

December 2008

Transactional Trends for Chemicals and Energy in 2009

By George Pilko, Chairman

Clearly the outlook for chemical and energy deals has changed dramatically during the past eighteen months - shifting from a strong Sellers Market dominated by PE Buyers to a Buyers Market where strategic buyers with cash, debt capacity or other "currency" can negotiate attractive bargains. These shifts in deal dynamics are the result of:

- The global economic downturn which will likely continue for several quarters, and possibly years.
- The collapse in equity prices since their peak in October 2007.
- Limited debt availability for all but the most creditworthy borrowers.
- Plunging energy and feedstock prices.

Given these changes, we decided to share our perspective on how deal dynamics will change during 2009 and what Buyers and Sellers will need to do differently to be successful.

Our perspective is based upon our ongoing Transactional Advisory work on the largest and most complex chemical and energy transactions globally - \$450+ billion of transactions involving operations in 48 countries. In addition, we have organized 25 Transactions Roundtables since 2000 involving Senior Deal Leaders and Deal Advisors to compare notes on Best Practices for handling high profile Acquisitions and Divestitures. Finally, during the past six weeks, I have spoken with Deal Leaders at the Oil & Money Conference in London and the GPCA Conference in Dubai about their intentions for 2009.

How Chemical and Energy Deals will change during 2009

- **Leverage has shifted to Buyers** - The joke regarding refinery divestitures in the 1990's was that one bidder was sufficient for an "auction" and two bidders constituted a "stampede." 2009 will be similar to

the 1990's for chemical and energy transactions. Deals will get done but they will look quite different than 2005-2007. Buyers with cash and debt capacity will be able to dictate terms, particularly to Sellers who must do a deal.

- **Asian/Middle East Buyers will Dominate** - Buyers from these regions have fewer obstacles in obtaining funding for deals and are typically willing to take a long term, strategic view of acquisitions, often seeking to build their technology portfolio and human resource base through such deals. They will clearly be the most active buyers during 2009 and will build upon their successes of the past 2-3 years.
- **"Forced" Sales** - An increasing percentage of the deals will be the result of financial restructurings, workouts or bankruptcies where the Seller must monetize assets. A growing number of companies will be forced into this position as the global recession tightens its grip on industry. For buyers, this provides an opportunity to acquire assets at favorable prices.
- **Sale of Weak Assets** - As some companies triage their portfolio of operating businesses and assets, a few will decide to dump the businesses/assets which are not a long term strategic fit - even in a weak market. This strategy allows management to focus their attention and limited resources on their core businesses.
- **Merger/Consolidation** - Even though equity values are depressed, selected companies will use their stock to merge with other companies whose stock prices are similarly depressed. These deals are often driven by a combination of: a) lack of a CEO successor; b) need to reduce costs or increase buying power; c) desire to increase market share; and, d) focus on upstream/downstream integration.



What Buyers and Sellers Need to do Differently

As a result of the changing economic and deal environment, Buyers and Sellers are shifting how they manage transactions.

Increased Focus on Operational Excellence Issues - Chemical and energy companies have gradually learned that a key to improving their overall profitability (as well as their EHS performance) is to strengthen their Operational Excellence (OE) processes. OE issues (for example, operating reliability, mechanical integrity, process safety, sustaining capital, etc.) are increasingly considered a key part of EHS related Due Diligence efforts. These issues are particularly important when the Seller has been cash strapped or overtly under-invested in the assets being sold. Click here for our [Grey Paper on Operational Excellence](#).

Use of Remote Sensing® to Gain Negotiating Leverage - Knowing more than your counterparty is a reliable strategy to gain negotiating leverage during transactions. Remote Sensing® is a technique we have developed during the past ten years to understand the EHS and OE situation at a target company before the Data Room opens without the knowledge of the Seller. This process is surprisingly effective in identifying the key issues at the target company and can be used effectively for a wide variety of transactions. During corporate mergers, Remote Sensing® is often the only form of Due Diligence which is available to the Buyer.

Demand by Buyers for More Extensive Due Diligence - As Buyers get increasingly focused on Operational Excellence issues, and they gain negotiating leverage in deals, they will demand (and receive) more access to conduct Due Diligence prior to submitting their final bid. No longer will Sellers be able to "stampede" Bidders into making bids with totally inadequate information. The result will be more access to records and documents, more time on sites and more access to a broader range of personnel.

Pressure for More Indemnity Protection - As negotiating leverage shifts from Sellers to Buyers, we will see Buyers demanding (and receiving) more extensive indemnity protection for EHS related issues. During the 1990's many Sellers were surprised after closing by the magnitude of EHS Claims they faced as a result of providing broadly defined indemnities to Buyers. The key for Sellers, of course, is to understand their Risks and Liabilities before opening a Data Room as well as carefully crafting indemnity provisions to limit opportunities for Buyers to "claw back" a major percentage of the purchase price. Another alternative will be for Sellers to reflect OE and EHS deficiencies in reduced valuations - effectively cashing out the issue upfront.

Need for Sellers to Understand What They are Selling - Vendor Due Diligence has become Best Practice on chemical and downstream petroleum deals. These VDD efforts will be increasingly important as Buyers conduct more extensive Due Diligence and squeeze Sellers for more comprehensive Indemnity Protection. In the absence of thorough VDD, Sellers are in the uncomfortable position of negotiating on issues where the Buyer knows more about the issue than the Seller. Often times Sellers can act on the VDD results to correct deficiencies and improve the "curb" appeal to reduce "deducts" and improve the attractiveness of the assets offered.

Focus on Transition Planning/Post Closing Integration - There is a growing realization that a high percentage of acquisitions do not meet their financial targets. As a result, Buyers are being more overt about Transition Planning as well as Post Closing Integration. This process should begin with the Data Collection during Remote Sensing® - that is, identifying issues as early in the deal as possible which will need to be dealt with at closing. Integration should start on the day of closing which requires Transition Planning to be handled between signing and closing.