Companies have successfully tapped the financial markets for funds

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Chemical financing hits record levels

Both debt and equity issuance achieve historic highs, and the outlook for 2017 appears healthy. However, Western initial public offerings remain challenged

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The year 2016 was modestly successful for chemical stock price valuation, but a very successful year for both debt and equity financing for the chemical industry. In dollar terms, both hit records by huge margins since Young & Partners has traced financing going back 30 years. However, the devil is always in the details, and 2016 was no exception.

There are three objectives of this article. First, we will report on how the stock market, equity financing and debt financing markets behaved in 2016 for both the overall market and for the chemical industry. Second, we explain why the financing market was so strong, but not for all companies and geographic regions. Third, we will share our predictions for the chemical equity and debt markets going forward.

EQUITY TRADING MARKETS

During 2016, the equity markets had a rocky start, plunging in January with some recovery in mid-February. Global markets also saw a drastic dip in the wake of the Brexit decision, but quickly recovered. The US presidential election results caused the stock market to rally in the tail-end of the year with the hope and expectation that President Trump will lower corporate taxes, spend on infrastructure, and change the tax laws so that US companies can repatriate cash from overseas and invest in the US.

Emerging market equities and, to a certain extent selected European equities, have been much less appealing to investors. The emerging markets continue to suffer because of their challenging economic and financial situations.

As a result, by the end of the year, the S&P 500 had increased by 11.2% and the FTSE Eurotop 100 by 17.2%.

Interest rates on a global basis have continued to be very low, with some countries issuing debt at negative interest rates. Although the US Federal Reserve hiked rates late last year, any increases in 2017 are likely to be very modest and will be overwhelmed by the low and negative interest rates elsewhere. A modest increase in US rates will not have much of an impact, although it will further strengthen the US dollar.

Overall, the flow of funds driver of investment dollars will continue to result in a relentless parking of funds in the safe haven US, Japanese and selected European equity and debt markets and real estate.

CHEMICAL STOCK PERFORMANCE

The stock market continues to favor the chemical industry due to its strong earnings and cash flow fundamentals. Until recently, the industry has been trading at a premium to the overall market. There has been a moderate weakening of chemical company valuations recently, but they are still trading close to the overall market valuation multiples.

US chemical companies did well, with the exception of fertilizers. The Young & Partners (Y&P) US Basic Chemicals index increased by 12.7%, the US Diversified Chemicals index gained 13.0%, the US/Canada Fertilizers index rose 2.6% and the US Specialties index rose 15.7%.

The Y&P Basic and Specialties indices in Europe did not do as well. The Y&P European Basic Chemicals index increased by 9.3%, European Diversifieds by 2.6% and European Specialties by only 2.0%.

In terms of valuations, as of the end of 2016, three of the seven Y&P chemical indices were trading at an EV/EBITDA (enterprise value/earnings before interest, tax, depreciation and amortisation) premium to the overall market indices.

Similarly, by the end of 2016, three of the seven Y&P chemical indices were trading at a P/E premium to that of the overall market.

While the overall picture on chemical stock prices turned out positively in terms of price movements and valuations for the industry as a whole, the picture was not uniformly positive for all chemical industry sectors and geographies.

DEBT AND EQUITY FINANCING

The overall debt issuance market for chemicals was exceptional, with the exception of some sporadic choppiness in high yield debt markets.

Global non-bank debt financing was $45.9bn in 2016, a huge increase over the $28.5bn for 2015. The previous record was $33.8bn in 2012.

Investment grade debt was the major reason for the increase with $37.7bn issued in 2016 compared to $20.1bn for all of 2015. Many companies rushed to borrow before the anticipated interest rate increase in December.

High yield debt issuance was also active, but flat at $8.0bn in 2016 versus $7.7bn in 2015. High yield started out weak with only $2.7bn of debt issued in the first half of 2016, but showed significant improvement in the second half.

Overall chemical equity issuance was also spectacularly strong in 2016 at $23.8bn from 81 equity offerings. This was more than triple the $6.5bn for all of 2015 and a 30-year record. The previous record was only $8.7bn in 2007. However, just as was true in the debt issuance market, the prosperity was skewed geographically.

The equity financing totals were dominated by Asia – $11.8bn of the $23.8bn of equity was issued in Asia by Asian companies, most of whom were Chinese. Of the 71 equity offerings globally, a massive 58 were issued in Asia.

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2016 CHEMICAL IPOS $M

Company	Amount	Location
ST Pharm	117.5	South Korea
Suli	97.3	China
Lily Group	86.4	China
Great Rich Technologies	76.3	South Korea
Suzhou Xingye Materials Technology	74.1	China
Guangdong Redwall New Materials	67.5	China
PT Aneka Gas Industri	65.1	Indonesia
Advanced Enzyme Technologies	61.1	India
SKSHU Paint	60.7	China
Jiangsu Flag Chemical Industry	58.8	China
Jiangxi Guotai Industrial Explosive Material Group	52.7	China
Suzhou Sunmun Technology	46.5	China
Sichuan Dowell Science and Technology	41.7	China
Wuxi Honghui New Materials Technology	38.7	China
Shandong Head	35.7	China
Jiangsu Kuangshun Photosensitivity New-Material	34.4	China
Zhejiang Jiaao Enprotech	33.2	China
Guangdong Dazhi Environmental Protection Technology	31.4	China
Sanxiang Advanced Materials	26.5	China
Shanghai Yahong Moulding	25.9	China

SOURCE: Young & Partners

With regard to initial public offerings (IPOs), although there was a record 20 IPOs in 2016, eclipsing the previous record of 14 in 1995, all were extremely small, Asian companies. The total dollar volume was just $1.1bn. There was not a single IPO completed in the US, Europe, South America or Africa.

Sadly, private chemical businesses and divisions of larger companies in the West have been locked out of the IPO market, and for some time now. Over the last 30 years, the highest IPO dollar amount was $5bn in 2006 and the highest number was 14 in 1995. For most years, the dollar volume was under $1bn and the number of IPOs was between zero and three. These are astonishingly low numbers. Sadly, the IPO market is at a virtual standstill for Western companies. Investors continue to have a strong appetite for existing public chemical shares, but little enthusiasm for IPOs of Western chemical companies.

DEBT AND EQUITY FINANCING OUTLOOK

Investor demand for investment grade debt has been very strong and will continue to be strong, driven more by issuer needs rather than investor demand, with mergers and acquisitions (M&A) related financing driving volume. However, we do not expect the total dollar volume to keep pace with last year's record levels because a healthy portion of the financing last year was in anticipation of rising interest rates.

High yield debt issuance will continue to show improvement, but higher interest rates may damage bond fund returns.

Equity financing volume will continue to be strong in Asia, but modest elsewhere, partly due to the chemical sector's limited need for equity capital. Equity issuance, both secondary and IPO related, has been and will continue to be dominated by Asian issuers.

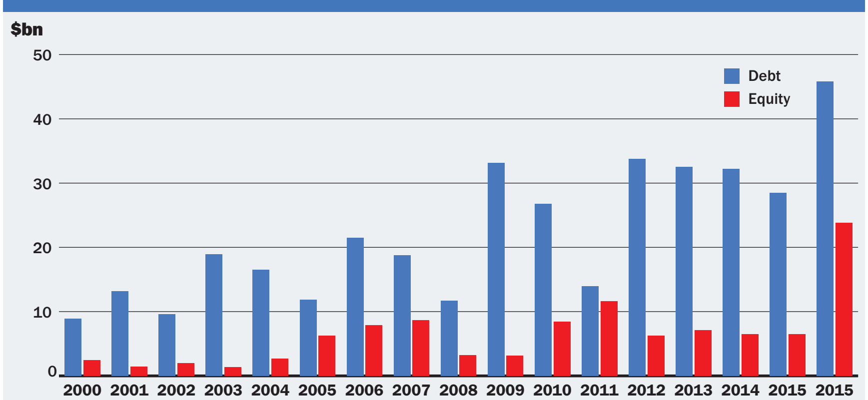
There will continue to be a strong number of IPOs, but they will be Asian and very small. Chinese and other Asian firms will continue to seek liquidity and funding on Asia stock exchanges. Western IPOs will continue to be dormant.

OUTLOOK SUMMARY

We think the equity and debt markets will continue to be strong, but not necessarily at the record levels we saw in 2016. We expect chemical public valuations to continue to erode modestly off of the high base and debt to be easily available. IPOs will be few and far between in the West and healthier, but very small in size in Asia (principally China). Investment grade debt issuance will continue to be strong and some of the large M&A in 2017 will drive the volume to high levels. Volume will continue to be issuer driven. High yield issuance will be more volatile and not as easy for private equity borrowers as it was in 2016. ■

Peter Young is President of Young & Partners, an international investment banking firm that focuses on chemical and life science industry M&A, financial advisory and financing. The firm has extensive industry knowledge, contacts, technical expertise, and an absence of conflicts of interest. Young & Partners has served a global client base of companies in Europe, North America, Latin America and Asia for the last 21 years.

CHEMICAL DEBT AND EQUITY OFFERINGS



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