ISSUE 7
May 2014

theValenceGroup Chemicals M&A Review

Highlights

- Larger step-out M&A deals most admired by chemicals industry senior executives and advisors
- Chemicals M&A volumes continuing the upward trend at the end of 2013 with more larger transactions being completed in 2014 Q1
- M&A now the major factor driving many of the Valence Indices with transactions such as Minerals Technologies-Amcol boosting the Inorganics index to the best performing in the last 12 months
- Fine chemicals and custom manufacturing (CM) – back in the M&A spotlight after industry restructuring and business repositioning while also benefitting from strong agrochemicals growth

As always, we welcome any feedback from issues raised here and hope they stimulate further ideas and debate.

IN THIS ISSUE

Most Admired M&A Deals
Valence Indices
Chemicals M&A Analysis
Fine Chemicals and Custom Manufacturing

New York
Tel: +1 212 847 7340

London
Tel: +44 (0) 207 291 4670

www.ValenceGroup.com

theValenceGroup

Chemicals M&A – The Most Admired Deals

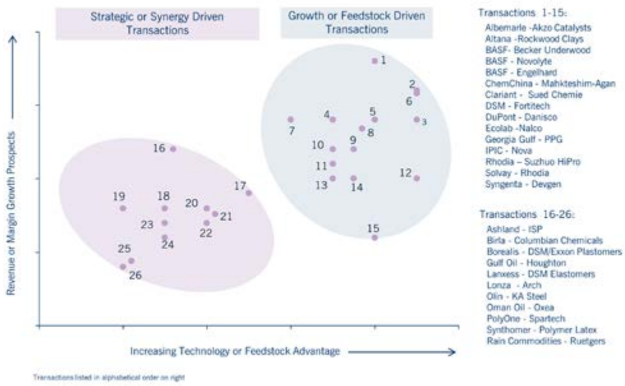
Defining the best chemicals M&A transaction will always fuel controversy. The parameters used to categorise a deal can be partially subjective and relate to strategy, positioning, defence or market access, all factors that are difficult to measure. Alternatively, more quantitative measures such as share price, trading multiple or return on capital cannot incorporate the impact of the external environment or of not having made the transaction ("the risk of doing nothing"). The result is often analysis that will deem the same acquisition both successful and unsuccessful depending on the metrics used.

Hence, rather than trying to evaluate deals on strict financial measures, The Valence Group, asked senior industry executives and advisors across different regions which recent chemicals M&A deals they most admired and respected. The results indicate that so called "step-out" or growth driven deals, where companies acquire larger businesses in adjacent and often in new segments, are those most often mentioned. Another group of deals which could broadly be termed "bolt-ons" or synergy driven, were often viewed positively but less often mentioned.

These two categories of deals are broadly outlined in Figure 1. The growth or feedstock advantaged transactions (right hand side) are predominantly step-outs. Deals such as Albemarle-Azko Catalysts, DuPont-Danisco, BASF-Engelhard, ChemChina-Mahkteshim Agan and even Clariant-Sud Chemie were cited because they were regarded as:

- bold and successful in repositioning the growth prospects of the company
- improving how the companies were perceived by investors (some might arguably be too recent to judge).

Figure 1 Selected M&A Transactions by Category (Position Estimated by Respondents)



Other transactions, such as Georgia-Gulf-PPG and IPIC-Nova were seen as accessing feedstock advantage to significantly alter the company structure. In most cases, the timing was mentioned as critical. Surprisingly, the value or multiple paid was rarely mentioned as being important, perhaps as the longer term transformational aspects were regarded as more relevant.

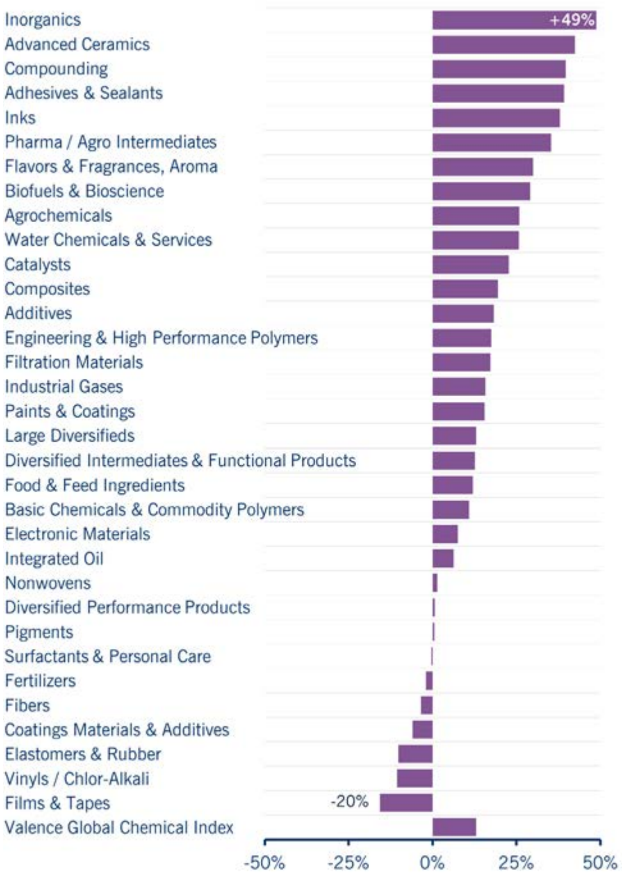
The group of transactions on the left of Figure 1 were mostly regarded as bolt-ons or where there was overlap with the current business. Perhaps unfairly, these deals were perceived as being more obvious and less of a "game changer". Strangely the price paid or multiple was more critical for these transactions and investors scrutinised these deals more closely. This outcome is contrary to expectations as acquisitions of competitors or in the same market/product areas would be assumed to be relatively straightforward and more likely to be successful.

The conclusion is that competitors, advisors and investors appear to reward bolder growth-driven M&A, especially as the chemicals industry, particularly in Europe, is searching for growth. As the industry continues to undergo a fundamental realignment due to speciality chemical consolidation, shale gas, and Middle East and Asian downstream expansion, M&A activity which repositions portfolios towards growth areas is likely to be viewed more positively. These transactions also seem likely to be most rewarded by investors.

Valence Indices

The Valence Indices are 33 chemical company sub-sector stock price indices. Over 250 global chemical companies are included and are regularly updated on The Valence Group website (www.valencegroup.com).

Figure 2 Valence Indices 1-Year Performance



Continuing the theme of the impact of M&A, The Valence Indices show how company and sector share prices can rise dramatically through transaction activity. As seen in Figure 2, the last 12 months' performance shows that Inorganics has, for the first time, been the best performing index. Undoubtedly this has been driven by the recent acquisition of Amcol, boosting the UK price and other companies' share prices in the sub-sector as investors weigh up the possibility of further consolidation.

The same could also be argued for the highly performing subsectors of Compounding and Adhesives & Sealants (Figure 3). Companies such as Hexpol, PolyOne, RPM and Sika have performed strongly recently due to their underlying performance and in anticipation that the companies will undertake more acquisitions and the sectors will consolidate further (Hexpol in particular has been the star performer and maintaining stock price growth expectations may require further M&A). Improving economic activity in housing and industrial sectors, especially in the US but also now in Europe, is additionally boosting these sectors.

Also shown in Figures 2 and 3 is the strong performance of Advanced Ceramics. Much of this has been due to the resurgent performance of the proppant suppliers such as Carbo Ceramics. Sales volumes in the industry are solid and with margins stabilising or increasing, the stock performance of the companies in the sub-sector have started to rise again (having originally fallen from a peak in 2011). The fundamentals of North American shale gas / oil exploration and development and "fracking" market remain robust and will likely benefit companies with significant oil and gas chemicals exposure. Trading multiples for companies in the sector remain high.

Another sector which continues to perform well is the Pharma and Agro Intermediates index which is made up primarily of custom manufacturing companies (Figure 3). After the overly enthusiastic boom and bust about 10 years ago, companies restructured, rationalised, closed capacity and even exited. Subsequently, up until two years ago the pharma and agrochemical index was one of the worst performing, but now with portfolio realignment coupled with strong agrochemical market growth across all regions and more outsourcing from agrochemical companies, the demand for agrochemical active ingredients and intermediates is rising strongly. Companies in the sector are now profiting from this change in sub-sector dynamics and stock prices have moved accordingly.

M&A has also had an impact on the poorest performing sectors. The Elastomers and Rubber index remains one of the worst performing indices (Figure 4). However, the sector index has been lifted by one of the most interesting transactions recently with the Kraton-LCY (Taiwan) combination. Overall several companies in the index are likely to remain under pressure in the short term as butadiene regional imbalances and competitive pressures create a challenging environment, despite market volume growth.

Figure 3 Selected Best Performing Indices (1 Year)

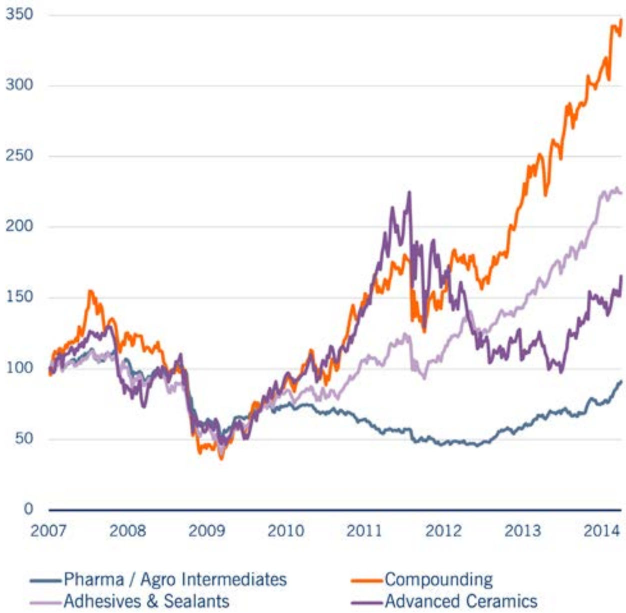


Figure 4 Selected Worst Performing Indices (1 Year)

Other poorly performing sectors are related more to a fall from previous strong share price growth (e.g. Axiall) and reflect a more balanced outlook rather than more fundamental change.

We expect the Valence Indices to trade in a narrower range over the next months as valuations are already trading at a high level and unless the sub-sector profitability outperforms, the outlook is for more generally muted performance.

Chemicals M&A Analysis

The most recent quarter (2014 Q1) has continued the trend seen at the end of last year with the number of transactions remaining at a high level (Figure 5). Further underpinning market confidence, numerous larger transactions were announced in the last few months including:

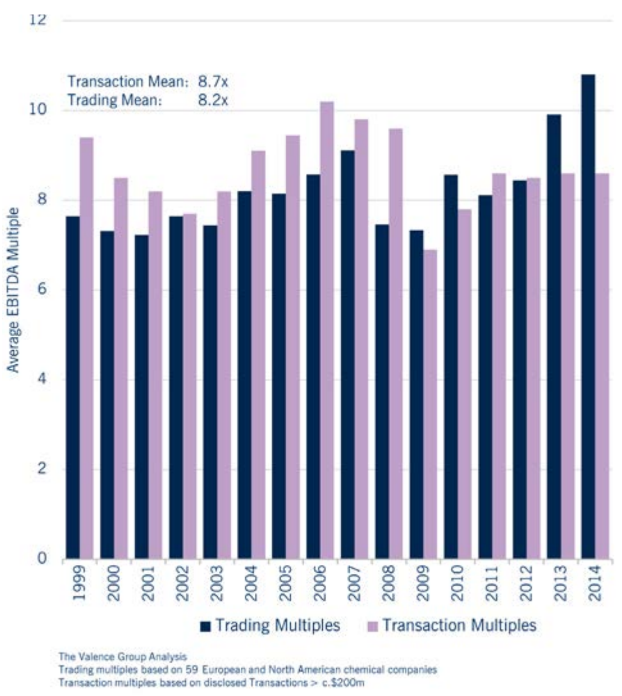
- Kraton-LCY
- Minerals Technologies-Amcol
- CDR-Ashland Water Technologies
- Goldman/Koch-Flint
- Platform-Chemtura AgroSolutions
- Rhone-ASK Chemicals
- Permira-CABB
- Balchem-Sensory Effects

With the sheer number of transactions announced plus those apparently being prepared, such as PQ and Dow's chlorine and epoxy businesses, it is clear that confidence has returned to the M&A market and companies are now more willing to invest in capital expenditure for both plant expansions and M&A. Several multi-billion US$ spin-offs are also being considered showing the strength of the overall market.

Figure 5 Number of Chemical Transactions – Monthly Since 2010

The current trading levels (Figure 6) and multiples have also encouraged sellers to divest businesses and some of the transaction values achieved have been surprising (e.g. Ashland Water Technologies). In addition, as can be seen from the preceding list, private equity is even more competitive and active in the market due to easily available low cost debt. With companies looking to boost revenues in often low growth environments, healthy company balance sheets, shale gas, activist investors and all regions actively and simultaneously repositioning their chemicals industry, chemicals M&A could soon surpass the high point of 2007.

Figure 6 Chemical M&A Trading and Transaction Multiples



Sector Review - Fine Chemicals and Custom Manufacturing

As noted earlier, the Pharma and Agro Intermediates Index has consistently been one of the best performing indices over the last 12-18 months. The recent history, especially in pharmaceutical custom manufacturing, was one of rapid capacity increase spurred on by the belief that pharmaceutical growth and outsourcing would be almost limitless. This ultimately ended with plant closures, divestments and exits as the market never materialised as predicted. Agrochemical custom manufacturing was, until six-seven years ago, relatively low growth and volumes were being outsourced to Asia.

The last few years have seen a resurgent fine chemicals and custom manufacturing sector. Companies have adopted a more realistic view of end markets, rationalised production, focused more on established products rather than discovery services/products while managing their cost base. The agrochemicals end market has grown strongly and is forecast to continue expanding (Figure 7) due to demographic pressures. Chinese and Indian custom manufacturers are now even losing market share.

Consolidation has now become a key strategy in the industry and as can be seen from Figure 8 the supply base is still fragmented. Activity involving several companies, such as CABB, Ampac and Albemarle, as well as other on-going transactions all point to more M&A resulting in a probable concentration of the sector. The remaining suppliers will profit both from a less competitive environment and from an industry that continues to mature. Buyers are seeking longer term strategic partnerships with companies in Europe and North America. Furthermore, as the outsourcing market is still a relatively small proportion of the total manufacturing spend and overall end market (Figure 9), there is still plenty of room for growth.

Figure 7 Agrochemicals Market Size and Growth

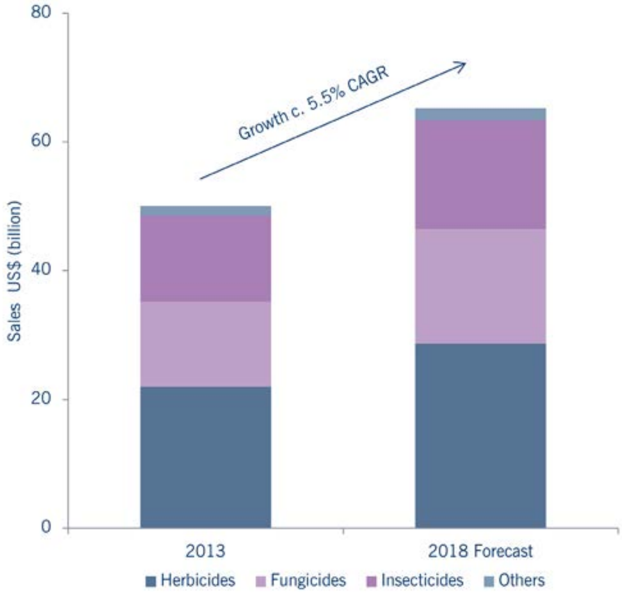


Figure 8 Outsourced Custom Manufacturing Supply Structure

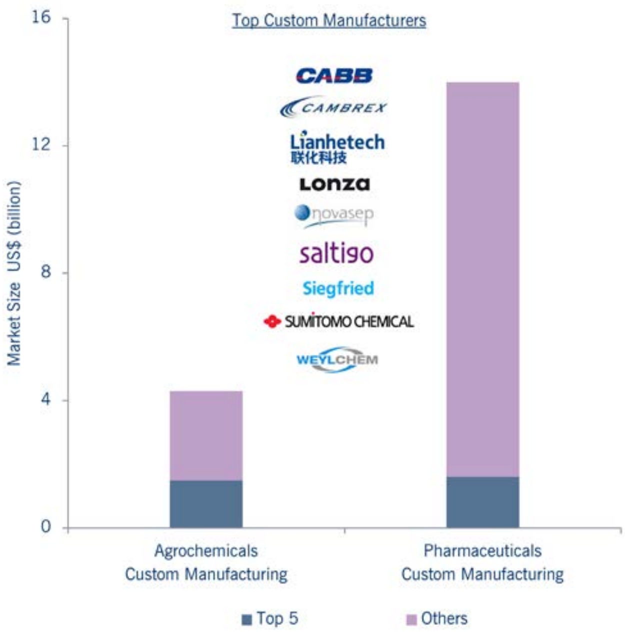
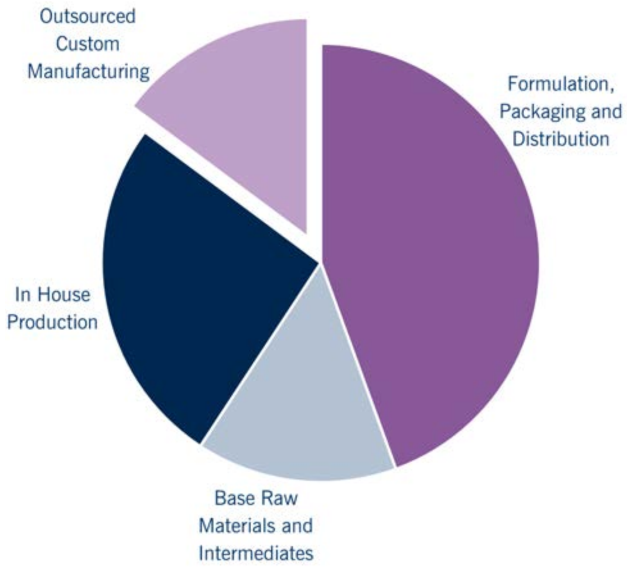


Figure 9 **Agrochemical COGS and Custom Manufacturing Share**



For the first time in many years the fine chemicals and custom manufacturing industry is poised to develop strongly, buoyed by an increasing end market and a more mature approach to capacity expansion. Perhaps the lessons of recent history have been heeded and this time the industry will see both strong *and sustainable* growth.

theValenceGroup

The Valence Group

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.

The firm's offices are located in New York and London.

Permira
has anounced its intention to acquire
CABB
from
Bridgepoint
The Valence Group acted as financial advisor to Permira

Arsenal Capital Partners
has acquired
ADCO GLOBAL
from
AURORA CAPITAL GROUP
The Valence Group acted as financial advisor to Arsenal Capital

DASH Multi-Corp
a portfolio company of
Arsenal Capital Partners
has acquired
pathwaypolymers
from
Vita
The Valence Group acted as financial advisor to Arsenal Capital

TESSENDERLO GROUP
has sold its Compounds Business to
MITSUBISHI CHEMICAL
The Valence Group acted as financial advisor to Tessenderlo

GOLDEN GATE CAPITAL
has acquired
AirMaz Custom Chemicals, Inc
from
SNOW PHIPPS
Common Objectives. Uncommon Commitment.
The Valence Group acted as financial advisor to Golden Gate Capital

Niacet Corporation
has acquired ChemSolutions BV from
kemira
The Valence Group acted as financial advisor to Niacet

DSM ExxonMobil Chemical
has sold
DEXPLASTOMERS
A DSM/EXXONMOBIL CHEMICAL JOINT VENTURE
to
BOREALIS
The Valence Group acted as financial advisor to DSM and ExxonMobil

HOUGHTON
Fluid Partnerships Making a World of Difference
an AEA portfolio company has been sold to
Gulf
The Valence Group acted as financial advisor to Houghton

IGM RESINS
has been sold to
Arsenal Capital Partners
The Valence Group acted as financial advisor to IGM Resins

ARKEMA
INNOVATIVE CHEMISTRY
has sold its Tin Stabilizer Business to
pmc
The Valence Group acted as financial advisor to Arkema

Arsenal Capital Partners
and
FOOSUNG
have sold
NOVOLYTE technologies
to
BASF
The Chemical Company
The Valence Group acted as financial advisor to Arsenal capital

Solutia
Ingenuity Productivity Performance
has been sold to
EASTMAN
The Valence Group acted as independent advisor to the Board of Directors of Solutia

theValenceGroup

TA Associates
has sold
Microban
antimicrobial product protection
to
barr
The Valence Group acted as financial advisor to TA Associates

KENNAMETAL
has acquired
Deloro Stellite
from
DUKE STREET
The Valence Group acted as financial advisor to Kennametal

PolyOne
has acquired
ColorMatrix
from
Audax Group
The Valence Group acted as financial advisor to PolyOne and issued a Fairness Opinion to PolyOne's Board of Directors

Bridgepoint
CABB
has acquired
KEMFINE
from
3i
The Valence Group acted as financial advisor to CABB

Tessenderlo Group
has sold its Fine Chemicals business to
Tennants Fine Chemicals Ltd
The Valence Group acted as financial advisor to Tessenderlo

CYTEC
has sold its Building Block Chemicals Division to
H.I.G. Capital
The Valence Group acted as financial advisor to Cytec

VERTEX
has sold substantially all its assets to
HAWKINS
The Valence Group acted as financial advisor to Vertex

Tessenderlo Group
has sold its PVC and Chlor Alkali businesses to
INEOS
Kerling
The Valence Group acted as financial advisor to Tessenderlo

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

Tessenderlo Group
has sold
CHELSEA BUILDING PRODUCTS
to
GRAHAM PARTNERS
The Valence Group acted as financial advisor to Tessenderlo

EASTMAN
has acquired
GENOVIQUE SPECIALTIES
from
Arsenal Capital Partners
The Valence Group acted as financial advisor to Eastman

AEA
HOUGHTON
has sold the U.S. Aluminium Hot Rolling Oils business of
Stuart, A Houghton Company
to
Quaker
The Valence Group acted as financial advisor to Houghton

DSM
has sold its Citric Acid business (Citrique Belge) to
ADCURAM GROUP
The Valence Group acted as financial advisor to DSM

cognis
has sold its UV Acrylates business to
IGM Resins
The Valence Group acted as financial advisor to Cognis

SK CAPITAL PARTNERS
has acquired the integrated Nylon business of
SOLUTIA
ASCEND Performance Materials
The Valence Group acted as financial advisor to SK Capital

Castle Harlan, Inc.
has acquired
id Quest
from
Arsenal Capital Partners
The Valence Group acted as financial advisor to Castle Harlan