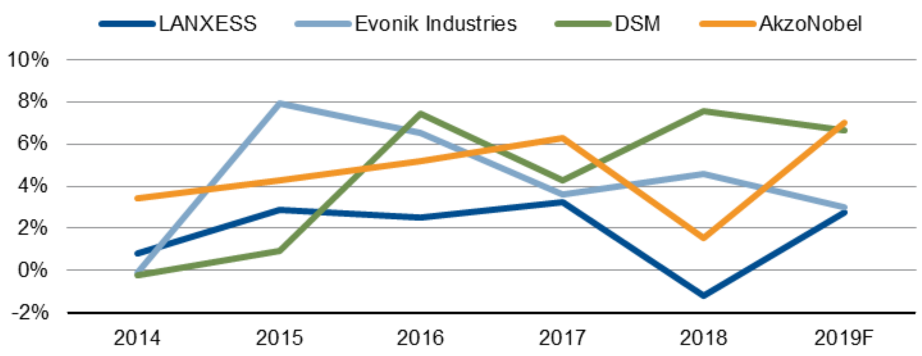
Europe's streamlined speciality chemicals companies braced for tougher times ahead

Europe's speciality chemicals firms have used the long economic upswing to bolster balance sheets while pushing their activities up market. Just as well. Tougher trading conditions and competition from bulk chemical companies are challenges.

Germany-based LANXESS (BBB+/Stable), Evonik Industries and Netherlands-based Koninklijke DSM and AkzoNobel – among Europe's biggest speciality chemicals companies – have made their portfolios more resilient by reshaping them through selective disposals and acquisitions while also investing in enhancing productivity. The companies have built up cash reserves as free cash flow has improved (see figure 1), as has profitability (see figure 2). LANXESS has exited the commoditised synthetic rubber business. Evonik has reduced its reliance on animal nutrition – notably methionine production – partly by ramping up its resource-efficiency unit, which supplies coating and high-performance polymers, among other products. In doing so, the company has benefited from demand for eco-friendly insulation and lightweight materials.

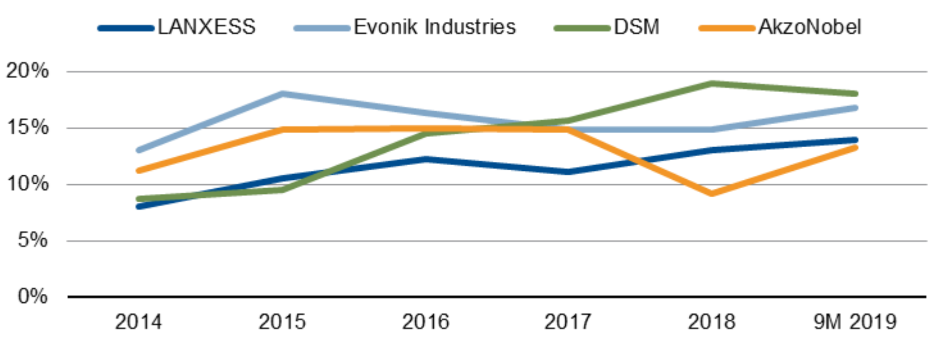
Figure 1: Free cash flow yield (free cash flow/sales)



Source: Scope, company data

Speciality chemical companies distinguish themselves by making products with specific properties for industrial use such as adhesives, industrial gases, coatings and agricultural chemicals, among other materials. Unlike bulk suppliers of base chemicals and materials – such as inorganic chemicals, fertilisers and polymers – specialised firms are less exposed to changes in oil and other commodity prices.

Figure 2: Profitability (EBITDA margin)



Source: Scope, company data

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In making higher value-added products, speciality chemicals firms tend to have greater pricing power with end-customers, such as those in the automotive, consumer products and construction sectors.

LANXESS, Evonik, DSM and AkzoNobel have chosen different approaches for improving their portfolios, as displayed in figure 3. AkzoNobel has focused on becoming a pure-play manufacturer in global paints and coatings, following the lead of its main competitors, which include US-based Sherwin-Williams, PPG, and Axalta, and India’s Asian Paints.

Figure 3: Summary – disposals and acquisitions of major European speciality chemical companies

LANXESS	Acquisition			Disposal		
	Year	**Name**	**Amount**	**Year**	**Name**	**Amount**
	2016	Chemtura	EUR 1.8bn	2015/2018	ARLANXEO	EUR 2.4bn
	2016	Chemours Clean and Disinfect unit	EUR 200m	2019	Currenta	EUR 630m
	2018	IMD Natural Solutions	n.a.	2019	Chrome chemicals	n.a.
	2018	Solvay’s Phosphorus Additive Business	n.a.	2019	Gallium-based organometallics	n.a.
Evonik	**Acquisition**			**Disposal**		
	Year	**Name**	**Amount**	**Year**	**Name**	**Amount**
	2016	Air Products Performance Materials division	EUR 3.5bn	2018	Jayhawk	<USD 100m
	2016	J.M. Huber Silica business	EUR 600m	2019	Methacrylate business (MMA/PMMA Verbund)	EUR 2.2bn
	2017	Dr. Straetmans	EUR 100m			
	2018	Peroxychem	USD 625m			
DSM	**Acquisition**			**Disposal**		
	Year	**Name**	**Amount**	**Year**	**Name**	**Amount**
	Various smaller bolt-on acquisitions, including: Royal CSK (2019), Tortuga (2019), Fortitech (2019)			2015	ChemicalInvest (share 35%)	EUR 200m
				2017	Patheon Pharma (share 49%)	USD 1.7bn
				2018	DSM Sinochem Pharmaceuticals (share 50%)	EUR 320m
AkzoNobel	**Acquisition**			**Disposal**		
	Year	**Name**	**Amount**	**Year**	**Name**	**Amount**
	Various smaller bolt-on acquisitions, including: Xylazel (2018), Fabryo (2018), Mapaero (2019)			2018	Speciality chemicals arm	EUR 7.5bn

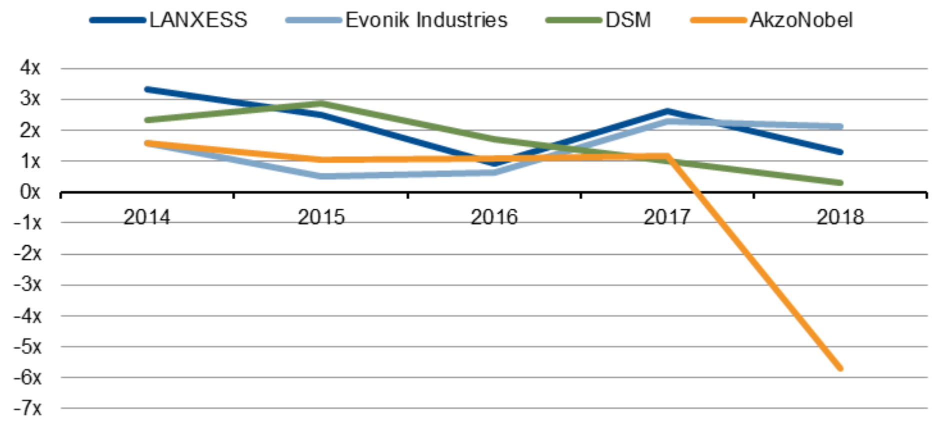
Source: Scope, company data

Reduced leverage – as CFOs have focused on improving free cash flow – has left the companies with greater financial flexibility. We estimate that LANXESS, Evonik, DSM, and AkzoNobel sat on roughly EUR 6bn of ‘dry powder’ as of end-September 2019, even after rewarding shareholders with special dividends and/or share buybacks. In this regard, AkzoNobel is an outlier, as most of the EUR 7.5bn proceeds from the sale of its former speciality chemicals unit were given back to shareholders via special dividends and share buybacks. That said, the company recorded net cash at year-end 2018 and disclosed cash reserves of about EUR 1.6bn as of 30 September 2019.

The sector's improved financial and operating resilience is welcome news for investors because the speciality chemicals industry, for all its strengths, is not immune to the business cycle. Slowing global economic growth, partly a reflection of the US-China and other trade-related disputes, and a cyclical downturn in important end-markets like auto manufacturing are weighing on demand in many speciality chemicals segments.

In addition, big bulk-chemicals suppliers, like Germany's BASF and Saudi Arabia's SABIC, are trying to enhance their portfolios by acquiring businesses with greater pricing power. Consequently, competition for assets is intensifying, as is downward pricing pressure in product markets. For instance, prices of superabsorbent polymers – used for disposable nappies – have fallen recently on a mix of oversupply and tough customer negotiations with giant consumer goods companies such as US-based Kimberly-Clark and Procter & Gamble. Evonik, BASF and Japan's Nippon Shokubai are the leading producers in this industry.

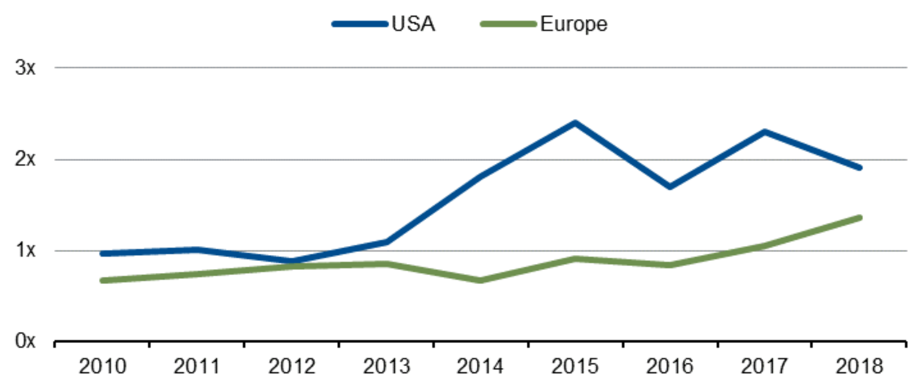
Figure 4: Leverage (Scope-adjusted debt/EBITDA)



Source: Scope, company data

Despite these challenges, the European speciality chemicals sector in general appears relatively well set to endure a cyclical slowdown, though the broader sector isn't necessarily in poor shape either. Net debt/EBITDA multiples for the broader sector in Europe have crept higher in recent years, though they remain below those prevalent before the global financial crisis. That is in contrast with those in the US, where multiples are higher than from a decade ago despite recent deleveraging.

Figure 5: Leverage (net debt/EBITDA)



Source: Scope, Bloomberg

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