2021 Chemicals Outlook

Credit outlook remains stable. Amid improving economic visibility and disciplined capital allocation, the deterioration of credit profiles in 2020 can be classified as a temporary event.

Chemicals, Scope Ratings GmbH, 18 January 2021

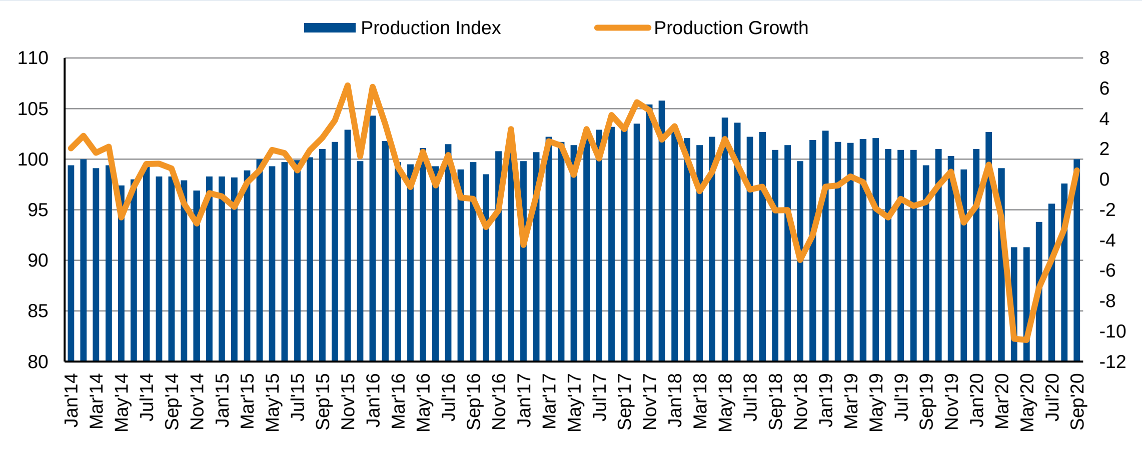
Executive summary

The credit outlook for the European chemicals industry remains stable. After the recovery in Q3 2020 and the typically seasonally weak Q4, we expect the underlying recovery from mid-2020 to continue this year. However, we do not expect earnings of some companies to return to levels recorded in 2018 before next year.

The main trends we expect for 2021 are:

- Producers of commodity-like chemicals benefit first from the economic recovery as bulk product producers are positioned at the beginning of the value chain, profiting from catch-up demand from the rest of industry.
- Trading conditions and growth expectations for specialty chemicals suppliers depend on the mix of end-markets and how well they recover. For instance, producers serving the automotive, aviation, and oil and gas industry are set to be the early beneficiaries of the economic rebound.
- Prices for petrochemicals and bulk chemicals will remain higher than in 2020 on the back of higher crude oil prices. Specialty chemical companies will pass through raw material price increases to customers.
- Debt capital markets should remain receptive to those issuers that refinance existing debt or raise funds for M&A.
- Prudent financial policies in the chemicals industry will continue in 2021.
- With improving economic and business visibility, M&A will remain part of companies' strategic playbook as management seeks to optimise product portfolios and strengthen market positions.
- The industry will continue to focus on addressing the sustainability of its activities, but ESG factors will have an insignificant impact on financial performance and creditworthiness in the short-term.
- Against the background improving economic visibility and disciplined capital allocation, the deterioration of credit profiles in 2020 will prove temporary.

Figure 1: Production index and production % change of the European chemistry industry



Source: Cefic, Scope Ratings

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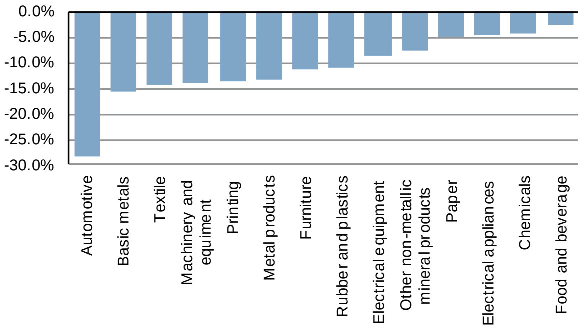
Key trends for 2021

The chemicals sector will benefit from fiscal stimulus worldwide this year in addition to the catch-up in demand after the pandemic-related disruptions of last year, with Asia, and especially China, leading the recovery.

We expect integrated chemicals producers to perform better than pure downstream chemicals players. Demand for end-products that require input from integrated chemicals should benefit from the cyclical upturn early just as they were the first the feel the impact of the Covid-19 crisis and fall in oil prices last year. Higher oil prices have led to rises in prices for petrochemicals and bulk chemicals will remain a relatively elevated levels this year compared with 2020. In this environment, we expect specialty chemicals suppliers to be able to pass on the higher raw material prices to customers.

As the specialty chemicals industry varies widely by application and end-market, the outlook for individual companies varies considerably, dependent on each one's business mix. In view of the near collapse of demand in the automotive, aviation and oil and gas industry in 2020, we see specialty chemicals players serving customers in those markets to be the early beneficiaries of an economic rebound. To cite a few examples, composite materials are heavily used in manufacturing of cars and planes, while the production of fuels requires several additives. Specialty chemicals producers of food additives and ingredients are likely to benefit from solid demand given the resilience of this part of the retail sector in the face of pandemic-related restrictions.

Figure 2: Manufacturing output: January – September 2020

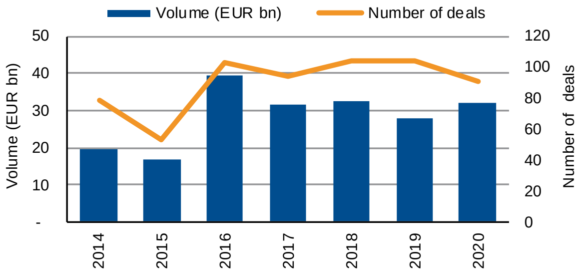


Source: Cefic, Scope Ratings

Favourable conditions for tapping capital markets

Investor appetite for debt issued by chemical companies in 2020 was healthy as central banks loosened monetary policy in face of the pandemic-induced recession. As shown in **Figure 3**, chemicals companies were big issuers of corporate debt in 2020 – the volume of overall deals rose – though the average size of individual issues fell.

Figure 3: Chemical sector corporate bond issues by volume and number of transactions



Source: Bloomberg, Scope Ratings

We expect total bond issuance to roughly comparable this year to that of 2019 and 2020 given the commitment to accommodative monetary policy by the European Central Bank and other central banks in tandem with improving economic perspectives and visibility. Chemical companies in Europe have around EUR 40bn in bonds coming due this year. Many companies may follow the lead of BASF SE, which successfully placed an EUR 1bn green bond last year, as did Arkema SA, with a EUR 300m issue.

Timely refinancing is likely accompanied by continuing M&A activity in line with trends of recent years. Integrated chemicals suppliers have bolted on businesses with high pricing power. Various specialty chemicals companies have reinforced their market position in the core activities or use acquisitions to change the end-markets they serve. We would expect to see deals similar to Arkema's divestment of its PMMA arm to Trinseo SA for EUR 1.1bn or PPG Industries Inc.'s offer to acquire Tikkurila Oyj for about EUR 1.1bn which were both announced in December 2020.

That said, we see few incentives for leadership teams to switch to more aggressive M&A or financial policies, from the conservative approach of recent times. Most currently investment-grade rated chemical companies are committed to maintaining credit ratings in investment-grade territory, so the likelihood of large debt-financed deals appears limited. Deals that are done are likely to follow the recent trend in which management chooses a mix of funding: debt, hybrid debt, equity and cash. For instance, last October, Covestro AG issued EUR 447m in shares to finance part of its around EUR 1.6bn acquisition of DSM NV's resins and functional material division, with the remaining amount financed with cash of around EUR 550m and debt of up to EUR 600m.

We see no change in the policy toward share buy-backs – disciplined use in Europe - and dividends, moderately raised in recent years.

Environmental, social, governance factors in focus

ESG-related topics continue to gain importance for share- and stakeholders, though we believe growing corporate emphasis on sustainability will have an insignificant adverse impact on financials and creditworthiness in the short term. Further reducing

CO2 emissions in tandem with improvements in the efficiency of energy and water use will remain on the agenda. Decisions on maintenance and growth capex will incorporate environmental features. A wide-ranging ban of certain single-use plastics products or an obligation to share the burden of waste management – subjects under continuing discussion – would be potentially negative for integrated chemicals companies credit quality though the impact would be modest.

Europe-based, IBoxx Main chemicals firm: snapshot

Our view of European-domiciled chemical companies is mostly the same as outlined in our previous publication (**European chemicals outlook: tough H1, bumpy H2 ahead, 2021 uncertain**). We now estimate a slight deterioration of Covestro's credit profile following the deal with DSM. The credit quality of DSM is expected to strengthen as the overwhelming amount of sales proceeds are likely to be parked on DSM's balance sheet. Sustainably higher oil prices may motivate BASF to float its oil and gas division Wintershall Dea GmbH and book the proceeds from the initial public offering.

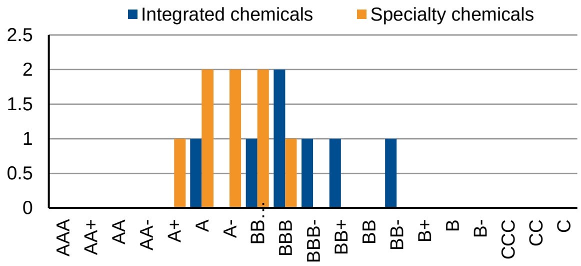
Figure 4: Europe-based chemical companies credit prospects (IBoxx Main components)

Company	Indication of development credit profile in 2021
Air Liquide	▲
Akzo Nobel	▲
Arkema	▶
BASF	▶
Covestro	▼
DSM	▶
Evonik Industries	▶
Lanxess	▲
Linde	▲
Sika	▲
Solvay	▶
Syngenta	▶

Source: Scope Ratings

The majority of chemicals companies in our rating coverage are investment grade, with a stable outlook. The main reasons for this: i) only a temporary deterioration of credit profiles in 2020 as economic visibility improves; ii) disciplined capital allocation, and iii) prevailing moderate levels of leverage and high cash balances (see: **Europe's streamlined specialty chemicals companies braced for tougher times ahead**). For example, Lanxess AG (BBB+/Stable) recorded cash and cash equivalents of roughly EUR 1.7bn versus financial debt of up to EUR 2.9bn at 30 September 2020. This should enable companies to comfortably repay maturing liabilities, while retaining significant financial buffers should the post-pandemic recovery falter or turn out to be slower than expected.

Figure 5: Rating distribution



Source: Scope Ratings

Risk factors

There are several risks to our stable outlook for the credit quality of the chemicals sector in 2021:

Figure 6: Identified risk factors 2021

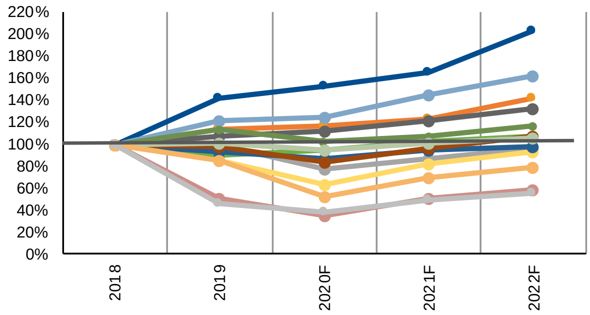
Risk	Scope of potential effects on the industry and credit quality
Dollar weakness	Moderate
Falling oil prices	Medium
Further commodisation or more intense competition in selected specialty chemicals markets	Medium
Collapse/ sluggish demand in main end-markets	High

Source: Scope Ratings

Credit outlook is stable

The credit outlook for European chemical industry for 2021 remains stable, unchanged from recent years. The Covid-19 pandemic has left its mark on financials, margins, and business conditions in 2020, our view of improving prospects for 2021 and beyond combined with prudent capital allocation policies should prevent a deterioration of credit profiles in the sector. However, we do not expect earnings of many chemical companies to regain levels recorded in 2018 before 2022.

Figure 7: Reported and estimated earnings (EBITDA) versus reported EBITDA in 2018 of integrated and specialty chemicals companies in our rating coverage and Europe-based chemicals companies in the IBoxx Main[1] index.



Source: Company data, Scope Ratings

[1] Figures unadjusted for acquisitions and offloaded assets

Annex II: Related research

“Creditors, taxpayers ride to rescue in 2020: Will shareholders provide credit relief in 2021?”, published Dec 2020 available here

“Sovereign Outlook 2021: global growth recovers amid high debt; changing fiscal, monetary frameworks”, published Dec 2020, available here

“European chemicals outlook: tough H1, bumpy H2 ahead, 2021 uncertain”, published Aug 2020, available here

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