

Kraton rethinks merger with LCY Chemical's SBC business

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Kraton Performance Polymers notified LCY Chemical (Taipei) on 30 June that Kraton's board of directors intends to withdraw its recommendation that Kraton stockholders approve the previously announced merger with LCY's styrenic block copolymer (SBC) operations. The Kraton board cites declines in the operating results of LCY's SBC business in the first quarter of 2014 and in its results outlook together with a related decline in Kraton's stock price and negative reactions from stockholders following Kraton's announcement on 24 June that the planned merger with the SBC operations of LCY may take two years longer to pay off than originally expected. Kraton's stock price fell 14% on the day of that announcement, losing \$3.60/share, to close at \$21.53/share. Plans for the merger were first announced on 28 January. The deal would create a leading worldwide manufacturer of SBC, with more than \$2 billion in annual revenue, and the merger had been scheduled to close in the fourth quarter.

LCY's SBC business has performed short of expectations, Kraton says. The unit reports adjusted Ebitda of \$20.6 million on volume of 65,000 m.t. in the first quarter of 2013, but adjusted Ebitda tumbled to just \$2.9 million in the first quarter of 2014 and volume fell to 62,000 m.t. Second-quarter 2014 results are similar, Kraton says.

Kraton and LCY may negotiate changes to the terms of the planned merger, to enable the Kraton board to continue to recommend the transaction to its stockholders. Kraton says it cannot predict whether negotiations will result in mutually agreeable changes to the agreement.

Analysts say the deal could nevertheless go ahead. "We still believe the deal has merit, but at a lower price," according to analysts at Oppenheimer & Co. (New York). Before the Kraton board formally changes its recommendation, it is required to provide LCY with at least five business days' written notice. "We expect that, over the next five days, Kraton and LCY will begin negotiations on a revised deal that fairly accounts for the precipitous deterioration in LCY results," Oppenheimer says in a note dated 30 June. "In our worst case scenario, Kraton cancels the deal."

Oppenheimer says it sees "good risk-reward in Kraton. "While the magnitude of lower revisions for its merger partner LCY's SBC business gives us pause, we are mindful that in commodity businesses like LCY's, it cuts both ways and see manageable risk in banking on a rebound from the current trough. The LCY deal, which we criticized as somewhat flawed in moving the product mix higher to commodity paving-footwear, is still a net positive in enhancing Kraton's overall manufacturing cost position, strategic raw materials sourcing, \$65 million in cost synergies, strengthening its Asian presence, and deleveraging," Oppenheimer says.

Source: IHS Weekly