SEPARATING FROM A CORPORATE PARENT

Big divestitures are pending at major chemical firms, but setting them up as **INDEPENDENT COMPANIES** can be fraught with complications

MARC S. REISCH, C&EN NORTHEAST NEWS BUREAU

OVER THE NEXT YEAR, five major chemical firms plan to carve out specialty chemical assets and either spin them off to existing shareholders, sell them off through an initial public offering of shares, or market them to outside buyers.

The businesses soon to leave the nest are parts of DuPont, Dow Chemical, BASF, FMC, and Bayer. Some will go to other big firms that hope to bolster an existing market position. But others will become independent of their parent and go to private owners or become stand-alone public companies. They will start out as fledglings that can no longer count on support from corporate parents who have provided many essential services.

Success for the young firms isn't guaranteed, despite their blue-blood parents. "I can't tell you how difficult it is to actually carve out a business from a large corporation and suddenly find yourself standing alone," says David Cartmell, who was chairman and chief financial officer of BWA Water Additives when it separated from Chemtura in 2006.

"The minutiae you have to deal with are daunting," says Cartmell, who recently left BWA. They include setting up legal support, finance departments, and human resource teams.

The chemical industry terrain is littered with firms that have struggled and sometimes failed after setting out on their own. Examples from just the past few years include Tronox, Momentive Performance Materials, and Kem One. These companies succumbed to bankruptcy reorganization because of business, environmental, or economic conditions they encountered as independent firms. Others no doubt suffer quietly with less public financial setbacks.

But many fledgling companies have embraced independence, overcome initial challenges, and successfully navigated business on their own. Executives at firms such as Archroma, Avantor Performance Materials, PeroxyChem, and United Initiators say their new owners, while demanding, provide the financial support to focus on their specialties, buy competitors, build new plants, and thrive.

The need for greater focus drives the spin-offs taking place across a wide swath of industries, says Raj L. Gupta, chairman of lab chemicals maker Avantor and former chief executive officer of Rohm and Haas.

TEN YEARS OF CORPORATE CARVE-OUTS

March 2006
Kerr-McGee spins out pigment business to shareholders. The business, Tronox, files for bankruptcy reorganization in January 2009.

May 2006
CBPE Capital purchases Chemtura's water treatment business for $85 million.

December 2006
Apollo Management buys GE's silicones business for $3.8 billion. The new firm, Momentive, files for bankruptcy reorganization in April 2014.

March 2008
Speyside Equity purchases Evonik Industries' peroxides and persulfates operations.

August 2010
New Mountain Capital acquires the Mallinckrodt Baker lab chemicals business from Covidien for $280 million.

August 2011
Rhône Capital and Triton Partners buy Evonik's carbon black operations for $1.3 billion.

Spin-off
Private equity sale
Sale to strategic buyer
Pending

As an independent firm, Avantor built up a business supplying electronic chemicals to customers such as Taiwan Semiconductor Manufacturing Co. Shown here is a TSMC technician at a plant that processes silicon wafers.

Tronox makes titanium dioxide at this plant in Australia.

Conglomerate Tyco International, for instance, split into six different businesses, one of which is Covidien. Covidien sold what is now Avantor in 2010 to the private equity firm New Mountain Capital.

"Complexity and scale are disadvantages in today's world," Gupta says. Success depends on speed, innovation, and concentrating on customer needs.

"In the old days, big firms had the money to invest in information technology," Gupta adds. But today, it is not so much cost but speed that matters. Smaller, more focused firms can adopt new technology more rapidly than larger and more diverse competitors, he says.

Often it is activist investors who are pressuring large corporations to spin off or sell businesses. "They are not always right," Gupta says, but they do have a place in pushing for change. "In my opinion," he says, "activist investors aren't just acting alone. Large institutional investors are frequently supporters."

AS THEY HAVE in other businesses, activist investors have made much noise in the chemical industry. Under pressure from Third Point, Dow plans to divest between $4.5 billion and $6 billion of what it terms "nonstrategic businesses and assets" by 2015, including its chlorine operations, one of its founding businesses. DuPont, facing prodding from Trian Fund Management, plans to spin off its performance chemicals business, which makes Teflon nonstick coatings and Suva refrigerants.

But other big firms came to the conclusion that they need to jettison once-desirable assets without obvious urging from vocal outsiders. Such is the case with Bayer, which plans to carve out and sell shares of its polymer operations to the public so it can focus on its health care business. Similarly, FMC plans to sell its soda ash operation so it can concentrate on faster-growing agriculture, health, and nutrition businesses.

No matter the conditions under which they separate, divested businesses that start life on their own will have to face many trials and tribulations. Avantor, for instance, dealt with some bumps in the road as it separated from Covidien.

Within the first two years of its new life, Avantor had what Gupta describes as a "false start." The implementation of new operations planning software went poorly, creating manufacturing and shipping problems that lasted for months. Avantor ended up suing IBM for misrepresenting the capabilities of the software it supplied.

"We learned a very valuable lesson," says Allison K. Hosak, communications vice president at Avantor. "If you move too fast, or if you don't have the appropriate resources in place to make the implementation a success, it can lead to unintended issues." IBM and Avantor settled the suit out of court last year.

In the transition from big company ownership, the firm also lost some valuable employees, Hosak acknowledges. "The fast-paced environment and increased workload" in a stand-alone business "aren't for everyone," she says.

But with the help of owner New Moun-

July 2012
Arkema pays Klesch Group $135 million to take its polyvinyl chloride assets. The new firm, Kem One, files for bankruptcy eight months later.

Union workers in Lyon, France, await court's decision on sale of Kem One.

May 2013
Private equity firm SK Capital Partners buys Chemtura's antioxidant operations for $200 million.

October 2013
Clariant sells its textile, paper, and emulsion chemicals business to SK Capital for $550 million.

March 2014
One Equity Partners acquires FMC's peroxygen business for $200 million.

July 2014
Ashland sells its water treatment business for $1.8 billion to Clayton, Dubilier & Rice under pressure from activist investor Jana Partners.

November 2014
Chemtura's seed treatment and pesticide business goes to new holding company Platform Specialty Products for $1 billion.

First-half 2015
In a change of course, FMC plans to sell its soda ash business.

First-half 2015
Under pressure from activist investor Third Point, Dow Chemical targets three noncore businesses for divestiture.

First-half 2015
Archroma, backed by private equity firm SK Capital, agrees to buy BASF's textile chemicals business.

Second-half 2015
DuPont plan to spin off unit that makes Teflon, refrigerants, and paint pigments to shareholders follows pressure from activist investor Trian Fund Management.

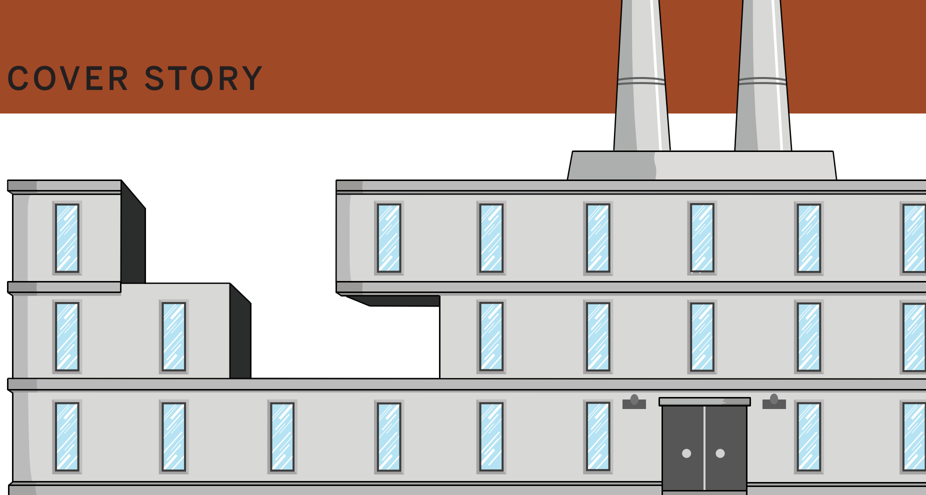
DuPont's Suva refrigerants will be part of the new performance chemicals company.

Second-half 2015
With Third Point urging it to break up into separate commodity and specialty firms, Dow reveals plan in December 2013 to carve out its chlorine operations for sale.

Dow plans to divest chlor-alkali assets at this site in Freeport, Texas.

After November 2015
Bayer plans an initial public offering of polymer operations to focus on its core health care businesses.

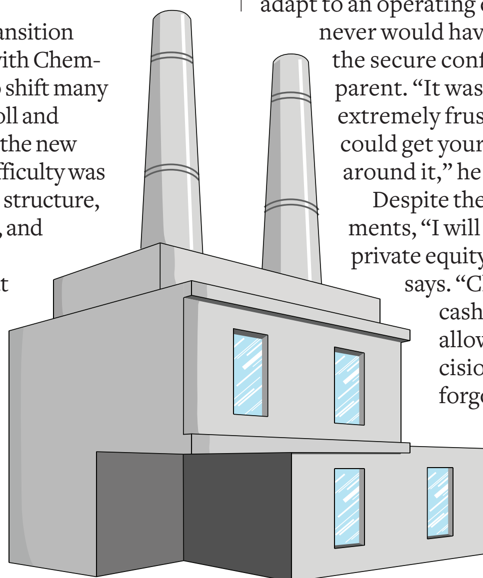
CREDITS: (CLOCKWISE FROM TOP RIGHT) DUPONT, DOW, MAXPPP/NEWSCOM, TSMC, TRONOX



tain, the firm was also able to move quickly and expand its global footprint in deals that probably wouldn't have happened under Covidien. Those deals included the purchase of Indian laboratory reagents supplier Rashtriya Chemicals & Fertilizers and Polish lab supply firm POCH.

BWA Water Additives similarly experienced some difficult moments after its sale to the private equity firm CBPE Capital. "People kid themselves," Cartmell says. "There's a lot of bravado about making transitions smooth and easy." For Cartmell, the 2006 transition was a lot of hard work.

THE FIRM HAD A transition services agreement with Chemtura that allowed it to shift many services such as payroll and medical insurance to the new entity. But the real difficulty was in setting up the legal structure, tax payment systems, and information technology (IT) software that would allow BWA to operate and sell its products in 80 countries.



"Not many people want to be involved in getting a Belgian value-added tax number, but it's essential if you're going to do business there," Cartmell says.

For Paul Turgeon, who worked as chief operating officer of BWA when the separation occurred, the experience was "like buying a house, walking in, and realizing the entire place needed to be renovated." With the aid of CBPE, "we were able to get most of the infrastructure set up within a year," he says.

However, private equity firms buy and sell assets frequently. Just two years after separating from Chemtura, BWA was sold by CBPE to Seera Investment Bank, a Bahrain-based firm that required BWA to operate under Sharia, or Islamic law.

"We couldn't put our money in interest-bearing accounts, and none of our contracts could reference interest payments," Cartmell recalls. He had to adapt to an operating environment he never would have encountered in the secure confines of a corporate parent. "It was fascinating and extremely frustrating until you could get your head wrapped around it," he says.

Despite the harrowing moments, "I will be a supporter of private equity forever," Cartmell says. "Chemtura used us as a cash cow. Private equity allowed us to make decisions" that included forgoing the purchase of manufacturing assets. BWA focused instead on researching and developing water treatment chemicals and contracted out manufacturing to experts, he adds.

The result was an increasingly valuable company. Chemtura sold BWA to CBPE for $85 million. It was bought by Seera in 2008 for $200 million and went to Berwind, a private family investment firm, for $300 million in 2011.

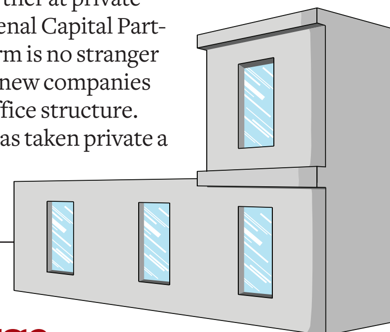
For PeroxyChem, which separated from FMC earlier this year under the ownership of One Equity Partners, the transition to private equity ownership was not as traumatic as it was for BWA. Because FMC operates its businesses in a decentralized way, PeroxyChem, which comprises FMC's former hydrogen peroxide and persulfate chemicals operations, essentially had its own operations, research, and basic finance departments, says CEO Bruce Lerner.

What PeroxyChem left behind at FMC were benefits, payroll, corporate IT, and treasury functions as well as computer servers and enterprise systems, says Lerner, who had led the business at FMC. Nine months into the transition, PeroxyChem has just three months left on its transition services agreement with FMC and has "mostly" staffed up its own treasury, tax, accounting, payroll, IT, and benefits units, Lerner says.

PeroxyChem has experienced a few "panic points," Lerner admits. For instance, a glitch early on almost prevented PeroxyChem from making its payroll. One Equity, which is the private investment arm of banking firm JPMorgan Chase, helped with that and other start-up problems. The bank also enabled an easy transition of other essential services such as mobile communications from FMC to the newly independent firm.

"It sounds trivial," Lerner says, but the bank's relationship with mobile service provider AT&T facilitated the handover. The same, he says, was true for credit card and insurance services that PeroxyChem also relies on.

However, not all firms carved out of large corporations have as much in-house capability as PeroxyChem did. Timothy J. Zappala, a partner at private equity firm Arsenal Capital Partners, says his firm is no stranger to dealing with new companies with no back-office structure. The company has taken private a number of former corporate



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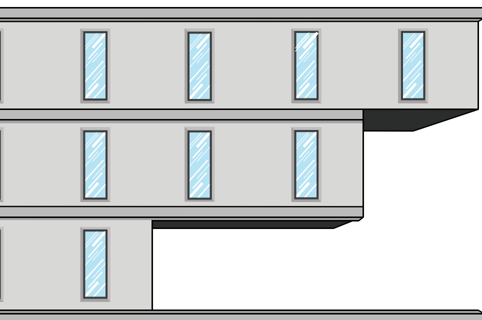

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businesses, including Evonik Industries' colorants business in 2012 and Ferro's battery electrolytes business in 2008.

Even before it acquires a business, Arsenal prepares a detailed transition plan to manage separation from a corporate parent and enable growth, Zappala explains. Arsenal also has in-house partners who lead company and external experts in setting up back-office services including tax, audit, and treasury functions. The goal is to end the unit's dependence on its former parent within about six months.

"WHEN YOU CARVE OUT a business, you typically get a strong commercial leadership team," but back-office services have to be replicated, Zappala says. Those services are higher as a percentage of overall costs for a smaller firm than they are for a larger firm, he says. However, when a stand-alone company acquires a competitor, it can spread its back-office costs over a larger business and operate more efficiently, he points out.

United Initiators, the former Evonik organic peroxides and persulfates business, was able to leverage its back-office structure when it acquired a competitor, Syrgis Performance Initiators, in 2012.

Ed Hoozemans, who became CEO of United in 2011, three years after it separated from Evonik, says "consolidation was part of the investment case" he made to private equity firm Vision Capital just before it took a controlling stake in United. Speyside Equity originally took the firm private in 2008.

Besides the acquisition, United has expanded its business in other ways. The firm recently completed construction on a new persulfates plant in Hefei, China, after Chinese authorities required the plant's relocation from Shanghai. The project required support from Vision Capital and Speyside, Hoozemans says.

As complicated as it is to successfully set small firms free from corporate parents, larger carve-outs have their own complications. When SK Capital Partners bought what is now Archroma from Clariant a year ago, the business had $1.4 billion in annual sales, 25 manufacturing locations it still shares with its former parent, 10,000 customers and suppliers, and 160 bank accounts.

"It was a massive carve-out," says Alexander Wessels, CEO of Archroma, which includes Clariant's former textile chemicals, paper specialties, and emulsions businesses. "Most services were transferred from Clariant by July," he says. Still to be completed is the complex task of untangling IT connections between Clariant production units and those of Archroma.

Archroma's goal is to participate in the

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> **"Eighty percent of what I did in a corporation I didn't need to do as an independent."**

consolidation of the textile chemicals industry, something Clariant would not have done. In May, Archroma bought a 49% stake in textile dye and chemicals maker M. Dohmen, and just last month, it reached an agreement to buy BASF's textile chemicals business. Expansions such as these are helped along by SK Capital, which Wessels identifies as not just Archroma's new owner but also its acting investment banker.

Archroma will soon have about $2 billion in annual sales and is aiming for $3 billion in sales within eight years, Wessels says. Although Western companies have largely left the textile chemicals business to Asian competitors as the center of textile manufacturing has moved east, Wessels is confident in the Swiss firm's ability to succeed. Two-thirds of its business is in Asia and the Americas, particularly the growing South American market. By that measure, "we would not label ourselves a Western competitor," he says.

WESSELS POINTS OUT that the privately owned firm has a less costly operating footprint now. Compared with publicly owned Clariant, Archroma has lower overhead costs and doesn't have the onerous obligation to comply with government-mandated investor reporting rules such as the Sarbanes-Oxley requirements in the U.S., he says.

Now, Wessels revels in the freedom he has to define an expansion strategy and act quickly when opportunities come around. Like many other executives who have worked under and thrived at firms bought by private investors, he is empowered under the new owners.

Former BWA chairman Cartmell says he also knows what it is like to fly under private equity ownership, where previously, he had to walk. "Eighty percent of what I did in a corporation I didn't need to do as an independent," he says.

As a business manager in a big corporation, Cartmell says, much of his time was spent writing reports to corporate managers and justifying proposed investments in the business that he often didn't get to make. "Chief executives at Dow, BASF, and other large corporations need structure. I was writing those reports to help the chief executive do his job."

But as a focused business without the corporate bureaucracy, BWA was free to take flight, Cartmell says. Despite the risks and some harrowing experiences, "it is so refreshing once you step outside the corporate structure," he says. Risk, it seems, has its rewards. ■

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