

# GRANT'S

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## You only get par

A whopping 4.5% drawdown in January–March leaves investment-grade corporate bonds priced to yield 2.2%, or 40 basis points less than the year-over-year rise in the March CPI. We write to pan the asset class in general and the long-dated A1/A-plus-rated debt of 3M Co. in particular.

“Since the chief emphasis must be placed on the avoidance of loss,” quoth Benjamin Graham and David L. Dodd in their 1940 classic, *Security Analysis* (see, also, page 8), “bond selection is primarily a negative art. It is a process of exclusion and rejection, rather than of search and acceptance.”

Pass on the opportunity to buy a common stock, and you may live to regret it, the two observed (it could be the next Amazon.com, Inc.), but there’ll be no such second-guessing for the failure to snag a 3M debenture. Between any two investment-grade corporate debt instruments priced at around par, the upside is the same (return of principal and coupon income along the way). Only the risks differ. “Hence, broadly speaking, there is no such thing as being unduly cautious or exacting in the purchase of fixed-value investments,” Graham and Dodd remind us (easy for them, perhaps, not having to make a living in this post-2008 yield famine).

The common shares of 3M may or may not be a great bargain at 20.5 times estimated 2021 earnings, but the senior unsecured 3.7s of 2050 offer little return and substantial risk. Priced at \$109.63 for a yield of 3.2% to the 2049 call at par (i.e., “yield to worst”), they are hostages to interest rates and fortune alike.

For instance, an upside move in in-

terest rates of as little as 100 basis points would cost the holder \$17.72, or 4.8 years of coupon income. Minneapolis Fed President Neel Kashkari professes to be OK with transient hot rates of inflation, but the holders of the 3M 3.7s would almost certainly be less OK.

Beyond interest rate risk, corporate creditors of course bear credit risk. Specifically, in 3M’s case, they face complications from a swarm of lawsuits relating to perfluoroalkyl and polyfluoroalkyl substances (together designated as PFAS), a versatile and troublesome chemical family that encompasses more than 1,000 formulations.

The famously diversified 3M operates in the realms of safety, industry, transportation, healthcare, consumer wares and electronics. Among its more than 60,000 products are N95 respirator masks, Duct Tape, Post-it notes, compressed-air eccentric sanders and an array of industrial chemicals. In the plague year of 2020, the front office managed to extract 17.8% more net income from a 0.1% bump in sales.

Net debt, including pension obligations and operating leases, summed to \$19 billion at year end, or 2.2 times trailing Ebitda. Operating income covered interest expense by 13.5 times.

DuPont de Nemours, Inc. and 3M were the biggest names in PFAS before those substances became notorious around the turn of the millennium. DuPont used them in Teflon, 3M in Scotchgard and fire-suppressing foam.

PFAS contain carbon-fluorine bonds, which Wikipedia describes as “one of the strongest bonds in organic chemis-

try, which gives these chemicals an extremely long environmental half-life.” Hence the unaffectionate nickname “forever chemicals.” Detectable levels of PFAS can be found in the blood of virtually every living American.

In 2004, DuPont paid \$405 million to monitor the health of 70,000 people residing near its Washington Works plant, which made Teflon, in Wood County, W. Va. What researchers found was a probable link between PFAS and six different disease states: testicular and kidney cancer, thyroid disease, ulcerative colitis, pregnancy-induced hypertension and high cholesterol.

PFAS featured in the 2018 documentary *The Devil We Know* and the 2019 thriller *Dark Waters*, starring Mark Ruffalo and Anne Hathaway. Before he became President Biden’s pick to head the Environmental Protection Agency, Michael Regan was chief of North Carolina’s environmental agency and in that capacity ordered Chemours Co. (as DuPont’s Washington Works and other problematic facilities were renamed after a DuPont spin-out) to clean up its wide-ranging PFAS mess.

Yes, a 3M spokesman, Sean Lynch, advised colleague Evan Lorenz by email, the designation of PFOA or PFOS (two types of PFAS) as hazardous substances would enable the EPA to seek recovery from “potentially responsible parties, as defined by the statute.” However, such a designation would not automatically impose any legal obligations on those parties. Nor would anything be sure to happen for many years.

“3M does not believe it is necessary or appropriate to designate PFOA and

PFOS as hazardous substances,” Lynch wound up. “We welcome opportunities to work with the administration and leaders in Congress to identify a collaborative path forward.”

Whatever happens in Washington, 3M has its hands full with litigation. Analysts say they can count nearly 1,000 cases. Some, launched by state attorneys general, are being consolidated in a federal multidistrict action in South Carolina, while Valero Energy Corp. is suing for liability related to aqueous film-forming foams, the kinds

used in firefighting. Individual plaintiffs and municipalities are likewise looking forward to their day in court.

“We estimate the cost of U.S.-scale remediation as anything from \$20 billion to \$50 billion with personal-injury claims additive,” analysts at Wolfe Research, LLC, led by Nigel Coe, advised clients at the end of March. Then, too, the so-called nuclear verdicts that are hammering insurance companies (see page 4) play their role in environmental litigation. “Note that a married couple has just been awarded a \$40m compen-

satory settlement (on appeal against DuPont) related to PFAS,” Coe and team observed.

“3M has significant liquidity to handle payments related to environmental claims to date,” Moody’s Investors Service recently concluded. “But the breadth and uncertainty of payments of existing and possible future claims will remain an ongoing risk to its credit profile for several years to come.”

With respect to the 3M 3.7s of 2050, what would Benjamin Graham do?

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