
***ABCs OF BANKRUPTCIES
AND THEIR IMPACT ON
EMPLOYEES AND STOCK
HOLDERS – THE CONTEXT OF
PETROCHEMICALS AND
PLASTICS***

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INTRODUCTION

The most recent news item on potential bankruptcy filing of LyondellBasell along with other devastating news on the petrochemical front of most top 50 chemical companies laying off employees, cutting programs, shutting plants and pursuing other means of financing, necessitates a broader review of bankruptcy procedures and issues that could impact the employees and stockholders.

The goal of this article is to provide a general introduction to bankruptcies in the context of petrochemical industry and their impact on employees and stockholders – a subject normally not discussed.

CURRENT STATUS

Small and medium sized firms in petrochemicals and plastics commonly undergo bankruptcy proceedings related to cash flow due to various reasons. Since 2004 the petrochemical industry majors have switched to Stock-holder value enhancement as the primary benchmark of operations. The petrochemical industry had to take this drastic approach to survive the onslaught of IT/service firms for capital that provided much higher returns than

petrochemicals. The high capital intensity of petrochemicals and long term returns were no match to low to none capital with multiples of 100 percent expected returns.

The year 2008 provided the perfect storm to this situation with the Global financial crisis and recession.

The financial dealings reached just a year ago with the optimistic forecasts from emerging nations, combined with high oil prices made petrochemicals very profitable and encouraged credit extensions. The market meltdown of October 2008 essentially put a strain on the petrochemicals and made the deals from early 2008 non-viable. This made major organizations to move to situation where bankruptcy protection is an option.

The Petrochemical and plastics industry is by no means new to bankruptcies – but the increasing frequency and the increasing trends in larger companies filing for one, essentially impacts more employees and stockholders. The petrochemical industries in general can be divided into: (1) small/medium companies and (2) large companies. Small/medium companies are subject to early bankruptcy due to cash flow and lower asset values. The larger organizations in most situations can avoid the theoretical bankruptcy by filing for protection under re-organizations.

How Does Bankruptcy Work?

The capitalistic economy is based on entrepreneurship – a freedom to take a chance and enjoy the related benefits and/or associated losses. The system, in its simplest form creates extensive synergistic opportunities. Once the enterprise is successful, the costs of failure are high due to ripple effects. Hence the Keynesian economists had to

put a safety net in terms of bankruptcy protection system managed by the Government. The overall goal of the bankruptcy system is to prevent the spread of potential losses of an enterprise to others and help the enterprise to get back to healthy condition with a minimum disruption to the general economy. There are two types of bankruptcies: Chapter 7, Chapter 13. A means of protection was designed in terms of Chapter 11.

Under Chapter 7, the company stops all operations and goes completely out of business. A trustee is appointed to "liquidate" (sell) the company's assets and the money is used to pay off the debt, which may include debts to creditors and investors.

This represents the extreme – and with major consequences to the whole economy – e.g., loss of one professional job in the petrochemical industry could result in loss of 3.7 jobs in addition to impacting the service industry – including physicians, lawyers, plumbers, cleaners, fast-food workers etc., The goal of the Government is to avoid/minimize Chapter 7 as much as possible.

The secured creditors are paid first, because the credit that they extend is usually backed by collateral, such as a mortgage or other assets of the company. Bondholders the debt of the company and the company has agreed to pay bondholders interest and to return their principal.

Stockholders own the company. The owners are last in line to be repaid if the company fails. In most cases they stand to lose everything.

Chapter 13 Bankruptcy, is essentially meant to protect the owners from risking their personal livelihood – a way to protect the entrepreneur's personal wealth from being part of the Chapter 7.

Chapter 11 Bankruptcy – is essentially a means of re-organization under the government.

Most publicly-held companies will file

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under Chapter 11 rather than Chapter 7 because they can still run their business and control the bankruptcy process. Chapter 11 provides a process for

rehabilitating the company's faltering business. Sometimes the company successfully works out a plan to return to profitability; or liquidate in extreme situations. .

How Chapter 11 Works

A chapter 11 case begins with the filing of a petition with the bankruptcy court. The petition may be a voluntary petition, which is filed by the debtor, or it may be an involuntary petition, which is filed by creditors that meet certain requirements.

Under Chapter 11 business will get a chance to try to become profitable again. Management continues to run the day-to-day business operations but all

significant business decisions must be approved by a bankruptcy court.

Three Examples of Different Stages/Bankruptcy in petrochemicals

Independent of the size of the organization, every viable business needs cash flow to cover the variable costs. Most of the variable costs should be covered by recurring sales – expenses. The lowering of demand and increase in raw material prices impact the variable costs, thus slowly moving the organization to negative margins.

The organizations cannot function for long with negative margins. All the corporate ideals go out the window – once an organization reaches negative margins – reasonably so.

Let us look at three situations – (1) Rexene, Sterling Chemicals, and Penn Specialty Chemicals' bankruptcies (2) WR Grace Bankruptcy and (3) potential bankruptcy of LyondellBasell

Rexene Corporation, Sterling Chemicals Penn Specialty Chemicals came out stronger than before after filing for Chapter 11 bankruptcy. Rexene declared bankruptcy during early 90s and sought Chapter 11 protection and came out successfully and was able to sell the organization at a much better condition to Huntsman.

WHILE BANKRUPTCY is a bane to shareholders, companies emerging from the process can find themselves stronger and better able to compete in today's challenging marketplace. Most recently, Penn Specialty Chemicals and Sterling Chemicals have filed reorganization plans to rise from the ashes of Chapter 11.

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WRGrace filed for Chapter 11 protection in 2001 and still is able to operate under chapter 11 protection with some restrictions. WR Grace's operating under Chapter 11 protection has not prevented them from most of the normal operations.

LyondellBasell Industries, the chemicals maker controlled by billionaire Len Blatnovik, is considering filing for bankruptcy as a way to restructure debt that financed its \$12.7 billion merger a year ago.

The chemicals maker is struggling with a collapse in home and auto sales that has depressed demand for everything from car bumpers to paint.

LyondellBasell's lenders face losses of more than 90 cents on the dollar as it seeks to restructure the debt-fueled buyouts of the past two years- hence the talk about potential chapter 11.

In all three cases, the original stockholders will get/got wiped out of their stock values. The organizations could progress much better and faster without the burden of financing the stock values.

Employee/Stockholder Impact

A company's securities may continue to trade even after the company has filed for bankruptcy under Chapter 11. In most instances, companies that file under Chapter 11 of the Bankruptcy Code are generally unable to meet the listing standards to continue to trade on Nasdaq or the New York Stock Exchange. However, even when a company is de-listed from one of these major stock exchanges, their shares may continue to trade on either the OTCBB or the Pink Sheets. Investors should be cautious when buying common stock of companies under Chapter 11 bankruptcy to avoid financial loss.

Although a company may emerge from bankruptcy as a viable entity, generally, the creditors and the bondholders become the new owners of the shares. In most instances, the company's plan of reorganization will cancel the existing equity shares.

If the company does come out of bankruptcy, they can issue "new common stock". The "old stock" is rendered worthless. This is by far the major stockholder confusion.

Does My Stock or Bond Have Any Value?

Usually, the stock of a Chapter 7 company is worthless and you have lost the money you invested.

If you hold a bond, you might only receive a fraction of its face value. It will depend on the amount of assets available for distribution and where your debt ranks in the priority list on the first page.

How Does it Affect my Retirement, 401K and/or Medical Benefits?

A Chapter 11 bankruptcy may or may not affect your pension or health plan. In some cases, plans continue to exist throughout the reorganization process.

In a Chapter 7 bankruptcy, the company liquidates its assets to pay its creditors and ceases to exist. Therefore, it is likely your pension and health plans will be terminated.

CONCLUSION

With Global recession in place with chemical industry's up-cycle just around the corner – Chapter 11 offers an excellent means of survival during these tumultuous times. You will see more bankruptcies on the horizon. The inconvenience and value reduction caused by these filings will not be significant compared to the overall loss of \$7 trillion wealth loss we just experienced.

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