Mixed outlook for chemical financing

Chemical debt financing plunges after 2020's borrowing spree while equity issuance rises. However, both markets are relatively healthy, providing a source of funds

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How has the chemical industry done thus far in 2021 in terms of their public valuations and their access to debt and equity financing? What are the drivers of these trends and what can we expect going forward?

2020 ended up a good year for the Western equity markets after a deep drop early in 2020 when the pandemic hit. Thus far, 2021 has been a continuation of that strong market performance. At the end of the first half, the S&P 500 had increased by 16.1% and the S&P Euro 350 by 12.7%.

The Young & Partners (Y&P) western chemical indices turned in a mixed performance relative to the overall market during that same time period - strong in the US and disappointing in Europe.

All of our US chemical indices did well. The Y&P US Basic Chemicals index increased 12.0%, the Y&P US Diversified Chemicals index jumped 24.2%, the Y&P US/Canada Fertilizers index gained 22.9% and the Y&P US Specialties index increased 17.4%.

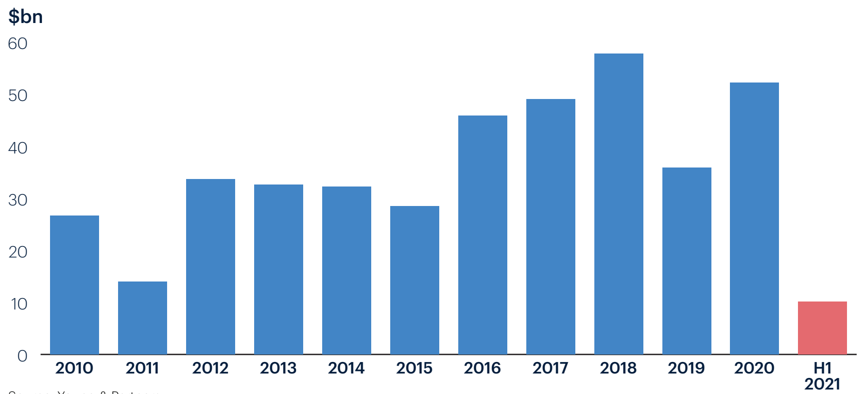
Our European indices increased, but did not do as well compared to the overall market. The Y&P European Basic Chemicals index increased 10.0%, our European Diversifieds index rose only 5.5%, and our European Specialties index gained 12.0%.

As a result, relative valuations were not as powerful as they have been in the past.

On an EV/EBITDA (enterprise value/earnings before interest, tax, depreciation and amortisation) basis, just three of the seven Western Y&P chemical indices were trading at a premium to the market indices as of the end of the first half of 2021.

Chemical companies do not have a need for more debt due to a slowdown in M&A and the large amount of borrowing they did last year to assure liquidity when the pandemic hit

Worldwide chemical debt financing



Source: Young & Partners

Not long ago, all of the western chemical indices were trading at a premium to the overall market. Nevertheless, the multiples are still quite high relative to historical multiples for most of the chemical industry sectors.

Financing trends

There was a dramatic reduction in chemical non-bank debt financing in the first half of 2021. Global non-bank debt financing was only \$10.1bn in the first half of 2021 compared to \$52.2bn for all of 2020.

Of that total, investment grade debt was \$8.0bn compared to \$38.5bn in 2020, a dramatic decrease on an annualised basis. High yield issuance dropped dramatically as well. Only \$2.0bn of high yield debt was issued in the first half of 2021, a fraction of the \$13.7bn issued in 2020.

This is not a sign of a weak market for chemical industry debt. Rather, it is because chemical companies do not have a need for more debt due to a slowdown in M&A and the large amount of borrowing they did last year to assure liquidity when the pandemic hit and to take advantage of lower interest rates.

There was a major increase in equity issuance in the first half of 2021 on an annualised basis with \$9.3bn of equity issued via 60 offerings. This compares to \$14.1bn of equity issued via 80 offerings for all of 2020. Asian companies dominated in terms of share of the overall equity issuance market.

Equity financing globally will continue to be steady in dollar terms, but involve a larger number of smaller offerings

In terms of initial public offerings (IPOs), 26 IPOs were completed worth \$3.4bn in the first half of 2021. This compares to 45 IPOs completed in 2020 worth \$6.4bn. So the number of IPOs increased, but the dollar volume is similar to last year on an annualised basis.

Essentially we are seeing a large number of small IPOs mostly done by Asian companies. There were only three Western company IPOs out of the 26 total, a continuation of a long-term trend.

Although there has been a great deal of publicity about SPAC (special purpose acquisition company) IPOs and the mergers of SPACs into private companies, there was only one SPAC related merger/offering in the chemical industry involving Origin Materials.

The future economic picture is positive in the US and China, but uncertain in other regions of the world. The future will depend heavily on how quickly the pandemic can be controlled.

China, and more recently the US, have been and will continue to enjoy strong economic results. But there are signs of a slowdown in China and the US economy will inevitably slow down after the recovery and economic stimulus measures wear off. Inflation in China and the US is also a source of concern.

The future for the rest of the world is uncertain due to the new coronavirus mutations and poor vaccination progress in Europe, southeast and east Asia, South America and Africa.

The chemical industry as a whole is doing well. We expect overall continued prosperity for the chemical industry in terms of demand and profitability under the majority of COVID-19/economic scenarios.

The US stock market has been buoyant

Equity market outlook

Future performance of Western chemical shares will depend more on the overall market performance rather than relative performance. Up to now, the equity markets in the West have been strong as flow of funds has forced investors to invest in Western equities given the unattractive alternatives in the fixed income and developing world.

But the recent concerns about inflation and a return to higher interest rates is hurting the stock market. The tug of war between the flow of funds and interest rates will continue through the rest of 2021.

Debt and equity financing outlook

Debt issuance will continue to be subdued in 2021. Volume has been driven by issuer needs rather than investor demand and the issuer needs have been diminished this year.

Equity financing globally will continue to be steady in dollar terms, but involve a larger number of smaller offerings. Asian IPOs and secondary offerings will remain very active and Western IPOs will continue to be modest.

Although there has been a great deal of publicity about SPAC offerings and mergers, we expect very few, if any, involving chemical companies. ■

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