Financing turns from hot to cold

The turmoil in worldwide financial markets is putting a damper on chemical debt financing. Also, the IPO market is stalling on weakness in the equity market

Rex Features

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So far, 2011 has been very positive for the chemical industry in earnings and cash flows. With the exception of the initial public offering (IPO) market, the chemical industry stock market performance and debt and equity financing markets were positive through the first half. Unfortunately, with the turmoil and uncertainty on the economic and financial fronts that escalated in early August, chemical stock prices and equity and debt financing conditions turned decidedly negative.

STOCK MARKET

The chemical industry as a whole performed well in the first half of 2011, both on an absolute and a relative basis, compared with the general market. This was a continuation of their strong performance in 2010.

As a result, by the end of the first half of 2011, the chemical industry as a whole was trading at a modest premium to the US benchmark S&P 500 on a price/earnings (P/E) basis, with only European Diversified Chemicals underperforming the general market index.

With the onslaught of negative economic and financial events… investor demand has collapsed and the… debt markets have retreated

Much of the increase in stock market values for the equity market as a whole was driven by macroeconomic factors, flows of funds and the lack of attractive investment alternatives for investors.

Until very recently, the market favored basic industries such as chemicals and the strong earnings and cash flows of chemical companies. Chemical firms well positioned in emerging markets were also in favor. Stock market events since the end of the first half have been dramatic. Jolted by the escalating economic and financial crisis in Europe, the US debt-ceiling debacle and Standard & Poor's downgrade of its sovereign debt – added to the alarming slowdown in Western economic growth – the stock market has suffered volatility and a drop in valuations.

This was particularly true for the chemical industry as its cyclical industry halo has now gone from a halo to a curse. As a result, chemical industry stock market prices and valuations have gone from a modest premium to a clear discount to the market.

NON-BANK DEBT ISSUANCE FALLS

A slowdown in chemical industry debt financings was noticeable in the first half of 2011. Global non-bank debt financing was only $5.8bn (€4.2bn) versus $11.2bn in the first half of 2010 and $26.7bn for all of 2010. Investment-grade debt totalled $3.7bn during the first half of 2011, compared with $2.6bn during the first half of 2010 and $12.6bn for all of 2010.

High yield debt issuance was only $2.1bn during the first half of 2011, compared with $8.7bn in the year-ago period and $14.1bn for all of 2010. Why the slowdown in the first half? Although the debt markets continued to be very strong, there was a dramatic reduction in issuer demand for debt capital.

However, with the onslaught of negative economic and financial events in early August, investor demand has collapsed and the high yield, bank and non-bank debt markets have retreated.

EQUITY FINANCING

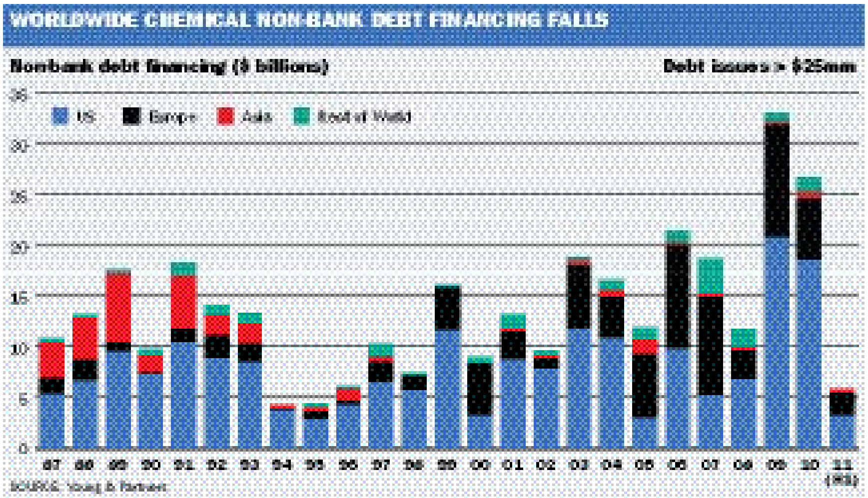
Global chemical equity issuance in dollars has historically been very modest each year because of low chemical company valuations and the limited equity financing needs of chemical companies.

In the first half of 2011, $9.5bn of equity was issued by the chemical industry. Although this number is small relative to M&A dollar volumes, it was the busiest six-month period in the chemical industry since Young & Partners began tracking the data in 1986.

In spite of this record volume, only one chemical company IPO was completed during the first half of 2011 – that of US-based fertilizer producer CVR Partners.

Most of the equity issuance involved the sale of shares by existing shareholders, with the sale of US fertilizer firm Mosaic shares by US agribusiness Cargill being a dominant portion of the equity financing dollar total.

The dramatic volatility and pullback from the equity markets since the beginning of August have made equity offerings and, in particular, IPOs very challenging to execute. Very



few equity offerings are moving forward. Equity financing volume will likely be modest given the market's historic bias against the chemical sector, the sector's limited need for equity capital and a weak IPO market for chemicals. Although the equity financing market for many non-chemical sectors started to show some revival in the first half, conditions have turned decidedly dark since the beginning of August with volatility and great uncertainty in the equity markets.

Numerous chemical companies filed IPO registrations to either sell equity or to use as leverage in an M&A sale process. The stalled IPO market will make these plans difficult. Except for unique emerging market situations, chemical equity financings will be modest given the poor condition of the equity markets, the negative bias towards the chemical industry, and the chemical industry's limited need for equity capital, unless there is a major change in the equity markets.

Debt financing volume will be driven heavily by issuer demand as opposed to investor demand. That has been the reason for the lower volumes recently. M&A-related financing will drive volume. However, the serious disruption of the debt financing markets since early August is likely to continue for some time. Financial problems in the eurozone, worries about the US and European economies and high levels of government debt, plus the loss of confidence in the tools and policies available to western governments has created fear in the debt markets and a flight from risk.

It is our hope that market demand for chemical company debt will recover after this recent period of weakness and volatility, but much depends on how a number of major economic and financial factors develop. ■

Peter Young is president of New York-based investment bank Young & Partners with over 25 years of experience. The firm serves the M&A, restructuring and financing needs of chemical companies on a global basis.