Recent cross-border M&A activities of western chemical companies entering the Chinese market

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The first half of 2020 has seen a relatively large number of investment announcements by foreign chemical companies in China, both greenfield investments and M&A transactions. It is tempting to see this as a consequence of post COVID-19 growth – after all, the most recent IMF report from June 2020 predicts that real GDP in advanced economies will shrink by 8% in 2020, while China will still have growth of 1%. However, given the time required to plan, search and execute an investment, especially when considering the additional China-West complexity, suggests these deals have been in the making for some time. It also does not capture several potential acquisitions not yet publicly disclosed. Rather, a longer-term strategic rationale seems to be at work. We will revisit this question after describing the recent investment wave in a bit more detail.

Table 1 provides an initial overview of recent M&A activities.

Let us briefly review these M&A deals individually.

UPL, a leading Indian agro chemical company, acquired a 75% share of Yoloo Laoting, a Hebei agrochemical company in a deal worth US$13.3-mn. UPL aims to utilise the existing customer relationships of the Chinese company to sell the wider portfolio of UPL products. UPL will also gain a formulation facility in China, strengthening UPL's access to the major Chinese crop protection market. Similarly, Elkem acquired Polysil, a Chinese silicone producer with strengths in baby care and food. This was a much larger deal with a value of about US$135-mn, as Polysil has about 400 employees and two production facilities. Again, the focus was on accessing the Chinese market, where Polysil makes 90% of its sales, in particular in South China. However, Polysil's strong position in specific applications and technologies also played a role. With an EBITDA multiple of about 8.6 and an EBIT multiple of about 1.5, the price paid by Elkem seems to be reasonable.

In contrast, Cabot's acquisition of carbon nanotube producer Shenzhen Shansun for US$115-mn certainly is at the upper range of typical multiples, with an EBIT multiple of about 4.1 based on the company's 2019 earnings of US$28-mn. This revenue is expected to grow at a rate of 20-25% over the next five years from continued growth in electric vehicles and other lithium-ion battery storage applications, providing an explanation for the high multiple paid by Cabot. In addition, Cabot presumably expects synergies with its existing portfolio, stating that "With this acquisition, Cabot becomes the only carbon additive supplier with commercially proven carbon black, CNT, carbon nanostructure and dispersion capabilities." Cabot also points out

Table 1: Recent M&A activities of foreign chemical companies in China

Company	Time	Investment	Country
UPL	Nov 2019	Indian agrochemical company, UPL acquired a majority stake in Yoloo Laoting Bio-technology Co. Ltd., an agrochemical firm based in Hebei province.	India
Elkem	Dec 2019	Elkem acquired Polysil, a leading China silicone elastomer and resins material manufacturer. Approximately 90% of Polysil's revenues are generated in China.	Norway
Cabot	Jan 2020	Cabot acquired Shenzhen Shansun Nano New Materials, a maker of carbon nanotubes in China, for US$115-mn. This strengthens Cabot's market position in the high-growth batteries market in China, the largest EV market in the world.	USA
Iberchem	Feb 2020	Iberchem Group, a Spanish private-equity owned flavor producer, acquired the Chinese flavor producer, Nanchang Duomei Bio-Tech, regarding the acquisition as a key step in the strategic expansion of the flavor division.	Spain
Azelis	April 2020	Chemical distributor, Azelis, acquired CosBond, a Chinese specialty chemicals and food ingredients distributor with a focus on personal care. Azelis describes China as a strategic market due to its growing middle class and personal care industry.	Belgium
DIC	May 2020	DIC has acquired liquid inks for the packaging business from Liaoning Tianqi Technology, a manufacturer of liquid inks for packaging for the food and beverage industry based in China.	Japan
Ascend	June 2020	Ascend Performance Materials purchased the assets of NCM (Changshu) and Tehe Engineering Plastic (Suzhou) in Changshu Yushan High-tech Industrial Park. Plans are to expand the compounding assets and establish a global R&D center.	USA

that the deal will strengthen Cabot's market position and formulation capabilities in China`s high-growth batteries market, the largest and fastest growing electric vehicle market in the world.

Iberchem is a private equity-backed producer of flavors that had already made a number of acquisitions worldwide in the past few years, including a flavor company in Malaysia this year. Buying Nanchang Duomei allows the company to participate in the growing Chinese market for food and beverage flavors. While the financials of the deal were not disclosed, we estimate that it is in the range of US$20 to US$30-mn, a not insignificant amount given Iberchem's 2019 sales of about US$193-mn. Margins in the distribution of commodity chemicals have been declining substantially. As a consequence, chemical distributors are seeking to enter niche markets based on specific applications, where better margins can be realized. Azelis' acquisition of chemical distributor, CosBond, is an indication of such a shift. CosBond focuses on chemicals for personal care in China, a segment that Azelis describes as attractive due to China's fast-growing middle class. Similar to Iberchem, Azelis is backed by private equity and follows a similar buy-and-build strategy, adding smaller companies to its business in the hope of thus increasing the overall value. Given Azelis' large size, this is a small deal, probably increasing Azelis' global sales by only 1-2%.

DIC's acquisition of a packaging ink business in Northeast China is an incremental addition to the company's China business, rather than a substantial change. The company already has production facilities for packaging ink in the South and East of China, both more important markets. The acquisition allows the company to compete better in the Northeast China market, and is stated to increase production capacity by about 20%. Again, even though financial details are not known, this is a very small deal compared to the size of DIC's global business. The most recent deal announced is Ascend's move into the Changshu Yushan chemical park via the acquisition of assets of two companies, NCM and Tehe. This secures Ascend a coveted location in an established park and may have saved the acquired companies from being ejected from the park. Ascend plans to expand PA66 compounding capacity in the park, support Asian customers and establish an R&D center, all initiatives that make the company an attractive tenant for the chemical park. This is Ascend`s first acquisition in China – according to a company statement, the attractiveness of the investment lies partly in the proximity of the site to Shanghai and its strong automotive production.

Some common denominators

This would be just a laundry list of deals without a bit of an analysis of common denominators among these trends.

- First, all seven deals above are more or less in the area of specialty chemicals. This is sensible as in China, commodity chemicals are generally not very attractive areas for foreign investment as margins are low and entry barriers are limited.
- The M&A deals are not huge, ranging from about US$10-mn to US$150-mn, as companies invest in China at a certain scale that does not risk hurting the company as a whole.
- A related aspect is that the foreign buyers – with some exceptions – are not big companies. For such companies, the acquisition of a local player may be more advantageous than a greenfield investment, as the risk, time needed, and local presence and knowledge required tend to be lower.
- Most acquisitions target smaller niches, either with regard to a specific region within China (e.g. South China for Polysil or Northeast China for Liaoning Tianqi) or a specific application segment (e.g. personal care chemicals or batteries for electric vehicles).
- Finally, and most importantly, the deals focus primarily on establishing production capacity in China to target the Chinese market. Exports from China do not seem to be a major part of the rationale.

The rationale behind these acquisitions

This leads us directly to the rationale behind these acquisitions. First and foremost, acquirers want to establish or enhance their China presence – to produce locally in order to supply the local market ("in China for China" strategies). This reflects the strong belief in China's future growth potential. In addition, recent policy changes and improvements in the Ease-of-doing-business ranking demonstrate to the acquirers that China still strongly encourages foreign investment. And finally, another factor may be that the tightening of environmental regulation and pressure to move into chemical parks has made local chemical companies more willing to consider selling themselves to foreign buyers.

We think that in the current situation – and with the added factor of China very likely emerging from post COVID-19 in a stronger position than before, as indicated by the IMF forecast – more foreign chemical companies will seriously consider an acquisition in China. Such companies should not wait too long before deciding in principle on whether to pursue an M&A deal, as the landscape is changing and the chances of a successful deal are higher now than they will be in 2-3 year. Next, companies should define criteria for their ideal M&A targets and prioritize them, for example, regarding chemical segment, size, location etc. This is to be followed by a search, evaluation and prioritization of targets. Once one or more potential targets have been identified, these companies need to be contacted. Depending on a company`s China experience, it is recommended to seek expert support in order to run a smooth M&A process, such as offered by us and other parties.