managing risk, enabling trade

market monitor

Chemicals and retail in: Italy and Spain
Chemicals in: Austria, Singapore, Canada

Short abstracts on chemicals performance in some main EU markets and the US

December 2011

Good news…but will it last?

With many dire economic warnings in the media, it's heartening to read about an industry that appears to be faring relatively well. That is the case for the chemicals industry – the main focus of this month's Market Monitor.

In all the countries surveyed – even Italy and Spain, where the economic climate is particularly tough - chemicals appears to be outperforming other industries, with high levels of liquidity and access to funding. Singapore in particular has carved a global reputation as a leading chemicals centre, with the world's major chemicals companies taking advantage of its business-friendly, low tax environment. Austria too is seen as a strategic centre for the major players in the industry, and throughout our reviews phrases such as 'strong equity, solvency and liquidity' recur.

This rosy picture comes with a health warning. Demand for chemicals often depends on the wellbeing of the industries in which those chemicals are used, which in turn are at the mercy of consumer confidence and spending choices. Thus, the outlook for major buyer sectors like construction will dictate the future for many segments of the chemicals industry. Moreover, chemical companies everywhere must be eyeing their key export markets with some trepidation, as the Canadian industry is with its major export market, the US.

This month we focus on the chemicals industry in Austria, Belgium, Canada, France, Germany, Italy, Singapore, Spain and the US, and on the retail industry in Italy and Spain.

On the following pages, we indicate the general outlook for each sector featured using these 'weather' symbols:

Excellent Good Fair Gloomy Bleak

Overview: chemicals in some major markets

Belgium

The Belgian chemicals and life sciences sector performed well in the first half 2011. According to the Belgian chemicals association Essenscia, turnover totalled € 30 billion (a 16.7 % year-on-year increase) while investments rose almost 50% to EUR 827 million. However, this positive development has been muted by growing uncertainty about global economic performance and the Eurozone crisis, and we have seen clear signs of deterioration since the summer. However, it is still too early to predict which individual subsectors will be worst affected by the expected downturn. The investment growth underlines the resilience of the sector and is a positive sign for the future.

On average, compared to other Belgian industries, the chemicals payment default and insolvency rates are still good: among the best in Belgium. Despite signs of a downturn, we have not seen a significant deterioration of our risk portfolio for the chemicals sector. As a result, our underwriting stance remains relaxed, with normal monitoring: i.e. buyers are reviewed at least once a year on the basis of new accounts or when new information is received. The latest balance sheet is always requested and we also seek interim results, and we review sensitive cases or companies with a high exposure on a monthly basis. When underwriting credit limits on companies that have been operating for less than a year, we look in particular at their starting capital and their subsector.

France

After strong performance in Q1 of 2011, production levels for the French chemicals industry slowed in Q2 and Q3. Between January and September, production increased by 7% year-on-year. In light of the expected economic slowdown and growing uncertainties in the Eurozone, production levels and demand from industrial clients are forecast to grow at a more moderate rate towards the end of the year and in 2012. The French chemicals industry association UIC forecasts 4.5% growth in 2011, and the growth forecast for 2012 has been revised downwards from its initial 2.4% to 1.8%.

The sector remains generally characterised by a high level of liquidity and access to funding. In our experience, payments in the industry - including those from abroad - take an average of 60 days. The insolvency rate in the French chemicals industry has remained better than other industries throughout 2011 and, since the first half of 2009, we have received only a low number of credit insurance claims. Despite a slight increase in claims received in Q3 of 2011, we do not expect any significant deterioration in the next six months. Our underwriting approach therefore remains generally positive for this sector.

Overview: chemicals in some major markets

Germany

The German chemicals sector continues to grow, although at a lower level than in H1 of 2011. The industry's payment morale has always been better than average with no notable payment delays. We have seen no change in payment behaviour or any increase in notifications of non-payment since our last Market Monitor analysis in February 2011, and expect this to continue in the coming months. Chemicals businesses are generally characterised by strong equity, solvency and liquidity. It is no surprise, therefore, that, compared to other industries, both sectors have a low insolvency rate across all subsectors. We do not expect any change to this in the coming 12 months. We expect the profit margins of businesses in most subsectors to remain stable.

Still we are more specifically evaluating the mineral oil subsector, as wholesalers in this subsector are generally characterised by low equity ratios and profit margins, as well as high turnover, compared to their equity and fixed assets. As the value of receivables in this subsector is generally quite high, bad debts are likely to jeopardise businesses´ financial health. In addition, we expect the demand for mineral oil to continue to decrease as new technologies make heating systems and car engines fuel consumption more efficient.

US

Following its moderate growth in the second half of 2011 compared to the first half of the year, US chemicals production is expected to continue to improve throughout 2012, provided that the US economy suffers no further setbacks. Cost containment measures, such as plant shutdowns, aggressive cost cutting and production improvements, should continue to bolster industry-wide margins. The resultant large cash flows may then provide opportunities for growth.

On average, payments in the chemicals industry take between 45 and 60 days, and payment delays have decreased since 2008, which was a particularly bad year. The chemicals sector is cyclical and heavily tied to the overall health and strength of the US economy. Therefore, any deterioration could also lead to increased payment delays. Insolvencies have not increased in the last couple of months and, assuming the situation in the housing and automotive industries does not worsen, this should continue. But, if the US does dip back into recession or the Eurozone crisis worsens, we could see insolvencies increase in 2012. There is still a danger that a soft patch in the economy could evolve into an outright downturn. The collapse of housing, the European debt crisis, US debt issues, and general uncertainty all work against recovery.

Due to the growing uncertainty about the future direction of the economy, our underwriting approach to the chemicals sector remains cautious. As the sector is highly fragmented, we have to scrutinize individual subsector trends and end-markets. Access to financial information is still a challenge, but is essential in considering larger US$ amounts. We are reviewing more accounts on a quarterly basis and adding more buyers to our 'watch' list.

Less dynamic performance in 2011

After significant growth in volume of 8% in 2010, and production worth EUR 52.6 billion, the Italian chemicals industry is facing a less dynamic result in 2011. However, turnover continued to increase, by 2-3% year-on-year in H1 of 2011, due mainly to foreign demand. The recovery in exports started in 2010 (+26.3% in value) and this growth continued into H1 of 2011(+ 18.7% in value and + 9.2% in volumes, according to the Italian Chemicals Association, Federchimica).

However, the first half of the year also saw more pressure from the rising cost of raw materials, both synthetic and natural, with prices almost always above their peaks of 2008. The profitability of Italian chemical companies, especially those downstream in the value chain, has deteriorated, because of the difficulty in passing on all of these costs in the final sale price.

Petrochemicals represent 14% of Italy's total chemical production. Between January and October 2011, consumption decreased 1.6% year-on-year (gasoline decreased 5.5% while diesel consumption rose 1.5%). The lower production in petrochemicals in Italy has also been influenced by the cessation of Libyan production caused by the civil war, although the situation has improved in recent months as some production has restarted.

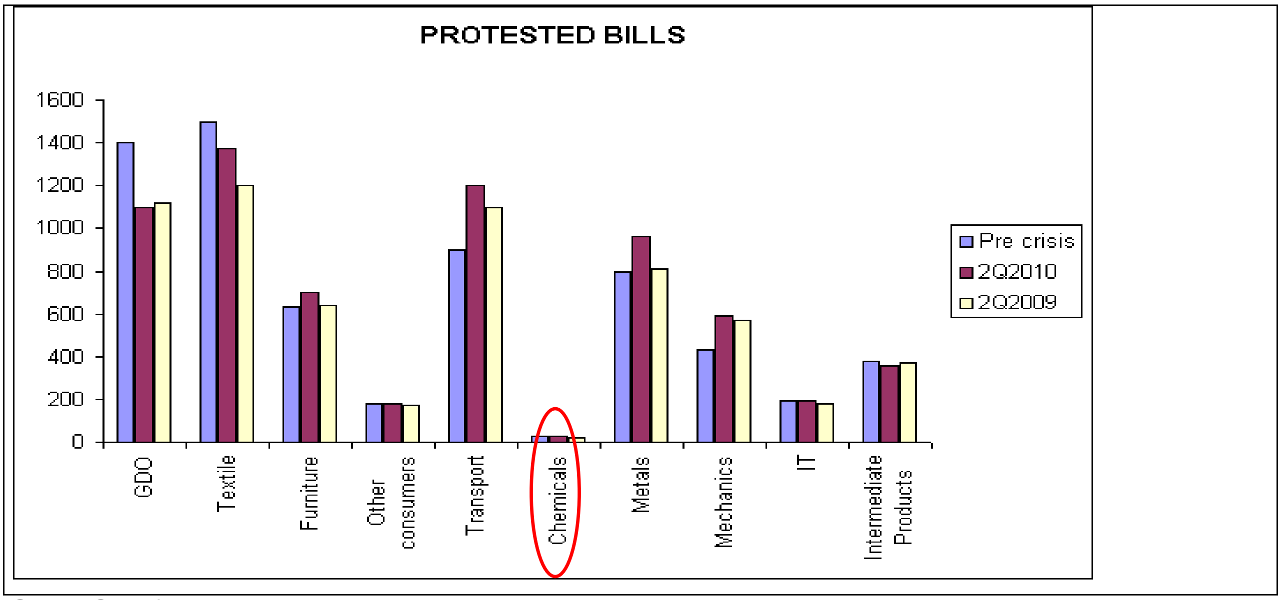
Basic inorganics (28.1% of production): this segment consists of industrial gases (3.8% of total Italian chemicals production), fertilizers (3.1%), plastic and synthetic rubber (14.5%) and man-made fibres (2%). Volumes in the industrial gas subsectors increased 9.8% in 2010 and, in H1 of 2011, the positive trend continued with volume increasing 4%. For the coming months there is more uncertainty due to the economic situation, but for the whole of 2011 2%-3% growth is expected. While, for basic inorganics as a whole production in 2011 is expected to be 1%-2% lower than in 2010, the plastics subsector will probably record a 4% increase this year after its 2.6% decrease in 2010. No significant changes are forecast for the fertilizer subsector, while man-made fibres will continue their growth path, with a 4% increase in 2011.

Consumer chemicals (19.7% of production): this segment consists of soap and detergents (12.4% of total Italian chemicals production) and perfumes and cosmetics (7.3%). For soap, the first six months of the year again saw a decrease in volumes (- 3%) due to the general contraction in private consumption. The forecast for 2011 is still subdued as, for the moment, raw material price increases have been absorbed by producers and not passed on to consumers. In contrast, perfume and cosmetic sales increased 3% domestically and 18% for exports.

Speciality Chemicals (38.2% of production): crop protection (1.9% of chemicals production), pharmaceuticals (5.7%), fine chemicals (18.6%) and varnishes and inks (12%). There has been a slight decrease so far in 2011 for crop protection (-2.6%), while the pharmaceuticals sector has been able to absorb the increase in raw material prices and has achieved a positive trend. There is also a positive export trend for fine chemicals, despite some concerns about the shortage of raw materials.

Italy: chemicals

In our experience, payments in this sector in 2010 took, on average, 90 days. We have seen no increase in the notification of non-payments in the last couple of months and, when looking at the number of unpaid/protested bills, it is evident that the sector is performing better than the Italian industrial average. Compared to other sectors, the chemicals insolvency rate is also below average and this is borne out by our claims experience.



Source: Cerved

Italian chemicals production is expected to grow around 2% in 2011, following a slowdown in the second half of the year

Italian chemicals sector performance

	2010 (EUR billions)	2010 (y-o-y change)	2011 (y-o-y change)
Domestic Demand	62.1	+6.9%	+2%
Import	32.1	+16%	+4.7%
Export	22.6	+23%	+5.8%
Production	52.6	+8%	+2%

Source: Federchimica

Italy: chemicals

Insolvency increase in 2012

Exports are, and will remain, the most important driver for growth in 2012. However, demand from abroad may decrease in the event of a global economic slowdown. At the same time it is likely that the slowdown in economic activity and deteriorating domestic demand resulting from Italy's current problems will affect the chemicals sector. In 2012 we expect that, with the ongoing economic problems, domestic demand for chemicals will remain lower in those industries currently struggling, such as construction, furniture, textiles and leather, and this will have an impact on chemicals businesses reliant on those sectors. The same goes for private consumption: dependent subsectors such as consumer chemicals (e.g. soaps and detergents) will suffer from lower consumer spending next year. In contrast, energy and pharmaceuticals will perform better than the sector average, thanks mainly to inelastic market demand. In addition, pharmaceuticals provide high market entry barriers for new players, requiring high investments to be profitable.

Although the chemicals sector's payment behaviour and insolvency development has been satisfactory until recently, we expect a higher number of insolvencies and more payment problems in the coming months. This will mainly affect segments directly connected to consumers, such as perfume and cosmetics, and companies reliant on the domestic market.

Due to the current political and economical uncertainties, our underwriters are monitoring the sector closely, so that they may anticipate possible defaults and identify the best performing subsectors. Therefore, our current underwriting stance for chemicals is cautious, especially for those sectors directly dependent on domestic consumption. Our main underwriting criteria are the age of the company, its capacity for absorbing decreasing sales and margins as a result of large own funds and/or a healthy financial structure, and for absorbing raw material increases by having the opportunity to pass them on.

Italian chemicals sector

Strengths	Weaknesses
• Good financial structure of the buyers • Sector ranks 3rd in Europe and 8th in the world • Many chemicals companies already oriented to export markets	• Sector is highly competitive • Shortage of raw materials • Difficulties in passing on increased raw materials prices to final consumers.

The non-food sector is at most risk

Italy's uncertain economic, political and financial landscape is discouraging demand and private consumption. According to Global Insight, private consumption rose only 0.6% in 2011 and will contract 0.1% in 2012. Italian retail sales have contracted since 2009, and are forecast to decrease 3.1% in 2011 and 1.6% next year. This has - and will - mainly hit the non-food retail sector: consumer durables no longer have the cushion of the public incentives that sustained the sector in 2010.

While the food retail sector has also seen a drop in demand, its non-cyclical nature means that it has so far escaped the worst effects of the downturn suffered by the non-food retail sector. According to a recent ISTAT survey of the food industry and our own analysis of large/medium scale food retailers, the overall trend in turnover shows a slight recovery of 2%-3% this year, despite stagnant orders and some poor balance sheet results. Lower consumption and intense competition have caused a slight contraction of gross and operating margins, while the bottom line has been hit by a higher incidence of financial charges. Most medium-sized food retailers have a modest equity base (average 20%) and higher recourse to bank loans to support their core business (average financial debt/equity ratio 164% in 2010 compared to 135% in 2009). General liquidity ratios for most companies in this sector are reasonably stable.

On average, payments in the large and medium-sized retailers business segment took 75 days in 2010. We have not seen an increase in payment delays in the food retail sector for the last couple of months, and expect this to continue to be the case for the coming months. However, we expect payment behaviour in the non-food segment to deteriorate.

In recent years, medium-sized retailers have suffered financial tensions and, in some cases, insolvency. Consortia in particular have been most exposed to changes in the economy, showing a higher rate of financial distress. In general, there have been problems with the quality of assets (credit, stocks, and fixed assets), a conflict of interest with associates and a culture of slow payment.

While we have received fewer credit insurance claims on the food segment this year, non-food has shown clear signs of worsening, mainly in the consumer durables subsector. Overall, we expect retail insolvencies to increase (mainly in the non-food segment) although it is difficult to make accurate forecasts. What is certain is that the economic environment will remain problematic and Italian retailers will continue to suffer from structural weaknesses such as high fragmentation, poor profits, low earnings retention and a modest equity base.

The outlook for the food retail subsector is positive, with demand expected to remain stable for both private labels and brands with perceived value added. However, there is still a risk of price volatility and a slowdown in demand, and this would affect food retailers in terms of their competitiveness and financial results.

Italy: retail

A more restrictive underwriting stance

The non-food segment is clearly exposed to the economic downturn, and the consumer durables subsector will remain among the weakest segments because of pressure on households´ purchasing power. Therefore, we are more restrictive when underwriting non-food retail.

However, our underwriting stance remains moderately positive for the retail food sector – although worsening economic conditions mean that we must remain alert to key risks, and anticipate and react to any potential liquidity problems.

Our main focus for the retail sector is on financial assessments and market information. On the financial side, we look at the management of working capital (which should remain structurally favourable with collection times shorter than payment times), average payment terms of no more than 120 days, cash flow generation, the cover of investments and the sustainability of net financial position. We also take into account shareholder skills, the management of key risks (credit, financial, governance) and the age of the company.

Italian retail sector

Strengths	Weaknesses
• Non-cyclical food sector	• High fragmentation of companies
• Good reputation of Italian food tradition	• Poor margins and solvency
• Niche sectors development	• Exposure to commodity prices volatility

Spain: chemicals

Strong overseas performance

According to the Spanish chemicals industry association FEIQUE the Spanish chemicals sector ended 2010 with growth of 6.2%, with promise of the beginning of a firm recovery in 2011. However, despite maintaining good production levels until April of this year, the results in the first seven months of 2011 reflect only modest year-on-year growth of 1.1%. This slowdown is apparent especially in subsectors such as biofuel, agrochemicals, paints and dyes, synthetic fibres and pharmaceuticals. On the positive side, we still see robust activity in basic chemical products, detergents and cosmetics, and raw materials for pharmaceuticals.

Despite decreasing production, turnover has continued to grow, thanks to a good performance in export markets and higher prices. Sales increased 8.6% year-on-year between January and July 2011. Overseas business (outside the EU) is still growing, and its total turnover is expected to increase to 8% in 2011 and 9% in 2012. However, profit margins have shrunk as a result of fierce international competition - mainly from emerging markets producers - and higher commodity prices.

Spain's current low growth, weak internal demand and dwindling domestic consumption mean that production will not return to pre-crisis levels until 2013. On average, payments in the Spanish chemicals industry take 60 days, and we have seen a slight increase in payments delays – a reflection of the overall domestic economic trend. However, this is still better than the overall industry average, and payment behaviour remains generally good. Given the rather negative economic outlook for the EU, we expect some deterioration in overall payment behaviour - from which the chemical sector will probably not escape. Nevertheless, we do not foresee a sharp increase in payment defaults for this sector in the coming months.

The rise in payment delays will probably, as a consequence, lead to an increased number of insolvencies. The plastics and rubber sector is facing more problems than others, as oil price increases have led to a reduction in margins and profitability. That said, on average (compared to other Spanish industries) the chemicals default/insolvency rate is still good.

Austerity measures will affect pharmaceuticals

So far this year, we have seen the adverse effects of increasing oil prices on several subsectors, including polymers and petrochemicals. However, we do not expect any further massive oil price increases in the coming months.

Domestically, for the chemicals industry 2% production growth is forecast for 2012, followed by 3% in 2013. That means that pre-crisis production levels will not be regained until 2013. Nevertheless, the sector's turnover in 2010 had already returned to 2008 levels. It is expected that in 2011 the chemicals sector will generate an estimated turnover in excess of EUR 57,400 million, followed by EUR 62,700 million in 2012. Profitability will remain an issue. Subsectors linked to the construction sector will continue to underperform while pharmaceuticals may face problems in 2012, as it is expected that the Spanish government will continue to cut expenditures in the health care sector. Those cost cutting measures will probably lead to reduced business activity and, consequently, less favourable financial performance.

Spain: chemicals

Export sales will continue to perform well, with growth of 6.9% in 2011 and 6% in 2012, reaching EUR 28,000 million. Basic chemicals and pharmaceutical raw materials are expected to outperform other subsectors, due mainly to the internationalisation of the Spanish chemicals industry. Conversely, we foresee a negative trend for bio fuels and pharmaceutical specialities.

Our normal underwriting procedures apply for the Spanish chemicals industry. However, special attention is given to subsectors particularly affected by oil price fluctuations, such as plastics and rubber, and activities related to the domestic pharmaceuticals sector.

Spanish chemicals sector

Strengths	Weaknesses
• Internationalisation of Spanish chemicals industry • Low debt burden • Modern and well structured industry with several profitable subsectors	• Strong dependence on oil price fluctuations • Competition mainly from BRIC countries • Poor forecast for Spanish and EU economic growth

Spain: retail

Declining sales in the food and non-food subsectors

Between January and October 2011, Spanish retail recorded a 5.5% year-on-year decrease in sales. Non-food retail decreased by 7.2%, while the food retail subsector contracted by 2.7%. Those mainly affected were independent retail traders, which suffered a 6.9% decline, according to the Spanish Statistics Office INE Small chains have also suffered from shrinking domestic demand.

Private consumption remains weak in Spain. Spanish consumer confidence is decreasing as a result of the uncertainties in the Eurozone, growing unemployment, scarcity of consumer credit and private household indebtedness. Wages continued to decrease in Q2 of 2011, by 0.5%. Apart from essential goods for daily use, there is an adverse trend or even stagnation, with values similar to those at the beginning of the year. The main victim of the economic volatility is the consumer durables sector.

Restrictive access to bank loans is also affecting retailer's liquidity, especially that of small independents, which have the most difficulty opening new credit lines to finance their businesses. The economic malaise has changed the behaviour of Spanish consumers, who are becoming more cautious in their spending habits. As a result, retailers have had to cut prices, despite the fact that prices for commodities, such as fuel, wheat, maize and copper, have risen – causing particular problems for those in the transport, food and household goods sectors. Rising commodity prices have also led to disputes between retailers - who want to keep prices low - and producers - who want to pass on at least some of the higher prices to consumers.

In the short term, commodity prices are expected to continue to rise, albeit less sharply than in 2011. However, the slowdown in global and Eurozone economic activity may help to relieve pressure on prices in the course of next year. Retailers are also revising their portfolios and beginning to disinvest or even close down those shops which aren't profitable. But, at the same time, some retailers are now renovating and modernising their shops to attract more customers.

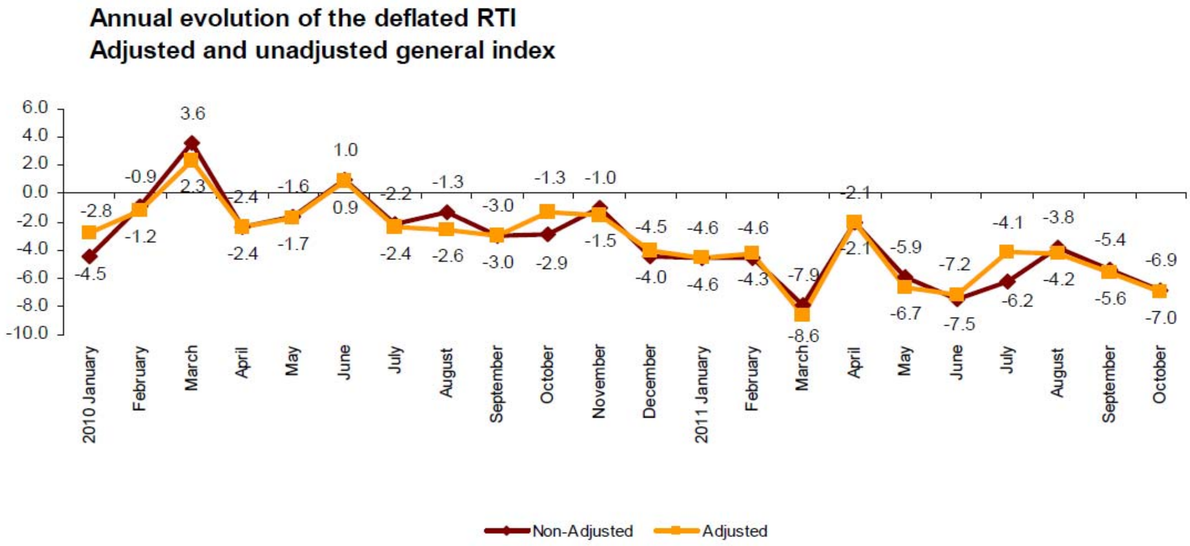
Payments and insolvencies have increased slightly

Payment behaviour in the retail sector is still better than the overall industry average in Spain. Our experience is that, on average, payments in the retail sector take between 90 and 120 days, while for perishable goods (food) payment times average about 30 days. Payment terms have remained unchanged in recent months, but we have seen a slight increase in payment delays - mainly in the last three months - due to falling private consumption and the shortage of bank credit. However, we do not expect any massive further deterioration in the coming months.

We have seen a slight increase in insolvencies in the retail sector over the last six months. While retailers focusing on basic goods like food are facing fewer troubles, other subsectors, like consumer electronics and household appliances, may not be as fortunate. But irrespective of the subsector, liquidity, financing needs and access to external financing are key issues. We do not foresee a serious increase in insolvencies in the retail sector in the coming months as long as domestic demand does not deteriorate seriously and commodity prices do not rise sharply again

Spain: retail

With the current economic woes in the Eurozone and Spain, we expect consumer spending to decline in the short term, and this is bound to hit the retail sector. October 2011 retail trade index (RTI) figures showed a major year-on-year decline in monthly retail sales (see chart below), and this tendency is likely to continue, although Christmas sales may provide some relief.



Source : Spain Statistics Institute (INE)

When underwriting the retail industry, we take into account that many businesses in this sector are very small/mid-sized and independent companies, and we factor in their subsector and product lines. Because food retailers, for instance, require a different underwriting strategy than consumer electronics or textile retailers, we therefore tailor our risk assessment accordingly. However, some general underwriting rules apply for the retail sector as a whole:

1) Due to the current economic situation, an analysis of businesses´ solvency and payment record is essential.
2) Dependence on external financing and the level of indebtedness are currently particularly important for Spanish businesses of all kinds. Therefore, it is essential that we understand each business's level of dependence on external financing and its debt management and debt amortisation schedules since, with decreasing consumer spending leading to price wars and shrinking margins in the retail sector, businesses may have problems settling their debts.

Spanish retail sector

Strengths	Weaknesses
• Importance and weight of the sector within the Spanish economy • Retail businesses have taken measures to weather the downturn.	• Dependence on external finance and consumer credit • Dependency on commodities price development

Austria: chemicals

Sector performing well

The chemicals industry accounts for 11% of Austria's total production value. Around 3,000 chemicals companies are active in the country, employing over 43,000 people. Two thirds of the total output is exported and in 2010 output rose 16% (after a 13.5% decrease in 2009), with exports increasing 17%.

Chemical production 2000 - 2010

	Production in Mio. EUR	Change in %
2000	10,257	10.5
2001	10,135	- 1.2
2002	10,786	6.4
2003	10,483	- 2.8
2004	10,950	4.5
2005	11,379	3.9
2006	12,479	9.7
2007	13,350	7.0
2008	14,117	5.7
2009	12,211	13.5
2010	14,165	16.0

Source: Association of the Austrian Chemical Industry (FCIO)

In 2011, chemicals´ year-on-year turnover has increased again. New orders have been on the rise since mid 2009, in line with the overall international trend in the chemicals industry. For the ten largest Austrian chemicals businesses, profitability is very good: with operating profitability of between 4% and 11%. Their equity situation is strong with equity ratios from 20% to 44%. In general, the solvency and liquidity of Austrian chemicals businesses is excellent.

The industry's domestic business depends very much on the performance of the construction sector. In 2011, the moderate upward trend in the Austrian construction industry (output increased 1% year-on-year in H1 of 2011) was good news for the chemicals sector. In the event of a potential downturn in construction, the well-established chemicals companies should be able to maintain their margins thanks to their strong market position and their bargaining power over suppliers.

Austria: chemicals

Well-prepared for any downturn

On average, payments in the chemicals industry take 45 days, and even less in the domestic market. We have seen no change in payment behaviour over recent months, and do not expect any change for the next six months at least. As the chemicals industry is generally characterised by strong equity, solvency, and liquidity, it is no surprise that, compared to other industries, it has a very low insolvency rate across all subsectors – and this was the case even at the height of the global credit crisis. The outlook is favourable, as chemicals businesses benefit from very good creditworthiness. Moreover, the leading, long-established companies benefit from good relations with the financial institutions and from their strong market position, and so are well-prepared to cope with any potential downturn in Eurozone and global demand. Therefore our underwriting stance towards this industry is, and will remain, relaxed.

Austrian chemicals sector

Strengths	Weaknesses
• R&D activities: many research institutions in Austria carry out business-oriented research projects for the chemical industry • Many players in the Austrian chemicals industry are long-established with a strong market position and good relations with financial institutions • Austria's central location in Europe: many foreign-owned chemicals companies coordinate their Central and Eastern European activities from Austria	• Dependency on oil and energy prices. Rising oil prices may put pressure on smaller producers as they may have difficulties in passing on price increases • Some companies, especially smaller ones, are heavily dependent on the development of the main players in the construction industry - which is a difficult sector • Growing competition, especially from Asia (China)

A leading global chemicals hub

Mega growth trends, such as rapid urbanization, changing demographics and the rise of the Asian middle-class, are shifting demand growth for products and services to Asia. With greater demand for transportation fuel, as well as petrochemical and speciality chemical products, Asian growth has created a window of opportunity for Singapore, with excellent connectivity to end markets, and a trusted and attractive location for investors. Singapore's Jurong Island is among the world's top ten petrochemical hubs. There are currently over 1000 speciality companies in Singapore, including high profile companies such as 3M, Evonik Degussa, Huntsman and Siltronic.

This city state is constantly working to stay at the forefront of the industry's advancement with a focus on developing competitive feedstock for petrochemicals, advanced materials and speciality chemicals. As the chemical industry moves into its next phase of growth, one of Singapore's strategies is to anchor a critical mass of olefin (the synthetic fibre) capacity. This will generate new manufacturing activity in higher value chemical chains such as C4 and C5 chemicals. Shell established its largest integrated oil and petrochemicals cracker in Singapore in May 2010. Together with the Exxon Mobil cracker which will come on-stream in 2012, these two projects will double Singapore's ethylene capacity to four million tonnes per annum by 2014, helping to create a new wave of high value downstream investments for its chemical industry.

The government has encouraged entrepreneurship and sought to attract foreign companies to establish their businesses in Singapore. In this business-friendly environment, most chemicals companies tend to do well, with low tax, a huge pool of qualified professionals, and widely available liquidity to fund projects and R&D. The chemicals industry is considered a mature and stable industry and, as a result, this has guaranteed a stable customer base, consistent demand and predictable annual turnover.

Table: Asia Pacific Petrochemicals Business Environment Ratings

	Limits of potential returns			Risks to realization of returns				
Country	**Petrochemicals market**	**Country structure**	***Limits***	**Market risks**	**Country risk**	***Risks***	**Petrochemicals rating**	**Rank**
Japan	73.3	90.1	*79.2*	85.0	78.7	*80.6*	79.6	1
China	93.3	65.6	*83.6*	55.0	74.4	*68.6*	79.1	2
South Korea	80.0	83.5	*81.2*	80.0	66.3	*70.4*	78.0	3
Singapore	60.0	90.8	*70.8*	90.0	79.3	*82.5*	74.3	4
Taiwan	70.0	76.6	*72.3*	75.0	74.1	*74.4*	72.9	5
Thailand	70.0	59.6	*66.3*	75.0	67.3	*69.6*	67.3	6
Malaysia	53.3	68.8	*58.7*	80.0	72.8	*74.9*	63.6	7
Australia	40.0	90.7	*57.7*	75.0	77.4	*76.7*	63.4	8
India	76.7	38.1	*63.2*	70.0	60.9	*63.6*	63.3	9
Indonesia	**46.7**	**39.8**	***44.3***	**60.0**	**49.4**	***52.6***	**46.7**	**10**
Philippines	20.0	51.2	*30.9*	75.0	54.7	*60.8*	39.9	11
Vietnam	10.0	44.5	*22.1*	60.0	45.9	*50.1*	30.5	12

Scores out of 100, with 100 highest. Source: BMI

Healthy profit margins and good payment behaviour

Profit margins are healthy, as the Singapore chemicals industry deals mostly in complex/speciality chemicals that command a premium. General equity strength for most established chemicals companies is satisfactory, as most are reasonably capitalized after years of stable growth. There are no problems with the general solvency and liquidity of most players in the industry.

The chemicals manufacturing sector has rebounded from the global economic downturn of 2009 with good rates of growth forecast for the future. However, rivalry in the sector is strong. While Singapore will remain a highly competitive, large-scale petrochemicals centre, the Chinese petrochemicals industry is set for major expansion. With slower rates of growth in demand in the Chinese market, surpluses in some segments could undermine prices and hit the margins of Singaporean producers.

Chemicals companies are usually in good financial shape and access to liquidity is eased by the number of banks, both local and foreign. We have received no notifications of non-payment by chemicals businesses in Singapore in the past six months and do not expect any payment delays from the Singapore market in view of its good payment behaviour.

The default/insolvency rate in Singapore's chemical industry is on par with other industries there. The number of overall business bankruptcy filings dropped 20% year-on-year - to 2,202 - in 2010, according to the Ministry of Law, and we do not foresee any major change in the insolvency rate. Although Singapore is prone to external factors, the building blocks of the economy are strong - as evidenced by its recovery from recession with double digit growth rates.

Currently the outlook remains positive

The outlook for Singapore's chemical industry in 2012 and beyond is stable, with continued positive, albeit lower, growth. Global economic conditions are expected to remain subdued in 2012. Despite the resilient demand from emerging Asian markets, this will not fully mitigate the effects of an economic slowdown in the advanced economies.

The competitive environment, world class production facilities and technical expertise – especially in petrochemicals and speciality chemicals – are accompanied by strong support from the government through continued infrastructure investments. With the Shell and Exxon Mobil complexes scheduled to begin operations in the next few years, the chemicals industry as a whole is expected to continue to perform well over the coming years, barring any major external adverse impact. In the mid- and long-term Asia's demand for petrochemicals is expected to rise steadily, with China accounting for a large part of that demand, and this promises export opportunities for Singapore.

However, this outlook does not factor in any major external blows that could severely affect Singapore's economy, such as a return to global recession, which in turn could lead to a major economic slowdown in China. Demand for chemicals generally tends to follow the performance of other broad based industries that require chemicals for their products, and therefore demand for chemicals is a good barometer of general economic growth.

As we currently view the chemicals sector in Singapore as stable and mature, we usually adopt a relatively relaxed underwriting approach for established players. Extra caution is usually taken only for newly established companies that have been around for less than 3 years, but this is the case for all industries and not specific to the chemicals sector.

The main criteria for underwriting companies in the chemicals sector are:

- years of establishment (preferably at least 3 years)
- management experience (years of relevant industry experience)
- financial profile
- industry reputation

Singapore chemicals sector

Strengths	Weaknesses
• The government has been willing to make large investments in infrastructure and support large-scale projects • Jurong Island offers a large petrochemicals hub, with integrated common facilities and an infrastructure that has attracted many international companies • Ideally located to benefit from Chinese and broader Asian demand • Has the world's third largest refining centre • New cracker capacity and associated production will turn Singapore into one of the world's 10 largest petrochemicals production centres.	• No domestic oil or gas production; has to import basic feedstock • Modest domestic polyvinyl chloride (PVC) production. • Small domestic economy with limited demand capacity / domestic consumption and hence unable to support the industry which as a result is very export oriented • Lack of natural resources

Canada: chemicals

Positive momentum returning in H2 of 2011

Canada's chemicals sector was hit hard during the recession, but made a solid recovery in 2010. Of all Canadian manufacturing sectors, chemicals is the second largest exporter (exporting 64% of its production in 2010 compared to just 25% in 1990) and the fourth largest in terms of sales. The United States remains its main trading export partner, as it is the destination for 76% of chemicals exports and the source of 60% of imports. The next largest export markets are the United Kingdom (4%), China (3%) and Brazil (2%).

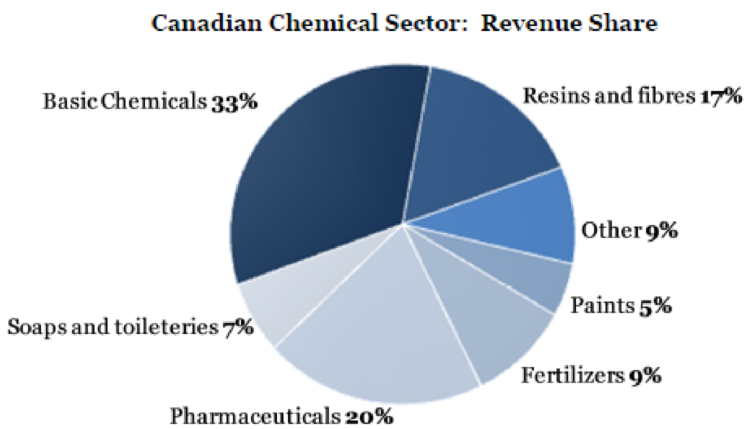
Canadian chemicals industry at a glance

Year	Businesses	Shipments (C$ billions)	Employment	Imports (C$ billions)	Exports (C$ billions)
2003	2,122	42.69	92 166	33.28	20.40
2004	3,315	47.16	84 091	35.57	24.29
2005	3,049	48.64	81 882	37.4	26.86
2006	2,955	49.89	79 990	39.35	28.93
2007	2,944	48.21	78 091	40.42	32.34
2008	2,834	49.65	80 934	42.1	31.99
2009	2,734	39.75	79 087	39.91	26.48
2010	2,734	42.45	77.670	40.86	27.93

Source: Chemistry Industry Association of Canada

According to the Chemistry Industry Association of Canada (CIAC), sales of basic chemicals and resins increased 14% year-on-year to C$ 21 billion in 2010, while operating profits rose 73%, to C$ 2.3 billion.

Industrial chemicals comprises about 50% of the overall industry on the basis of value of shipments.



Source: Chemistry Industry Association of Canada

Exports of basic chemicals and resin also increased 14%, with those to the US rising 19% despite an adverse exchange rate. But the profit increase was not reflected in capital expenditures, which declined by 33%: reflecting investor uncertainty in the volatile economic environment.

According to Statistics Canada, the chemical sector's GDP performance was tracking below its 2010 performance in H1 of 2011 - almost mirroring 2009. This slowing trend followed the general direction of the Canadian economy (In Q2 of 2011, GDP contracted 0.4% on the previous quarter).

That said, preliminary performance indicators were showing that positive momentum was returning to the chemicals sector, with wholesale trade figures showing positive year-on-year and month-on-month performance (see chart below).

Sales by NAICS*	Sep-11	Aug-11	Jul-11	Jun-11	Year to Date
	C$ million				
Wholesale Trade	48,674	48,517	48,385	47,911	428,720
% year-on-year change	7.4%	8.0%	9.4%	8.3%	7.4%
% month-on-month change	0.3%	0.3%	1.0%	0.1%	
Chemicals Trade	1,241	1,188	1,165	1,177	10,412
% year-on-year change	18.7%	9.5%	10.6%	18.1%	15.1%
% month-on-month change	4.5%	2.0%	-1.0%	0.4%	

* North American Industry Classification System

Source: Statistics Canada

Most industry participants expect sales to increase for the full year in 2011, but at a slower rate than in 2010. There is concern that the rate of recovery in the US is slowing and a higher-value Canadian dollar will make it more difficult to sustain sales levels. Developments in the US economy will have the greatest impact on this sector because of the importance of the US as a trading partner. If the US economy stalls, then the Canadian chemicals sector will be negatively impacted. Other challenges include continuing protectionism in the US, a declining Canadian manufacturing sector and heightened competition from the Middle East, China and India.

Some increase in payment delays and insolvencies expected

We believe that the current very low level of payment delays is not reflective of the actual market situation. While the chemicals sector is performing acceptably, delinquency rates are artificially low - masked by low interest rates and generally acceptable economic conditions. As the Canadian economy slows (as evidenced by weakening GDP performance and forecasts) payment delay rates are expected to rise to a more normal level.

The same goes for insolvencies. Even though we expect the current environment to remain stable, the insolvency ratio has been well below average and will increase in the future. However, on average (compared to other Canadian industries) the chemicals default/insolvency rate is and will remain very good.

Our underwriting stance towards the Canadian chemicals sector remains conservative as the sector outlook remains ′stable′. However, concerns linger because of global economic uncertainty. We have seen buyers´ credit profiles improve, with large established chemicals businesses on the primary production side remaining strong - but the smaller secondary manufacturers have mixed profiles and volatility is still impacting input costs (raw materials, energy, transportation). Furthermore, despite our positive payment default/claim experience, concerns still exist that the plastic packaging and rubber manufacturing segments are unable to pass on cost increases.

For credit limit applications of less than C$ 250,000, we will consider the number of years that a buyer has been operating and other available credit information. If this information does not support the amount of the application, financial statements or specific bank and trade references will be required.

To consider applications over C$ 250,000, we need to see the last two fiscal year-end financial statements. If the buyer is part of a larger group, we will still try to obtain financial statements and, if these are not available, our decision will be based on the parent′s profile.

Canadian chemicals sector

Strengths	Weaknesses
• Strong domestic economy • Business-friendly Federal government • Modernised industry	• Elevated Canadian dollar • Dependence on declining Canadian and US-based manufacturing sectors • Volatile oil price

Atradius
Level 5, Export House
22 Pitt Street
Sydney NSW 2000
Australia

www.atradius.com.au

Atradius
Level 7
70 Shortland Street
Auckland
New Zealand

www.atradius.co.nz