Private equity to drive performance

Most value created by private equity in chemicals comes from operational improvements

JOSEPH CHANG NEW YORK

Value creation of chemical assets under private equity ownership depends mostly on operational performance improvement and growth rather than negotiating a good price or timing the market, said panellists at a meeting of the Chemical Marketing & Economics Group (CME).

"It's not just about buying low and selling high as negotiation and timing represent just a third of the value created, with 60-70% from operational improvement," said Sam Samdani, senior industry knowledge expert at McKinsey's chemicals and agriculture practice.

"And within operational improvement, cost cutting is not the defining factor. It's about how you grow the business before you exit," he added.

This can involve supply chain planning, transforming the pricing strategy, a different

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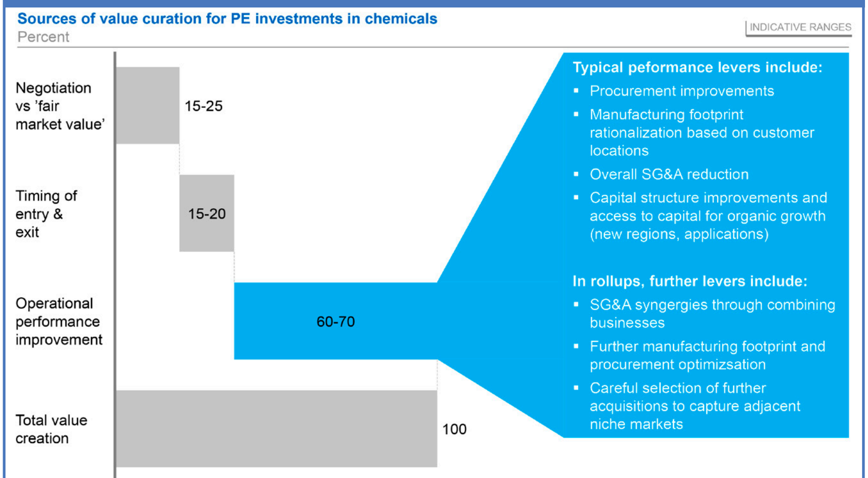

SOURCE: McKinsey analysis

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CHEMICAL M&A MARKET SHIFTS TOWARDS SPECIALISATION

THE CHEMICAL mergers and acquisitions (M&A) market is moving towards greater focus and specialisation after a period of mega mergers, said panellists at a Chemical Marketing and Economics Group (CME) meeting.

"In this cycle, the pendulum is swinging. The chemical industry had mega mergers and they largely failed to create value. Management teams, seeing that didn't work, are now separating assets out," said Jonas Oxgaard, chemicals equity analyst at Bernstein Research.

"Focused companies do better. Companies that are spun out, whether to private equity or not, tend to see massive outperformance as they become more focused and nimble versus dying under an umbrella," he added.

JONAS OXGAARD
Analyst, Bernstein Research

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Having focus and specialisation "shines a spotlight" on a specific strategy that would make that business successful, said Stephen D'Incelli, managing director at private equity firm SK Capital Partners.

Corporates that carve out businesses to focus resources on the rest of their portfolio can also "be very value creative if this is managed well", he added.

The level of corporate carve-out activity in the chemical sector has picked up, with larger companies becoming more focused and private equity sometimes the buyer of the carved-out assets.

In December 2019, Germany-based BASF announced the sale of its construction chemicals business to private equity firm Lone Star for €3.17bn in a deal expected to close in the third quarter of 2020.

Earlier in August, BASF announced the sale of its global pigments business to Japan-based DIC for €1.15bn.

Switzerland-based Clariant in December agreed to sell its global colour and additive masterbatch business to US-based PolyOne for $1.45bn.

And US-based DuPont in December agreed to divest its Nutrition and Biosciences (N&B) business through a merger with US-based IFF involving a tax-free Reverse Morris Trust (RMT) transaction valuing the business at $26.2bn.

On 5 January, US-based Huntsman completed its previously announced sale of its chemical intermediates business which includes propylene oxide (PO), methyl tertiary butyl ether (MTBE) and surfactants, to Thailand-based Indorama for around $2bn.

Corporate carve-outs were a key theme in 2019 chemical M&A and this is set to continue through 2020. ■

approach to procurement as well as making manufacturing operations more efficient. Subsequent roll-up acquisitions can also play an important role in optimising the manufacturing footprint and procurement, along with capturing adjacent niche markets, said the consultant.

"Cost take-outs are just table stakes. There's a migration to teams with capabilities and expertise to develop operational and commercial excellence for profitable and sustainable growth," said Stephen D'Incelli, managing director at private equity firm SK Capital Partners which focuses solely on the specialty materials, chemicals and pharmaceuticals sectors sectors.

In the chemical sector, where businesses have varying degrees of cyclicality, the natural instinct in a downturn would be to cut costs. However, companies should think about capturing more market share by investing in commercial resources while also seeking to reduce the fixed cost burden, he noted.

Private equity ownership can kick start a business by taking a new approach towards growth that may have been lacking in previous ownership.

"Private equity is like a personal trainer on January 1. Companies with a long history find

McKinsey consultant Sam Samdani, SK Capital managing director Stephen D'Incelli, Columbia University senior lecturer Donna Hitscherich, SafeRock CEO Shah Karim and Bernstein Research analyst Jonas Oxgaard spoke on the CME panel in New York

changing the way they operate tough and sometimes hire consultants every few years to shake things up," said Jonas Oxgaard, chemicals equity analyst with Bernstein Research.

"Private equity can do a complete overhaul, often because the former owner could not do it themselves," he added.

A hallmark of private equity is "nimbleness of decision-making", said SK Capital's D'Incelli.

"Public company executives are often forced to think short term - sometimes quarterly. We think long term to achieve sustainable, defensible growth," he added.

Culture change plays an important role in success, the panellists pointed out.

"The component of culture is number one. People do want to be part of the winning team and know if their company is not great. If you're bought by private equity, it can be terrifying but if employees feel that the company is now a winner, it makes a big difference in how a company performs," said Bernstein's Oxgaard.

Private equity will continue to play a major role in the chemical sector's evolution with a growing number of players and higher levels of capital to put to work.

North America private equity assets under management have ballooned to around \$3.1tr from just above \$500m in 2000, noted McKinsey's Samdani.

And with growing pension liabilities, coupled with future projected annual returns from US public equities of 4.0-6.5% expected to trail the almost 8% annual returns over the last 30 years, more funds should be moving into alternative investment vehicles such as private equity, he added. ■