High-yield debt issuance has declined and will continue to be weak

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Chemical financing activity declines

Equity and debt markets are robust but issuance in the chemical sector is down significantly year on year as mega M&A activity has slowed

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The stock market and financing activities this year have experienced some noticeable changes through the third quarter. By the end of the first three quarters of 2019, the S&P 500 had more than recovered from a dismal 2018 by increasing 18.6%, while the FTSE 100 had a partial recovery, increasing by 10.0%.

Chemicals staged a recovery as well. The Young & Partners (Y&P) US Basic Chemicals index increased by 23.0%, our US Diversified Chemicals index by10.5%, our US/Canada Fertilizers index by 3.4% and our US Specialties index by 23.0%.

The Y&P European Basic Chemicals index increased by 23.2%, our European Diversifieds index by 10.7% and our European Specialties index by 19.1%.

There was a major decline in debt issuance by the chemical industry in the first three quarters of 2019 across the board, even with a decrease in interest rates

Although all of our chemical indexes in the West increased, some did not increase as much as the market. In terms of price/earnings (P/E) valuations, only one of the seven Y&P Western chemical indices traded at a premium to the overall market indices at the end of the third quarter. On an enterprise value/eanings before interest, tax, depreciation and amortisation (EV/EBITDA) basis, only one of the seven Western Y&P chemical indices traded at a premium to the market indices as of the end of the third quarter.

Although multiples are still strong, the chemical industry has lost some ground to the overall market. There was a major decline in debt issuance by the chemical industry in the first three quarters of 2019 across the board, even with a decrease in interest rates.

Global non-bank debt financing was only $23.6bn in the first three quarters of 2019 compared with $40.6bn in the first three quarters of 2018 and $57.7bn for all of 2018.

Investment grade debt was only $19.5bn in the first three quarters of 2019 compared to $29.9bn in the first three quarters of 2018 and $46.7bn for all of 2018. This was not because chemical companies could not access the investment grade debt market on favorable vterms, but because their need for debt was not as high with the lack of large deals.

The situation was somewhat different in the high-yield debt market. This market has deteriorated significantly as investors have pulled back due to concerns about the risk profile of the issuers and the uncertainties in the market. Only $4.1bn of high-yield debt was issued in the first three quarters of 2019 compared with $10.8bn issued in the first three quarters of 2018 and $11.1bn issued for all of 2018.

EQUITY FINANCING TRENDS

The chemical equity issuance market was very weak for the first three quarters of 2019.

Only $3.6bn of equity was issued from 18 offerings in the first three quarters. This compares with $20.3bn of equity issued from 43 offerings in the first three quarters of 2018 and $24.5bn of equity issued from 57 offerings for all of 2018.

Part of the explanation for the major drop-off was that 2018 was a robust year as Bayer issued stock and sold shares of Covestro to fund the acquisition of Monsanto. However, $3.6bn and 18 offerings is still a significant fall in volume.

In addition, there were only eight IPOs completed worth $2.2bn in the first three quarters of 2019. This compares with 13 IPOs completed in the first three quarters of 2018 worth $2.3bn. Clearly this drop was not because the US and European equity markets were weak.

The weakness of the IPO and the secondary issuance markets was due to the volatility and weakening of the Asian equity markets since Asian companies issuing in the Asian public markets have dominated the IPO and secondary offering markets.

MACRO OUTLOOK

The future economic picture is very uncertain. Although overall global growth is reasonable, growth has been weakening in China, Europe and many of the emerging market countries and is expected to continue to weaken.

The trade dispute between the US and China has been drawn out and has damaged both countries' economies and other global economies. Even if an agreement is reached, the negative effects will last for some time. Brexit is also having a negative effect.

The US deficit and debt levels are increasing and may, at some point, along with rising interest rates and higher oil prices, create a negative tipping point for the US economy.

None of these developments are good for the chemical industry. We expect a gradual erosion of chemical company profitability and growth overall for the rest of this year and next, but no disaster.

The hardest hit will be the commodity chemical companies due to increases in capacity and diminished demand from China and the automotive industry.

Investor demand for investment grade debt has weakened and will continue to be weak going forward. Volume will be driven heavily by issuer needs rather than investor demand

Growth will continue to be hard to come by and certain specific markets will continue to suffer where there is a sector specific weakness.

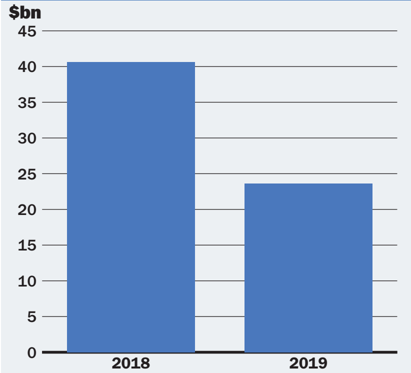
EQUITY MARKET OUTLOOK

The stock market favoured the chemical industry for many years due to the industry's strong earnings fundamentals and tie to industrials, which had been in favour. As a result, the industry had been trading for the last number of years at a premium to the overall market.

This changed significantly in 2018 as the chemical industry lost some of its lustre and its premium to the overall markets. This loss of a premium continues in 2019.

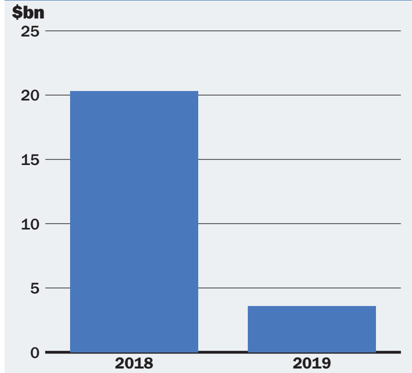
For much of the rest of 2019 the global equity markets will continue to be unpredictable, buffeted by the increase in interest rates and a long list of economic, financial and geopolitical stresses.

GLOBAL CHEMICAL NON-BANK DEBT FINANCING THROUGH Q3



Source: Young & Partners

GLOBAL CHEMICAL EQUITY FINANCING THROUGH Q3



Source: Young & Partners

The chemical industry will not go to a major valuation discount, but it will trade at a modest discount to the market as it is doing currently.

FINANCING OUTLOOK

Investor demand for investment grade debt has weakened and will continue to be weak going forward.

Volume has and will be driven heavily by issuer needs rather than investor demand, with investment grade debt issuance continuing to be weaker due to a much weaker M&A market.

High-yield debt issuance has declined and will continue to be weak going forward.

The surge in equity issuance in 2017 and 2018 was driven by Asian issuers and inflated valuations in the Chinese stock market.

Without their volume, equity financing volume would have been modest given the market's historic bias against the chemical sector and the chemical sector's limited need for equity capital.

Now we see a slowdown in Asian secondary and IPO offerings as Chinese stock market valuations continue to weaken. Asian IPOs will be modest in volume and continue to be very small in size. Western IPOs will continue to be dormant.

Equity issuance going forward, both secondary and IPO related, will be modest. We predict a continuation of the slowdown in Asian IPOs given the weaker Chinese economy and the drop in Chinese stock market values. ■

Peter Young is president and CEO of Young & Partners, an international investment banking firm that focuses on the chemical and life science industry M&A, financial advisory and financings. The firm has extensive industry knowledge, business and financial strategy expertise, first class investment banking skills, and no conflicts of interest. Young & Partners has served a global client base of companies in Europe, North America, Latin America and Asia for the last 24 years.
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