Chemistry Industry Association of Canada
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2014 Year-End Survey of Business Conditions

2014 YEAR-END SURVEY OF BUSINESS CONDITIONS[1]

Industrial Chemicals

HIGHLIGHTS

In 2014:

- Sales of industrial chemicals will increase 10% compared to 2013, going above $29 billion and surpassing the previous high mark set in 2008, just prior to the recession.
- Exports rose 5% to $19.6 billion.
- Operating profits will reach $3.9 billion, setting an all-time record for the second year in a row
- Capital expenditures will increase by over 20%, to reach $2.6 billion.

Looking ahead to 2015:

- A decline of 7% is projected for overall sales. Most of this reduction will be due to anticipated lower commodity prices.
- Profits are also forecast to decline slightly, but will remain high by historical standards.
- The outlook for capital investment remains strong, jumping by 30% based on the projected outlook.

[1] The Chemistry Industry Association of Canada (CIAC) conducts a survey of its member companies to obtain views on their economic forecast as reflected by sales, trade and employment indicators. This report is prepared by CIAC's Business and Economics Team and is based on aggregated results from the survey. The responses by CIAC members are based primarily on the performance of their operations in Canada.

INDUSTRIAL CHEMICALS PERFORMANCE IN 2014

For 2014, it is estimated that year-end sales of industrial chemicals will reach $29.1 billion, an increase of 10% compared to 2013, passing the pre-recession record achieved in 2008. The aggregate price index increased 6% during the year, so on a volume basis, output is estimated to have increased by about 3% (using constant-dollar shipments as a proxy for volume).

Exports will increase 5% in 2014 to reach $19.6 billion. The Canadian industrial chemical industry is export-intensive, with two-thirds of domestic production being exported, and three-quarters of that going to the United States. The next largest export destinations in 2014 were China (7%), United Kingdom (5%), and Mexico (2%).

Operating profits for Canadian operations will rise 10% to $3.9 billion, setting an all-time record for the second year in a row. Low input costs due to natural gas and natural gas liquid prices, and higher selling prices for chemical products were strong contributors to profitability during the year.

Capital investment will increase over 20% compared to 2013, reaching $2.6 billion. This is the second consecutive year where capital investment will have grown at over 20% reflecting the improvement in investment conditions within Canada, and North America generally.

KEY OPPORTUNITIES

New Investment

Two consecutive years of robust investment growth underline that the investment climate in North America and Canada has improved dramatically from where it stood a few years ago. There had been almost no major new investments in the industrial chemical industry in Canada between about 2000 and the recession. The situation started to change in 2010. Several significant new projects have been undertaken since then, others are under construction, and still more are at various stages of evaluation. Investment location decisions by companies involve a complex analysis of many variables. Strong factors working in Canada's favour include:

- The shale gas phenomenon has created the prospect for long-term availability of relatively low-cost natural gas and natural gas liquids in North America. Low prices provide a competitive advantage for all Canadian producers that consume natural gas as energy, and are doubly important for petrochemical producers that rely on natural gas as the primary source of feedstock. These same advantages also exist in the United States, so sites in Canada must compete against jurisdictions in the United States in order to secure new projects. To-date, all of the announcements for new ethane crackers have been in the United States.
- Corporate tax rates in Canada are internationally competitive. In the key provinces of Alberta and Ontario, the combined federal/provincial rate is 25%. In British Columbia the combined rate is 26%, and in Quebec it is 26.9%.
- Demand is strong for inorganic chemicals that are used in the production of crude oil and natural gas.
- Canada is well-positioned to attract new investments to produce industrial biochemicals given the volume and diversity of biomass available in the country.

KEY CHALLENGES

Economic Uncertainty

The recovery from the great recession continues to be slow and uneven, and there remain risks that could trigger a return to recessionary conditions in some parts of the world. This creates an overall sense of uncertainty that acts as a drag on new investments by all industries, including industrial chemicals and their customers.

Feedstock Availability

Growing supplies of shale gas in the lower 48 states has dampened demand for exports of Canadian natural gas, and reduced drilling activity in the Western Canadian Sedimentary Basin. When less gas is produced, fewer liquids are recovered with the consequence that the Alberta petrochemical industry had been short on ethane for some time, and ethylene-based derivative units had been running under-capacity. The situation now is more in-balance because companies have implemented innovative strategies to augment the supply of feedstock such as importing ethane from North Dakota, doing more field extraction, and recovering ethane from bitumen upgrader off-gases. In Ontario, ethane is now flowing into Sarnia from the Marcellus shale formation in the United States.

Canada is also rich in shale gas resources, but the key will be to adapt to the new reality where exports of natural gas to the United States will continue to decline. In order to make production of Canadian gas economical, a combination of off-shore and expanded domestic markets will need to be developed.

Treatment of Capital Expenditures

Canada currently offers an Accelerated Capital Cost Allowance (ACCA) that provides a cash-flow advantage for new investments in manufacturing machinery and equipment. The ACCA is scheduled to expire at the end of 2015. CIAC is engaged in advocacy to see it replaced with a more-permanent, enhanced depreciation allowance with the objective to allow new investments in Canada to be depreciated at least as quickly as those in the United States, on an ongoing basis.

Electricity Costs

For CIAC members the cost, availability and reliability of electricity continues to be a competitiveness concern in all provinces, even in those that have historically enjoyed a cost advantage such as Quebec and British Columbia. While electricity costs are of concern to all industrial chemical producers, the impact is particularly acute for those firms producing inorganic chemicals.

Labour

Concerns about labour costs are most evident in Alberta due to robust demand for workers in the energy sector, especially the oil sands. The strong pull from the oil sector is placing upward pressure on chemical company wages in order to retain workers. If oil prices remain soft for an extended period of time, this situation may begin to change again. In other provinces, labour issues are related primarily to the limited supply of skilled new workers that will be needed as an aging workforce begins to retire in larger numbers.

Canadian Dollar

Currently the exchange rate is lower than it has been in the recent past, providing an edge for Canadian exporters, particularly those selling into the United States. Uncertainty about the future exchange rate is an ongoing concern for Canadian exporters, and companies have developed strategies to cope with upward and downward swings to minimize their impacts.

Rail

Issues related to availability, reliability and liability for rail car shipments continue to pose a challenge in getting product to market, leading to higher transportation costs and negatively impacting on competitiveness. These issues will be raised during the Review of the Canada Transportation Act to be undertaken by the federal government in 2015.

ECONOMIC OUTLOOK FOR 2015

In its October Monetary Policy Report, the Bank of Canada projected that full-year GDP growth in Canada will be 2.3% for 2014 and 2.4% in 2015. Growth in the United States is projected to be essentially the same as in Canada for 2014 at 2.2%, and then grow more rapidly at 2.9% in 2015. It is projected that Europe will see very minimal growth of 0.8% in each of 2014 and 2015. The projection for China is for 7.4% growth in 2014, followed by 7.0% growth in 2015, continuing the downward trend observed in recent years.

The major Canadian banks are forecasting that the value of the Canadian dollar will be in the range of $0.85-0.90 compared to the U.S. dollar through 2015. The banks are projecting a range of $70-80 for WTI crude oil prices, and natural gas price is in the range of $4.00-4.50 per million Btu next year.

OUTLOOK FOR CANADIAN INDUSTRIAL CHEMICALS IN 2015

CIAC survey respondents are forecasting a 7% drop in overall sales next year, with most of the decline coming from anticipation of lower global commodity prices. On a volume basis, output in 2015 is expected to be slightly lower than in 2014.

Small declines in exports, profits and employment levels are also forecast.

Despite the slight decline, profitability will continue to be very strong by historical terms. Following record-high profits in 2014, the forecast calls for 2015 to be the 2nd-most profitable year on record.

Investment in capital projects is anticipated to continue to follow the strong growth trend exhibited since 2012, with a forecast 30% jump to $3.4 billion to occur in 2015. This bullish outlook reinforces the message that companies in Canada are ready to take advantage of the attractive investment climate that currently exists.

INDUSTRIAL CHEMICAL INDUSTRY[1]

(millions of current dollars except where noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013[2]	2014[3]	2015[4]	%chg 14/13	%chg 15/14
Sales	26,037	26,882	26,236	27,122	18,262	22,000	25,262	24,630	26,550	29,160	27,070	10	-7
Sales (Constant 2010 $)[5]	28,702	28,770	27,160	26,227	19,803	21,998	22,703	22,120	23,430	24,210	23,720	3	-2
Price Index (2010=100)	90.7	93.4	96.6	103.4	92.2	100.0	111.3	111.3	113.3	120	114	6	-5
Exports	16,829	17,865	19,736	18,390	13,215	15,703	18,619	16,956	18,710	19,610	19,240	5	-2
Operating Profit	1,640	1,362	1,640	951	1,055	2,333	3,351	2,890	3,570	3,940	3,860	10	-2
Capital Expenditures	753	600	606	880	1,279	692	1,829	1,670	2,170	2,630	3,440	21	31
Employment	19,830	18,739	17,827	18,125	16,138	17,158	17,184	17,210	16,880	16,480	16,190	-2	-2

1 Basic chemical manufacturing (NAICS 3251) and resin, synthetic rubber, and artificial and synthetic fibres and filaments manufacturing (NAICS 3252) closely matching the output of member companies of the Chemistry Industry Association of Canada.

2 2013 estimates are based on the monthly 2013 vs. 2012 % change applied to data from Statistics Canada’s 2012 Annual Survey of Manufactures and Logging, the most recent available.

3 2014 estimates are based on January to September monthly 2014 vs. 2013 % change applied to the 2013 estimate.

4 2015 forecast is based on the Chemistry Industry Association of Canada's annual year-end survey of business conditions. Responses were received from members representing about 90% of total member-company sales.

5 Calculated using a chemical price index from Statistics Canada.