Chemical financing market remains open

Author: Peter Young, President, Young & Partners
March 15, 2011
ICIS Chemical Business Magazine

Nonbank debt issuance continued at strong levels in 2010, although down from a record 2009, while equity financing needs remained modest

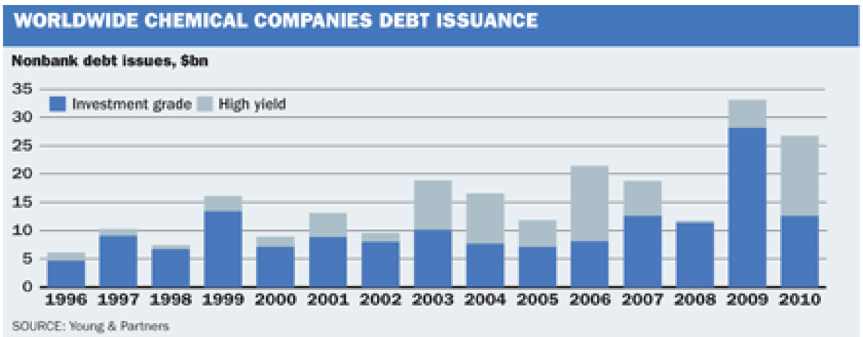
Last year was a very positive one for the chemical industry on the earnings and debt-financing sides, but decidedly mixed on the equity front. We expect the mixed news to continue for equity issuance and the good news to continue on the debt side, as long as there is no financial or economic disruption.

As chemical earnings continued to be robust, bond investors sought safe places to invest with any kind of yield, moving first into investment-grade debt, and then into high-yield debt. Banks also continued to lend for working capital, expansion and acquisition needs of chemical companies.

The equity side has been more of a roller-coaster. Although chemical company stock prices outperformed the overall market and have generally reached parity with the general market indices, equity financing continues to be weak. There was only one **initial public offering (IPO)** in chemicals in 2008 and 2009, and 2010 was no different with only one IPO.

NONBANK DEBT ISSUANCE SURGES

Global nonbank debt financing in 2010 was $26.7bn (€19.5bn) versus $33.1bn in 2009. Although debt financing volume was down nearly 20% in 2010, it was still the second-most active year historically for the chemical sector.



Although the debt capital markets were available to investment-grade rated companies throughout the year, volume in the investment-grade sector fell, as many companies already had completed their refinancing needs in 2009.

High-yield debt issuance was $14.1bn in 2010 - just over 50% of the year's total debt issuance, and almost three times the high-yield issuance volume for 2009.

Interest rates are exceptionally low and investor demand has been high as investors chase yields. In addition, covenants on all nonbank debt have been increasingly generous to borrowers, reminiscent of the 2006 and 2007 borrowing environment. This raises the obvious concern that we are creating another credit bubble. However, the total amount of leverage allowed is still more conservative today.

BANK LENDING EASES

Banks have been lending given the strong financial performance of chemical companies in a fragile, but growing global economy. With lots of liquidity and access to low-cost capital, incentives on the part of banks to lend are there. Also, banks have always favored the chemical industry because of its strong cash flows.

However, like the nonbank debt market, banks are still being cautious about the amount of leverage they are allowing.

EQUITY FINANCING

Global chemical equity issuance in dollars historically has been very modest each year due to low chemical company valuations and the limited equity finance needs of chemical companies. This has been compounded by a difficult general equity issuance market.

In 2010, chemical equity issuance rose to $7.8bn, from $3.2bn in 2009. However, this total is still modest when compared to the size of the industry and the debt, mergers and acquisitions market volumes.

High-yield debt issuance was almost three times the high-yield issuance volume for 2009

There were attempts to do IPOs in 2010, but only one was completed - that of Malaysia's **Petronas Chemicals**. The company's $4.1bn IPO was heavily oversubscribed. This IPO was an emerging markets growth play, and at the same time, an offering by a large company with a robust earnings outlook.

Unless the general IPO market becomes stronger, we do not believe enthusiasm for this IPO will carry over to chemical companies that do not have the emerging markets theme or that are smaller in size.

WHAT WILL THE FUTURE BRING?

For chemical companies seeking debt financing either to refinance or to finance acquisitions, the future looks bright as long as there are no severe economic or financial disruptions.

However, because of the ongoing political crisis in the Middle East, the possibility of disruptions related to sovereign debt problems around the world and the threat of inflation and escalating oil prices, the possibility of severe disruptions has certainly increased.

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 industry's limited need for equity capital. This will hold unless there is a major change in the equity markets.

*Peter Young is president of New York, US-based investment banking firm **Young & Partners**, and has more than 25 years of experience in chemical and life science finance. Young & Partners has a front-line understanding of chemical industry financial trends.*

Author: Peter Young