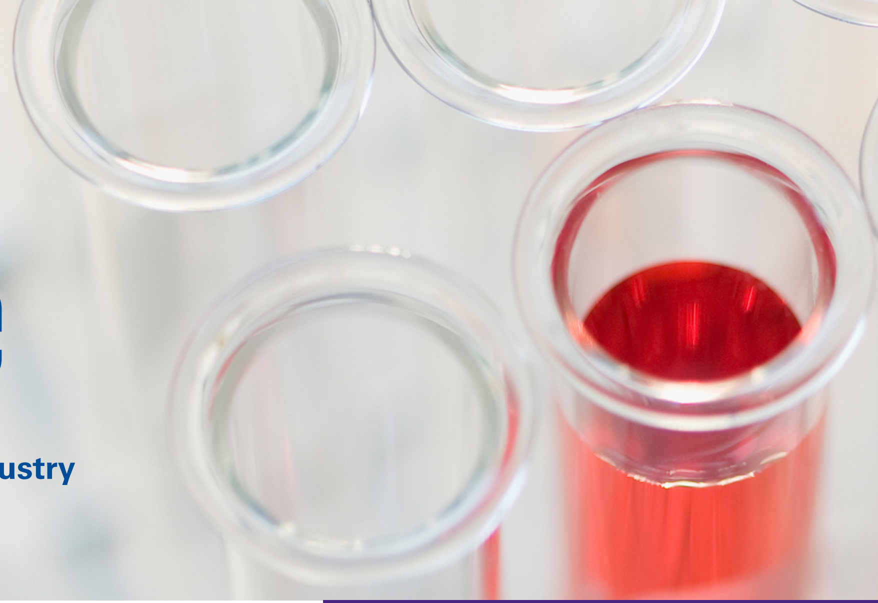

KPMG

ReactionTime

Issues impacting the Chemical industry

Globalization Accelerates Chemicals Mergers and Acquisitions

The recent Dow Chemical and DuPont merger and planned follow on disaggregation announcement has attracted a lot of attention. Could you explain the components of the deal and share a view on Dow and DuPont's intent?

Yes. On December 11, 2015, the boards of DuPont and Dow Chemical unanimously approved an all-stock merger of equals. After merger, they will separate or create three scale companies—in the areas of material science (e.g., acrylic monomers), agrochemicals, and specialty products (e.g., electronics chemicals). The intent is to achieve annualized cost synergies of approximately $3B, growth synergies of $1B, and overall projected value creation of ~$30B on a base of roughly $100B[1].

How has the proposed plan been received so far by the industry analyst community? What has the initial stock market reaction been?

The market reaction was very positive, with an initial 11 percent increase in share price across both DuPont and Dow Chemicals. Over the last two months, share prices have remained on average 5 percent higher than their starting points relative to the S&P 500 chemical industry index[2]. The majority of the analyst community likes the combination and sees long-term cost synergies, as well as more focused and market-leading positions in each of the three new companies—globally largest agrochemical business at $19B, a large and diverse specialty products business of $33B, and the world's second largest material science business at $51B[3]—and, relatedly, stronger free cash flow and M&A platforms in each business.

Are we likely to see more chemical M&A activity of this nature?

We believe so. The global chemicals industry is going through a profound disruption, with rapid growth in emerging markets (expected to grow four to five times as fast as OECD markets over the next 15 years)[4] and the emergence of substantial new emerging market

[1] *Wall Street Journal, Benoit, December 11, 2015*
[2] *S&P Capital IQ, February 28, 2016*
[3] *Dow Chemical Press Release, Broodo, December 11, 2015*
[4] *ICIS Supply and Demand Database, January 15, 2016*

Welcome to the first edition of *ReactionTime*, the KPMG Global Chemicals Institute's monitor of key issues for decision makers in the global chemicals sector. *Reaction Time* offers insights from KPMG thought leaders on the trends that are driving and shaping chemical companies today.

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About the GCI

KPMG's Global Chemicals Institute provides clients with deep chemical industry expertise and leading insights in all key markets. As part of the GCI, you'll be able to access valuable insight covering critical business topics and industry issues.

players such as Sabic in Saudi Arabia, Sinopec in China, and Reliance in India. In addition, the U.S. industry has been given a substantial push through the shale gas and light tight oil discontinuity, creating a resurgence in major U.S. chemical investment and competitiveness.

Thus, the chemicals industry is globalizing and following patterns seen in other globalizing industries: a race for new markets and global scale, heightened competitiveness, a robust M&A environment, and ultimately the emergence of a new industry structure where midsized, average performers give way to advantaged scale and scope, niche excellence, and national champion players.

Thus, we expect chemicals industry M&A deals to continue to rise through 2016. ChemChina's recent acquisition announcement for Syngenta, valued at $43B[5], is a case in point.

What role have investor activists played in the Dow-DuPont merger and disaggregation? Will activists continue to play a role going forward?

Investor activists have recently (since around 2012) been increasingly attracted to the chemicals industry as cash levels increased, shareholder returns underperformed market expectations, and a perception grew that chemical company portfolios were lacking sufficient strategic rationale. At DuPont, Trian Fund Management took an active role in driving the Chemours divestment, pressuring for the CEO's departure and advising the new CEO on the merger[6]. At Dow Chemical, Third Point was involved in both trying to break up the company and replacing the CEO (who will be leaving after key merger activities are completed).

Investor activist funds have over $170B under management, with active activism happening across several different types of chemical companies—e.g., Air Products, American Pacific, Ashland, Calgon Carbon, Ferro Corporation, and OMNOVA Solutions. We expect more activism in light of globalization dynamics, creating a context for business portfolio restructuring (to focus on businesses with global leadership potential and drive divestments of noncore businesses that do not have this potential).

What is it going to take to be successful in this new chemicals M&A environment?

Given the above set of globalization forces, exacerbated by increased investor activism, we anticipate chemical companies will need to be highly prepared to participate in M&A. We advocate that chemical company leaders "be their own activist" and leverage the following five best practices to prepare for a period of substantial M&A activity:

- First, leadership across the organization needs to align and clearly define its growth ambitions, and how its approach is competitively advantaged - the means by which the company will create greater value than its competition.
- Second, the company needs to define which markets and business models will help them to achieve their ambition and sources of advantage, and then to identify which potential M&A targets align to those markets and models.
- Third, the company will need to evaluate which of the potential targets offer the best opportunity to achieve their strategy and maximize value.
- Fourth, they need to have the capability to execute the deal, and do so quickly.
- Lastly, the effective integration of the acquired company is key to realizing the expected value.

A final consideration, in light of potentially pursuing multiple deals, would be to make the above practices repeatable. That is, build both an M&A road map and playbook to appropriately screen, pursue, complete, and effectively integrate opportunities. This last step enables the company to create an enduring M&A capability versus a one-off pursuit.

[5] *Wall Street Journal, Basel, Revill and Spegele, February 3, 2016*

[6] *Wall Street Journal, Benoit, December 11, 2015*

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