Broad-based recovery in end markets creates potential for more sustained chemical earnings and for lower end-market concentration risks.

Pandemic-related supply constraints should continue, perhaps for longer than we initially anticipated.

Inflationary pressures, in particular around raw material costs, transport/freight, and personnel/labor, will become an important credit factor.

Macroeconomic stability, in the absence of pandemic-related, geopolitical, or other demand shocks, and ongoing access to global and regional capital markets, support our stable outlook and offset some of the sector-level credit risks.

Ability to pass on most cost pressures generally, and particularly around petrochemicals and fertilizers, should support margins.

Neutral or supportive financial policy, especially around shareholder rewards or mergers and acquisitions, should support current credit metrics.

Demand shock. Strong demand growth in recent years and a diversity of end markets have supported credit quality and offset risks related to supply chain, inflation, and other disruptions. A sustained stagnation in, or reversal of, this growth will weaken the sector’s credit metrics relative to expectations.

Decline in pricing power would reduce the sector’s ability to maintain margins in the face of rising costs.

Uncertainty caused by inflation. Chemical markets have functioned for over a decade mostly in the absence of meaningful global cost inflation, and with a gradually improving global supply chain. This year could derail these trends.
Ratings trends and outlook

Global Chemicals

Chart 1
Ratings distribution

Chart 2
Ratings distribution by region

Chart 3
Ratings outlooks

Chart 4
Ratings outlooks by region

Chart 5
Ratings outlook net bias

Chart 6
Ratings net outlook bias by region

Source: S&P Global Ratings. Ratings data measured at quarter end.
Chemicals

Ratings trends and outlook
We expect ratings will stabilize in 2022 following a year of recovery from the recessionary conditions of 2020. Despite some credit challenges, we believe companies will by and large benefit from steady demand and macroeconomic conditions. Reflecting these assumptions, over 80% of outlooks are currently stable.

Main assumptions about 2022 and beyond

1. Stable fundamentals
Strength in demand--even for some cyclical commodity chemicals--underpins our near-term view on the sector. While we expect supply to improve gradually, especially in the second half, we don't expect an oversupply situation for most chemicals. The resulting favorable supply-demand outlook for most chemicals should support credit quality. Specialty chemical producers, including some paints and coatings producers that experienced unusual weakness in demand last year, should experience more stable demand. In some commodity chemicals, where the supply-demand balance is usually more volatile than at specialty chemicals, supply could increase but not to an extent that creates excess supply.

2. Chemical companies by and large pass on inflationary cost pressures
For both specialty and commodity chemicals, input costs are likely to rise. Specialty chemical producers typically tend to find it easier to pass on cost increases relative to commodity producers. However, this year we expect many commodity producers will also benefit from favorable demand and pass on most of these cost increases. There will be exceptions, especially at lower-rated companies and at companies with relative weaknesses in market positions, but we also expect some instances of margin expansion, in subsectors such as fertilizers, which could benefit from exceptionally favorable market conditions.

Credit metrics and financial policy
Credit metrics of chemical companies will stabilize in 2022, following a recovery in end market demand. While there will be differences by region or subsector, on balance, we expect a relatively comfortable median leverage in our global chemical portfolio of just above 3.0x on an adjusted basis.

Strong balance sheets and healthy cash positions after a robust 2021 raise the risk of a shift to more-aggressive financial policies, such as those that would deploy the accumulated capital for mergers and acquisitions (M&A) or shareholder distributions. Most of the acquisitions will probably support our view of business profiles, leading to potential strengthening of market positions, diversification of geographical presence, and the opportunity for growth. Nevertheless, these investments will be made against a still-uncertain market environment, with mounting inflationary pressures, supply chain disruptions, and the COVID-19 pandemic that has not quite run its course. Notwithstanding our assumption of ongoing healthy cash flows in 2022, the return to aggressive financial policies may set back balance sheet improvements attained in 2021.
Key risks or opportunities around the baseline

1. Unexpected softening in chemical demand
   The unlikely delinking of chemical demand from our anticipated positive global GDP growth, or a downturn in global GDP, could undermine our assumption for steady demand growth at a time of rising input costs. This would almost certainly weaken earnings and credit metrics across the board. Companies have varying levels of cushion under credit metrics at their current ratings, but generally speaking lower-rated companies have less ability to withstand shocks of this nature. In such a situation, downgrades could increase, especially at lower-rated companies.

2. Pricing power at chemical companies weakens
   Chemical companies, especially commodity producers that typically have less pricing power than specialty producers, typically depend on favorable market conditions, in addition to their market position, to retain pricing power. Not all chemical companies have customer contracts with built-in cost pass-through mechanisms. A loss of pricing power at a time of cost inflation could pressure margins more than we anticipate. This risk may be heightened in developing regions such as Brazil or Argentina, which have a history of extraordinary levels of inflation.

3. Rising inflation throws up unfamiliar challenges
   The chemical sector has not seen broad-based cost inflation in a while, and could face demand pressures if customers switch to lower-cost alternate products, or simply hold off on chemical purchases where feasible. These risks increase if inflation remains a factor for longer than a year, raising the odds that continuously rising prices weaken demand. Even for chemicals that are not entirely substitutable, demand could decline in a high-cost environment. For example, some paints and coating manufacturers have revised their product formulations to reduce the cost of a key input, such as titanium dioxide, during previous periods of high input prices.

Steady or rising demand for a varied range of chemicals, from a diverse range of end markets, should shore up credit metrics this year. However, the extent and duration of the stability—or strengthening—of these metrics at individual companies is uncertain. In our base case, sector average or median leverage metrics (such as debt to EBITDA and funds from operations to debt) are stable through the end of 2023, even as EBITDA margin declines slightly. Sector level numbers don’t necessarily reveal company-specific risks. The sector risks, including a potential softening in chemical demand/pricing power and rising inflation, will impact individual companies in different ways, and will hurt more, generally, at low-rated or more financially aggressive companies.

Even at the sector level, the generally stable conditions over the next 12 months are the product of unusual circumstances that won’t last forever. At some point, chemical end markets will no longer be in recovery mode from an increasingly distant 2020 recession, while supply issues will likely sort themselves out, benefitting some companies but perhaps setting the stage for a less favorable supply-demand balance for others. These changes will undoubtedly bring on new challenges, but for now, a more entrenched and widespread recovery benefits credit quality at most chemical companies.
Industry forecasts

Global Chemicals

Chart 7
Revenue growth (local currency)

Chart 8
EBITDA margin (adjusted)

Chart 9
Debt / EBITDA (median, adjusted)

Chart 10
FFO / Debt (median, adjusted)

Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.
Cash, debt and returns

Global Chemicals

Chart 11
Cash flow and primary uses

Chart 12
Return on capital employed

Chart 13
Fixed versus variable rate exposure

Chart 14
Long term debt term structure

Chart 15
Cash and equivalents / Total assets

Chart 16
Total debt / Total assets

Source: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2021) figures are using last 12 months (LTM) data.