Maintaining continuity

Distributors adapt to unprecedented market conditions

The COVID-19 pandemic is a severe test of chemical distributors' resilience. Companies have maintained continuity of operations so far, but falling demand in the second quarter is a big concern.

Ian Young

Chemical distributors have reacted quickly to the unprecedented challenge of the coronavirus disease 2019 (COVID-19) pandemic. Companies have introduced a range of crisis-management measures to maintain continuity in their warehousing and logistics operations, and minimize disruptions to supply chains. Demand and prices have fallen for many of the chemical products that distributors handle, and the second quarter of 2020 is shaping up to be very tough, but business is good for products used to tackle COVID-19. Meanwhile, the pandemic is likely to accelerate digitization in the sector.

The crisis measures introduced by companies have prioritized maintaining operations and managing inventories at their warehouses, as well as servicing customers, while protecting employees. Distributors are understood to have at least 50% of their staff working from home but staffing levels at their warehouses are higher to ensure operations.

Distributors appear to have succeeded so far in maintaining continuity. "Companies need people at their warehouses and, so far, problems have been avoided," says Günther Eberhard, managing director at consulting firm DistriCon-sult (Wädenswil, Switzerland).

Brenntag, the distribution market leader in sales terms, says it has instituted crisis-management teams in all regions to lead the company's response. Brenntag's plan to ensure continuity of operations includes identifying critical functions to minimize service interruptions, implementing backup logistics, adjusting inventories in response to surges in demand, maintaining active and ongoing communications with suppliers, and equipping the company's locations with disinfectants and additional safety measures.

"We managed to handle this crisis very well as of today," says Christian Kohlpaintner, CEO of Brenntag. "Of course, our primary goal is to take care and assure the health and safety of our employees around the globe. Business functions performed well and almost all our warehouses stayed operational and provided full service to our customers."

Univar Solutions, the second-biggest player in terms of revenue, has established a dedicated global response team that is "focused on minimizing any disruptions, while helping to ensure the safety and well-being of our employees, customers, suppliers, and the broader global community," says Univar Solutions president and CEO David Jukes. "Currently our global distribution centers remain operational. We're executing our business continuity plans to help monitor and mitigate impacts on our operations as well as continuing to test and evolve our scenario planning across our network and make any adjustments as needed," Jukes says.

The resilience of distributors' asset-light business model, with strong cash generation and tight management of working capital—which has helped them through previous crises—is a source of strength. "Though a global pandemic is uncharted territory, responding to a crisis is not," Jukes says. "Univar Solutions has a proven record of maintaining continuity during adverse conditions and being a dependable partner for our suppliers and customers. We are confident in our preparedness as we proactively take steps to maintain reliability, including contingency shipping routes and modes, securing additional logistics capacity, and moving chemicals and ingredients in our network to maintain reliability."

Azelis, another leading player, says that very early in the outbreak it put together a cross-functional COVID-19 coordination team that monitors developments and implements measures across Azelis as the situation evolves.

"When this all started, the health and safety of our employees were our highest priority," says Azelis CEO Hans Joachim Müller. "In light of that and in line with local authority recommendations, the majority of our employees have been working from home for weeks now."

Azelis says it has succeeded in avoiding interruptions to its service. "Thanks to the resilience and creativity of both our own staff and our partners, we have hardly experienced any disturbances to our business despite the unprecedented times we are going through right now," Müller says. "All of our warehousing and logistics partners are as flexible and dedicated as we are in serving customers."

IMCD, also a leading distributor, says it has implemented precautionary working practices that allow its employees and staff to work from home as much as possible. The company says it "remains open for business and is committed to its role as distributor in supply chains. Through technology and strong digital capabilities, IMCD continues to serve and to keep close contact with its suppliers and customers."

Distributors say that pressure on their supply chains resulting from COVID-19 was first felt in China early in the year with plant shutdowns, disruption to internal logistics, and difficulties shipping products out of Chinese ports. Many distributors in North America and Western Europe source significant volumes of product from China for distribution in their home markets. "There is much less traffic in and out of China," Eberhard says. "There has been massive disruption on the logistics side."

Supply-chain disruption has become a worldwide issue as the pandemic has spread. "There is a problem with intercontinental, maritime transportation," Eberhard says. Reduced air travel has resulted in less air-freight activity, which has also meant less space for transportation of small-volume chemicals by air, he says.

This is a major concern for distributors that represent non-European suppliers in the European market. "Sourcing from outside Europe has become difficult," Eberhard says. "Imported goods are no longer flowing in, not just from China." However, falling demand is balancing the supply shortages for some products, he says.

Meanwhile, chemical distribution within the EU has become more complicated since EU member states closed their national borders as an early response to the outbreak, hindering the functioning of the EU single market. This caused traffic jams of up to 60 kilometers at some borders.

In late March, the European Commission requested that member states designate all necessary internal border-crossing points as "green lane" border crossings. Green-lane border crossings should be open to all freight vehicles and whatever goods they are carrying, with crossings, including any checks and health screenings, not taking longer than 15 minutes, the commission said. The green lanes are intended to ensure that EU internal borders stay open to freight and that supply chains for essential products are guaranteed.

Road and rail transportation have improved in Europe in the past month after EU member states opened green lanes at their borders, distributors say. "It has stabilized and become more manageable," says Eberhard. "They are letting the trucks through. They have found a way to keep essential traffic going."

The leading distributors say the scale of their worldwide procurement and distribution networks has helped them overcome supply-chain and logistics challenges. "In spite of border controls and external logistics challenges, Brenntag is able to leverage its extensive operational network to meet local needs across the globe," says Kohlpaintner.

KOHLPAINTNER: Brenntag able to leverage its network.

JUKES: Increased demand for digital capabilities.

Distributors say their flexible operating model enables them to adapt to fast-changing situations. "When demand patterns shift, for whatever reason, our agile business and supply-chain model allows us to quickly adjust and continue supply," says Jukes. "And our geographic reach gives us the ability to provide sourcing options from around the world even under difficult circumstances."

IMCD CEO Piet van der Slikke says, "With our company's diversified activities, asset-light model, and strong financial position, we will ensure that the continuity of our business is in place to offer full service and support to our partners."

Distributors also point to the local nature of the business, which has not altered. "We've always been able to supply 'local,' and that hasn't changed with COVID-19," Jukes says. "We have seen increased demand for our digital capabilities, technical expertise, and market knowledge to help our customers navigate dynamic market conditions."

Azelis's business "is local in nature, whereby local sellers serve local customers," says Müller. "The company headquarters steers the strategic development of the group, defines a set of guidelines and processes, and gives access to our ERP platform. The group also ensures that we deliver to promise in the strategic partnerships we have with our principals. Other than that, the day-to-day business in satisfying customer needs has been in the hands of our local teams all along, so no need to adapt anything here."

However, distributors' ability to serve customers locally depends on reliable supplies from principals. "If your incoming product stream is OK, your situation is manageable," Eberhard says.

Other pressures arising from the crisis include the need for careful credit management. Distributors' insurers could withdraw credit insurance for certain customers, if their ability to pay has diminished as a result of the lockdown. "Credit management is a challenge that now needs more attention," Eberhard says. "Some customers will lose their credit insurance, so it is harder to sell to these companies. Also, in times of uncertain demand, customers will likely order late and in small quantities. That is less risky, but overall more administration is needed."

Despite a huge demand shock for certain products, the overall impact of COVID-19 on distributors' sales has been asymmetrical, as has been the case in the wider chemical industry. Heavy exposure to certain industries like the automotive sector has meant demand destruction for many products, but exposure to others like food and life sciences has brought rising consumption, shortages, and higher prices for some products. "There has been a shift in demand and consumer behavior that has benefited some parts of the industry," Eberhard says.


MÜLLER: Life-science business should weather the storm.

There has been an estimated decline in demand for chemicals from the automotive industry of 30–80% as automakers worldwide idle assembly lines. This has slashed consumption of many products that distributors handle, such as specialty plastics, plastic additives, synthetic rubber, and paints and coatings. Meanwhile, falling feedstock costs have triggered price pressure down chemical value chains with distributors' customers expecting lower prices.

But demand is holding up for agricultural chemicals, and products for household and industrial cleaning like biocides, food additives including nutraceuticals, personal care products, pharmaceutical ingredients, surfactants, and water-treatment chemicals. Even consumption of printing inks is higher because of their use in food packaging, for which demand has jumped since people are buying more processed food.

"Given that more than 60% of our portfolio serves life-science industries, we are pretty confident that this portion of our activities will weather the storm well," Müller says. "On the industrial segments the picture is somewhat less favorable but still, even here we do see quite a few of the segments holding up nicely."

Demand for isopropyl alcohol (IPA) and ethanol is booming because of their use as active ingredients in hand sanitizers, for which there is a worldwide shortage. Producers of IPA are struggling to keep up with demand and prices have risen to record levels. Some of the leading chemical producers have adapted their plants to produce hand sanitizer and have teamed up with distributors that have the necessary bottle-filling lines and supply network to deliver product quickly to where it is urgently needed. "The big chemical companies need someone to do this job for them and distributors have the equipment," Eberhard says.

Univar Solutions has agreed to help distribute hand sanitizer produced by Ineos in the UK. Ineos started producing hand sanitizer at Newton Aycliffe in late March. Univar says that its UK team mobilized the full capabilities of its Middlesbrough, UK, homecare and industrial cleaning solutions center—near Newton Aycliffe—to provide technical and formulation advice. Meanwhile, the team at Univar's Cadishead production site near Manchester, UK, is providing packaging, bottling, warehousing, and logistics support.

Separately, Univar Solutions is supplying ethanol to Perstorp in Sweden to produce hand sanitizer and disinfectant. It has also linked up with ExxonMobil to support the US Transportation Security Administration by blending, packaging, and delivering products to help keep essential travel operating, while at the same time protecting officers.

Ethanol produced by Clariant is being mixed with other ingredients to produce disinfectant at Brenntag's sites at Basel and Lohn-Ammannsegg, Switzerland. Clariant is donating about 80 metric tons of disinfectant per month to the Swiss federal authorities for use in tackling COVID-19. "Brenntag is well positioned to support its business partners and wider society in the current crisis with the supply of a full range of products for disinfection, hygiene, and pharma applications," says Kohlpaintner.

The full impact of COVID-19 is not visible in distributors' first-quarter financial results, because most of the lockdowns in North America and Europe did not become effective until about mid-March. As a result, companies are reporting fairly strong results for the quarter, although much of their earnings and sales increases are from acquisitions rather than organic growth.

Brenntag reported solid first-quarter results with COVID-19 having a slight impact during the period. First-quarter net profit of €115.0 million ($124.3 million) was up 9.3% on the prior-year figure of €105.2 million, on sales up 0.7% to €3.2 billion. Operating gross profit was €745.6 million, a year-on-year (YOY) increase of 8.3% and operating EBITDA rose 10.1% YOY to €262.3 million.

"The COVID-19 pandemic had a limited impact on our business and financial performance in the first quarter," says Kohlpaintner. "We were able to maintain business operations at our sites worldwide."

IMCD brought forward publication of its first-quarter results to 20 April from 7 May. The company reported net profit before amortization and nonrecurring items up 13% YOY to €50.2 million and gross profit growth of 12% to €176.4 million. Revenue in the first three months of 2020 was €748.8 million, an increase of 6% compared with the same period in 2019.

The reported increase in gross profit of 12% consists of organic growth of 7%, and growth from the first-time inclusion of acquisitions of 5%. All regions contributed to sales growth. The increase in revenue consists of organic growth, 1%, and the first-time inclusion of acquisitions in 2019 and 2020, 5%, the company says. Van der Slikke calls IMCD's first-quarter results "strong" but cautions that the impact of the COVID-19 pandemic is not reflected fully in the figures.

Azelis says that it too had a robust first quarter, partly because of its low exposure to industries like automotive. "Similar to some of our peers who have little or no exposure to the automotive industry, we also saw a rather strong first quarter," Müller says.

The second quarter is already very challenging for distributors and their financial performance in this period will feel the full force of the pandemic. Some companies are anticipating one of the worst quarters, if not the worst quarter, in their history. Distributors also say it is hard to predict beyond midyear.

"With the duration of the COVID-19 crisis still unpredictable and the severity of its effect on the global economy yet unknown, it is difficult to quantify how it will impact our results in the months to come," says van der Slikke.

According to Müller, "As the economic implications of this pandemic are still unfolding, it's hard to predict how much of our business will be affected."

Brenntag suspended its full-year forecast in early April because of uncertainty over the effects of the pandemic. The forecast will be updated once the effects on Brenntag's further business performance in 2020 can be reliably determined, the company says.

However, one already clear outcome of COVID-19 is the acceleration of digitization in the chemical distribution sector and the wider chemical industry. With large sections of their workforce at home, companies are relying more on automated systems and e-commerce to do business. And proof that this way of operating works could mean it is here to stay. The most successful distributors will likely be those that embraced digitization early. "The irony of this crisis is that a biological virus is acting as a catalyst for accelerated digitization," says Kohlpaintner.

Univar Solutions worked quickly to enable its digital teams to maintain productivity, while working remotely and adhering to shelter-in-place guidelines, says Brian Herington, senior vice president and chief commercial officer. "This included deploying additional computer equipment to employees and establishing cadenced communications to keep our teams connected and updated. For some time, our customers have been seeking to interact with us through the web and COVID-19 only increased this demand. We are well positioned with UnivarSolutions.com and our e-commerce capabilities to meet this demand and help customers select, source, and self-serve with competencies designed to identify the right product with pricing and purchase information."

The speed with which distributors have changed their customer interactions demonstrates their agility. "This is a different way of working, but chemical distribution has quickly adapted, and we have already built new tools to reach our customers and stay connected," says Herington. "In the long run, COVID-19 will accelerate the digitization of chemical distribution."

Azelis has made big investments in its technology, digital/IT platforms, and services and, as a result, "the move from office to home working was a nonevent with regard to our ability to provide high-quality service," Müller says. "This crisis and the sudden switch have surely confirmed our hypothesis that the significance of digitization will further increase in our industry. It's not only about EDP connectivity, but for us specifically it's also about moving some portion of our innovation capabilities into the digital world. For example, e-labs will increasingly help clients to explore new formulation concepts based on guidance we provide."

Specialty chemicals and food ingredients, Azelis's main focus, will nevertheless remain "a people business," Müller says. "This will not change, but digitization has surely proven an excellent complementary added value and has been instrumental for business contingency and resilience."

The crisis is showing that digitization can help distributors, but digital operations could be severely tested in the months to come, says Eberhard. "Digitization has become a more viable concept. Warehouse automation has held up so far," he says. "But digital systems rely on smooth, steady operations. Systems could still be overwhelmed by volatility in the chain."

EBERHARD: Shift in demand and consumer behavior.

Meanwhile, M&A, normally a constant in the fragmented distribution sector, has slowed dramatically with the onset of the crisis. DistriConsult estimates that in the first quarter there were 9 recorded transactions, compared with 24 deals in the first four months of 2019. There were an estimated 58 deals in the whole of 2019 (*chart*).

The crisis "will bring multiples down and make it hard for two sides to agree on an asset valuation. This will take the froth out of the whole M&A market. Basically, M&A is on hold so long as volatility is high and visibility low," Eberhard says.

Eberhard expects M&A to stay quiet for some months, as uncertainty about the economic outlook and pressure on valuations remain high. "Later in the year we may also see some sales of 'distressed assets,'" he says.

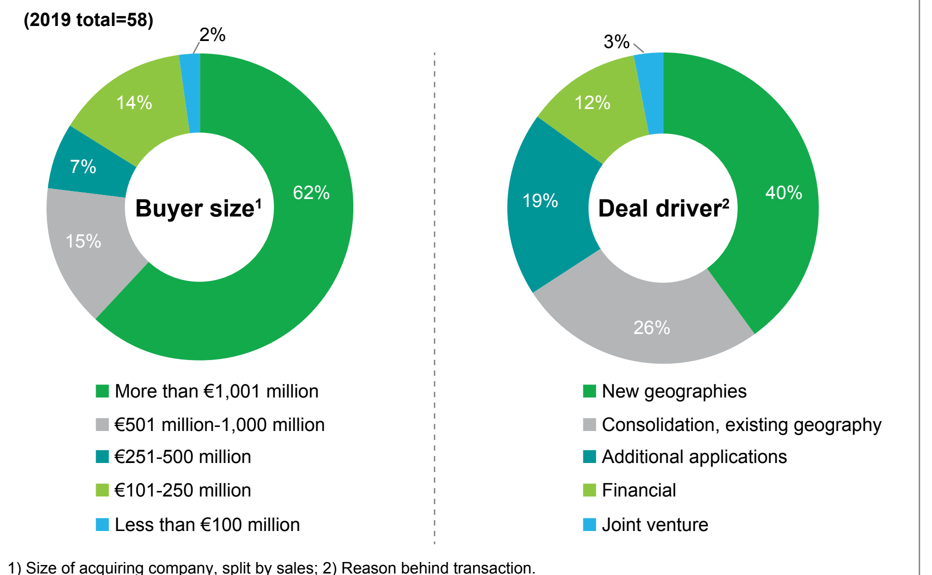
Müller says there has been no change in Azelis's M&A strategy. "Organic growth is always our first priority but carefully selected acquisitions with the right strategic and cultural fit continue to have their place in our growth plans," he says. "All recently-announced acquisitions have gone through undisturbed and all integration processes are either complete or on track. With regard to new acquisitions, this process may have slowed slightly here and there due to lockdowns in different regions and countries, but certainly it has not been abandoned."

The distribution market is lacking direction but the next few months should provide some signs for later in the year. "Overall activity will go down," Eberhard says. "It will take a while to even stabilize. The mood early in the third quarter, going into the summer, will be a big indicator."

It is not known how long the crisis will last, but senior executives at the leading distributors believe the impact will be felt for a long time to come. "Nobody can tell with any certainty right now, but we are working on the assumption that the pandemic will have an impact on business at least for the entire year 2020, likely longer," says Müller.

Based on previous crises, particularly the Great Recession, the effects could last well beyond this year, says Kohlpaintner. "Looking back to the financial crises in 2008–09 and the consequences the global economy had to face afterwards, it will probably again take years to return to the industrial productivity levels of 2019, given the tremendous impact of the COVID-19 pandemic," he says. ■

Distributor M&A deals



1) Size of acquiring company, split by sales; 2) Reason behind transaction.
Source: DistriConsult, company reports.