SCOPE Scope Ratings

2020 Chemicals Outlook

The credit outlook for the European chemicals sector is stable. Specialty chemicals suppliers are likely to face less pressure on credit quality than integrated or bulk suppliers exposed to more commoditised products as global economic growth slows.

Corporates, Scope Ratings GmbH

Executive summary

The credit outlook for the European chemicals sector is stable. In the context of more sluggish economic growth, specialty chemicals suppliers are likely to face less pressure on credit quality than integrated or bulk suppliers, which are exposed to more commoditised products. Credit quality could improve if underlying economic growth does not slow too drastically.

The main trends we expect for 2020 are:

- Integrated chemical players remain vulnerable to slowing economic growth due to the cyclical nature of their businesses, including low pricing power – as prices for most basic chemicals and plastic resins are set by the market, while they are also highly sensitive to prices of oil-based commodities.
- Aftermarket mix is among the most important factors driving the credit quality of specialty chemicals producers.
- Several European producers of specialty chemicals have used the long economic upswing to bolster balance sheets while pushing their activities up-market.
- Europe-based specialty chemicals producers are less indebted than their US-based counterparts so are better prepared to cope with a cyclical downturn in demand.
- Commodity-orientated players are likely to acquire downstream assets in addition to weeding out poorly-performing businesses, while also focusing on improving efficiency, as well as paying down debt.
- European-based players will remain cautious on M&A, capital expenditure, dividends and share buybacks, compared to their US-based competitors.

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Key trends for 2020

The credit outlook for the European chemicals sector is stable. In the context of slowing economic growth, specialty chemicals suppliers are expected to face less pressure on credit quality than integrated or bulk suppliers that are exposed to more commoditised products. Credit quality could improve if underlying economic growth does not slow too drastically.

Bolstering balance sheets

Integrated chemicals companies

Europe's integrated chemicals players are strengthening their portfolios by acquiring downstream assets and weeding out poorly-performing businesses, while also focusing on improving the efficiency of existing operations and paying down debt. BASF is a good example. The German-based company sold its construction chemicals and pigments business in 2019 and is in the middle of an 'Excellence program 2019-2021' designed to improve profitability.

On the negative side, commodity-oriented players are likely to face headwinds from shrinking utilisation rates and prices for several base chemicals and basic polymers after heavy investment in US production capacity. Roughly 334 projects, equivalent to an investment of USD 204bn, came on stream in late 2018 and early 2019, according to Deloitte. Many of these greenfield and brownfield projects are on the US Gulf Coast, benefiting from low-cost ethane from US shale-gas producers. In addition, regulatory-compliance costs are in danger of rising for the sector as the industry and policymakers discuss how chemicals companies operate more sustainably. Producers of basic polymers face the possibility of a stricter regulatory framework aiming to reduce plastic waste from customer products. The industry remains under pressure to reduce carbon-dioxide emissions and improve the amount of waste recycling.

In summary, we think the financial leverage of European-based players should decline moderately in 2020 in contrast with US counterparts, which have reduced indebtedness in recent years and which should now remain stable.

Specialty chemicals companies

We believe specialty suppliers of products such as flavours, fragrances, food ingredients and industrial gases will benefit from their exposure to less cyclical patterns of demand from their end customers in sectors such as food retailing, healthcare and technology.

Specialty companies should also benefit from innovation as new products come to market following the ramp-up in research and development spending in the aftermath of the global financial crisis. R&D spending in the EU sector rose to EUR 10 billion in 2018 from EUR 7.9bn in 2011, according to Cefic. We think R&D spending should remain on that level in 2020. Successful new-product launches can improve near-term financial risk profiles and improve long-term market positioning. We expect this trend to be most visible in agrochemicals and biodegradable plastics.

Several European specialty chemicals companies have strengthened market positions or diversified (i.e. aftermarket mix) in recent years. Consequently, European-based specialty chemicals producers are less indebted than their US-based counterparts, so are better prepared to cope with a cyclical downturn in demand.

Economic clouds on industry horizon

Slowing global economic growth, possibly exaggerated in the near term at least by the coronavirus outbreak in China, threatens to weigh on chemicals demand in 2020. (see Scope's China: coronavirus outbreak's longer-term policy side-effects more important than direct GDP impact 31 January 2020).

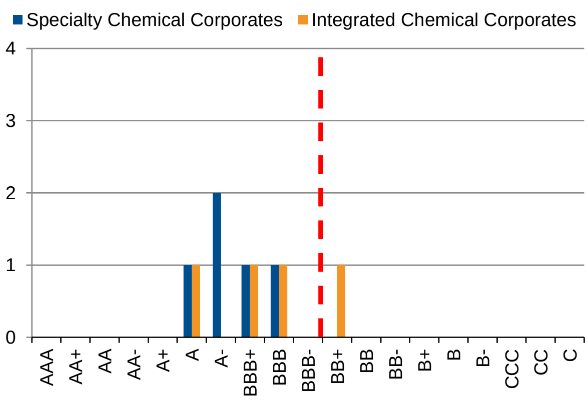
Our December 2019 estimate for 2020 economic growth was around 3%, little changed from 2019 but down from 3.6% in 2018: see our Sovereign Outlook 2020. Another risk is a re-escalation of trade disputes between the US and its major trading partners, the EU and China.

Chemicals demand from some industrial sectors – among them automotive, mining and metals, and electrical equipment – is expected to remain weaker in 2020, compared to the previous year.

Stable credit outlook

The success that European chemicals companies have had in using the long cyclical upswing of the past 10 years to improve their credit profiles is visible in the solid credit quality of most of the companies we analyse. On the positive side, we believe European-based players will remain cautious on M&A, capital expenditure, dividends and share buybacks compared to their US-based competitors.

Figure 1: Distribution of credit ratings among chemicals companies analysed by Scope



Source: Scope Ratings

Annex I: Related research

"China: coronavirus outbreak's longer-term policy side-effects more important than direct GDP impact", published Jan 2020 available here

"Sovereign Outlook 2020: slow growth, political uncertainty, rising debt add pressure on policymakers", published Dec 2019 available here

"Europe's specialty chemical firms find that cash is king as cyclical downturn threatens", published Dec 2019 available here

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