M&A higher but uneven amid volatile debt, equity markets

Announced mega deals continue to dominate discussions, but the volume and value of deals closed in the first half reveals an uneven M&A market, according to one industry banker. Specialty chemical markets and values remain extremely strong in contrast with commodity transactions, and activity continues to shift toward Asia, says Peter Young, president of Young & Partners (Y&P; New York, New York). Roughly $23 billion in chemical M&A transaction valued at more than $25 million were completed in first-half 2016, up slightly from the prior-year figure of $22 billion, according to Y&P data. The number of deals closed was 39, down from the year-ago period.

YOUNG: *High-yield debt markets 'choppy.'*

The full-year 2016 figure is likely to exceed last year's $65-billion figure thanks to the strong pipeline of deals. Young puts the value of deals announced but not yet closed at $142 billion, with the figure dominated by the pending Dow Chemical–DuPont merger and ChemChina's takeover of Syngenta. In total, 47 announced deals were in the pipeline that had not closed as of 30 June. "We expect dollar value of deals this year to exceed last year's $65 billion because there are large deals out there. There is uncertainty about some, but enough should close," Young says.

The strong top-line numbers mask shifting underlying fundamentals, Young adds. Specialty deal flow is stronger than commodities, and activity continues to shift toward Asia, Young says. Investment-grade borrowers have generally free access to debt markets, whereas high-yield, which tends to dominate private equity borrowing, remains constrained. Those debt constraints, aggressive strategic bidding, and high valuations have kept private equity in check. Private equity accounted for less than 10% of industry deals in 2015 and first-half 2016 well below their typical range of 20–25%.

Asia has taken the lead in deal activity by deal volume, Young says. "Asia and the rest of the world accounted for 51% of deals completed worldwide in 2015," Young says. "In the first half of 2016, Asia deals rose to 59% of all transactions." The high-level activity reflects the size and maturation of the Asian markets as well as economic uncertainties in Europe and North America, Young adds.

Young says the drivers for solid M&A activity remain in place despite some caution. These include a desire use M&A as growth lever in a weak economic environment, portfolio realignment and restructuring, and the need to use cash on balance sheets, Young says. These factors, however, are somewhat tempered by economic and political uncertainty.

Equity and financing markets are mixed as well. Although equity markets had a rough start to 2016, they have recovered in recent months—benefitting US chemical makers. Y&P expects pubic-market valuations in chemicals to remain historically high, although IPOs in the sector will remain scarce. "We expect public valuations to say high for the moment," Young says. This is due in large part to the "flow of funds" into the stock market in search of investment returns, Young adds. Chemical valuations should remain solid, however.

Debt should also be "easily available" in the coming months, according to Young. "Investment-grade issuance will continue to be strong and issuer-driven, and high-yield will be stable but fragile," he adds.

During the first half, there was "sporadic choppiness" in high-yield markets because of concern about rising interest rates and economic uncertainty, but debt markets have generally been healthy in 2016, Young says. Y&P says nonbank debt financing in chemicals totaled $16.8 million during the first half of 2016 compared with $28.5 billion for all of 2015—a modest increase on an annualized basis.

Some $14.1 billion, or 84%, of 2016's total was investment-grade debt compared with 71% for all of last year. This drove the increase but points to the choppiness in high-yield debt markets. High-yield markets have improved mostly as the year has progressed but started the year mired in a slump that stretched back to the second half of 2015.

—VINCENT VALK AND ROBERT WESTERVELT