Sunny outlook for chemical financing

The chemical industry's debt and equity markets are poised to perform well in 2013, especially if global economic growth revives

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Last year was a positive one for the chemical industry in terms of its stock market performance and its ability to raise debt. Both achieved stellar performances that could be repeated in 2013 if there are no major economic/financial disruptions.

Only chemical industry equity financing was tepid, a chronic outcome for the industry. This weak performance was also true for chemical company initial public offerings (IPOs). Although there was a doubling of the number of IPOs in 2012 versus 2011 to six from three, the numbers were still small and quite modest in dollar terms.

STOCK MARKET

The history of the relationship of the stock market to the chemical industry has always been a difficult one, with the industry severely undervalued for perhaps seven out of every 10 years, and overvalued in the remaining 3 years.

In 2012, the overall stock market did well, with the S&P 500 increasing by 12% and the FTSE Euro Top 100 by 8%. But the chemical industry did even better, with strong relative and absolute performance.

Five of the seven Young & Partners Chemical Indices outperformed the S&P 500 index and all seven outperformed the FT Top 100 index.

The Young & Partners US Basic Chemicals index increased by 31%, the US Specialties index by 36%, the US Diversified index by 20%, and the US/Canadian Fertilizer index by 11%. The performance in Europe was similar. The Young & Partners European Basic Chemicals index increased 16%, the European Diversified index by 33% and the European Specialties index by 9%.

As a result, chemical industry stock market valuations went from generally equal to the market to a clear premium. This was driven by disappearing market fears that the cyclical industries, such as chemicals, would suffer in a severe economic downturn. This led to a celebration of the strength of their earnings and cash flows in a stable, but weak global economy.

High-yield debt issuance will continue to be volatile, but relatively strong in the US and more depressed in Europe

The stock market has been modestly favoring the chemical industry due to the industry's strong earnings fundamentals and restrained capacity increases.

Although the chemical industry is currently trading at a premium to the general market, it is unclear where the industry valuation will be heading, given the overall uncertainty in the economic and financial markets.

Should global economic growth revive, we would expect chemicals to outperform the market. However, in an era of sluggish or no growth, the industry is likely to trade at a discount to the market.

NON-BANK DEBT SURGES

There was a major increase in chemical industry debt financings in 2012. Global non-bank debt financing was strong, with $33.8bn (€24.9bn) issued in 2012 versus $13.9bn in 2011.

Part, but not a majority of the increase, was in investment-grade debt. Investment grade debt totalled $17.9bn in 2012 compared with $10.8bn in 2011.

Investment-grade companies, where prudent, took advantage of low interest rates to refinance and to finance acquisitions. Investors flocked to these debt issues in search of higher yields attached to strong corporate credits. The increase would have been greater except for the fact that issuers did not have a need for more debt.

High-yield debt issuance also revived dramatically, with $15.8bn issued in 2012. This compares to $3.0bn issued in all of 2011 when the high yield market nearly shut down. The dramatic and negative economic and financial events starting in August 2011, particularly in Europe, caused the debt markets to deteriorate significantly.

Through the fall of 2011 there was the near shutdown of the high-yield issuance market (particularly in Europe) with major high-yield mutual fund cash outflows and a flight to safety by investors.

But as the crisis in Europe partially eased

Rex Features

and the potential for a major meltdown in the eurozone diminished, the high-yield market came back with a vengeance.

Investment-grade debt volume will be driven by issuer demand as opposed to investor demand, which we expect to stay strong. M&A related financing will drive volume.

High-yield debt issuance will continue to be volatile, but relatively strong in the US and more depressed in Europe due to the sovereign deficit and debt problems in the eurozone.

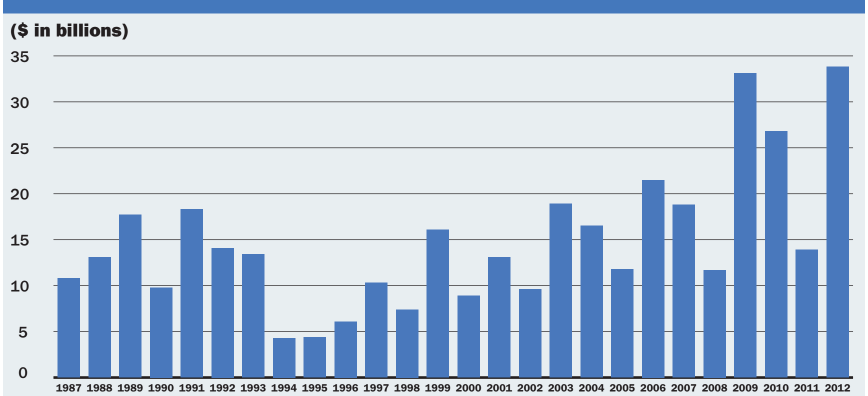
EQUITY FINANCING

Global chemical equity issuance has historically been very modest each year. Last year, with strong cash flows, excess cash, access to low cost debt financing, and no large mergers and acquisitions (M&A) deals requiring subsequent balance sheet adjustments through the issuance of equity, the chemical industry's need for public equity was limited.

However, it is also true that the equity markets have not been in love with the chemical industry. Even when valuations have been strong, interest in chemical industry new equity has been much weaker than for many industries.

In 2012, only $6.2bn of equity was issued as a result of 17 offerings by chemical companies – very modest numbers. This compares with $11.6bn issued in 2011 from 19 offerings. This is particularly modest considering the strong equity stock price performance of chemicals in 2012. Six of the offerings in 2012 were IPOs.

CHEMICAL NON-BANK DEBT FINANCING



SOURCE: Young & Partners

It did not help that in 2012 there was a perception of heightened market risk, dramatic volatility in the equity markets, and a general weakness in equity issuance activity market wide, particularly with regard to IPOs. As a result, equity offerings for all industries were challenging.

Of the fairly small number of chemical IPOs that have been completed in the past five years (12 in total), almost all have been either fertilizer/agricultural chemicals or emerging markets companies. The only exceptions were US-based companies Kraton, PetroLogistics and U.S. Silica, and Norway-based Borregaard.

In 2012, the six IPOs were for U.S. Silica, Mexico's Alpek, Taiwan's Rotam Global AgroSciences, PetroLogistics, Philippines-based D&L Industries and Borregaard, ranging from $41m-595m and totalling $1.6bn.

Of those, Alpek, D&L Industries and Rotam Global AgroSciences fit the emerging market or fertilizer/agricultural chemical themes.

Although a number of chemical companies significantly larger in size tested the IPO market, none succeeded in 2012.

Equity financing volume will likely continue to be modest given the market's historic bias against the chemical sector, the chemical sector's limited need for equity capital, and the weak general IPO market. ■

Peter Young, president and managing director of international investment banking firm Young & Partners, has more than 26 years of experience in chemicals and life science M&A.