

Chemical Week



Distribution gets a lift

Chemical market growth
and M&A boost prospects

TOP OF THE NEWS

Strong chemical segment
results lift BASF profit

P8

AMERICAS

Early specialty earnings
mixed on storm impacts

P10

EUROPE

BASF to acquire seeds,
herbicide assets from Bayer

P16

ASIA

Refining, petrochemicals
boost Reliance's results

P21



Distribution gets a lift

Market expands as M&A continues to dominate industry

The evolution of the chemical distribution industry from essentially a delivery service to a much more sophisticated model that adds value to suppliers has helped lead growth in the sector, which is expected to surpass chemical consumption for the next several years. Despite steady mergers and acquisitions (M&A) activity, the sector remains highly fragmented as consolidation continues to reshape the sector.

▼ Jing Chen

Chemical makers historically have viewed distributors as “necessary evils,” to be used if they cannot be avoided. That view has evolved in recent years as many chemical companies see distributors as an integral part of their commercial and growth strategies, particularly with smaller or nonstrategic accounts that are more costly to serve. With a push from both suppliers and consumers for value-added services, distributors today also increasingly take on responsibility for logistics, mixing, blending, packaging, and technical support. David

Jukes, president of Univar’s US and Latin America business, told CW that customers are looking for distributors who can solve problems with these services. “We had a customer who had issues with the formulation of their body wash, and our labs worked with them to help stabilize the pH,” Jukes said. Univar (Downers Grove, Illinois) is investing more resources on value-added services through improving and expanding the company’s technical development and capabilities as well as its labs.

Frank Bergonzi, CEO and president of Azelis Americas (Stamford, Connecticut), agrees. The company is investing in

application labs around the world, as customers are increasingly in need for distributors with market-focused technical capabilities. “Our customer base requires formulation assistance. When you have the capability to do so, we add value and increase the retention rate,” Bergonzi told CW.

Steve Holland, CEO of Brenntag (Mülheim, Germany), also said that customers are asking for “superior services” from distributors, including application labs, formulation know-how, warehousing, and logistics. Brenntag gets involved in the development process, including providing application know-how, and technical and marketing

expertise, and developing customized solutions for its customers.

The shifts are reflected in results. Brenntag, which had sales of €10.5 billion (\$12.4 billion) in 2016, reported a 4.6% increase in second-quarter net profit compared with the corresponding period of last year, to €106.8 million, on sales up 12.7% year-on-year (YOY) to €3.0 billion. Univar had \$8.1 billion sales in 2016, and has the number one market position in North America and number two in Europe. In August, however, Univar said it was cutting its third-quarter adjusted EBITDA by \$10–\$25 million from its previously expected third-quarter adjusted EBITDA due to natural disasters. Univar had previously said that it expected third-quarter adjusted EBITDA to rise by a “high-single-digit” percentage from the year-ago figure of \$145.9 million, so it appears that expectations have been trimmed by 6–16%.

First-quarter sales at Nexeo Solutions (Fairfield, California) were up 6.4% YOY to \$917.7 million. However, it reported a net loss of \$1.1 million for the period, mainly due to \$13.1 million in charges. Meanwhile, IMCD (The Netherlands) reported a 4.6% YOY increase in net income for the second quarter to €106.8 million, on sales up 12.7% to €3.0 billion.

Consolidation continues

As the sector consolidates, the distribution market is expected to expand faster than the overall chemical and industrial production market. Udo Jung, senior managing at Boston Consulting Group (BCG), said during his presentation at the European Association of Chemical Distributors (FECC; Brussels, Belgium) meeting in June, that total third-party chemical distribution sales will increase from €225 billion (\$252 billion) in 2017 to €313 billion in 2022, representing a compound annual growth rate (CAGR) of 6.7%. Meanwhile, global consumption of chemicals is forecast to grow at a CAGR of 4.5% during the same period.

Growth in distribution will be led by China, supported by its strong economic development. BCG estimates that China’s distribution market will grow at a CAGR of 9% through 2022, compared with chemical consumption for the country at a CAGR of 6% for the same period. Meanwhile, distribution growth is expected to be limited in North America—as the market in the region is already fairly developed—at a CAGR of 4% compared with chemical consumption at a CAGR of 3%.

The sector remains highly fragmented, and industry experts agree that consolidation will remain a defining trend with no sign of slowing down.

Holland told CW that acquisitions are a “key component” to the company’s overall strategy. Brenntag spends about £200–£300 million (\$236–\$355 million) a year toward acquisitions. The company announced in July that it has agreed to acquire the Wellstar Group, consisting of specialty chemical distributor Wellstar Enterprises (Hong Kong) and its three Chinese subsidiaries, located in Shenzhen, Guangzhou, and Shanghai. It is a two-step acquisition, under which Brenntag will gain a stake of 51%, with a first tranche in 2017 and the remaining 49% by 2021. The business will be operated as joint venture (JV) from 2017 until 2021. Brenntag has said that the acquisition is “well-positioned to grow on the back of favorable market trends, such as the growth in the automotive industry in China.” And Brenntag is not done. Holland told CW that the company “will continue to seek acquisition opportunities.”

Jukes also stresses that consolidation has been a long-standing trend in chemical distribution. “I’ve been in [the chemical distribution industry] for 40 years, and consolidation has been a trend for 40 years,” Jukes says. “Univar will play its part in the overall consolidation trend.” While the company does not have a targeted figure toward its acquisitions efforts, Jukes says that Univar’s “healthy cash flow” allows for deals—big or small—that fit into its overall strategy. Univar’s acquisition of Tagma Brasil (Paulinia, Brazil) last month supports its expansion into the Brazilian agricultural market, one of the fastest-growing agricultural markets in the world. Brazil has agriculture and agro-food exports of more than \$89 billion and a domestic market that serves nearly 210 million people, Univar chairman and CEO Steve Newlin said when the acquisition closed. Tagma formulates and packages crop protection chemicals, which includes herbicides, insecticides, fungicides, and surfactants. The acquisition also builds on

Univar’s existing business in Canada—the company acquired wholesale fertilizer distributor Nexus Ag (Saskatoon, Canada) in March 2016.

Geographically, specialties player Azelis’ M&A pipeline includes the Latin America market, which it currently has very little presence. Bergonzi says Azelis is currently looking to broaden its presence in the

Americas, including potential acquisitions in Latin America, Mexico and South America. The company is also considering expansion in the food sector, as well as rubber and plastics markets in the North America. Azelis acquired US specialty chemical distributor KODA in December 2015 to boost its presence in the Americas. That division is now known as Azelis Americas.

Eric Byer, president of the National Association of Chemical Distributors (NACD; Washington, DC), told CW that “[consolidation] has been pretty aggressive in the industry, especially in the last six to nine months, and [we] have seen anywhere from eight to twelve of our members [acquired].” Many distributors encompass mergers and acquisitions in their growth strategies to cater to the growing demand for chemicals in developing regions like Asia-Pacific, Africa, and the Middle East. Many multinationals are acquiring smaller distributors

to achieve economies of scale and are focusing on upgrading sales channel strategies, rationalizing their distributor base, and strengthening their distribution management.

Digitization

Digital transformation has become a pivotal part of many distributors’ operations and strategy. The potential benefits of digitization for distributors include improved processes, higher revenue, and reduced costs, said Wolfgang Falter, chemicals and specialty materials sector leader at Deloitte Global, at the FECC meeting.

Despite Univar boasting its early entry to digitization in the late 1990s and early 2000s, Jukes says that the effort is now accelerating. “It took us 20 years to become an overnight success in the digital space,” Jukes says that



BYER: Regulations put immense pressure on distributors.



BERGONZI: Investing in application labs.

Univar currently spends about \$10 million per year to build out the company's digital capabilities—significantly higher than in previous years. Univar currently offers two-click reorders, online shipment tracking capabilities, instant document access and product catalog, and Jukes expects the company to transact a “significant portion” of its business through its web portal next year. “We order food online, we order shoes online. So why shouldn't we do the same when it comes to work?,” Jukes said.

Holland told CW that Brenntag recently opened a digital business unit in Amsterdam that will focus on identifying digital opportunities for the company. Despite the industry acknowledging and taking action to expand digital capabilities at their companies, Falter said at the FECC meeting that collecting internal and external data, then applying the resulting algorithms to make decisions and initiate actions, could be some of the challenges the industry may need to overcome for a successful digital overhaul. Falter added that distributors should also be aware of a possible emergence of a “Chemazon” platform, which could threaten to disrupt the value proposition of chemical distributors to their customers using digital business models that enable them to “do things faster and better than distributors.” Distributors could respond by establishing a joint platform to compete with the emerging e-commerce platforms, he said. Falter expects chemical producers ultimately to shift 15–25% of their

“Suppliers want distributors who can solve their problems and add value to their businesses.”

David Jukes
President, Univar US/Latin America

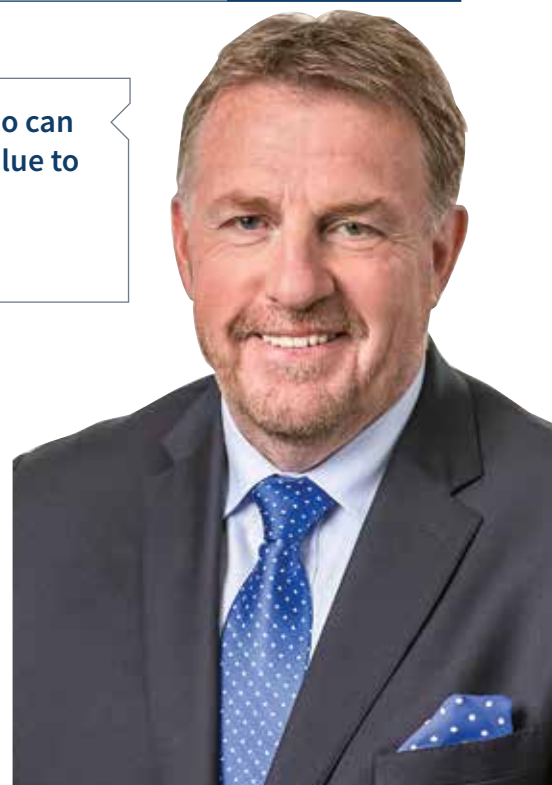
sales to e-commerce, and says that distributors should meet the challenge by seizing the opportunity to work with their suppliers to establish new relationships.

Cybersecurity threats are another concern in the digital movement. As they explore and capture the e-commerce opportunity, distributors must identify and mitigate the cybersecurity risks that accompany digitalization, according to the speakers at FECC. “The weakest link in the supply chain will be the entry point for attacks. Security must be granted along the workflow,” said Peter Wimsperger, a lead partner at Deloitte, at the FECC meeting.

Falter expects the digitalization process for distributors to be more of an evolution than a disruption, but he stresses that distributors have no choice but to adapt. “It's no longer business as usual,” he said. “Doing nothing is not an option.”

Regulatory challenges

Regulatory requirements continue to be a main concern for distributors large and small, as they require companies to dedicate



additional investments and resources.

“Compliance is something you have to plan for. You need to invest in additional resources,” Bergonzi said.

Despite optimism from distributors at NACD's annual meeting last year following the election of President Donald Trump, whom many thought would scale back regulations, the enthusiasm has simmered down a bit. Byer says that while Congress has cut about 800 rules, “there is still a lot to be done.”

“It is still an overregulated environment. [Regulation] is a big deal for the smaller guys because it's always a challenge for them to keep up with the regulatory changes, as most don't have the finance or a team dedicated to compliance.” Byer adds that he is hopeful that Congress will pass bills for health reform, infrastructure, and labor, which he believes would benefit the industry and its employees.

Meanwhile, Guenther Eberhard, senior and managing partner at DistriConsult (Wädenswil, Switzerland) says that the regulatory outlook for the sector is hard to predict, given the “erratic” state of the current US administration.

However, Byer also sees a more positive relationship between distributors and regulators in the last year than in previous years. “[Distributors] want to comply, but sometimes the smaller guys can't always catch up to the rules that may be applicable to them, but the current administration is more willing to work with them through these issues.” ■

HOLLAND: Acquisitions are key to Brenntag's strategy.

