The chemical industry financing market is on its way to recovery

Is the financing crisis over?

25 May 2010 21:19   Source: ICIS Chemical Business

Author: Peter Young, President, Young & Partners (Chemicals and Life Sciences Investment Bank)

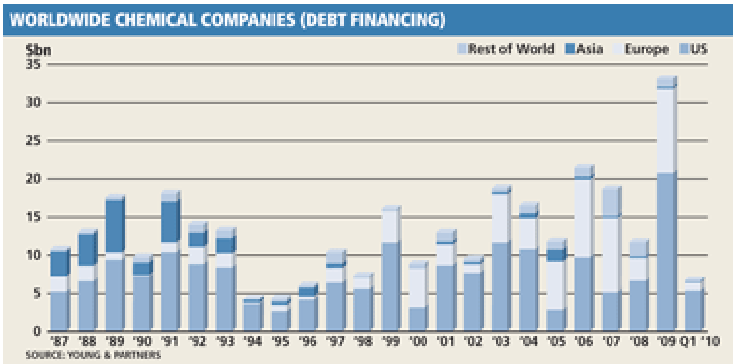
After the turmoil of the financial and economic crisis of 2008-2009, what's next for the chemical market?

THE FINANCIAL crisis that started in the fall of 2008 had a gripping and negative effect on the availability of equity and debt financing for the global chemical industry. But is the crisis over, and how much better off are we today?

When the global recession hit in 2008, credit became virtually unavailable on all fronts as lenders and fixed-income investors either could not or would not lend.

The lack of credit severely hindered the ability of many chemical companies to acquire businesses and to finance working capital. Equity was equally scarce as the equity markets froze under the glare of uncertainty and confusion.

A large number of chemical companies found themselves under financial stress due to various combinations of depressed earnings and cash flows, high levels of debt or debt service, or an inability to refinance maturing debt. A rash of bankruptcies ensued.

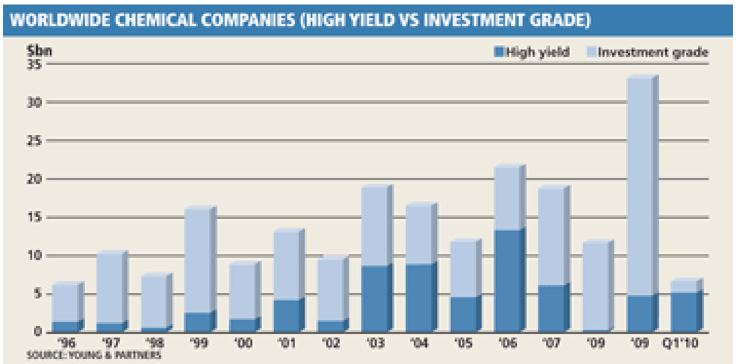


However, as a result of extensive government intervention around the world, many parts of the credit market started to work again in 2009.

NONBANK DEBT MARKET SURGES
Early on, the commercial paper market revived through government intervention. Then global nonbank debt financing in chemicals surged to $33.1bn (€25.8bn) in 2009, versus only $11.1bn in 2008 and reached $6.7bn in the first quarter (Q1) of 2010.

What drove this surge? After a period of time, investors could not live with the meager returns of treasuries, went searching for yield and decided to accept some additional risk.

As a result, the investment grade debt market surged to $28.7bn in 2009 from $11.4bn the previous year, heavily dominated by issuers such as US-based **Dow Chemical** and German chemical major **BASF**, which were refinancing acquisition-related debt.



In Q1, with most of the refinancing done, chemical investment-grade issuance slowed to $1.5bn. Issuers in Q1 included US-based industrial gases firms Airgas and **Praxair**. But with a large number of announced chemical deals by investment-grade chemical companies, it is likely that there will be a slug of investment-grade debt issued later this year to finance those deals.

High-yield debt issuance showed a moderate improvement in 2009, with $4.9bn issued versus $330m for all of 2008. This was an improvement, but still well off the high-yield issuance levels of $13.3bn in 2006 and $6.2bn in 2007.

However, in Q1 2010 the recovery escalated, with high-yield debt issuance of $5.2bn. UK-based petrochemical and plastics firm INEOS, US-based specialty chemical company **Hexion**, and Netherlands-based petrochemical and polymers major **LyondellBasell Industries** were the prominent issuers.

BANK DEBT ISSUANCE LESS ROBUST
Curiously, although nonbank debt issuance surged in 2009 and during Q1 of 2010, bank lending has been less robust as banks continue to be reluctant to lend.

With lots of commercial real estate loans and leveraged loans maturing or potentially defaulting, banks are holding back and trying to keep their powder dry.

EQUITY FINANCING
Equity financing was moribund in 2009 with most investors not willing or unable to purchase new shares. In chemicals, there were only nine public chemical equity offerings completed globally in 2009 for a total issuance amount of $3.2bn. This was about the same as the 13 public equity offerings worth $3.1bn issued in 2008, another depressed year.

Dow Chemical represented $1.9bn of the equity raised last year. Only one was an initial public offering (IPO) - US-based **Kraton Performance Polymers**, which was completed under difficult circumstances in Q4.

In Q1 of 2010, there were no public equity offerings completed globally.

Although there were a number of attempts to complete IPOs in Q1, none succeeded, including the failed attempt by Belgian amines producer **Taminco**. Since the end of Q1, there have been other IPOs filed, such as US-based **Arizona Chemical** and Russia's UralChem. UralChem, however, has postponed its offering.

FINANCING OUTLOOK

We expect continued improvement in the non-bank debt financing markets in 2010 as long as the global economic and financial trends continue to show improvement.

However, the need by investment-grade chemical firms to borrow will be limited, except where mergers and acquisition (M&A) related. Bank lending will continue to be sluggish as banks hold back.

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

CAVEATS

The major uncertainty, however, is whether the global economy or financial system will suffer another downturn or disruption.

The looming massive defaults that we see coming in the commercial real estate debt market and the sovereign debt problems that have been unfolding that will effect the financial system and the European economy are all significant areas of uncertainty.

A key concern, even in the context of the current predictions of an ongoing recovery, relates to how economies and financial systems handle the withdrawal of numerous simulative and financial support programs.

Any number of these factors could halt the improvements we have been seeing in the debt financing markets and the modest progress in the equity markets.

Peter Young is president of New York, US-based investment banking firm Young & Partners and has more than 20 years' experience in chemical and life science finance. The company has a front-line understanding of economic and financial trends.