Debt financing to be difficult in 2023

After a major drop in debt financing in 2022, the outlook is challenging once again, especially with economies headed for a downturn and M&A activity constrained

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2022 was a difficult year with regard to the equity and debt markets. There was a 20% drop in the S&P 500 and a 16% drop in the S&P Euro 350. This was all happening in a difficult environment (weaker economic growth, high inflation, rising interest rates) and amid a drop in M&A activity. It is not surprising that in 2022, the dollar volume and number of chemical debt and equity financings fell significantly.

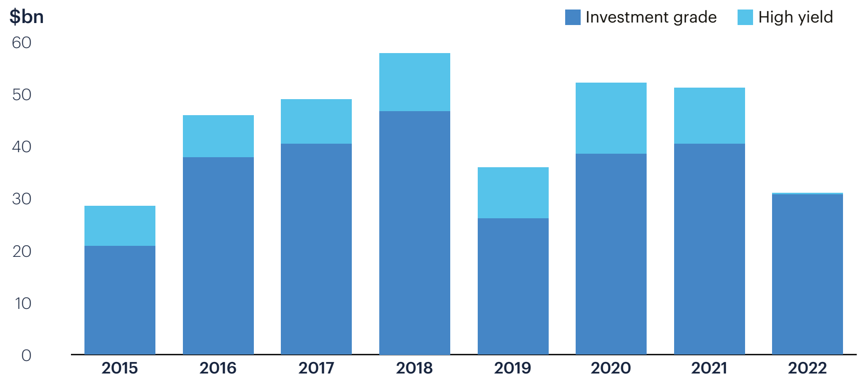
Global non-bank debt financing was only \$31.0bn in 2022, a dramatic fall compared to \$51.3bn in 2021. As interest rates went up, the drive to refinance disappeared and lower M&A volumes reduced the amount of transaction-related debt financing required. Higher interest rates were partly the cause, but underwriters also held back due to the economic, interest rate and geopolitical uncertainties.

Investment grade debt issuance was only \$30.7bn compared to \$40.4bn in 2021, representing half of the total debt issuance drop in 2022. High yield debt volume collapsed entirely, with only \$0.3bn of high yield debt issued in 2022 compared to the \$10.8bn issued in 2021.

On the equity side, \$17.7bn of equity was issued via 91 offerings in 2022, a serious drop in activity compared to the \$22.3bn of equity issued via 116 offerings in 2021. The disruptions to the equity markets and lower stock prices which led to a severe drop in valuations contributed to a slower pace of equity issuance.

Initial public offerings (IPOs), strangely enough, fell but not by as much. 41 IPOs were completed worth \$9.4bn in 2022 compared to 58 IPOs completed in 2021 worth \$11.2bn. Asian companies issuing in the Asian public markets continued their domination of both the IPO and secondary offering markets. Only two of the 41 IPOs were non-Asian issuers.

Global chemical nonbank debt financing



Source: Young & Partners

Subdued level of issuance

With the continuing increases in interest rates, an ongoing deterioration in the global economic and geopolitical environment, and a subdued level of M&A activity, we expect a subdued level of investment grade debt issuance this year. The high yield debt market will also continue to be stagnant with the abandonment of higher risk lending and assets.

Also, the anticipated downturn in the global economies will increase the number of defaults and tighten the terms that lenders will extend to borrowers. However, we could see some improvement by the end of the year as the debt that could not be placed by underwriters with institutions (Twitter, Cisco, etc) reaches some stability and if the Federal Reserve is less aggressive with interest rate increases as inflation dampens, and recession concerns abate.

The health of the equity issuance market will depend heavily on how the overall stock market and chemical company share prices fare this year. Since it is almost impossible to predict how the stock market will do, forecasting equity issuance is also impossible.

Senior management approach

With less availability of low-cost debt and equity, management will have to focus on their own cash flows and balance sheets for at least the rest of the year.

Financing acquisitions will continue to be difficult, so to the extent that deals get done, they will rely less on debt financing and using the buyer's shares. Selling of non-core assets should be considered if a reasonable price is available, which is likely to continue to be true in specialty chemicals. Management will be cautious about dividend and stock repurchase activities to the extent that there's a burden on their balance sheets and overall cash flows.

Impact on private equity

There is no question that higher interest rates, more conservative lending practices, and the retreat from lending by many traditional lenders to private equity are all having a negative impact on private equity firms that are trying to finance acquisitions, refinance, or recapitalise existing portfolio companies. We are seeing creative approaches being taken and an increase in the amount of equity used for acquisitions.

Private equity firms will continue to divest their mature specialty chemical businesses, but be they will be constrained with regard to acquisitions due to higher interest rates and less available debt financing. ■

Peter Young is CEO of Young & Partners, an international investment banking and strategy consulting firm that focuses on the chemical and life science industries. The firm executes corporate and financial strategy projects, M&A, private placements of debt and equity, and financial restructuring. Young & Partners has served a global client base of companies in Europe, North America, Latin America and Asia for the last 27 years.