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HD **Orica's latest break-up to drive value**

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It has taken almost a decade but Orica is on the cusp of shedding the last vestiges of its origins as a chemical **company** to become a pure-play **mining** services operation.

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The potential $1 **billion sale** of spin-off of Orica's chemicals unit has been on the cards for more than a year, which has sparked some interest from potential private **equity** and trade buyers.

Unless Orica can secure a knock-out price for the business, a demerger remains the preferred option. The decision looks like a no-brainer given the **company**'s track record with spin-offs and the potential value that could be unlocked by setting the business free. Orica exited its majority share of fertiliser outfit Incitec Pivot in 2006 but it was the 2010 demerger of the Dulux paints business which raised the bar. Dulux's market value has more than doubled since then and it trades at a higher multiple than its former parent.

Orica management will be hoping for another Dulux moment if they decide to push ahead with the chemicals demerger in November. It will complete the move towards being a pure-play explosives manufacturer which was kick off by former chief executive Malcolm Broomhead a decade ago and continued under current boss Ian Smith.

Orica's chief deal maker, Andrew Larke, has also played a pivotal role in that transformation. He was appointed to run the chemicals business last year and is expected to head a stand-alone **company** if it is listed separately on the ASX. The business makes up less than 10 per cent of Orica's overall earnings and the idea is that it will have greater access to capital and management's time as a stand-alone entity instead of being a distraction from the main **mining** services business. Larke has already restructured the division, particularly the Latin American business which has had its challenges. The division's first-half earnings were impacted by one-offs relating to that as well as disruptions on some **mining** projects but conditions are expected to improve in the second half.

The idea is that the market would have to reassess the value of Orica's two stand-alone businesses if they were separated. Analysts have valued the non-**mining** chemicals business, which is focused on caustic soda, water care and chemical distribution, between $900 **million** and $1 **billion**. Comparable companies such as Germany's Brenntag trade at 9.5 times forward EBITDA. If things go right it should be able to generate around 10 per cent earnings growth in its first year and pay a decent fully-franked dividend.

Orica sees growth opportunities in the fragmented chemicals import market, where it currently has around a 10 per cent to 15 per cent share. It will be eyeing growth opportunities in markets in Asia and Latin America and from customers in the **oil** and gas and agriculture sectors.

A stand-alone chemicals business would also be free of the reputational issues Orica is dealing with following chemical leaks at its Kooragang Island and Port Botany plants.

The parent company would retain any environmental liability.

A sale to one of the private equity or trade buyers currently kicking the tyres remains possible, though, and they would need to pay a control premium to get a deal across the line. Private equity firms Bain, TPG, and CVC and all have experience owning chemicals companies and are taking a look at the Orica business.

Five of the world's top seven chemical distribution firms are owned by private equity. They include Brenntag, Univar, Nexeo Solutions, Azelis and IMCD. IMCD, a Dutch firm, and Univar in the United States are in the process of being floated. Potential trade buyers such as Chinachem are expected to look.

Australian conglomerate Wesfarmers is not expected to make a play for the business despite its huge warchest for acquisitions.

Wesfarmers is more of chemicals manufacturer compared to Orica's operations, which include a distribution and trading business.

Goldman Sachs, Citi and Lazard are advising Orica on the demerger and potential sale. Strategically, the move makes sense and should ultimately deliver value for shareholders. It would leave Smith to focus on the core mining services business, which faces huge challenges as mining investment cools. The company reported a worse than expected half year result in May. There will be a lot of pressure on Smith and his team to what may be Orica's last big transformational deal right.

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