All shook up

Mergers and acquisitions activity in the plastics packaging sector appears to be bouncing back after 12 months of stagnation, but how will the post-Covid landscape impact future investment opportunities? Noli Dinkovski reports

While much of the world remains constrained by various forms of lockdown, the buying and selling of businesses within the plastics packaging sector, at least, appears to be very much alive.

US flexible packaging converter ProAmpac's acquisition of UK-based Rapid Action Packaging, the buyout of speciality bag maker Initial Packaging Solutions by Coveris, converter TricorBraun's takeover of Quebec-based Roda Packaging, and the Clondalkin Group's sale of Dutch film manufacturer LPF Flexible Packaging to Südpack are just some of the deals that have been confirmed in 2021.

Jason Whitworth of business advisory firm BDO says there are currently more buyers than sellers, as companies seek to position themselves for the medium-to-long-term and are attracted by the potential of reduced valuations

In fact, according to market intelligence firm Zenith Global, there were 21 mergers and acquisitions (M&A) involving packaging firms in the first two months of this year alone – more than half of the 41 recorded across the whole of 2020.

The extent to which the increased activity is a bounce-back from the stagnation caused by Covid is unclear, but what is certain is that the pandemic has shaken up the market considerably. And it seems, understandably, that those companies that have emerged from the past 12 months with strong balance sheets are the ones ready to take advantage of opportunities to invest and acquire.

"In times of economic challenge, the winners take advantage and the losers seize opportunities – so it would not be unreasonable to expect that, as businesses become able to put their heads above the parapet, there is extra scope for structural change," suggests Richard Hall, Zenith Global founder and chairman.

"Inevitably, if movement recovers, then activity recovers. There's a sense that business owners have pent up ambition to initiate fresh starts and create new beginnings. As long as they can find ways past the obstacles, I think there will be greater desire as this year progresses to overcome them."

When markets suffer an "exogenous shock" such as Covid, it's natural for M&A markets to become restrained – as was the case in 2020, says Nicholas Mockett, corporate financier at M&A advisory firm Moorgate Capital.

"When there is economic uncertainty, chief executives are more reluctant to make bold strategic moves," he says. "You are unlikely to be sacked for sitting on the sidelines and missing a buy-side opportunity, but if you 'bet the ranch' on taking over a competitor, which ends up holed-below-the-plimsoll-line, you might just be."

Another constraint on M&A activity, according to Mockett, has been on the ability to make site visits – which he says are usually fundamental to deals in the plastics packaging sector. "If the acquirer cannot travel to inspect the assets in action, it's a major impediment. Equally, negotiating the terms of a transaction is usually conducted face-to-face. Having got deals over the line during the pandemic, I can say it is not quite the same on Zoom."

While Covid remains a preoccupation for most businesses, packaging overall has performed relatively strongly. After all, as Mockett puts it: "People do not stop eating, drinking, and brushing their teeth just because of a crisis."

Furthermore, those companies that have fared well now have enhanced "war chests" with which to make further acquisitions, he says. Meanwhile, firms that were heavily-reliant on the out-of-home market have struggled, leading Mockett to believe it will drive further activity. "Some disposal processes that were abandoned will probably come back to market in the next year or so," he predicts.

Whether company valuations have settled down after such a volatile year is also open to question. As the pandemic took hold, some packaging firms saw their valuations tumble by as much as 50 per cent. However, most seem to now be performing strongly.

"Before Covid, there was a general consensus that valuations in the plastics market were on the increase," says Jason Whitworth, M&A partner at business advisory firm BDO. "And while quoted company valuation multiples in the sector have been impacted, they still remain relatively strong. The multiples for sector-quoted companies on 3 March 2021 were 10.6 x EBITDA [earnings before interest, taxes, depreciation, and amortisation]."

Still, ongoing market uncertainty means there might be bargains to be had, and with a record $1.7 trillion of private equity (PE) 'dry powder' looking for investment, according to recent estimates, all signs point to a buoyant market in the year ahead.

"Parties are likely to seek to bridge gaps in valuations by adopting traditional contingent purchase price mechanics such as earn-outs," says Whitworth. "That said, we have seen a vastly different response in buyer appetite following Covid, compared with the financial crash of 2007-08, when buyers were scarce. Currently, we see more buyers than sellers, as companies seek to position themselves for the medium-to-long-term and are attracted by the lure of potentially reduced valuations."

One unavoidable influence on company valuations is the ongoing war on plastics – Mockett concedes that some debt providers and PE houses will no longer invest in plastics businesses, while keen to point out that Moor-

gate is "very close" to a select number of funds that take the contrarian view.

Part of that war – the threat of increasing regulation – also creates market uncertainty, as Rob Gilfillan, head of applications for fibres, films and flexible packaging at Wood Mackenzie explains.

"Most converters and brands are looking to increase recyclability and are adding post-consumer recycled (PCR) resin to packaging, but overall, the industry still lacks the collection and recycling infrastructure to meet regulatory demands," Gilfillan says. "The fact that regulations differ greatly from country to country is also a point of confusion for plastics converters and brands."

In Europe, regulations are spurring on recycled-content goals, and in the US, California's recent AB793 legislation, for example, mandates recycled content goals for plastics beverage containers subject to the California Refund Value by specific dates. Wood Mackenzie says these regulations are generating new market dynamics for the recycled PET (rPET) industry and will continue to support rPET price premiums.

Despite this, in many cases a lack of clarity around regulation can have a detrimental effect on M&A activity. "Industry values clear criteria for future investment. Numbers and dates focus attention," says Hall at Zenith Global. "It's important that they are the right numbers and dates, they are practical and implementable, and take the debate forward."

While acknowledging that the pandemic has highlighted the value of plastics, Hall doesn't buy into the suggestion that Covid has bought the industry more time when it comes to its impact on the planet. In a time of crisis, he argues, people tend to ask more fundamental questions about society, life and the economy. "And while it may not have been practical to implement certain things during Covid, those questions have still been asked – and they've perhaps been asked more intently," he says.

"I think that the climate change denial in some quarters over the past few years has made it more difficult for this debate to advance. However, the COP26 UN climate change conference in November will likely be the biggest focus the world has ever had on sustainability and climate issues."

The flipside with regulation is that when changes are implemented, new opportunities tend to emerge. This, suggests Mockett, can lead to M&A activity as buyers look for businesses that have a competitive edge, and PE targets companies with technologies to exploit.

"We have seen a surge in PE interest in businesses that 'close the loop' in particular, including recycling, waste-to-energy, and materials handling," he says.

Whitworth at BDO has also witnessed a rising M&A trend in recent months around the recycling and sustainability markets. He cites as examples the acquisition of biodegradable plastics maker Polymateria by Planet First Partners, and the sale of Coral Products (Mouldings) and Interpack to IPL Plastics Group – a business with recycling facilities.

A number of resin firms have invested in mechanical and chemical recycling businesses over recent years, according to Wood Mackenzie's Gilfillan. However, he adds that, rather than target acquisitions, they often instead look to integrate recycling lines within their own operations.

More generally, Gilfillan predicts further consolidation within the flexible packaging sector, but suggests it will remain a highly-fragmented market. "Persistent effects of Covid will present both challenges and opportunities in the short term. Longer term, legislation may make the sector less attractive to enter. However, the Southeast Asian markets, for example, will continue to offer growth opportunities and, therefore, be an attractive proposition for M&A or joint venture."

Whitworth supports the view that much of the plastics industry remains fragmented. As a result, he anticipates consolidation in the sector and a strong upturn in M&A activity. In addition to increased regulation and companies embracing innovation and funding the development of advanced recycling technologies, he says margin pressure, and the ability to control supply chains as well as enter new markets, remain key drivers for industry consolidation.

"Large industry players are recognising the immediate wins that can be achieved through the anchoring of new geographies," Whitworth says. "Cross-border M&A accounted for 33 per cent of deals in 2019, and over 60 per cent in 2020 – and it appears that geographic expansion may be an ongoing theme as the requirement to own supply chains becomes more prominent.

"It will be interesting to see whether reduced valuations will manifest, or whether competition for companies, the sheer quantity of money looking for a home, and fundamental M&A drivers prevailing in the industry, will support values. Certainly, those companies with strong balance sheets going into the crisis are better-placed to weather the immediate effects and are ready to take advantage of opportunities to grow, invest, innovate and acquire."

While the challenges for the plastics packaging industry are clear, industry observers agree that those operators that can successfully navigate changes and offer innovative solutions will be the most attractive to market-consolidators looking to acquire knowhow, a geographic foothold, or market scale. The market looks set for another eventful year. P

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