Debt and equity markets buoyant

Global chemical non-bank debt issuance surged to $36.4bn in the first half of 2020 as firms sought to shore up liquidity. Both debt and equity markets remain healthy

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This year has been a very challenging one due to the pandemic which has had a serious impact on global health, economic conditions, the stock market, and the lives of billions of people around the world.

As a result, the stock market and financing markets have also gone through major fluctuations as the uncertainties and circumstances have changed.

The chemical industry went through disruptions in demand, supply chains, and operational changes to accommodate social distancing and stay-at-home requirements during the year. On a relative basis, the industry has done better than the energy, entertainment and hospitality sectors, but worse than industries such as life sciences and online delivery and services.

During the first half of 2020, global equity markets saw severe declines followed by partial recoveries in direct response to the coronavirus pandemic and associated government efforts to stimulate national economies.

The S&P 500 decreased by 4.8% and the European markets did poorly with the FTSE 100 falling 18.9%.

With the exception of the Young & Partners (Y&P) Specialty Chemical indices, all of our chemical indexes suffered declines.

The Y&P US Basic Chemicals index decreased by 7.9%, our US Diversified Chemicals index by 17.2%, our US/Canada Fertilizers index by 33.9% while our US Specialties index increased by 0.4%.

The Y&P European Basic Chemicals index decreased by 0.1%, our European Diversifieds index by 14.3% while our European Specialties index increased by 22.1%.

In terms of price/earnings (P/E) valuations, only two of the seven Young & Partners Western chemical indices were still trading at a premium to the overall market at the end of the first half of 2020.

On an EV/EBITDA (enterprise value/earnings before interest, tax, depreciation and amortisation) basis, only one of the seven Western Young & Partners chemical indices were trading at a premium to the market as of the end of the first half of 2020.

This is a sharp contrast to the situation not long ago when the chemical indices were trading at a premium to the overall market.

Why is this the case? The market has favoured industrial companies for some time now, but the economic downturn has created negative sentiment in terms of the market's view of industrial companies.

Debt financing trends

Global non-bank debt financing was $36.4bn in the first half of 2020 compared with $36.0bn in all of 2019. This was a huge surge in activity on an annualised basis.

In addition to their normal refinancings and financings in a low interest environment,

Global equities markets saw sharp declines in the first six months of 2020 followed by partial recoveries

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chemicals companies issued large amounts of debt so that they would be assured of ample liquidity during the pandemic. Massive support by the central banks kept the debt markets healthy and liquid.

Investment grade debt was $29.7bn of the total in the first half of 2020 compared to $26.1bn in all of 2019 - a dramatic increase on an annualised basis.

Around $6.7bn of high yield debt was issued in the first half of 2020 compared with $9.8bn issued in all of 2019, a slight increase on an annualised basis.

Equity financing trends

Equity issuance is generally modest in chemicals. Only $3.6bn of equity was issued from 21 offerings in the first half of 2020. This compares to just $5.6bn of equity issued from 34 offerings for all of 2019, a slight increase on an annualised basis.

There were nine initial public offerings (IPOs) completed worth $1.2bn in the first half of 2020. This compares to 18 IPOs completed in 2019 worth $3.2bn. This is a continuation of the declining number of IPOs since the peak a few years ago. However, Asian companies issuing in the Asian public markets continued their dominance of both the IPO and secondary offering markets, as has been true for many years.

Economic and chemicals outlook

The future economic picture is very uncertain. The pandemic has been seriously damaging the global economy across almost all countries.

The move to remove the lockdowns in certain parts of the world and in the US has resulted in a second surge in infections and deaths.

The most optimistic scenario is an opening up of major economies later in the autumn with no surge in infections thereafter, followed by a gradual emergence from a severe downturn. This may be coupled with one of the antiviral drugs working to improve patient recovery and an effective vaccine, such as the one being developed by the University of Oxford.

A second scenario is a continuation of the coronavirus infections at high levels through the autumn and winter, with a severe economic downturn and some spillover into the financial ecosystem. This may be coupled with the delayed effectiveness of one of the existing antiviral drugs working in the autumn and an effective vaccine becoming available in spring of 2021.

A serious downside scenario is if there is no existing antiviral drug that works well, the pandemic lasts for a year or more, and a vaccine is not available for 12-18 months or more. In this case, it is almost certain that we will reach depression-like economic conditions with a recovery that takes years.

In all three scenarios, there is a negative effect on all chemicals companies. The hardest hit will be the chemicals companies serving impaired industry/market segments such as automotive, oil and gas, and transportation.

Commodity chemical companies will also suffer heavily due to increases in capacity that were already coming on stream and diminished demand from China and the automotive industry.

Stock market outlook

The stock market favoured the chemicals industry for many years due to the industry's strong earnings fundamentals and ties to industrials, who have been in favour. As a result, the industry has been trading for the last number of years at a premium to the overall market.

This changed significantly in 2018 as the chemicals industry lost some of its luster and premium to the overall market. This loss of a premium continued in 2019 and in early 2020.

There will be continued healthy debt issuance unless there is a major spillover from a downward spiraling economy into the financial markets

For much of 2020, the global equity markets will continue to be unpredictable, buffeted by a long list of economic, financial and geopolitical stresses and uncertainty

The chemicals 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.

Debt and equity financing outlook

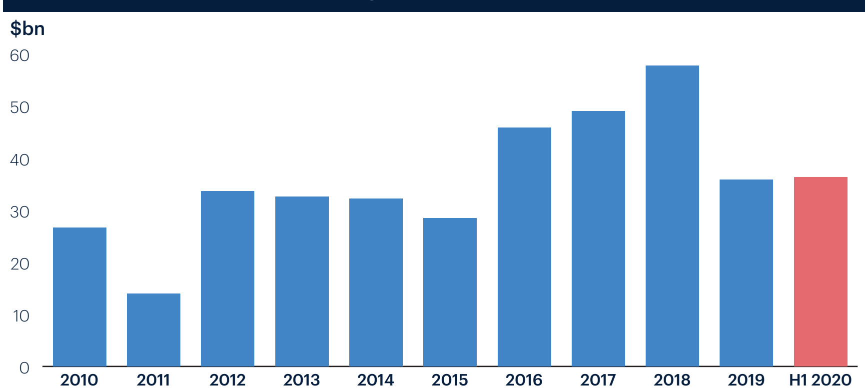
There will be continued healthy debt issuance unless there is a major spillover from a downward spiraling economy into the financial markets.

Volume will be driven heavily by issuer needs rather than investor demand, with M&A related financing driving issuance.

Investment grade and high yield debt issuance will be driven by the M&A market and not by refinancing needs once chemical companies have reached the liquidity levels they have targeted.

Equity financing will continue to be subdued globally. The Asian IPOs and secondary offerings have already tapered off and will continue to be subdued until there is a significant economic and equity market recovery in Asia and specifically China. Western IPOs will continue to be dormant. ■

Worldwide chemical debt financing



Source: Young & Partners

Peter Young is CEO and president of Young & Partners, which is in its 25th year as a focused chemical and life science industry corporate strategy and investment banking firm serving the strategic consulting, financial advisory, M&A, and financing needs of clients in North America, Europe, Asia and South America.
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