It Takes Two to Tango

Things to Keep in Mind as M&A Activity in Chemical Distribution Continues at High Rate

In the drive to reach growth objectives, or to maintain and enhance “critical mass”, mergers & acquisitions (M&A) has been a theme for the chemical distribution industry for years. The industry leaders (by size and geographic reach) were all built through a series of such transactions. As the practice is further trickling down to the smaller and mid-sized company layer of the sector, and more distributors espouse external growth options, it is worthwhile to spend some time on a reflection of recent events in this context.

Building a Broader Geographic Base

In 2016 most of the M&A transactions in the chemical distribution space, which were announced or completed, again were placed in Europe or North America. On the buy side, it was the group of larger companies (with an annual turnover above EUR 250 million), that was most active. Some companies have almost become “serial acquirers” doing a number of different transactions within a short time-period. Overall, the number of recorded transactions in 2016 is slightly below the peak, which we recorded for 2014.

A number of the transactions were in business activities “outside” the core industry of chemical distribution. For Brenntag this trend towards diversification meant that acquisitions were completed in the lubricants distribution industry around the globe. Deals were concluded in Singapore and the U.S. More recently, Brenntag has also invested in two service companies, one that provides pipeline testing and maintenance service and one that provides packaging services for small containers with chemical products. The other global diversified distributor, Univar made further investments in the area of environmental and/or maintenance services, particularly in the US.

When is the Next IPO Going to Come?
Last year, the long-time private equity sponsors of IMCD, funds advised by Bain Capital, have sold off a final tranche of 4.20 million shares to institutional investors at a price of EUR 31.25 per share in a private placement (March 2016), completing the exit from IMCD.

After that last transaction, IMCD is now 100% owned by institutional and private investors.

Also in March 2016, the market experienced a sort of indirect IPO, when WL Ross Holdings Corp. announced that it was going to acquire chemicals and plastics distributor Nexeo from private equity firm TPG. Nexeo has since become a unit of WL Ross Holdings Corp. The group subsequently changed its name to Nexeo Solutions and is now being traded on Nasdaq.

The chemical distribution industry today has several listed companies, e.g. Brenntag (GE), DKSH (CH), Hawkins (US), IMCD (NL), Megachem (SG), Nexeo (US), and Univar (US). Many stakeholders and industry watchers are now waiting for the initial public offering (IPO) of Azelis. That company had made a big jump across the Atlantic with the establishment of Azelis Americas, resulting from merging business activities in Canada and the U.S. into the acquired business of Koda Distribution Group. The group has recently only made some smaller add-on acquisitions, on both sides of the Atlantic, expanding geographic coverage or giving it a more balanced access to certain industry sectors. The big move is still ahead.

**Suppliers Go For “One Size Fits All” Network Design**

When suppliers of specialty chemicals are looking for distributors, their crucial selection criteria include market reach and capillarity, a complementary product portfolio (which is often application specific), logistics capabilities, technical competence, project management skills, reporting systems and transparency, just to name a few. Increasingly the market reach, which a distributor is expected to have, is not limited to a country or group of neighboring countries. Instead, suppliers try to find and select distributors that can handle a whole continent such as Europe or a major economic area, such as ASEAN in Asia Pacific or Mercosur in Latin America.

The approach towards distribution channels, even by mid-size producers/principals, is increasingly moving away from the assembly of a whole portfolio of “local champions”, towards partnering with a limited number of larger distribution groups. It is in a way a “one size fits all” approach to setting up channel network. Principals are trying to reduce the complexity of their indirect sales channel,
without losing too much flexibility and at the same time maintaining relevance in the market. This is not always easy, as the attractive companies in the distribution space tend to have long-time relationships with large multinational producers. This puts smaller distributors under a certain growth pressure.

Size matters quite a lot, in the sense that attaining “critical mass” is needed. However, there are some limits to how far the consolidation can go. Potential conflicts between suppliers in a distributor enlarged by the combination of two businesses will have to be resolved or at least “tolerated”. The former forces the losing principal to go elsewhere and often triggers (temporary) disruption that nobody likes, the latter is difficult to manage and very rarely practiced. When neither is possible, the potential for combining companies may be limited. The deal may not be implemented.

At any rate, a lot of upfront work needs to be done to make M&A transactions work as conceived and planned.

**Sell Side Considerations**

When planning the sale of a distribution company, preparation may need to start a few years ahead of the actual “hot” process and a related transaction date. Based on our experience (and that of other advisors involved in this type of activity), we would suggest a few points worth considering upfront and well in advance:

- Take out real estate, as buyers often only have an interest in the “business”, without too much “ballast”
- Divest/phase out non-core activities as focus will help
- Allow for time to distribute excess cash and prepare the sale
- Be informed and get real about valuations, not everybody feels the same emotional attachment to a company
- Take expert advice

Good advance preparation facilitates the transaction. It enhances and secures the value that can be realized.

**Caveat Emptor**

Many companies, in their recurring strategy development processes, do regularly talk about M&A being a pathway to growth. In our view potential buyers can increase their success rate with a few basic preparatory steps:

- Scan the market and be ready to move fast, when an opportunity arises and is presented to you
• Make your interest to be a potential buyer of businesses known
• Take expert advice
• Don’t get carried away during the process in a bout of “deal fever” and try to avoid “bidding against yourself”

While M&A may be a key part of your strategy, accept that finding and buying a company is by definition somewhat opportunistic, as they say ... “it takes two to tango”.

“**It’s the Integration, Stupid**”

Once an M&A transaction is signed and closed, often the real work is about to start. Post-merger integration, or “PMI” as it’s called in corporate finance circles, is the project phase that is often not given enough upfront consideration, and later on an appropriate level of top management attention. Even when product ranges are complementary and the price paid has been right, a lot of other things can still go wrong in a merger of two entities. Company cultures may be too far apart, people simply cannot get along with each other. Sometimes suppliers of the acquired company may exercise the right to terminate a distribution contract based on a “change of ownership” clause, they had put into many years ago, when it was negotiated and signed. Customers may feel that they have been neglected in the months leading up to the deal - and so on. The list of reasons for underperformance and shattered expectations can be long and diverse. A lot of value can be lost in the aftermath. It pays off to think about life “after the deal” in an early stage of the acquisition process. Happy hunting!

**Autor(en)**

Guenther Eberhard, Jürgen Mohrhauer, DistriConsult

**Kontaktieren**

**DistriConsult GmbH**

Säntisstrasse 69C
8820 Wädenswil
Switzerland

*Telefon: +41 44 680 1431*
*Telefax: +41 44 680 1432*