

# Mergers and Acquisitions as Value Lever

M&A Activity in Chemical Distribution Likely to Increase in the Next 12 Months



Chemical distribution as an integral part of the chemical value chain becomes increasingly important for the chemical industry. Its growing importance can be attributed to two major aspects: The distributors of chemicals have a distinctive access to the market – because of their high proximity to the (final) customer – and they increasingly offer additional services.

Having acknowledged the value of chemical distribution, chemical manufacturers (so-called principals) sell more than 10% of their chemicals (specialty chemicals and base chemicals) to downstream market participants via chemical distributors. The distributors were able to greatly benefit from the positive market environment and the overall growing chemical industry in recent years. This positive development was accompanied by an increasing number of M&As in the chemical distribution industry. In particular the big players were hungry for acquisitions – nearly weekly significant M&As on a national or global scale were announced. These big players (partially stock listed) were busy acquiring companies to further boost their already substantial growth.



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Now the leading questions with respect to M&As are: What is the status quo of M&As in the chemical distribution industry (in Europe) and how will the number of M&As evolve in the upcoming 12 months? What are drivers for M&As in the industry and how does the smoldering crisis in Europe affect the industry? Do chemical distributors concentrate their M&A activities on certain European regions only?

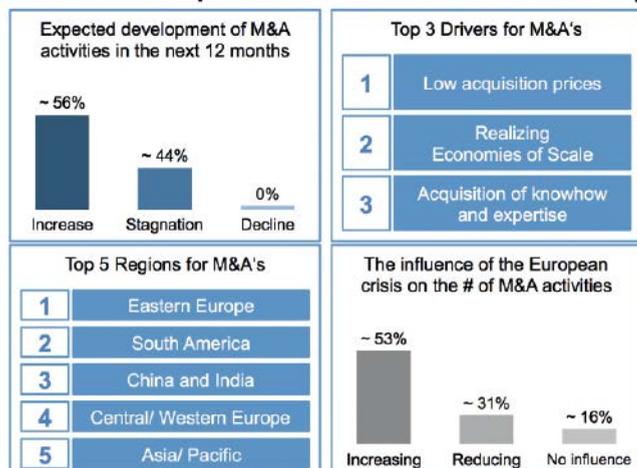
To go further into these questions, Grosse-Hornke Private Consult laun-

ched the short survey “M&A in the European Chemical Distribution Industry” in March and April. The key results of the survey are explained and discussed here.

## Market Demands Still Promote M&As

In the next 12 months, 50% of the study participants (N=32) expect a growing number of M&As; the other half of the participants anticipates stagnation. This development is, among others, justified by the growing expectation of the customers of chemical distributors to offer at least coverage of the European markets. Especially the more local or very specialized market participants with a limited coverage of the market face the problem of critical profitability.

### M&A in the European Chemical Distribution Industry<sup>1</sup>



<sup>1</sup> Online study conducted in March/ April 2013, N = 32, Participants: mainly management and sales dep. of chemical distributors

Besides the argument of growing customer expectations with respect to a full (European) market coverage of chemical distributors, the already well-advanced consolidation of the principals is perceived as another reason for the expected increase of M&As in the industry. Yet another aspect supporting this trend can be seen in the recent legal development. Small companies are not capable of handling the ever-changing national and European legislations for safety, health and environmental protection (e.g., REACH) and the respectively triggered investments.

### Low M&A Prices Attract 'Bargain Hunters'

Declining demand in southern European countries burdens especially the local and very specialized chemical distributors but allows financially strong, diversified companies to negotiate advantageous M&A prices. Hence, more than 60% of the study participants indicate that low acquisition prices through economic disadvantages are seen as a major driver for new M&As.

However "bargains" in terms of purchase prices still require a profound integration and a realization of synergies. Sometimes "bargains" can mask the follow-up costs of the integration, putting the overall success of the M&A at risk. Therefore a substantial evaluation of the target especially with respect to market coverage, served customers and products offered is still required.

Although the agricultural chemistry industry is not suffering from excess capacity and extensive market price competition opposed to, e.g., the automotive or the building chemistry industry, buyers should focus not only on the purchase price of an acquisition but also on the total costs of the M&A.

### Strong Cross-Border Activities

Study participants indicated that overseas markets would offer even more potential for M&A activities as they perceive European markets to be saturated and negatively influenced by the European crisis. In contrast to Europe, participants predict strong M&A activities in South America, Asia/Pacific and particularly in China and India. An increasing internationalization of the principals (and their products) will reinforce such a development. Barriers for cross-border M&As include cultural barriers, legislation and market particularities that are underestimated by the buyer.

### M&As as a Way to Sharpen the Value Proposition

In their comments, study participants pointed out that M&A activities and potential targets have to be evaluated in the light of the market structures. While big, international players (Tier 1 chemical distributor) with a diversified product portfolio lack proximity to customers, the pan-European distributor (Tier 2) and the local or niche supplier (Tier 3) that are closer to the customer lack the compensating effects (i.e. risks mitigation) of a diversified product and customer portfolio. It is thus advisable to align the M&A activities to the market structures and to focus on the value proposition offered by the target. Consequently the key to the success of the M&A lies within the strategy and due diligence phase of the M&A process.

### M&A as a Challenge for Management

In case of M&A activities, the management of a chemical distributor has to make considerable efforts to ensure the success of the acquisition besides meeting the challenges of the daily business. The management contributes to the success by selling the M&A story to the customers and employees while ensuring the continuity of the business. In addition, management has to plan and perform further activities of the integration, e.g., the revision of the product portfolio, internal and external communication, training of employees, etc. The comments of the study participants revealed a need for stronger support of management in acquisitions.

Overall it can be said that M&As (again) become a strategic option for the chemical distribution industry to face the challenges of the markets in Europe. Financially strong market participants interested in acquisitions are advised to constantly screen the market for promising targets. Low acquisition prices and low financing costs for M&As can support the extension of the product portfolio and the realignment of the strategic value proposition – even beyond Europe.

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## STATEMENTS

### Market Trends

#### The M&A situation in the Chemical Distribution Sector

You can in the last few years observe an increasing market consolidation. Suppliers and customers optimize their contacts and concentrate on selected partners. To reduce efforts and optimize costs in the supply chain, suppliers use their distributor as a development and technical service partner for their mutual customers. Distributors grow together with their suppliers and act for them pan-European. For this reason M&A is as important as organic growth. With our newest acquisition of Küttner and our joint venture with Biesterfeld Nordic, we continue this path.



Birger Kuck, CEO, Biesterfeld

We assume that consolidation will continue in the coming years. While in the past, this process was driven primarily by private equity owned companies, the rising potential for portfolio conflict is making it extremely difficult for private equity companies in Europe today to make worthwhile acquisitions. In view of this situation, traditional distribution companies are increasingly coming to the fore, many of which are still family-owned and owner-operated. And it is these companies that are set to drive forward consolidation in Europe, not least because smaller family-run companies will often fail to find a successor. Moreover, we are also seeing a clear trend toward specialization among market players, with companies increasingly focusing on individual sectors. Whereas in the past, a distributor will have covered a range of different industries, it will in future have to focus on specific business segments in order to prevail in the long term. At Krahn Chemie, we have done just this. Among our core segments is the paint and coatings industry, which in turn was what motivated us to buy the Dutch ICH Group at the beginning of the year. Our company strategy clearly stipulates in which areas we want to grow organically, and in which through acquisitions. We are therefore set to continue our activities with regard to acquisitions and, as such, will actively contribute to market consolidation.



Axel Sebbesse, CEO, Krahn Chemie

The chemicals distribution industry is still very much diversified in terms of regions and product specialization. In order to stay attractive to potential principals thus maintaining a profitable growth, size of the distribution business matters more and more. Particularly the success of the price-driven commodity business is very much dependent on economy of scale from the perspective of procurement, on local stocks in close proximity to the big consumers, low freight costs, high throughput and high automation. Taking a look at the landscape, autonomous regional growth gets difficult because of the big number of established regional players and legislative hurdles. Therefore selected mergers and acquisitions are a healthier way to create growth becoming a pan-national, Pan-European or a global distributor.



Dr. Peter Manshausen, managing director, Caldic Deutschland Chemie

I don't see reasons that the M&A trend will significantly change in the near term. On the one hand, we have big global players, which are linked to the capital market or are in hands of financial investors. Growth targets and ROIs above average are crucial for this kind of shareholder and require more than organic development. Acquisitions are a must. On the other hand, large to medium-sized distribution organizations are also looking for growth opportunities. The motivation to look for a specific acquisition target may differ from acquirer to acquirer, e.g., improve supplier network, enlarge regional coverage, allow for synergies on the cost side, etc. Acquiring the "right" target is more important than just buying a "big" one. Tailor-made deals will be required.

A short look back over the last three years confirms the trend to smaller targets. In 2011, we witnessed about 20 major acquisitions worldwide. More than 50% of the acquired companies reported annual sales above € 50 million. In 2012 and Q1 2013 the share of deals of this size dropped below 30%. During recent years 50% of the transactions were done in Europe; the other half was shared between the Americas and the Far East, including India. Europe is still an agile marketplace for M&A activities. Acquisition targets that are on the market these days come mainly from Spain, Italy and Turkey rather than from countries like Germany, France and from northeastern Europe, where the consolidation process is much more advanced.

Implying a rampant appetite on the buy-side, one has to admit that potential targets become less and less available the higher the consolidation process in a country has progressed. Beyond Europe, growth areas like the Far East and South America seem to be already on the radar screens of the big players.



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