

## Current State of Chemicals M&A Market

Dear Friends and Colleagues,

I recently met with Rob Westervelt, Editor-in-Chief of Chemical Week, to discuss the current state of chemicals M&A. We discussed some key themes for the industry and the questions on everyone's mind regarding the state of Chemical M&A. Here are the nine key points.

### QUESTION 1. What is the overall outlook for M&A (deal volume, values, and multiples)?

**ANSWER:** The overall outlook for M&A, (deal volumes, values, and multiples) is that deal volume will continue to be depressed in 2009. For the twelve months ended January, FactSet Mergerstat reported that deal volume was down 30% year-over-year. I do not see a significant change until the economy stabilizes and the credit market comes back. Deal values will also continue to be down because there are fewer big deals getting done right now – companies are less willing to make a big bet on a large acquisition when the economy is struggling and many firms are fighting to keep their own financial performance stable.

Multiples are difficult to measure in this market because there are fewer transactions. Seller expectations are still, on the whole, higher than buyer expectations except with deals that are highly strategic fits or where the seller is motivated to sell due to financial difficulty or some other factor. This is contributing to the decline in deal volume. Much of the multiples data we have right now are for distressed transactions and if that activity continues then we would expect to see a continuing downward trend in multiples for the market as a whole.

### Q2. Who has the ability (and nerve) to invest in this environment?

**A:** There are still many companies, both large and small, who have cash or access to capital. The ones with the nerve to invest are the bargain hunters and those companies who are presented with an opportunity that is a very strategic or a complementary fit to their existing business.

### Q3. What types of deals can get done in this environment

**A:** There are two primary types. First are distressed deals, where the seller is motivated by the need to do a transaction in order to avert bankruptcy or where they are in or near default on their debt. An example is Chemtura, which has said they are exploring asset sales to help payoff a large principal payment on debt that is coming due in July. The second type are highly strategic deals, where the buyer is already in the same business as the seller and can use the transaction to help achieve growth or realize significant synergies. Examples are Agrium and CF Industries or CF

Industries and Terra Industries.

### Q4. Will strategic players become more aggressive?

**A:** We have seen strategic players become less aggressive since the beginning of November when the chemical industry took a hard turn for the worse. The past few months since then have sapped the willingness of many strategic players to do deals because they have had to focus on their own operations and balance sheets. I think there will need to be a clear sign of a bottom in the industry's performance before strategic players as a whole will become more aggressive. In the mean time, there will be pockets of activity for the right kinds of deals.

### Q5. Is there still potential for Asian and Middle East investors?

**A:** Until recently, Japanese investors were still very active in the market even while everyone else was pulling back. In the past few months, economic events have hit Japan fairly hard and our Japanese clients have become more conservative in their M&A activity.

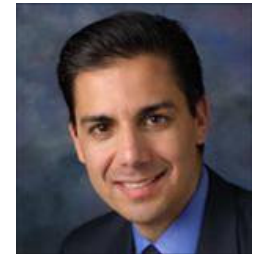
We are still having discussions with Indian pharma chemical companies and they remain cautiously interested in opportunities in the US and Europe. However, given the drop in oil prices we have not seen as much activity by Middle East investors. Kuwait's withdrawal from the joint venture with Dow Chemical is an example.

### Q6. How active are financial buyers?

**A:** Financial buyers continue to struggle with the depressed lending markets that they rely so heavily on to fund their leveraged acquisitions. They are still out looking for deals and most are more willing to be flexible with transaction structures in order to help overcome credit shortfalls.

### Q7. What is the credit/bond market outlook? What is borrowing like in this environment?

**A:** Borrowing remains a challenge compared to prior years but we are finding that the lending market is often open for the right deal. We do not think the credit market outlook will get much worse because it has been stable for some time and there is increasing pressure on banks to lend money. The easiest way to finance a deal in this environment is to work with an existing bank that has a longstanding



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relationship with the buyer, or to have a strong borrowing base of assets that can provide security for a credit facility.

When borrowing is available, banks are more stringent than they were in the past. Leverage multiples have come down by around 1 to 2 multiples of EBITDA since the market peak, pricing is more expensive and covenants are more restrictive.

### Q8. Will the downturn accelerate restructuring as sellers and buyers overhaul portfolios?

**A:** Absolutely. We have already seen a wave of restructuring announcements across the chemical industry beginning in early December. Many chemical companies are struggling to meet debt obligations. This has already begun to drive divestiture activity (Chemtura) and bankruptcies (Merisant) and I predict that such activity will increase in the next few months unless chemical industry demand picks up soon.

### Q9. What are the most active sectors?

**A:** There is still a lot of activity in pharmaceuticals and agrochemicals. We also expect to see more consolidation in petrochemicals since that market has been under such duress for the past 3 to 4 months.

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