The chemical financing market remains choppy, despite improvements

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The chemical financing markets will continue to be choppy, but expect more debt issuance ahead. Initial public offerings will be difficult

Gareth JJ Burgess

Having ridden through the depths of the economic and financial crisis in late 2008 and all of 2009, the chemical industry entered 2010 looking forward to more stability and a clear path to normality.

Although the global economy is clearly in better shape, and many parts of the financing system are now functioning and there are fewer financially stressed chemical companies, to say that we have entered calm waters would be inappropriate.

The industry could be facing an economic and financial roller coaster of highs and lows and an uncertain future.

Although much has improved economically and financially, there is a distinct fear that the current recovery will be anemic in the West and that any number of forces could materially turn negative: a slowing of the US, Chinese and European economies; the end of government stimulus programs; escalation of the European sovereign debt problem; the looming commercial real estate loan defaults; and the Chinese real estate and bank lending bubble.

It is almost certain that at least a number of these forces will hit. If so, the equity and debt financing system will inevitably suffer setbacks. But where are we today?

STOCK MARKET PERFORMANCE
After a reasonable first quarter (Q1), the performance of the **Young & Partners** chemical indexes was poor in Q2, along with the overall stock market. Even though earnings have been up, stock prices have gone down and compressed the chemical stock price multiples to general

market levels. This has clearly affected the valuations of chemical companies and their ability to get attractive equity financing when they need and want it.

NONBANK DEBT SURGES
Global nonbank debt financing in the first half of 2010 was $11.3bn (€8.9bn) compared with $33.1bn for the whole of 2009. Although the annualized rate of $22.6bn is slower than last year, it is a strong showing for the industry.

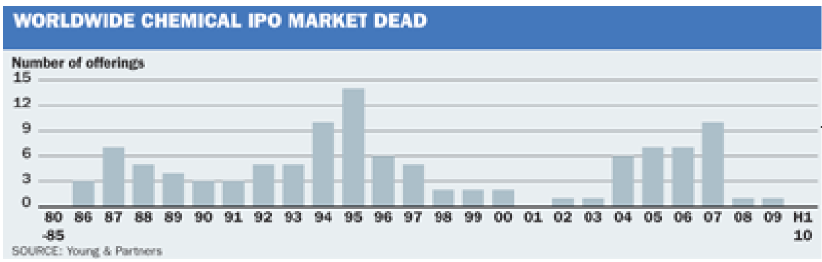
One key difference compared with last year was a shift to high-yield, versus investment-grade debt. High-yield debt issuance was $8.7bn of the $11.3bn total debt issuance. This was more than the high-yield issuance for all of 2009, which was $4.9bn.

This is a reflection of high demand for yield by the market. The only reason why investment-grade debt issuance fell was because issuer demand went down as the investment-grade companies completed most of their refinancing needs in 2009. On the other hand, investment-grade companies such as US-based industrial gases firms **Praxair** and Airgas, US specialty chemical firm **Solutia**, Austria-headquartered chemical major **Borealis**, and Chilean chemical and fertilizer giant SQM did tap the nonbank debt markets in the first half.

What has been driving the high-yield issuance surge? On the demand side, investors who cannot live with the meager returns of treasuries, went searching for yield and decided to accept some additional risk. On the high-yield issuer side, we are seeing a mixture of private equity deals, merger and acquisition (M&A) financings, and debt restructuring by companies who went through bankruptcy or financial stress in 2009.

US fertilizer firm CF Industries issued $1.6bn of high-yield debt to finance its acquisition of Terra Industries. Netherlands-based chemical major **LyondellBasell Industries** and Swiss-headquartered INEOS raised a combined $4.8bn as part of their emergence from financial stress or bankruptcy. US-based **Hexion** Specialty Chemicals issued $1.0bn as part of its balance sheet restructuring. A number of these companies would have or did face difficulty issuing last year.

BANK LENDING TIGHT
Curiously, although nonbank debt issuance surged in 2009 and was healthy during the first half of 2010, bank lending has been more difficult to obtain as banks continue to be reluctant to lend.



The banks are facing their worries with commercial real estate and sovereign loans on their balance sheets, and economic/financial uncertainties. As a result, banks are lending, but very cautiously, as they try to keep their powder dry.

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 companies. There were no public equity offerings completed globally during Q1 and only $1.4bn in Q2. These are very paltry numbers. There have been a number of attempts to do initial public offerings (IPOs), but none have succeeded in the first half, including **failed attempts by Belgium-based amines company Taminco** and Russian fertilizer giant **Uralchem**.

Other companies are still trying, such as US-based Arizona Chemical, but have yet to be successful. This situation is a product of a very difficult overall IPO issuance market and the equity market's unwillingness to allow chemical IPOs, except in narrow circumstances.

WHAT WILL THE FUTURE BRING?

We expect continued strength in the nonbank-debt financing markets in 2010, as long as the global economic and financial trends continue to improve. But investment-grade chemical companies' need to borrow will be limited, except where there is M&A financing need. Banks will continue to hold back from lending. With the pick-up in M&A and the return of the financial buyers, there should be a fair amount of M&A-driven debt financings using bank and nonbank debt.

With weak valuations and a difficult equity market, chemical industry equity issuance will remain sparse until a stronger economic recovery is underway, the equity issuance markets improve, chemical equity valuations are stronger, and there is a pick-up of M&A deals that require some form of equity financing. Some of these same factors will also continue to inhibit IPOs of chemical companies.

The key question is whether there are major disruptions in portions of the global economy or a surge in stress on the financial system.

We believe the most likely scenario is that only a few of the potential problems listed earlier will hit and that there will be some uncomfortable moments on the economic and financial roller coaster.

Although this will be stressful, most chemical companies will make it through this period in a reasonable fashion.