio restructuring, partly driven by increasing shareholder activism. Look for a strong deal market in 2014

JOSEPH CHANG NEW YORK

Alamy

Portfolio restructuring is a key theme, while oil and gas and water chemicals areas are hot

The global chemical mergers and acquisitions (M&A) market is set to get an extra kick in 2014 as chemical companies become more aggressive on transformations, shedding non-core assets to focus on key growth areas. The financing market for deals is also expected to remain strong, along with buyer interest from both strategic and financial players.

"Barring some major jolt to the global economic or financial situation, we expect a continuation of a healthy chemical M&A market, with some increase in the number of large deals. The only area where volume will continue to be subdued is in Europe due to weak industry conditions," said Peter Young, president of investment bank Young & Partners.

"In the second half of 2013 everyone threw their non-core assets onto the selling block, as the pendulum swung definitively into being a seller's market," said Telly Zachariades, partner at investment bank The Valence Group. "Valuations are relatively high but there is still an absence of organic growth. M&A is one way to jump-start growth," he added.

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President, Young & Partners

A number of chemical companies such as Dow, DuPont, Ashland, LANXESS, Chemtura and Rockwood, have announced portfolio restructurings. "Yet not all of those restructuring announcements will result in M&A. A good example is DuPont where it ended up deciding to spin off its performance chemicals business to shareholders rather than sell to a strategic or financial buyer," noted Young.

In October 2013, US-based DuPont announced the planned spinoff of its performance chemicals segment which includes its titanium dioxide (TiO2), and chemicals and fluoroproducts businesses. These assets had sales of around $7bn in 2012. The spinoff to existing shareholders would take place in around 18 months from the announcement. DuPont had been evaluating all strategic options for the businesses, including a sale.

In July 2013, activist investor Nelson Peltz, who runs Trian Partners, announced he was making a major investment in DuPont. In August he reportedly had a 2.2% stake in the company. "Some of this activity has been prompted by shareholder activist actions, but many of those have not resulted in a sale of all or part of the companies targeted," noted Young.

On the buy side, chemical companies are still interested in acquisitions as they seek to boost growth in core businesses. "In the US there is a lot of interest in M&A activity to refocus and grow in core businesses. Some companies have been rewarded by the market and are emboldened to do transactions," said Leland Harrs, managing director and head of chemicals at investment bank Houlihan Lokey.

One prominent example of a company proactively making acquisitions to bolster core businesses and divest non-core asset sales is US-based coatings firm PPG Industries.

Following a series of moves, including the merger of its chlor-alkali business with Georgia Gulf to create integrated polyvinyl chloride (PVC) producer Axiall, and the acquisition of AkzoNobel's North American architectural coatings business, PPG has 90% of its pro forma sales in the core coatings business.

"There is more of an imperative to focus on core businesses. Those with non-core assets are feeling more pressure to divest," added Harrs. The more sanguine outlook based on portfolio restructuring follows what many bank-

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ers considered a weaker-than-expected M&A market in 2013. "There are a lot of larger transactions slated to take place now, but in the past, many divestitures revolved around smaller sub-$200m deals, and we haven't seen a lot of those," said Mario Toukan, managing director and head of the chemicals investment banking at KeyBanc Capital Markets.

"There was a meaningful increase in both the number and dollar volume of chemical M&A deals completed in 2013 compared to 2012's trough levels - on the order of 25-30%," said Young of Young & Partners.

"However, the average deal size is still relatively moderate. There are just fewer large deals than what we saw in 2011."

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PORTFOLIO RESTRUCTURING

However, larger companies are certainly accelerating transformations by putting assets up for sale, partnerships or initial public offerings (IPOs). US-based Dow Chemical is carving out its chlorine and derivatives businesses – assets with annual sales of around \$5bn – for future transactions in 12-24 months from December 2013. This includes its US chlor-alkali, global epoxy resins and global chlorinated organics businesses.

"For Dow, there is a higher probability that these assets will be sold, but it is clear that Dow will not sell any business unless it gets the right price. The probability of a spinoff is not zero," said Young of Young & Partners," said Young of Young & Partners.

Dow pulled the sale of its plastic additives business in September 2013 because the bids were too low.

The global TiO2 sector is poised to see a major shift in ownership with US-based Huntsman also planning an IPO of its combined TiO2, inorganic pigments and functional additives businesses, following the completion of its acquisition of Rockwood Holdings' specialty TiO2 business for \$1.1bn in cash and \$225m in assumed pension liabilities. The acquisition is expected to be completed in the first half of 2014, and the IPO within two year of the close. The combined assets have sales of around \$3bn.

Huntsman is also restructuring its surfactants business in Europe. In October 2013 it said it was "in discussions with potential partners for certain facilities".

Also in October, US-based Chemtura announced it is exploring the sale of its agricultural chemicals business after signing a deal that month to sell its consumer products division to Canada-based KIK Custom Products for \$315m in cash.

Chemtura's agrochemicals business generated sales of \$435m and earnings before interest, tax, depreciation and amortisation (EBITDA) of \$89m in the 12 months to June 30, 2013.

While recognising the strength of the agrochemicals business and its growth prospects, Chemtura CEO Craig Rogerson said that after receiving unsolicited interest, the board decided that "this is the right time to invite and evaluate offers for the business". "It's not a bad business, but management is thinking: What better time than now to unload?" said one source in the financial community.

Germany-based LANXESS has identified several businesses with combined annual sales of around €500m (\$687m) and €30m in EBITDA it deems non-core, and for which it is evaluating strategic options. This includes the Perlon-Monofil polyamide and polyester monofilaments unit of its high performance materials business, the accelerators and antioxidants business of its rubber chemicals division, and the nitrile butadiene rubber line of its high performance elastomers business.

While there could be a higher amount of large chemical deals – those \$1bn and above – in 2014, the odds of a major rebound are slim, said Young of Young & Partners.

"A scenario by which people are going to be-

M&A JOSEPH CHANG NEW YORK

EXCELLERE PARTNERS SEEKS WATER TREATMENT CHEMICALS ACQUISITIONS

US-BASED PRIVATE equity firm Excellere Partners is working with a former chemical company senior executive to acquire one or more water treatment chemicals businesses.

"Water continues to be an area of focus for our firm. The combination of our experience within the industry and our proprietary value creation process allows us to be a strategic and financial partner to the entrepreneurs and management teams we seek to partner with," said Scott Friar, vice president at Excellere Partners.

Friar on the hunt for deals

Turgeon back into water

Excellere has partnered with Paul Turgeon, former president of BWA Water Additives. BWA was sold to US family-owned investment firm Berwind in 2011. Turgeon is currently a board member at U.S. Water Services, a current Excellere investment.

"We are looking for the right opportunity from which to build upon, bringing value, product development, and potentially taking the business international," said Turgeon. "We're looking for a water treatment chemicals business with minimum EBITDA [earnings before interest, tax, depreciation and amortisation] of \$4m (€3m), and on the high side, EBITDA of \$20m-25m. The sweet spot is likely \$10m in EBITDA."

While U.S. Water Services focuses on services, which includes the blending and application of chemicals and provision of technical field support, it does not manufacture chemicals. Rather, it sources specialty chemicals from companies much like the manufacturing businesses targeted for investment by Excellere.

The planned new acquisition or series of acquisitions in water treatment chemicals would be independent from U.S. Water Services, noted Friar.

"The M&A landscape is attractive, and we are taking a proactive approach with investment bankers, brokers, business owners as well as Paul's business network. We're in active dialogue with multiple parties now and continue to identify other potential opportunities," said Friar.

Excellere is investing from its current \$472m fund.

The firm is relatively conservative in that it typically targets a 50% equity/debt split, he noted.

"It is very much a partnership approach, where we will work with current management to build upon the foundation of the business by leveraging Excellere's tools and resources and my industry experience, while aggressively pursuing a strategic plan to enhance the company's customer value proposition leading to attractive revenue and profitability growth," said Turgeon. ■

ACTIVISTS IN CHEMICALS

Activist shareholder	Target	Stake
Trian (Nelson Peltz)	DuPont	2.2%
Pershing Square (Bill Ackman)	Air Products	9.8%
Jana Partners	Ashland	8.4%
FrontFour Capital/Quinpario Partners	Ferro	4.3%
Quinpario Partners, FrontFour, others	Zoltek	NA
Cornwall Capital	American Pacific	14.8%
Mill Road Capital	American Pacific	11.7%
Starboard Value (Jeffrey Smith)	Calgon Carbon	9.7%

Source: US Securities & Exchange Commission, media reports

ASSETS FOR SALE OR DIVESTITURE

Company	Businesses	Sales
Dow Chemical*	US-chlor-alkali, global epoxy, global chlorinated organics	$5bn
DuPont**	Performance chemicals (TiO2, fluoro products)	$7bn
Ashland	Water technologies, elastomers	Water ($1.7bn), Elastomers ($300m)
LANXESS	Monofilaments, rubber additives, nitrile butadiene rubber	€500m
Chemtura	Agrochemicals	$435m

* Businesses being carved out for future transactions

** Spinoff planned

Source: Companies, ICIS

come very confident and pursue many large deals is highly unlikely," Young said. "You would have to see real signs of a major improvement in Europe to get a real boost in confidence. There is also the upcoming debt ceiling in the US along with a huge overall fear of Fed (US Federal Reserve) tapering."

ACTIVIST INVESTORS

The acceleration of portfolio restructuring among chemical companies is not coming out of nowhere. The flurry of activist investor activity in the sector isa major factor in driving such activity.

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Managing director, Houlihan Lokey

"2014 will be a better year, partly because there is so much corporate divestiture activity in the pipeline. And these portfolio realignments are partly being driven by activist activity," said Chris Cerimele, managing director at investment bank Grace Matthews. "Activist investors are pushing boards to evaluate their portfolios." In the US, activist investors have taken stakes in DuPont, Air Products, Ashland, Ferro, American Pacific and Calgon Carbon.

"Managements are very conscious of the potential for activists getting involved if they are not proactive stewards of their portfolios," said Houlihan Lokey's Harrs. "There has been the rise of targeted hedge funds willing to take these positions, whereas private equity firms typically cannot do hostile transactions, as indicated in their charters."

Yet investors can be creative. One hybrid private equity/activist investor entity founded by Jeffry Quinn, former CEO of US-based chemical company Solutia, along with other Solutia executives, is Quinpario Partners.

Quinpario Partners "specialises in transforming underperforming and underfunded businesses to create shareholder value". It has taken stakes in US chemical companies Ferro and Zoltek, pushing for changes. Carbon fibre producer Zoltek is being sold to Japan-based Toray.

In August 2013, Quinpario Partners completed a $172.5m IPO of Quinpario Acquisition Corp, a "blank-cheque company formed for the purpose of effecting a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or similar business combination with one or more businesses".

PRIVATE EQUITY INTEREST

There is no lack of interest among private equity firms, as they continue to scour the market for deals, often in connection with former chemical executives.

Private equity firms led by or with ties to prominent former chemical executives include New Mountain Capital with former Rohm and Haas CEO Raj Gupta; Arsenal Capital with John Televantos, former president of the Aqualon division of Hercules and CEO of Foamex; and SK Capital with Barry Siadat, former chief growth officer of AlliedSignal; and Lion Chemical Capital, which owns styrene butadiene rubber (SBR) and ethylene propylene diene monomer (EPDM) producer Lion Copolymer.

"The more successful private equity firms in chemicals tend to have former executives on staff. The chemical sector is not as intuitive a business as other industries, and also a bit of a club," said Cerimele of Grace Matthews.

OIL AND GAS, WATER

Hot sectors of focus for private equity, along with other buyers, include oilfield chemicals and water treatment, along with chemical distribution. There is consensus among investment bankers that oil and gas chemicals is one of the hottest sectors, attracting interest from both corporate and private equity buyers.

"One sector that's on fire is oil and gas chemicals. It is one of the few areas where private owners are selling. There are half a dozen deals out there," said KeyBanc's Toukan. "A number of these companies were just start-ups a few years ago, but the growth path is phenomenal."

"There is a high degree of interest in acquiring oilfield chemical assets that will fuel good activity as noted by the recent announcements of the acquisition of Chemlogics by Solvay, Bachman Services by Innospec, and Permian Mud Service (Champion Technologies) earlier in 2013 by Ecolab," said Allan Benton, vice chairman and the head of the chemical practice at investment bank Scott-Macon.

Belgium-based Solvay bought US-based oil and gas chemicals company Chemlogics for $1.35bn in October 2013. US-based Ecolab closed its acquisition of Champion in April 2013 for around $2.3bn, including the assumption of debt.

In December 2013, Canada-based Chemtrade Logistics agreed to buy US-based General Chemical for $860m in cash. General Chemical operates in water treatment chemicals, sulphuric acid and specialty chemicals. The purchase price represents a multiple of 7.8 times last 12 months EBITDA. In December 2013, private equity firm

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