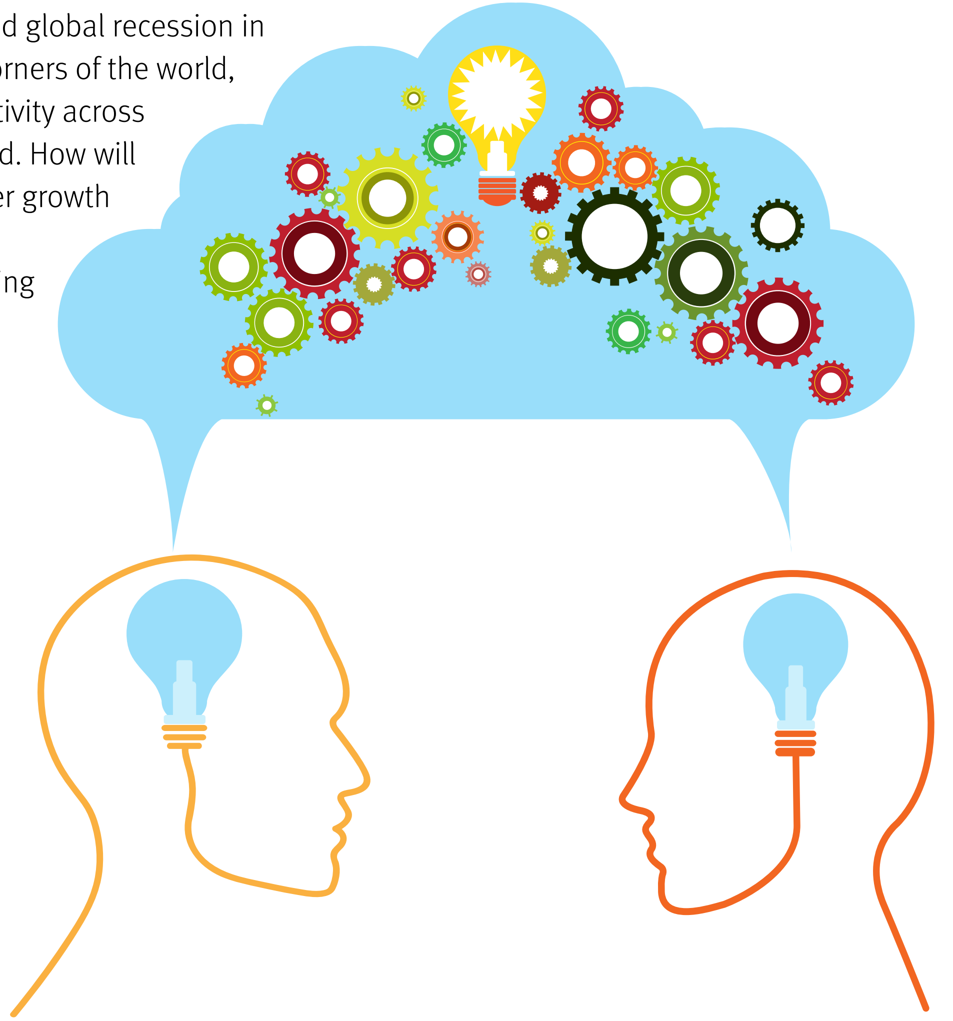
Mergers and acquisitions within the gases business – where are we now?

Following an unprecedented global recession in 2008/9, which shook all corners of the world, a slowdown in the M&A activity across all industry sectors occurred. How will our industry adapt to slower growth expectations and will the spotlight turn inwards, raising the prospect of more M&A activity? **Stuart Radnedge** investigates.



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The first decade of the 21st century was a very active one for the industrial gases sector. Several major acquisitions were made throughout the 10-year period through to 2009 – most notably Linde's acquisitions of AGA and BOC, Messer's change in ownership and subsequent divestments and a buyback by the Messer family, Airgas' purchase of BOC's and Air Products' packaged gases business in the US, and the merger of Nippon Sanso with Taiyo Toyo Company to create Taiyo Nippon Sanso (TNSC). These deals themselves amounted to in excess of $16.5bn in value.

Since 2012, mergers and acquisitions (M&A) activity has understandably stagnated, while companies readdressed the way they operated, with more focus on the bottom line, profitability and reducing costs.

Anyone who has attended one of our industrial gas conferences around the world will recall hearing, that our industry is recession proof. In 2009, even our industry suffered and despite a solid rebound in 2010/11, the rate of growth has slowed to between 2-3% per annum

But are we seeing a change in focus by our industry? 2014 began with an increase in M&A activity, not just in the gases sector but also in the equipment support industry. Air Liquides' acquisition of Voltaix, Trinity acquiring Wesmor and APC, and Praxair selling its French business to Messer and vice versa in Italy are just some examples. This activity has continued in early 2015, with MATHESON (TNSC's US subsidiary) announcing the acquisition of Air Liquide's Hawaiian business, and two acquisitions already made by US distributor nexAir.

Who benefits?

Put simply, M&A is one company seizing an opportunity to acquire another to strengthen its existence on a financial basis – by increasing its footprint to offer its products, or capitalise on another company's ability to turn a profit.

This statement was reinforced by Wayne Twardokus. The League Park Director agreed, "The basis of M&A deals needs to be founded on fundamental economics, however, in many cases the closing of a deal is based on the personalities of the companies involved."

One recent but high-profile case involved Air Products' failed attempt at acquiring Airgas in 2010. What began as a civilised, private, attempt of a deal between the companies quickly turned into a very public and hostile affair.

"Despite the fact that Air Products' hostile offer appeared to be a meaningful premium and substantial valuation, Airgas' Board of Directors led by Peter McCausland was not succumbing to a deal that was not on their terms," stated Twardokus, adding, "With the benefit of 20/20 hindsight, it appears Airgas' board was right, as the stock has increased an additional 50+% from Air Products' offer (essentially mirroring the S&P 500) – as the economy was rebounding in 2011, Airgas began to realise operating leverage from its 900-strong branch network."

From this very public and well-publicised event, we all learned one valuable lesson – one view of a good and fair deal may not be universal.

Room for one more big deal?

If the Air Products-Airgas deal had been a success, it would have created a new number one player in North America – the world's largest market – even following mandated divestments from an anti-trust perspective.

The largest M&A deal since this attempt *did* involve Air Products, when it acquired the largest independent gases company in South America – Indura – in 2011 for around $884m. Since then, our industry focus has been inward on improving the bottom line.

With growth prospects relatively modest over the next five years, however, and an industry as a whole which has emerged from a global recession stronger than it was before, is there potential for another major deal to be done to create a larger going concern? Or will smaller deals continue to consolidate the industry in certain regions around the world?

Due to the impacts of currency, Twardokus believes a major deal may be on the horizon. "With the recent dramatic movements in currencies, we believe a near-term deal of a European company purchasing a major US company is unlikely; however, a US-based major may look to extend its global reach. Over the long-run, we think more significant deals will be done. The gas market will always be a regional business and as the global economy evolves, companies will look to reposition themselves to benefit from these movements."

Analysing the business dynamics of the 'Big 6' in the US (Air Liquide, Air Products, Airgas, Linde, Praxair and MATHESON) Leaders LLC's Brian Deveaux says it's a 50/50 split with how the businesses operate. He said, "Half of them have a strong packaged gas business and half do not. Air Products expressed a clear desire to get back into packaged gases based on its hostile bid for Airgas in 2010. We suspect that desire remains intact under the new Air Products regime. Air Liquide and Linde are likely having similar discussions in their boardrooms."

"Whether the Airgas board would be receptive to another overture is anyone's guess. With Mitsubishi's new majority ownership at the Taiyo Nippon Sanso level, MATHESON's long-term strategy in the US is likely under review – although its continued investments

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in production capacity and acquisitions of packaged gas distributors suggest a growth strategy in the US market, rather than an exit from the market."

Deveaux continued, "As for a combination of two of the 'Big 6' based purely on expanding market share and achieving cost synergies, it seems less likely at this time. The market capitalisations of four of the 'Big 6' are similar enough in size, and have increased enough recently, that an outright acquisition of one by the other seems unlikely. Furthermore, a merger of two, if for no other reason than the different 'nationalities' of the major players, would be a challenge."

"That said, the market for large mergers and acquisitions across broader markets remains active and this market pressure, coupled with more active shareholder contingents, may put pressure on boards and management to consider a deal that would ultimately create a new 'superpower' in the industry."

Scenarios

Spiritus Consulting's John Raquet believes there are a number of likely M&A scenarios that could take place over the next 2-3 years. He states, "There's been speculation for quite some time that another Tier 1 company deal could be done. But that's very limited, in my opinion. I believe that Airgas' share price level at the moment does not just reflect an impressive performance of the company, but that there is a premium built into the share price with the expectation that Airgas will be acquired. This is similar to the premium share price AGA attracted in the 1990s – and ultimately AGA was acquired."

He continues, "More regional M&A activity may well take place – possibly concerning some Tier 2/3 gas companies. For example, I have believed for some time that Air Products has the ability to convert some of its larger equity affiliate holdings in some important Tier 2 players like CryoInfra, SAPIO, BIG, and APSAP. It would not be easy, but certainly possible, and all these businesses are strong and profitable and would boost Air Products' shareholder value as a result."

Another question that may be on the lips of those in the industry is, could a chemical or power company acquire a gases producer? Raquet is unsure and questions the long-term ramifications for the industry. "We have seen interest in our industry in the past decade from both the chemicals and power sector. However, these companies are interested in the tonnage business – such as a power company adding value to a unit of power produced through generating and selling oxygen. However, on viewing the rest of the business, particularly the cylinder business, these companies lose interest – despite its profitability," he explains. "It would require a complete restructure of parts of our industry; tonnage becoming a utility/commodity product, with bulk and package gases becoming a specialist sector."

However, chemical companies purchasing a gas company can happen – as we witnessed last year. In May 2014, news broke of Mitsubishi Chemical Holdings Corp.'s aforementioned $980m offer to secure a majority stake in TNSC. It was stated that Mitsubishi Chemicals intended to bolster its share in TNSC with the offer of 1,030 Yen per share – nearly doubling its stake from 27% to a majority holding of 51%.

Once the deal was completed, TNSC's strategy was modified in order to become an even larger Tier One player – with expansion plans into flourishing overseas markets. TNSC should even benefit from Mitsubishi Chemical's position in the US petrochemicals sector, thanks to the abundance in the country of cheap gas due to the shale gas revolution.

Future

According to Intelligas Consulting's J. R. "Buzz" Campbell, " the next several years could be an active period for M&A in our US space of industrial, medical and specialty gases. While M&A has been recently quiet, two active M&A items involved the increasing interests of a few of the 850-900 US Gas & Welding distributors in merging with one another to gain a larger critical mass in capital, skills, operations and market power. This also includes a few of the larger distributors buying up smaller ones to increase market footprint. These should increase as the US economy continues to improve, with relatively low interest rates permitting the use of debt to leverage purchases. The US also has a large number of niche players in the specialty and medical gas sectors, including small marginal operations of large process and chemical companies which can be usefully spunoff, and can be attractive acquisition targets for the larger gas distributors. Another area of increasing acquisition interest is for gas distributors is to gain or accelerate growth in their propane position, a relatively easy expansion opportunity for the well capitalised and operated gas distributor.

"Another fertile M&A area is made up of the hundreds of technology businesses which design/build the gas industry's production, distribution and applications equipment and systems.

"There are about 850-900 distributors in the USA and, as the economy improves with interest rates being so low, there could be some activity between some of these distributor companies merging with each other."

Many of these companies have excellent products but limited market access, or products that are not up to the requirements of the advancing and consolidating gas production and distribution businesses. Also many of these companies are too small to operate in the growing advantages of exporting their advanced design/build products, and protecting their US markets against similarly positioned imports. A few of these US companies represent excellent landing pads for offshore companies wanting an improved position in the large US gas and related markets.

Campbell concludes that, "All of this will make for more active M&A activity in the industrial, medical and specialty gases space in the US offshore as we look out to 2017 and beyond."

gasworld understands that our industry is also seeing increased activity in the equipment side of the business. Cryogenic Industries was recently marketed and while nothing has been realised to date, it is a large and important player in the support side of our sector. Other equipment manufacturers are also being marketed, which will lend itself to consolidation in some crowded markets such as cryogenic and high pressure equipment sectors.

M&A will, and always will, allow companies to grow at a faster rate than with current market growth – but only if the purchasing company can meet the valuation of the company being acquired. With the recovery of global financial markets, following the economic crash of 2009, has the next phase of M&A activity just begun? gw