The M&A boom drives reshaping

Chemical M&A activity has rallied since the middle of last year, creating opportunities to reshape the European petrochemical sector. But will it lead to a more competitive landscape?

JOHN BAKER BRUSSELS

The recent move in the US specialty chemicals sector by Ashland to buy ISP for $3.2bn (€2.2bn) is just the latest significant merger and acquisition (M&A) deal in the past 12 months.

Financially, chemical producers in Europe and the US are performing strongly thanks to good demand and high oil prices. And, with cash flows high and debt levels low, they are in a position to reshape through M&A.

The reasons underlying this resurgent activity and what it might mean for Europe's petrochemical sector were the subject of May's ICIS/Booz & Company CEO Roundtable on European Petrochemicals, the fourth meeting of its kind, held in Brussels, Belgium.

BIGGEST YEAR

As Richard Verity of global management consultancy Booz said: "Global M&A in chemicals continues to stage a recovery, in terms of deal size and valuation multiples. The year has seen several large deals and there are more to come."

But whether these will be successfully chosen and executed is not always assured, he added (see page 36). Booz says 2011 could be one of the biggest years for chemicals M&A, on par with 2007, if not greater, in terms of deal value.

Tom Crotty, director of Swiss petrochemicals major INEOS, concurred. "M&A is very timely, as the industry is in a new phase of growth and we are developing a 2007 feel." However, he said, the M&A landscape is different today. Deals are not being driven so much by private equity but by industrial players.

"Financial investors were driven by a simple model of taking costs out of acquired businesses, but cost bases have come down significantly over the past five years. The key issues now are all about scale and de-risking." He points to the INEOS/BASF styrenics deal as a case in point, and says the sector will see more of these sorts of plays.

Kees Aartsen, director, olefins & gases at SABIC Europe, added that around a third of recent M&A deals have been executed to increase global footprint, with players in emerging markets teaming up with companies in developed markets. This has been the case in the refining sector – with INEOS and PetroChina, for instance – and in polyester, with Thailand's Indorama Ventures, for example, acquiring polyester assets in Europe, the US and Mexico and Asia to extend its global position.

"There will always be a certain proportion of M&A activity that is like a carousel, with no real strategic reasons behind it, but globalization will be the motive for much M&A activity in future," said Aartsen.

DRIVERS FOR M&A

Ralf Kuhlmann, owner of German consultancy Dr Kuhlmann International, elaborated on the various drivers for M&A in today's market. Restructuring is one, but the acquisition of complementary opportunities is another – for example, with the Solvay/Rhodia deal in specialty chemicals and polymers in Europe there is not much overlap in their portfolios – while extending global reach is a third key driver.

Delegates regard the merging of Solvay and Rhodia as a positive move, and one that would help to strengthen European business through consolidation. The complementary nature of the two portfolios, said Kuhlmann, would strengthen the two businesses and lead to synergies in knowledge, skills and technology. "Rhodia has huge potential and will add value to Solvay, which will be stronger. We will see more of these deals."

The emphasis in M&A for increasing global reach is shifting more towards players in developing regions seeking greater presence in

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Director, olefins & gases, SABIC Europe

the developed ones, which raises various issues. Although the acquired assets are not wanted by the sellers, they are still operated by the acquirers so that any restructuring effect are minimal. Indeed, in some cases the assets are managed well and output is increased and value added.

"We need to understand what the financial support behind this type of activity is," said Kuhlmann, "and what the consequences are of having new players in the existing market. Often, the new owners transfer different thinking and values to the business. They might be able to transfer costs into the market and even reshape it as they come in as new players. Can we learn from the newcomers?"

For Francois Vleugels, CEO of Bochemie and chairman of Spolchemie, both specialty chemical producers in the Czech Republic, and former CEO of Unipetrol, the recovery in the sector may have come too soon, so some companies that are being kept afloat by today's »

CHEMICAL ACQUISITIONS

RETREAT OF PRIVATE EQUITY?

ALTHOUGH THE interest of private equity (PE) in the chemical sector is diminished, deals are still being made, notably the $1.6bn Bain/Styron styrenics deal (see above), the $9.7bn move in the US for specialty producer Lubrizol by Berkshire Hathaway and the Blackstone purchase of US-based Polymer Group. But, in general, the appetite is lower and activity is more muted.

As Vleugels said, in the years up to 2008–09 recession and financial crisis, the private equity players saw a "fat" industry with opportunities to restructure and consolidate. Plus they were able to leverage deals highly with readily available debt.

Now, chemical companies are much leaner and private equity funds are more reluctant to invest in the sector after the severe problems suffered by highly leveraged companies, such as US-listed petrochemicals major LyondellBasell Industries.

In effect, says Crotty, they are somewhat scared of the chemical industry after the 2008 downturn, and are much warier of getting involved. ■

US PETROCHEMICAL FEEDSTOCKS

LIMITED IMPACT OF US SHALE GAS

NO PETROCHEMICAL discussion, it seems today, can escape the question of shale gas and its impact on US and even global petrochemical production. The revival of US feedstock competitiveness and resurgent plans for additional US ethylene capacity based on cheap ethane has become a major talking point.

But around the table, the feeling was definitely that the shale gas phenomenon should not be overhyped or overstated. "Yes, it's a big development but there will not be a huge overall global impact," commented Kees Aartsen. "The new units may well replace existing naphtha based crackers, and we may only see 2m or 2.5m tonne/year of capacity realized.

Said Crotty: "There is a degree of hype. You might think this is a Middle East, but it's not. The location and scale are different," he added, referring to the location of the Marcellus shale fields in the northeastern US states, well away from the Gulf petrochemical industry. "There are logistical challenges, but it will make a significant difference, and we will see the first new crackers built in the US for 10 years or so."

And Kuhlmann noted that there would be little change on the supply/demand balance point of view, but that the availability of low cost gas is improving competitiveness of the US Gulf Coast producers. But, he added, the shift to gas feedstocks away from liquids will have an impact on the availability of propylene and butadiene (BD) in the US. They will get more expensive, added Aartsen, prompting more on-purpose production of C3s and C4s.

Vleugels agreed it will put the US back on the competitive map. "The US was feeling more and more frustrated, but this makes it much more sustainable and it will have to import less than it has been as a consequence of the new capacities." But he believes new capacity will not be built purely for export reasons.

So how should Europe react? In Kuhlmann's eyes, Europe's producers should ensure they can operate with maximum flexibility on feedstocks. And as Aartsen added, "In chemicals these days you need to keep all options open – and not just with the furnaces." ■

inflated earnings should not really exist in the longer-term. He points to the problems of shutting non-integrated crackers and thus the polyolefins units they feed.

"There is still a lot of PE capacity around that is not shut down"

FRANCOIS VLEUGELS
CEO, Bochemie/chairman, Spolchemie

"There is still a lot of PE capacity around that is not shut down as we can't easily lower output or shut down ethylene units."

But, he recognized that there is plenty of cash around and some attractive deals, even if these are not so cheap in valuation terms. He, too, sees companies in China sitting on a lot of cash and eying Western technology via M&A activity. He cited the example of the recent takeover of Hungarian polyurethanes (PU) and polyvinyl chloride (PVC) producer BorsodChem by China's Wanhua Group as a case in point. "Chinese and Indian companies are coming here, " he added, "and they think very differently."

Crotty adds that often, such as in the case of PetroChina, the emerging economy players coming into Europe have long-term strategic plans to become global companies. "They compare themselves with the likes of US oil and chemicals major ExxonMobil then look to add the pieces of the jigsaw." On the other hand, Kuhlmann believes the Asian players see opportunities for fast growth for themselves through M&A activity in Europe and the US.

One thing the panel all agree on is that in many cases the acquirer is able to simplify structures and cut complexity and costs, while at the same time running plants harder, even if margins are low as a result. The problem then is what the impact is on the market as a whole and the rest of the existing producers.

RESTRUCTURING IN EUROPE

Turning to the issue of restructuring in Europe, Vleugels said there is still room for major restructuring in Eastern Europe, where the petrochemical industry is still too fragmented

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Owner, Dr Kuhlmann International

and many players are too small to survive. "They need to shut down – there is vast competition in polyolefins, for example – and even players with good assets have not done enough upgrading to move into high-value-added products."

Even though many of the assets are of decent scale and have refinery integration, help

M&A SUCCESS

IT IS ALL DOWN TO TARGETING AND EXECUTION

M&A MAY be booming, but will the results be all that are desired. In many cases, the answer is no, as merger planning and execution often leave much to be desired. As with any activity, practice is a good remedy for poor performance and indeed, companies with regular M&A activity do seem to do things better.

Or to put it another way, "Will we witness the same unintended acts of value destruction that occurred over the last decade? asked Booz's Richard Verity.

Much, he answered, "depends on the ability of senior managers to play three roles: merger strategists – to choose the right deal; merger negotiator – to price the deal right; and merger integrator – to integrate the two companies."

As a merger strategist, they must choose the right market and target company, analyzing market and company sizes and growth, but without neglecting the type of company. The closer the two companies are in the way they approach the market, in their products and services and their capability systems – their coherence - the higher the chance of M&A success, explained Verity.

As merger negotiator, they must develop an accurate valuation of their targets, and not get side-tracked by banking and marketing-type appraisals of the target. "It's much better to create a net present value model," he advised. And as an integrator they must create a robust bottom-up process for capturing synergies.

They must also, explained Verity, create the right reporting and systems infrastructure to generate trustworthy management information. And manage the inevitable organization culture clashes.

"Companies are good at understanding cultural issues but not so good at managing them", said Verity. "They are not terribly comfortable doing so." He suggests a process of "pride building" which works well in the M&A situation and "effects change from the inside out, not from the outside in or top down." ■

is unlikely from West European players, as there is competition for each and every investment euro, commented Crotty.

"If you are going to move into Eastern Europe, you need to spend a lot of money – so do you spend it here or elsewhere? This is a big limiting factor [in investing in the region]."

Companies with a base in Europe have to allocate significant amounts to keep existing assets up to scratch and so how do you grow – not by going into Eastern Europe, he added.

DILEMMA FOR PRODUCERS

Aartsen said that it is a dilemma for producers in Western Europe. Growth is faster in Eastern Europe at the moment, but if you want to team up with someone in the region for asset integration with refineries, can you be sure things are up to scratch? Is the benefit good enough, or would you be better to export material from Western Europe?

In Western Europe there are also pockets of the petrochemical market that are overdue for restructuring. The PVC market was one identified by participants as overdue for further rationalization due to the fragmented nature of the market. However, there seems to have been little in the way of progress in recent years.

"The industry is in a new phase of growth and we are developing a 2007 feel"

TOM CROTTY
Director, INEOS Group

With company performance continuing to look strong and balance sheets lightly loaded, the outlook is for continued M&A activity in the chemical sector.

GET THE BALANCE RIGHT

There will be a balance between restructuring deals at business unit level, outright mergers as companies seek scale and market extension, and deals looking for geographic expansion, largely from developing to developed markets.

All will continue to shape and reshape the European chemical sector.

It is a large and mature market but one that still has a viable future as long as it concentrates on what it does best – operational excellence, innovation and asset integration and good infrastructure. ■

For more information on Booz and how to succeed in a recession, go to icis.com/booz

TAKING PART IN ROUNDTABLE

- **Tom Crotty**, director, INEOS Group
- **Ralf Kuhlmann**, Dr Kuhlmann International/International E-Chem
- **Francois Vleugels**, CEO, Bochemie Group/ chairman, Spolchemie
- **Kees Aartsen**, director, olefins & gases, SABIC Europe
- **Richard Verity**, senior vice president, chemicals and energy, Booz & Company
- **John Baker**, global editor, ICIS