

# Univar Solutions, Inc.

GICS Sector: Industrials  
June 3, 2019

NYSE: UNVR

Dow Jones Indus:	24,819.78
S&P 500:	2,744.45
Russell 2000:	1,469.98
Index Component:	N/A



## Capitalization and Trading Multiples (\$MM)

Share Price	\$20.53		<b>2016</b>	<b>2017</b>	<b>2018</b>
Diluted Shares (MM)	165	EV/EBITDA	14.0x	11.9x	7.8x
Market Cap	\$3,379	P/E	NM	36.4x	14.6x
Debt	\$3,726	P/FCF	10.9x	22.3x	12.9x
Cash & Investments	\$(788)	EV/Sales	0.8x	0.8x	0.6x
Enterprise Value	\$6,317	Price/Book	NM	NM	NM

## Trading Statistics

Dividend Rate	n/a	Avg. Daily Volume (3mo) (MM)	1.837
Dividend Yield	n/a	Short % of Float	5.0%
Payout Ratio	n/a		

	High	Low
52-Week	\$31.23	\$16.33
5-Year	\$33.15	\$10.65

## Valuation

Intrinsic Value	\$43	Time Horizon	2021
Implied Upside	108.6%		
Hidden Assets	No		

## Share Ownership

	Economic	Voting
Officers & Directors	0.46%	0.46%
<b>Major Shareholders (6/30/18)</b>		
The Baupost Group	5.6%	5.6%
Glenview Capital	2.6%	2.6%
Valinor Management	2.5%	2.5%

Clients of Boyar Asset Management, Inc. own 6,452 shares of Univar Solutions, Inc. common stock at a price of \$22.95 a share.

Analysts employed by Boyar's Intrinsic Value Research LLC own shares of Univar Solutions, Inc. common stock.

## AAF History

Report Type	Update
Initially Probed	May 2018
Last Probed	
Trigger	
Situation	Business Value

## Selected Financial Summary (\$MM)

	2015	2016	2017	2018
Revenues:	8,982\$	8,074\$	8,254\$	8,633\$
Adj Operating Income	368\$	314\$	375\$	443\$
Margin (%)	4.1%	3.9%	4.5%	5.1%
Adj EBITDA	593\$	552\$	576\$	623\$
Margin (%)	6.6%	6.8%	7.0%	7.2%
Capex	145\$	90\$	83\$	95\$
Capex (% of Revenues)	1.6%	1.1%	1.0%	1.1%
Free Cash Flow	211\$	360\$	196\$	195\$
FCF/Gross Profit	11.7%	20.8%	10.9%	10.3%
Net Debt/EBITDA	5.0x	4.8x	4.2x	3.6x
Share Repurchases (MM)	\$0	\$0	\$0	\$0
EPS (diluted)	0.14\$	(0.50\$)	0.86\$	1.21\$

Fiscal Year End: December 31

## Overview

Univar Solutions ("Univar," "UNVR," or "the Company") is the largest chemical distributor globally, with 2018 revenues of \$8.6 billion and EBITDA of \$623 million. We initially profiled the Company in the May 2018 issue of *Asset Analysis Focus*<sup>1</sup> (at a share price of \$27.12), noting an intrinsic value estimate of \$57/share. Since then, however, there have been some headwinds affecting the Company. Weather-related issues saw 2018 get off to a slow start in Canada, a relatively small one-time event that nonetheless came during an inflationary period in the chemicals space and thus affected the outlook for upstream chemicals producers, leading Univar to pass along price increases. Further impacting the cost inflation were truck driver shortages across the U.S. as a result of the strong economy. As the year progressed, Canada continued to struggle, as a long winter season at the beginning of the year gave way to an earlier cold season in the fall, with adverse currency movements and a customer plant shutdown capping struggles in the region.

As macroeconomic uncertainty began to grow in the second half of 2018, Univar noted during

its 3Q earnings call that customer ordering patterns were becoming somewhat choppy, reflecting some demand uncertainty that management noted was likely temporary, resulting as it did from inventory destocking by customers. Finally, the largest factor affecting the stock's performance in 2018 came toward the end of the year, when Univar went against its deleveraging and small bolt-on acquisition strategy by acquiring Nexeo Solutions for ~\$2 billion. While the acquisition price was attractive (as outlined hereafter) and the merger resulted in a dominant market share in North America, Univar had just brought leverage down to the 3.5x range on a net debt-to-EBITDA basis (its lowest since going public in 2015). The deal was expected to raise leverage to back above 4x in the midst of an uncertain industry backdrop, as just outlined. These factors led to a large correction in shares of UNVR, with the stock declining from a high of \$31.23 to a low of \$16.33 in a matter of 3 months. As we discuss hereafter, these adverse factors were mostly transient in nature, and the acquisition strongly supports long-term value creation efforts by management.

The Company is a consolidator in a fragmented global market where the top 2 producers combined represent just ~10% of market share. In North America, however, the Company has a commanding position of ~25%-30% as a result of the recent Nexeo acquisition. We believe that the impact from this deal alone makes a compelling case for owning the stock. Despite shareholder concerns over the Company's leverage, the acquisition of Nexeo was too attractive to pass up. While it is unclear whether Secretary of Commerce Wilbur Ross's ownership in Nexeo had any influence on the sale of the company, Univar was able to take over the number 3 player for just 8x EBITDA (compared to most transactions occurring in the 9x-10x range). After accounting for synergies, as well as for the sale of the noncore Nexeo Plastics division, that multiple comes down to just 4x. Put another way, Univar was able to dramatically increase its North American presence, take out a competitor, and bring in an advanced digital ERP system in which the Company was going to invest anyway—all without meaningfully affecting its leverage ratio.

Accordingly, we believe the fourth quarter selloff was overdone, as the Nexeo deal will have a positive meaningful impact on the Company, and the North American issues should prove temporary in nature moving forward, while inflationary pressure will likely prove to be behind the Company. While 2019 may be a pause year in the grand scheme of things, the integration of Nexeo, along with some other improvements, should still provide some margin uplift and strong free cash flow generation. This should enable Univar to delever to the high end of management's targeted range of 3.0x-3.5x by the end of 2019 and get back on track with its consolidation and organic growth strategy.

The Company is led by CEO David Jukes and Chairman Stephen Newlin. Combined, the two bring ample turnaround experience to the Company, which we believe is a strong selling point for investment in UNVR. Mr. Newlin turned around PolyOne Corporation from a low-margin plastics compounder and distributor into an innovative leader in the space geared toward the higher value-added segment of the same market. David Jukes overhauled Univar EMEA and focused on higher-margin sales and operational efficiency, turning the unit into a significant EBITDA contributor to the overall Company. In 2017, the two introduced a strategy to improve Univar's sales force, which was previously being incentivized to sell commoditized products at low or negative margins. To accomplish this, they organized personnel into specialized product teams and changed incentive structures to target higher-margin sales. This strategy led to high sales force churn in 2017 before stabilizing in 2018 and 2019. However, because staff take 12-18 months to get up to full production, 2019 should be the year when we begin to see whether the strategy is paying off. Initial evidence from the numbers does show signs that the overall emphasis on higher-margin sales is influencing results, with gross profit improving on product mix and pricing despite declining volume.

Given the advanced stage of the current economic expansion, we believe that macroeconomic uncertainty played a big role in the recent selloff of UNVR shares. However, distributors' ability to pass along pricing changes insulates them against cyclical more than producers. Furthermore, much of the market served by third-party distributors comprises small or medium-sized businesses that do not carry significant inventory and thus will need to continue ordering chemicals. On the supplier front, as producers start to get hurt in downturns, they may rely more on third-party distribution to help cut costs and maintain margins. This, combined with the fact that the market remains underpenetrated, provides ample white space for the Company to continue growing against the current economic backdrop. Finally, the chemical distribution business is capital-light, enabling solid cash flow generation through the cycle. For reference, in 2009, peer Brenntag (UNVR was private at the time) saw only modest declines in gross profit and EBITDA, and gross profit to EBITDA conversion ratio continued to expand.

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For all these reasons, we believe that Univar is very attractive at today's low valuation. However, to reflect the current overhang on shares, we forecast performance by including only contributions from the Nexeo deal accretion and synergy capture, modest 2% GDP-like growth in 2020 and 2021, and slight improvements in gross margins as the Company targets higher-value sales. These assumptions reflect our rationale for finding Univar attractive today: the Nexeo deal provides a floor under the valuation, and the positive industry- and company-specific attributes provide upside optionality despite near-term uncertainty. Using precedent transactions in the space as a guide, we value Univar at 10x 2021E EBITDA, arriving at an intrinsic value estimate of \$43/share, representing upside of 108.6%.

### **Company History**

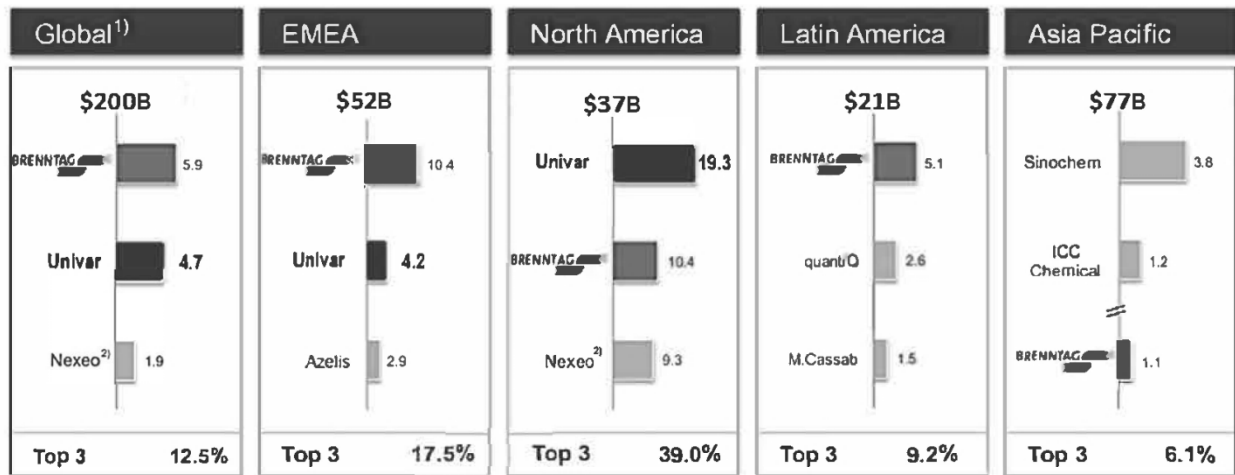
Univar's history dates to 1924, when its predecessor, Van Waters & Rogers, opened its doors in Seattle, Washington, offering a narrow range of chemicals and raw materials. Throughout the 1930s and 1940s, the Company expanded organically and through acquisitions. Van Waters & Rogers made its first public offering of stock in 1956. Its strategy was to "acquire rather than be acquired," and by the end of the decade, the Company had locations in all 11 western states, Texas, and western Canada. In 1966, the Company merged with United Pacific Corporation, changed its name to VWR United, and listed on the NYSE. Stating a goal of becoming a national distributor, the Company continued to expand through acquisitions. It changed its name to Univar in 1974, and the acquisition of McArthur Chemical gave it a major presence throughout Canada. In 1986, with revenues in excess of \$1 billion, Univar acquired McKesson Chemical, the third-largest U.S. chemical distributor at the time, from McKesson Corporation. The acquisition made Univar the largest chemical distributor in North America and allowed McKesson Corporation to focus on pharmaceuticals distribution.

During the early 1990s, Univar made 4 acquisitions in Europe. However, in 1996, Univar was acquired by the Dutch company Royal Packhoed, which then merged with Royal Van Ommeren in 1999 and changed its name to Royal Vopak. In 2002, the Dutch distribution and logistics giant spun off its chemical distribution activities, citing lack of synergies. Univar N.V. began trading on the Amsterdam Stock Exchange with worldwide sales of \$4.7 billion. In 2007, CVC Capital Partners, Europe's second-largest private equity firm, acquired Univar for \$2.1 billion. In 2010, Clayton, Dubilier & Rice (CD&R) acquired a 42.5% stake in Univar from CVC for \$760 million, valuing the Company's equity at \$1.8 billion. In 2015, Univar became publicly traded on the NYSE at \$22 per share, for an equity value of ~\$3 billion. Concurrent with the IPO, Temasek Holdings, Singapore's sovereign wealth fund, acquired a stake in Univar through a \$350 million private placement. Throughout 2016 and 2017, UNVR conducted a series of secondary offerings through which CVC entirely divested its interest in the Company, and both CD&R and Temasek reduced their ownership stakes. As of January 31, 2018, Temasek and CD&R owned 9.9% and 8.2%, respectively (~18% combined), of UNVR's shares outstanding. On March 1, 2019, Univar closed on the acquisition of Nexeo Solutions, the third-largest global chemical distributor, and subsequently divested the noncore Nexeo Plastics, a deal we describe in further detail hereafter.

### **Business Description**

Univar Solutions operates across four regional segments: USA (57% of revenues), Canada (15%), EMEA (23%), and Rest of World (5%; primarily Latin America but also Asia). In 2018, the Company generated revenue of \$8.6 billion and EBITDA of \$623 million while finishing the year with a net debt/EBITDA leverage ratio of 3.6x. According to calculations by competitor and former leading chemical distributor Brenntag, Univar was the second-largest player in the space globally as of 2017, as seen in the following chart:

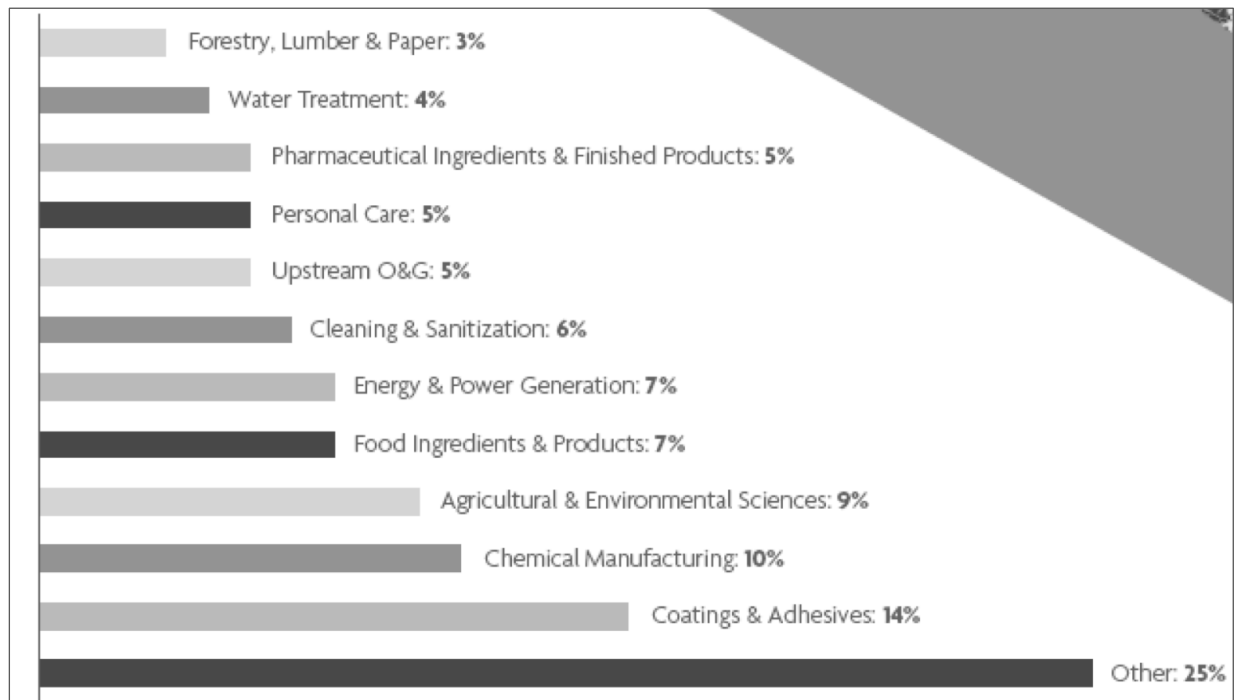
**Chemical Distribution Market Share**



Source: Brenntag AG, company presentation, November 2017.

While Univar was slightly behind globally, the overall market is clearly very fragmented. Looking at North America, however, the Company had a strong lead in the market, which was further consolidated by the Nexeo acquisition. Combined, we estimate that Univar Solutions is the largest distributor both globally and in North America.

**2018 Net Sales by End Market**



Source: Univar Solutions 2018 Annual Report.

In terms of end markets, there are a few items worth noting. First, ~17% of the Company's revenues are derived from noncyclical end markets (e.g., food ingredients, personal care, pharmaceutical ingredients). The remainder are diversified among multiple cyclical end markets, limiting exposure to downturns in individual markets. As we discuss later, the effects of this diversification can be seen in the Company's 2018 results, as Canada had a challenging year in the agriculture sector and coatings struggled in various geographies, which weighed on results but was offset by sales into other end markets in the four regions, helping drive overall revenue

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growth. While the Company doesn't disclose sales breakdowns between commodity and specialty chemicals, strategic emphasis has been placed on sales on the specialty end of the spectrum as it overhauled the sales force in recent years to target higher-margin sales.

The Company owns or leases over 600 distribution facilities, employs more than 8,500 employees in 31 countries, and delivers to more than 130 countries. In the U.S., UNVR operates its own fleet of distribution vehicles, which it utilizes in conjunction with third-party carriers to manage margins. Additionally, Univar offers value-added services, which generate superior margins for the Company: (1) ChemPoint is a distribution business which provides digital promotion and e-marketing for specialty and fine chemicals. It operates in North America and EMEA, and it focuses on expanding market share for producer partners. (2) The ChemCare waste management service collects both hazardous and nonhazardous waste products from customer locations in the U.S. and Canada. (3) Mini-Bulk offers a safe auto-replenishment service for corrosive chemicals. (4) UNVR also offers industrial cleaning, site remediation, and emergency environmental response services to its customers.

### **Nexeo Solutions Acquisition**

While the Company targeted ~\$200 million in bolt-on acquisition spend per year at its 2017 investor day, management certainly went after a much bigger target in Nexeo Solutions, the number 3 player in the North American chemical distribution market. We view the deal as very positive for the overall strategy of profitable organic growth combined with consolidation of the industry. As outlined hereafter, the deal accretion alone provides a floor under further share price declines in the short to medium term as the Company looks to continue executing on its organic growth strategy.

#### ***Deal Summary***

The acquisition of Nexeo Solutions added ~\$4 billion in sales and \$200 million in EBITDA. Originally, the deal was for ~\$2 billion including debt, or \$11.65 per share (\$3.29/share in cash + .305 shares of UNVR). However, as a result of UNVR's selloff in Q4, the deal was ultimately closed at \$9.34 (\$3.02/share in cash + .305 shares of UNVR) per share. Accordingly, the original valuation of ~9x 2018E EBITDA was reduced to ~8x (~4x including synergies and Nexeo Plastics sale). While it is unclear whether the sale of Nexeo was forced because it was owned by U.S. Secretary of Commerce Wilbur Ross, Univar acquired a strong business at a discount, allowing it to dramatically increase its market share, especially in its primary North American market.

#### ***Rationale***

The Nexeo deal fits Univar's strategy of profitable growth via higher-margin sales, organizational improvements, and industry consolidation. The combined Company will have the largest chemicals distribution sales force and broadest range of product offerings in North America, supporting its recent sales force turnaround strategy. Combined, we estimate that the new Univar Solutions will have a market share of between 25% and 30% in North America, giving the Company a significant advantage in a fragmented industry where scale is becoming increasingly important to both customers and suppliers. Furthermore, Univar was planning to invest in a systemwide digital ERP system, a goal that can now be accomplished by integrating Nexeo's system.

In conjunction with the close of the deal, UNVR was able to sell its noncore Nexeo plastics division, which accounted for a third of EBITDA (~\$70 million out of \$200 million in 2018). The \$650 million received was well above our original estimated range of \$500-\$600 million and allowed the Company to pay down debt. After incorporating the plastics sale in the original deal value, and assuming that Univar is able to achieve the expected \$100 million in net synergies, we estimate that Univar paid just ~4x EBITDA to take over one of its main competitors in the U.S. Put another way, after these adjustments, the size of this deal effectively has minimal impact on leverage while dramatically increasing the Company's market share in the U.S., enabling it to roll out an ERP system to keep up with customer needs and improving the quality of its sales force. For these reasons, we view the deal as a key investment factor for Univar and believe that the recent selloff was overdone.

#### ***Market Reaction***

Initial market reaction to the deal was positive, with shares rising by over 10%. Since that initial rally, which saw shares reaching 52-week highs of \$31.23, the stock sold off precipitously, by almost 50%. This decline was likely due to a return of elevated leverage to Univar's balance sheet at a time of increasing uncertainty in the industry. We believe that this selloff was overdone, and the stock has accordingly recovered somewhat since then, with the recovery topping out in conjunction with the close of the deal. This rebound was likely due to Univar's

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having quickly found a home for the Nexeo Plastics unit, freeing up ample cash to quickly bring leverage back down below 4x and on pace to finish 2019 at 3.5x.

### **Other Recent Developments**

#### ***Leverage Concerns***

Univar's leverage has been elevated in recent years at above 3.5x-4.0x on a net debt to EBITDA basis, which is the primary reason the Company has traded at a discounted multiple compared to its primary competitor, Brenntag. The \$2 billion acquisition of Nexeo didn't exactly help with this perception, which we believe was a primary contributor to Univar's stock having sold off at the end of 2018. However, the sale of the Nexeo Plastics unit allowed UNVR to help bring leverage back down to less than 4x as of the most recent quarter. Furthermore, strong free cash flow generation (management anticipates \$250-\$300 million net in 2019, which we expect to grow in 2020 and 2021) should put the Company on a path to reach its leverage goal of below 3.5x EBITDA by the end of 2019, and even between 2.5x and 3.0x by 2020, excluding further acquisitions.

As of Q1 2019, the outstanding debt balance was ~\$3.8 billion, with an average interest rate paid on long-term debt of 4.21%. Looking at the maturities, much of the debt is due in 2024, with a smaller slice due a year earlier, in 2023. We do not view the debt load as overly burdensome to the Company at this time and expect balance sheet strength to improve fairly quickly over the next 2 years. As we outline in our discussion of financial performance, the expected results of the Nexeo deal alone should provide an ample margin of safety to enable the Company to pay down its debt and provide upside for equity holders.

#### ***Challenging Conditions in Canada***

Univar's 2018 performance was weighed down by temporary issues in Canada. At the beginning of 2018, a late winter season boosted results with increased sales into natural gas pipelines. However, as the cold dragged on into April, the weather started negatively impacting sales in the agricultural sector. While this should have been a one-time blip, an earlier cold season in the fall again negatively impacted sales into the space, as fewer farmers than usual were able to treat their crops in the fall to protect them from weeds, fungus, and insecticides.

Beyond weather, a couple other issues are worth mentioning. In 3Q 2018 and 4Q 2018 there was an unexpected plant shutdown by one of Univar's largest Canadian customers. The shutdown was for mechanical reasons, and management noted that the Company had not lost the customer's business; rather, this was just a temporary issue. Finally, rounding out the Canada issues were FX headwinds affecting the performance of the region (2018 sales of -12.6% including FX; -8.1% ex FX).

Despite the challenges, there were signs of improvement in the region. In 2Q 2018 and 3Q 2018, adjusted EBITDA was up by double digits, with EBITDA margins expanding as well. This points to the operational improvements made by UNVR in recent years as well as to the emphasis on better sales force execution and higher-margin sales.

#### ***Macro Concerns in North America***

When the Company reported its 3Q 2018 results, it noted some signs of uncertainty among customers in the U.S. Amid macroeconomic uncertainty related to the late-stage economic expansion, potential trade wars, and tightening on the part of the Federal Reserve, management noted that demand was starting to be somewhat "up and down", with some weeks seeming normal only to be followed by periods of decreased ordering. Management did note, however, that the environment seemed to be related more to customers' destocking of their inventories than to an actual slowdown in demand. While some softness has continued, leading to decreased growth expectations in 2019, so far there have not been any major demand concerns facing the Company. It should be noted that competitor Brenntag did not experience much inventory destocking but did see some pockets of weakness. Most of Brenntag's customers, however, are on the smaller end in North America and thus do not carry significant inventories. Furthermore, while it is the second largest player in North America, Brenntag has much more of a presence in Europe.

If the current weakness were to turn into a recession, we would expect Brenntag and Univar to be net beneficiaries, as the smaller customers that they serve would continue to need supplies, unlike the larger customers directly served by the chemical producers, who would work through existing inventories. For this

reason, the distributors would likely be able to manage better in adverse scenarios while potentially winning more business from suppliers as they look to cut costs during a downcycle.

On the cost side, there were a couple of issues to point out for 2018. The chemicals industry as a whole faced a cost-inflationary environment throughout the year. Contributing to this issue were increased freight costs from truck driver shortages and rising fuel prices. As mentioned in our initial profile of Univar, cost-related issues are not as significant for distributors as they are for producers, who often have to absorb the costs from rising prices, which negatively affects margins. The distributors, by contrast, pass them along fairly quickly to customers (whereas in deflationary environments, distributors pass decreased costs with a lag). Customers weren't happy with cost increases, but they did understand—and, more important, they kept ordering: as chemicals often make up a small portion of input costs, they might well have had little inventory to fall back on. Additionally, on the trucking front, UNVR owns a substantial trucking fleet of its own, especially after its merger with Nexeo, that enables the Company to mitigate some of the increased costs by optimizing truck routes and schedules and decreasing dependence on third-party carriers that must increase their prices.

**Sales Force Turnaround Update**

As outlined in our initial profile, during the Company's 2017 investor day, management detailed its sales force overhaul plans. Historically, the Company indirectly incentivized sales staff toward lower-margin, higher-volume sales through a compensation structure defined by high fixed salaries, capped commissions, and volume-based incentives that disincentivized sales staff from selling higher-margin chemicals, which are usually sold in smaller quantities. Furthermore, the staff consisted of all generalists who did not have enough technical knowledge of products, which further led them to shy away from selling more specialty chemicals. To combat this, the Company changed the compensation structure and divided staff by product lines while pairing technical personnel with each sales team. This has had the effect of creating more knowledgeable sales teams that can even go a step farther to help customers determine what formulations may be needed to create certain products.

The overhaul of the sales force was not expected to be a quick one, as evidenced by the improvements' having only slowly begun to be realized almost 2 years later. Although 2017 was characterized, as expected, by very high sales force turnover, this has since stabilized. Most of the commentary in quarterly updates has been neutral, with management noting that turnover has come down but that the focus has shifted to training the sales staff. It takes 12-18 months for sales personnel to get up to speed and performing well, so 2019 and 2020 should demonstrate whether the improvements will pay off. However, there are some signs of movement toward higher-margin, lower-volume selling, as seen in the following chart:

**2017 NA Performance**

Net sales percentage change due to:		Gross profit percentage change due to:	
Acquisitions	0.1 %	Acquisitions	0.1 %
Reported sales volumes	(7.1)%	Reported sales volumes	(7.1)%
Sales pricing and product mix	5.9 %	Sales pricing, product costs and other adjustments	10.0 %
Total	(1.1)%	Total	3.0 %

**2018 NA Performance**

Net sales percentage change due to:		Gross profit percentage change due to:	
Reported sales volumes	0.9%	Reported sales volumes	0.9%
Sales pricing and product mix	5.6%	Sales pricing, product costs and other adjustments	4.3%
Total	6.5%	Total	5.2%

Source: Univar 2018 annual report.

While 2018's results were clouded due to the inflationary environment, the commentary in the report did mention that gross profits were up, in part due to favorable product mix. Results for 2017 show that despite declining volumes, gross profits were up, driven again in part by favorable product mix. If the sales force

improvements pay off, we would expect to see results similar to the 2017 chart, with volumes declining or growing slowly, while product mix and pricing continue to grow due to the shift to higher-margin product sales.

**Markets Remain Underpenetrated**

In recent years both Brenntag and Univar have noted that the chemical distribution industry is underpenetrated. Over the past decade, third-party specialty chemical distribution has grown faster than overall sales of specialty chemicals, leading to increasing penetration by distributors (~10% as of 2017). As seen in the following chart, this trend is expected to continue over the next few years, favoring the larger distributors in particular as they continue to increase their scale.

**Industry Growth Rate Forecast**



In a recent report by Deutsche Bank, analysts mentioned that industry insiders see a 10%-20% penetration range as a fair estimate of the industry today. However, these experts noted that less than truckload quantities (i.e., those going to small and medium-sized customers serviced by distributors) likely represented ~40% of the overall market, which would imply that true penetration of the addressable market is somewhere between 25% and 50%. In either scenario, we believe that there remains ample white space for the distributors to target within the chemicals industry.

One notable area of the market that may be interesting for Univar is the recent three-way split of DowDuPont into Dow Inc., Dupont, and Corteva Agriscience. As a result of the spinoffs and the associated management compensation plans, the companies may look to find cost savings via increased distribution outsourcing. The new Univar Solutions provides the best scale proposition for the North American market as well as a competitive presence in Europe, eliminating the headache of contracting with many different distributors. Evidence of this potential trend can be seen in recent announcements from Univar in March and May 2019 related to new authorizations from Dow, as well as in an award from DuPont in May naming Univar the top distributor of the year.

**Portfolio Evaluation**

In the Company’s 1Q 2019 earnings call, management mentioned that it was taking a look at its portfolio and determining whether Univar Solutions was the right home for each of its business lines. From the discussion, it seems the process is still in the very early stages, and it is still unclear whether the Company will in fact divest any assets. However, we view this as a positive sign for shareholders. After such a large transaction and years of bolt-on acquisitions, it is a good time to evaluate whether the businesses all fit together properly. Given that the Nexeo Plastics sale yielded a higher sum than our estimated range of \$500-\$600 million, there may be room to unlock additional value for shareholders from other noncore assets. Proceeds from such divestitures could help the Company accelerate the deleveraging process and return to making bolt-on acquisitions to consolidate the market and add new relationships. Beyond this, we see some potential to even return capital to shareholders via buybacks, should shares continue to trade at a discounted valuation.

**Strong Leadership Duo**

***A Chairman With a Solid Track Record***

Chairman Stephen Newlin previously held the role of CEO of PolyOne Corporation, a plastics compounder and distributor. When he took over that role in 2006, the company was a low-margin business struggling to differentiate itself. In his capacity as CEO, he took a middle-of-the-pack firm focused on commoditized low-margin products and transformed it into a specialized, innovative company. Changes he made included the following:

- Increasing R&D spend and specialization of products
- Introducing innovation centers where customers could test new ideas or see new products made using PolyOne’s products and technologies (something Univar has used to attract more small customers that don’t have R&D budgets or lab space)
- Focusing on increasing on-time delivery rates.

Although this strategy took some time to play out, the results were overwhelmingly positive:

- ROIC increased from 6% in 2006 to 11.3% in 2014, when he left.
- Working Capital as a percentage of sales dropped from 16% to 9.9%.
- FCF grew from \$70 million to \$115 million and EBITDA from \$137 million to \$380 million.
- Adjusted EPS grew from \$0.12 to \$1.80.
- Volumes decreased 11%, while gross profits increased 154%.
- Share price appreciated by over 500%.
- In the plastic distribution business, which was operating at a paltry 2.6% operating margin, a company presentation noted that ROIC improved from 15% to 52% and that the operating margin grew to 6.1%.

***A CEO With Turnaround Experience Within Univar***

Similarly, David Jukes was tasked with turning around Univar’s EMEA division. Since 2013, he has embarked on a pan-European strategy (instead of a country-based approach) to consolidate the European operations, including IT systems, raw materials procurement, logistics, route operations, and relationship management, intending to benefit from scale and improve cost efficiency while also focusing on higher-growth end markets and making bolt-on acquisitions to increase UNVR’s geographic and end market presence. Much as with Mr. Newlin, Mr. Jukes’s results speak volumes:

- Gross margins increased from ~18.4% in 2013 to 22.7% in 2017 and adjusted EBITDA margins from ~2.3% to 7.6%.
- In 2013, EMEA contributed 8.8% of the total Company adjusted EBITDA. In 2017, this contribution grew to 21.8%, even though sales had declined by over 20%, maintaining the same ~22% contribution to total company sales.
- Capex decreased from \$23.8 million to \$14.6 million.
- The unit just posted its 22nd consecutive quarterly currency-neutral EBITDA growth.

**Financial Performance**

**Summary of Historical and Forecast Results**

	<u>2015A</u>	<u>2016A</u>	<u>2017A</u>	<u>2018A</u>	<u>2019E</u>	<u>2020E</u>	<u>2021E</u>
Sales	\$8,982	\$8,074	\$8,254	\$8,633	\$10,253	\$10,458	\$10,667
Growth	-13.4%	-10.1%	2.2%	4.6%	18.8%	2.0%	2.0%
Gross Profit	\$1,799	\$1,727	\$1,806	\$1,900	\$2,358	\$2,426	\$2,496
Margin	20.0%	21.4%	21.9%	22.0%	23.0%	23.2%	23.4%
Adj. EBITDA	\$593	\$552	\$576	\$623	\$743	\$829	\$900
Margin	6.6%	6.8%	7.0%	7.2%	7.2%	7.9%	8.4%
Gross Profit/EBITDA Conversion	32.9%	32.0%	31.9%	32.8%	31.5%	34.2%	36.1%
FCF	\$211	\$360	\$196	\$195	\$260	\$343	\$462
Net Debt	\$2,963	\$2,643	\$2,428	\$2,259	\$2,538	\$2,194	\$1,733
Net Debt/EBITDA	5.0x	4.8x	4.2x	3.6x	3.4x	2.6x	1.9x

Univar has posted mixed results over the past few years, as seen in the preceding chart. The drops in revenue and EBITDA in 2015 and 2016 were caused by a decrease in sales to oil and gas customers following the decline in oil prices that began in 2014. We note that while the top line decreased at a double-digit rate, gross profit—a more important measure for distributors—declined at a slower mid-single-digit pace in 2016. Since then, the Company has reduced exposure to the space and has focused on improving margins, reducing debt, and winning new supplier and customer relationships, both organically and through bolt-on acquisitions. This strategy has worked for Univar, with gross margins expanding by 200 basis points between 2015 and 2018, and EBITDA margins expanding by 60 basis points. Gross profit to EBITDA conversion (or “conversion ratio”) has held steady at between 32% and 33% during the period as well, pointing to consistent operating performance at the Company. Conversion ratio is another important metric used within the industry, and we believe that the Company will begin seeing improvements on this front. We estimate that the largest impact to profitability will be from expected synergies of \$100 million as a result of the Nexeo acquisition, with some additional support coming from higher-margin sales. Finally, free cash flow generation has been stable, despite being affected by various headwinds throughout the past few years. This is reflective of the distribution industry’s capital light model and is the reason why the Company has been able to delever the balance sheet while still making strategic acquisitions.

Seemingly, 2019 will be a pause year for the Company after the various moving parts came together to end 2018 with headwinds in Canada and the U.S. as well as the large Nexeo acquisition. Because of these issues, the stock exhibited a steep selloff in 4Q 2018. Looking at the numbers, however, the setup is quite favorable even if 2019 does turn out to be a reset year as the Company integrates Nexeo’s business. Our EBITDA forecast of ~\$750 million is roughly unchanged over the prior year once Nexeo’s performance is included. Our free cash flow estimate (in line with management guidance) would point to growth of 33% over the prior year and represents a yield of 7.7% to the current market cap. Additionally, looking out over the next 2 years, the yield measured with respect to 2021E FCF is 13.7%.

We believe that Univar will primarily use FCF to bring leverage down to management’s target of 3.0x-3.5x EBITDA, getting below the high end of this range by the end of 2019. Once this goal is achieved, we expect UNVR to once again resume making various bolt-on acquisitions. During the 2017 investor day, management estimated an annual spend of \$200 million on acquisitions, at an average acquisition multiple of 7.5x EBITDA. However, unless UNVR exceeds this target amount or decides to make another large acquisition, we project that there will be excess free cash generated by the business. We would not be surprised if management were to put some of this money to work via share repurchases, as net leverage would still be ~3x after using all of the 2020E FCF, for example. However, given that the Company is able to acquire businesses for high-single-digit multiples, then reduce that multiple by a turn after extracting synergies, we would not fault management for deciding to keep cash in the bank in order to be ready to take advantage of interesting acquisition opportunities.

## **Valuation**

Before diving into the valuation, we have summarized our model assumptions as follows:

- No growth in 2019 beyond the Nexeo impact.
- While we believe 2020 and 2021 should see a return to top-line growth, we estimate just 2% in each year given the various moving parts and the macro uncertainty overhang.
- We estimate moderate growth in gross margins as the Company targets higher-margin sales.
- EBITDA margin expansion primarily results from synergy capture related to the Nexeo deal.

We believe that these assumptions, while conservative in nature, reflect the ample margin of safety provided by the current share price. For comparison, during its 2017 investor day, the Company was targeting double-digit organic EBITDA growth primarily due to the sales force improvements and the favorable environment in the chemical distribution space. Although we believe that such a level of growth is achievable, our thesis does not depend on it. In fact, our model sees EBITDA growing at a double-digit CAGR through 2021 despite the conservatism. That investors can gain access to a healthy business today and receive that additional growth as the cherry on top of unlocking the currently hidden value is very attractive.

**Precedent Transactions**

<b><u>Date Announced</u></b>	<b><u>Acquirer</u></b>	<b><u>Target</u></b>	<b><u>EV/EBITDA Multiple</u></b>
Mar-16	WL Ross Holding Corp	Nexeo Solutions Holdings LLC	8.0x
May-15	IMCD N.V.	The M.F. Cachat Company	9.3x
May-15	Apax Partners	Quality Distribution, Inc.	9.0x
Jul-12	Olin Corp.	K.A. Steel Chemicals Inc.	10.6x
May-12	GS Capital/P2 Capital	Interline Brands, Inc.	9.7x
Dec-10	Bain Capital	IMCD N.V.	9.3x
Nov-10	TPG Capital	Ashland Inc.	10.4x
Oct-10	Univar Inc.	Basic Chemical Solutions, L.L.C.	9.8x
Sep-10	Clayton Dubilier & Rice, LLC	Univar Inc.	9.2x
Jul-10	Brenntag AG	EAC Industrial Ingredients Ltd. A/S	9.5x
May-08	Carlyle Group	Neochimiki S.A.	9.4x
Jul-07	CVC Capital Partners Ltd.	Univar Inc.	8.8x
Mar-07	Univar Inc.	Chemcentral Inc.	9.3x
Jul-06	BC Partners Holdings Limited	Brenntag AG	8.8x
Jun-06	Ravago S.A.	Muehlstein Holding Corporation	8.4x
Oct-00	Brenntag AG	Holland Chemical International N.V.	9.1x

Source: Univar Nexeo merger proposal.

As displayed in the preceding chart, much of the deal activity in the chemical production and distribution spaces has occurred in the 9x-10x EBITDA multiple range. (One notable exception was the 2016 deal by WL Ross to acquire Nexeo Solutions. We believe that the presence of the less profitable plastics unit likely contributed to the discounted multiple of 8x attached to the Nexeo deals in 2016 and 2018.) We believe that the combined market share of the new Univar Solutions, favorable industry trends, and the scale afforded to the Company, as well as the increased power to attract suppliers and customers that comes with such scale, all justify a multiple for Univar at the high end of the range, with the potential to expand above that range as the Company delevers and economic uncertainty is removed. Thus, at 10x 2021E EBITDA, we estimate Univar's intrinsic value to be \$43/share, representing upside potential of 108.6% from today's levels, as seen in the following chart:

	<b><u>2021E</u></b>
EV at 10x EBITDA	\$9,003
Net Debt	\$1,733
Equity Value	\$7,270
Per Share	\$42.83
<i>Upside</i>	<i>108.6%</i>

**Risks**

- Continued macro uncertainty may lead to decreases in volumes and pricing. However, UNVR is affected by volumes only, and pricing is generally transferred with a lag that insulates margins in the short term. Furthermore, distributors serve the smaller customers, which tend to continue needing chemicals for their businesses.
- Decreased free cash flow generation could put some pressure on the Company's ability to delever. Its first major debt maturity is in 2023.
- Inability to capitalize on sales force improvements, and/or increased sales force churn.
- Issues or delays with respect to the integration of the Nexeo assets.
- Ill-timed, unattractive, or poorly executed M&A and potential increases to leverage.

**UNIVAR INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In millions, except per share data; unaudited)

<b>ASSETS</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Current assets:		
Cash and cash equivalents	\$788.0	\$121.6
Trade accounts receivable, net	1,466.5	1,094.7
Inventories	996.6	803.3
Prepaid expenses and other current assets	<u>195.9</u>	<u>169.1</u>
<i>Total current assets</i>	<i>\$3,447.0</i>	<i>\$2,188.7</i>
Property, plant and equipment, net	1,168.2	955.8
Goodwill	2,472.1	1,780.7
Intangible assets, net	398.5	238.1
Deferred tax assets	24.4	24.8
Other assets	277.6	84.3
<b>TOTAL ASSETS</b>	<b><u>\$7,787.8</u></b>	<b><u>\$5,272.4</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term financing	\$4.3	\$8.1
Trade accounts payable	1,096.7	925.4
Current portion of long-term debt	27.2	21.7
Accrued compensation	92.7	93.6
Other accrued expenses	<u>467.0</u>	<u>285.8</u>
<i>Total current liabilities</i>	<i>\$1,687.9</i>	<i>\$1,334.6</i>
Long-term debt	3,694.0	2,350.4
Pension and other postretirement benefit liabilities	252.5	254.4
Deferred tax liabilities	114.4	42.9
Other long-term liabilities	<u>258.0</u>	<u>98.4</u>
<i>Total liabilities</i>	<i>\$6,006.8</i>	<i>\$4,080.7</i>
Stockholders' equity:		
Preferred stock, 200.0 million shares authorized at \$0.01 par value with no shares issued or outstanding as of March 31, 2019 and December 31, 2018	\$-	\$-
Common stock, 2.0 billion shares authorized at \$0.01 par value with 169.7 million and 141.7 million shares issued and outstanding at March 31, 2019 and December 31, 2018, respectively	1.7	1.4
Additional paid-in capital	2,978.0	2,325.0
Accumulated deficit	(822.2)	(761.5)
Accumulated other comprehensive loss	<u>(376.5)</u>	<u>(373.2)</u>
<i>Total stockholders' equity</i>	<i>\$1,781.0</i>	<i>\$1,191.7</i>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$7,787.8</u></b>	<b><u>\$5,272.4</u></b>