



Comparing the Valuations of Chinese and Non-Chinese Chemical Companies Using EBITDA Multiples

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Interest in cross-border M&A transactions involving Chinese chemical companies is quite strong and probably increasing. Domestic chemical companies rightfully see an overseas acquisition as a way to quickly access overseas markets and acquire advanced technology, while overseas buyers aiming to increase their China presence also frequently see an acquisition of a domestic company as the fastest and most promising way to expand their presence in the largest chemical market in the world. For both types of transactions, the alternative is to build a business organically, which is not always a realistic option due to the complexities and the long time required in setting-up a new presence in a region, resulting in costs without offsetting revenues during the early years of establishing a new business.

Needless to say, in buying any company – independent of the region or the business segment – valuation plays a key role in determining whether a deal will take place and if such an acquisition will eventually be regarded as successful. Though determining the value of an individual company is eventually the result of a detailed analysis

of its business activities, including financial projections and cash flow modeling, comparing market multiples of listed companies provides an initial benchmark regarding the expected deal value. EBITDA multiples are a commonly used indicator, supported by Price/Earnings, Price/Sales, Price/Book and other ratios. It varies from deal to deal, but EBITDA is the most consistent means for comparing valuations across regions.

We therefore performed a detailed analysis of the current valuation of listed chemical companies in and outside of China. For each of the two regions, we selected about 100 companies which we grouped into four categories, namely commodity chemicals, diversified chemicals, specialty chemicals and agrochemicals. The result of this analysis – done at the end of April 2019 – is shown in Table 1.

Of course, these are trailing multiples, i.e., they are based on past EBITDA performance. Forward multiples (i.e., those based on expected future EBITDA) may already paint a different picture but can of course only be obtained via future EBITDA estimates that will require a number of theoretical assumptions as part of the financial projection and cash flow modeling process. Also, these multiples are trading multiples, meaning they are based on the stock market valuation of companies. Transaction (M&A) multiples are typically higher but the pool of past examples will be far smaller.

It is also important to understand that valuation of public shares can have certain distortions and pricing phenomena due to several factors (e.g. retail versus institutional

Table 1 EBITDA multiples of chemical companies in and outside of China by segment, April 2019

Average EBITDA multiples	China	Global
Specialty	16.8	12.8
Agrochemicals	12.1	11.6
Diversified	7.1	7.6
Commodity	7.4	8.9



investors, lack of short selling and limited investment opportunities in China). However, for all these potential issues, comparing EBITDA valuations is the starting point in setting buyer and seller price expectations.

The key difference between the valuations for chemical businesses in China and elsewhere is the higher valuation of specialty chemicals in China, while for the other chemical segments, valuations are broadly similar. Also, obviously specialty chemicals and to some extent agrochemicals are generally valued more highly, both in China and globally.

Let us examine some of the reasons for these differences.

Across the globe, specialty chemical and agrochemical businesses tend to achieve higher valuations. This is because these segments generally have higher growth and better expectations regarding margin development as they are less threatened by commoditization but instead benefit from a lower degree of competition, higher entry barriers, higher dependence on specific technology knowledge and IP, closer customer relationships, higher likeliness of development of innovative products, etc. In the Western world, this has led to many chemical companies gradually shifting their portfolio out of commodities and into specialty chemicals, a process that is still ongoing and now also reaching China.

Also, across all regions, diversified chemical companies seem to have the lowest valuations. This could either be the consequence of some unrelated effects (e.g. Japan has a larger share of diversified chemical companies than other regions, and the valuation of chemical

companies there is relatively low), or it could reflect investor unease with chemical companies without a clear focus.

However, the key observation from the data in table 1 is certainly the higher valuation of specialty chemicals in China as compared to the rest of the world. Compared to the share of specialty chemicals in the Western world, the share of specialty chemicals in China as part of the total chemical industry is still relatively low. However, growth expectations are much higher for specialty chemicals in China than for specialty chemicals elsewhere. This reflects the trend towards an upgrading of the manufacturing industries in China towards innovation and quality as opposed to volume, as outlined in the most recent Five-Year Plan. Indeed, specialty chemicals in China are very likely to benefit from several government initiatives, not only those pushing for innovation and industry upgrading but also those emphasizing environmental protection and energy savings. It is fair to say that China so far only has a limited number of specialty chemicals companies whose success is truly based on delivering differentiated products and services, thus giving ample room for growth for companies in this segment. Another aspect is that of ownership – as specialty chemicals tend to require less capital investment, the segment is dragged down less by state-owned chemical companies with their mostly commodity-focused portfolio.

What are the implications of these differences for potential Western buyers of Chinese chemical companies, and for Chinese buyers of Western chemical companies?

First of all, the high valuations of specialty

chemicals in China may be a barrier for Western buyers, as these potential buyers usually have a preconceived idea of an acceptable EBITDA multiple they are willing to pay – which may be too low to be a successful buyer in China. As a consequence, they will need to assume substantial growth in their post-acquisition business plans to justify the higher multiples. Inversely, theoretically the relatively lower valuation of specialty chemicals outside of China should provide acquisition opportunities for Chinese buyers. In reality, potential Chinese buyers still seem to regard the multiples payable for Western specialty chemicals companies as too high. As a consequence, Chinese buyers may have to become more active in integrating acquired companies, rather than pursuing the current practice of mostly leaving such foreign acquisitions alone. Therefore, Chinese companies will need to be more proficient in deploying management teams with integration capabilities as most of the synergies should be captured within 12-18 months from deal close or institutional knowledge of the acquisition from the teams that worked on the deal will be lost – resulting in a potentially overpriced deal. This is probably the greatest challenge for Chinese companies in general, and specialty chemicals specifically, to succeed in overseas M&A.

While some buyers and sellers may decide such methodologies are not important, knowledge of these techniques will in the least gain an understanding of a counterparty's thinking during the negotiation process, providing a helpful tool to avoid conflicts and facilitating a successful transaction. ■