Managing risk, enabling trade

July 2018

market monitor

Focus on chemicals/pharmaceuticals performance and outlook

Disclaimer

In this issue...

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

Excellent
The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend

Good
The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend

Fair
The credit risk situation in the sector is average / business performance in the sector is stable

Poor
The credit risk in the sector is relatively high / business performance in the sector is below its long-term trend

Bleak
The credit risk in the sector is poor / business performance in the sector is weak compared to its long-term trend

More mergers and acquisitions to come

Globally, the chemicals industry seems to be performing quite well, with generally robust business financials, good payment records and low insolvency rates compared to other industries. The performance of the chemicals sector in all countries covered in this issue of the Market Monitor is rated between 'Good' and 'Fair'. Robust global GDP (forecast to increase more than 3% in 2018) supports higher demand for chemicals from key end-markets, including automotive, construction, and electronics.

The surge of M&A activity since 2015 is likely to continue in 2018, sustained by the willingness of external investors to increase their activities in the chemicals industry and the currently benign global financing environment with low interest rates.

However, as the chemicals industry is cyclical, highly dependent on changes in the global economy and reliant on basic commodity costs (especially oil and gas), increased commodity price volatility and the looming threat of escalating trade disputes are major downside risks for the outlook.

The global pharmaceuticals market continues to face pressure on price and demand for value. Global pharmaceutical sales are expected to grow about 3% in 2018, slower than in previous years, with the oncology drugs market forecast to be the largest contributor to growth.

The impact of patent expirations on traditional products will be moderate this year, while prices for generic drugs continue to decrease. In 2018 more M&A activity in the pharmaceuticals industry is expected, driven by slower organic growth, higher volatility of revenues, increasing research and development and marketing costs, as well as longer and more uncertain returns on investments.

India

- **Decreasing profit margins in the pharmaceuticals segment**
- **Payments take between 60 days and 180 days on average**
- **Lending conditions remain benign**

Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✔		
Development of non-payments over the coming 6 months			✔		
Trend in insolvencies over the last 6 months			✔		
Development of insolvencies over the coming 6 months			✔		
Financing conditions	**very high**	**high**	**average**	**low**	**very low**
Dependence on bank finance			✔		
Overall indebtedness of the sector			✔		
Willingness of banks to provide credit to this sector		✔			
Business conditions	**significantly improving**	**improving**	**stable**	**deteriorating**	**significantly deteriorating**
Profit margins: general trend over the last 12 months				✔	
General demand situation (sales)			✔		

Source: Atradius

The Indian chemicals industry is forecast to record value added growth of 6.8% in 2018 after increasing 4.9% in 2017. Petrochemicals producers benefit from moderate oil price levels, resulting in better margins. The outlook for the agrochemicals and fertilizer segment is stable, based on the expectation of a “regular” monsoon season and government initiatives. Speciality chemicals remains a fast growing segment, on the back of favourable oil prices and strong domestic and export demand.

Growth of India’s pharmaceuticals and healthcare market is supported by a robust economic outlook and increasing private and public healthcare spending. However, revenue growth is expected to remain at a single digit level, due to increasing substitution of patented drugs with generic drugs in the US and Europe as well as growing competition in the domestic market. Branded generics account for about 70%-80% of the Indian drug retail market, with low price levels due to intense competition. This competition is about to become even fiercer due to the increasing use of generic drugs and a decline in the approval of new products.

While many pharmaceutical businesses continue to engage in acquisitions in order to overcome regulatory and competitive headwinds, increased R&D expenditure, price capping of about 375 drugs by the National Pharmaceutical Pricing Authority, and price pressure in the US and European markets resulted in decreasing profit margins in 2017 and early 2018, and this trend is set to continue over the coming months.

On average, payments in the Indian chemicals/pharmaceuticals sector vary between 60 days and 180 days, depending on the position in the value chain and businesses bargaining power, credit policy and geographical position. E.g. pharmaceutical companies supplying generic drugs have to offer extended credit terms due to high competition in this segment, while chemicals manufacturers purchasing raw materials have shorter credit terms.

India: Pharmaceuticals

	2017	2018f	2019f
GDP growth (%)	6.3	7.3	7.0
Sector value added growth (%)	2.8	8.3	7.3

Average sector growth over the past 3 years (%)	7.7
Average sector growth over the past 5 years (%)	5.9
Degree of export orientation	high
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

The level of payment delays and insolvencies is rather low in the chemicals and pharmaceuticals sectors, and no major increase in business failures is expected in 2018. Despite decreasing profit margins, the financial position of most pharmaceutical businesses remains satisfactory, with healthy capital structures and robust debt protection measures. Lending conditions are still benign, and many companies have been successful in raising funds from banks for capital expenditure and buyouts.

Due to the general financial strength, our underwriting approach to the Indian pharmaceuticals sector is generally open, despite price capping measures having an adverse effect on profit margins. Businesses with strong brands in the OTC (over the counter) segment are well suited to overcome market difficulties.

Indian chemicals/pharma sector

Strengths	Government initiatives like "Make in India" boost domestic chemicals production
	Low per capita consumption of chemicals in India provides opportunities for new investments
	Cost competitive manufacturing/ availability of skilled workforce)
Weaknesses	Strict regulatory environment in some subsectors with price controls
	Exposed to currency volatility due to dependence on imported commodities
	Highly fragmented and competitive domestic market with cheap imports

Source: Atradius

That said, our underwriting approach to the chemicals sector is generally just neutral for all main subsectors (basic chemicals, petrochemicals, agrochemicals and fertilizers), despite the growth outlook. In the petrochemicals segment manufacturers and traders with large raw materials inventories could be adversely affected by sudden oil price changes. Stiff competition and price pressures in a very strictly regulated market environment impact the basic chemicals subsector. The performance of the agrochemical and fertilizers segment remains highly dependent on the outcome of the monsoon season and the amount of government subsidies, while businesses in this segment are characterised by large inventories and high working capital requirements.

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals
		

Source: Atradius

Italy

- **Expectations for 2018 are positive for now**
- **Payments take 60 days on average**
- **Non-payment issues in the oil/fuel wholesalers segment**

Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✔		
Development of non-payments over the coming 6 months			✔		
Trend in insolvencies over the last 6 months			✔		
Development of insolvencies over the coming 6 months			✔		
Financing conditions	very high	high	average	low	very low
Dependence on bank finance				✔	
Overall indebtedness of the sector				✔	
Willingness of banks to provide credit to this sector		✔			
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months			✔		
General demand situation (sales)			✔		

Source: Atradius

Italian chemicals production increased 3.5%, to EUR 55 billion in 2017. Exports, which accounted for 55% of total revenues, grew 9%. Domestic demand increased and expanded across all customer segments, except for construction and consumer durables. The fine chemicals and specialties segments grew 12.7% and 7.8% respectively.

The outlook for 2018 remains positive for the time being, despite a slowdown in early 2018 (in Q1 of 2018 Italian chemicals production grew just 1.5%, below the European average of 1.9% and Italian manufacturing average growth of 4.6%). This slowdown was mainly due to increased domestic and international political uncertainty, impeding higher chemicals purchases.

Production of the pharmaceuticals industry amounted to EUR 30 billion in 2017, with foreign-owned pharmaceuticals producers accounting for 61% of total revenues. Exports accounted for 75% of total revenues, while at the same time public expenditure for pharmaceuticals in Italy is among the lowest in Europe and decreasing further.

On average, payments in the Italian chemicals/pharmaceuticals sector take around 60 days. Payment experience is good, and the level of protracted payments has been low over the past couple of years. The level of payment delays and insolvencies is low, and this should remain generally unchanged in H2 of 2018.

However, we expect non-payments to increase in the oil/fuel wholesalers segment, affected by low profitability due to heavy taxation (VAT amounts to 22% and, together with other excises on fuels, the fiscal burden amounts to 64% of the final sales price of fuels) and international competition. Fiscal crimes (i.e. import of fuel from illegal markets to avoid VAT payments) have increased, while public authorities have started to investigate. In some cases, the bank accounts of companies involved in these crimes have been blocked.

Italy: Chemicals

	2017	2018f	2019f
GDP growth (%)	1.5	1.5	1.1
Sector value added growth (%)	2.1	3.7	1.0

Average sector growth over the past 3 years (%)	1.7
Average sector growth over the past 5 years (%)	1.0
Degree of export orientation	high
Degree of competition	average

Sources: Macrobond, Oxford Economics, Atradius

Considering the generally positive outlook for the industry, the low level of bank bad debts and the above-average solvency of many businesses, our underwriting approach to the Italian chemicals/pharmaceuticals sector remains relaxed. However, subsectors and businesses dependent on construction, construction materials and consumer durables still require particular attention. At the same time, any increase in insecurity over the domestic and international economic situation and trade policies remains a downside risk.

Italian chemicals sector

Strengths	High degree of internationalisation
	The sector records above average solvency and profit margins compared to Italian manufacturing
	The industry has the lowest bank bad debt ratio in Italy
Weaknesses	High energy and labour costs affect margins
	The oil/fuel downstream segment is affected by low margins and increased fiscal crimes
	Increasing competition, especially from Asia

Source: Atradius

Compared to producers, chemicals/pharmaceuticals wholesalers generally show lower solvency and higher gearing ratios to finance their working capital needs. Due to the issues mentioned above a more cautious underwriting approach applies to wholesalers of fuel products. Wholesalers and retailers of pharmaceuticals, which are dependent on public healthcare expenditure and suffer from long payment duration by public entities and decreased margins, also remain in focus.

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals
		

Source: Atradius

United States

- **Many segments continue to enjoy the cost advantage of shale gas**
- **An escalation of trade disputes would severely hurt the sector**
- **Payments take between 30 and 90 days on average**

Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✔		
Development of non-payments over the coming 6 months			✔		
Trend in insolvencies over the last 6 months			✔		
Development of insolvencies over the coming 6 months			✔		
Financing conditions	**very high**	**high**	**average**	**low**	**very low**
Dependence on bank finance		✔			
Overall indebtedness of the sector			✔		
Willingness of banks to provide credit to this sector		✔			
Business conditions	**significantly improving**	**improving**	**stable**	**deteriorating**	**significantly deteriorating**
Profit margins: general trend over the last 12 months			✔		
General demand situation (sales)			✔		

Source: Atradius

Despite disruptions caused by Hurricane Harvey, chemical production volumes continued to increase in 2017 (up 0.8%), with robust growth expected in 2018 and 2019 (3.7% and 3.9% respectively), according to the American Chemistry Council. The upturn is sustained by robust demand from the automotive and construction sectors, capital investment and the fact that many chemical subsectors continue to enjoy the cost advantage of shale gas. The US has moved from being a high-cost producer of key petrochemicals and resins in the past to being the world's second lowest cost producer.

Exports of US chemicals linked to shale gas are projected to reach USD 123 billion by 2030. Chemical producers are clearly looking to take further advantage of continued low natural gas prices in the US, which is enabling the significant expansion of methane-based projects.

The comprehensive tax reform will offer chemicals and pharmaceutical corporates based in the US a lower corporate tax rate and allows them to repatriate some of the cash they hold overseas. An influx of repatriated cash could be used to repay company debt, fuel new business development activities or reinvest in US-based projects.

The large infrastructure improvements announced by President Trump soon after his inauguration would widely benefit US chemical businesses providing polymers, coatings, adhesives, solvents and other materials used in the construction industry. However, concrete measures have not been decided yet.

On the contrary, currently it seems that the potential downside risks related to President Trump´s economic policies outweigh the business opportunities, after punitive tariffs have been raised

USA: Chemicals

	2017	2018f	2019f
GDP growth (%)	2.3	2.8	2.4
Sector value added growth (%)	2.3	4.1	3.8

Average sector growth over the past 3 years (%)	1.0
Average sector growth over the past 5 years (%)	0.6
Degree of export orientation	average
Degree of competition	average

Sources: Macrobond, Oxford Economics, Atradius

on steel and aluminum imports and additional tariffs on Chinese imports worth USD 50 billion have been announced. Should international trade disputes escalate there is the immedeate risk that retaliatory measures by trade partners would hit the US chemicals industry, given its substantial trade surplus (Mexico alone accounts for more than half of the US chemicals trade surplus). At the same time potential taxes on chemicals-related imports could find US chemicals businesses paying more for feedstocks and would negatively impact supply chains.

The US pharmaceuticals sector is expected to record value added growth of 1.6% in 2018 and 2.8% in 2019. In early May 2018 President Trump voiced his intention to lower the price of prescription drugs, and while the Secretary of Health and Human Services confirmed in mid-June 2018 before the Senate Health

US chemicals sector

Strengths	Strong international competitive advantage due to low energy prices in the US
	Stable profit margins and low level of protracted payments
Weaknesses	Stronger USD hampers export performance
	Sector is vulnerable to global protectionism

Source: Atradius

Committee that several companies are being scrutinised, it was also said that it could take some time for price cuts to actually materialise. Drug manufacturers have yet to announce lower drug prices, and no company has publicly indicated an intention to do so. The pressure from the US administration to reduce drug prices is not expected to have a material impact on the industry in the near-term. Continued production and sales growth should be sustained by the aging “baby boomer” generation and a subsequent surge in demand for pharmaceutical/health care products.

Profit margins of US chemicals and pharmaceuticals businesses are generally stable, and the amount of protracted payments is low. On average, payments in the industry take between 30 and 90 days. The number of insolvencies is low compared to other sectors, and is expected to remain so in 2018, consistent with improving demand for chemicals and pharmceauticals.

Our underwriting approach to the chemicals and pharmaceuticals sector remains generally positive to neutral for the time being. As the sector is highly fragmented and dependent on the broader economy and input costs, we scrutinise single subsector trends and end-markets. We also closely monitor US chemicals companies that do business in countries where the local currency has significantly devalued against the USD.

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals
		

Source: Atradius

Market performance at a glance

Brazil

- In line with the recovery of the Brazilian economy (GDP is forecast to increase 2.4% in 2018 and 3.2% in 2019) the chemicals sector is expected to grow by more than 3% in 2018 and 2019. Both chemicals and pharmaceuticals businesses are expected to improve their results and margins further this year. The level of competition in both the chemicals and pharmaceuticals sectors is high and a concentration process is ongoing - in particular among medium-sized and large players.
- Turnover in the pharmaceuticals segment increased 6.2% year-on-year in Q1 of 2018, up to BRL 11 billion, which nevertheless was below expectations, due to price adjustments below inflation. That said, stable sales growth is forecast for pharmaceuticals in the coming months. Larger drugstore chains continue to expand and to open new stores, increasingly offering over-the counter (OTC) products like cosmetics and selling natural healthy foods. Another boost could be the potential expansion of the "Aqui tem Farmacia Popular" scheme, which aims to improve public access to medicine, offering subsidized products.
- Apart from a few large players, most Brazilian chemicals and pharmaceuticals businesses are highly leveraged, which is also the result of previous expansion activities before the recession started in late 2014. While being highly dependent on bank financing, financial institutions are generally willing to provide loans to chemicals and pharmaceutical businesses.
- Payments take up to 120 days in the chemicals sector and average 90 days in the pharmaceuticals industry, with payment behaviour influenced by consumer spending capacity and public sector spending behaviour. In the pharmaceuticals segment, businesses that are serving the public sector and retailers suffered payment delays in 2016 and in 2017. However, the current economic rebound should help to avoid a further increase in late payment cases, and business insolvencies in both the chemicals and pharmaceuticals sectors are expected to decrease in 2018.
- Our underwriting stance on the pharmaceuticals sector is generally open, as the main market players are rebounding. However, there are still players that could suffer from restrictions in federal spending for public health, while a continued high unemployment rate could hamper higher growth in the retail segment.

Brazil: Chemicals

	2017	2018f	2019f
GDP growth (%)	1.0	2.4	3.2
Sector value added growth (%)	0.6	3.5	3.2

Average sector growth over the past 3 years (%)	-2.1
Average sector growth over the past 5 years (%)	-1.3
Degree of export orientation	medium
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals
		

Source: Atradius

- Our underwriting stance on the chemicals sector is neutral. The agrichemicals sector remains susceptible to sudden changes in important exogenous factors like climate, market prices and exchange rate fluctuations. In the basic chemicals subsector most raw materials have to be imported, and production costs are therefore exposed to exchange rate volatility and the looming threat of trade restrictions. Petrochemicals performance is impacted by higher oil prices (denominated in USD) and currency volatility, leading to higher costs, while demand has not yet fully rebounded.

Indonesia

- The Indonesian pharmaceuticals sector value added grew 7.1% in 2017, and in 2018 an increase of about 7.5% is expected, driven by a rising population and roll-out of the government's universal healthcare insurance system, which will expand access to medicine and healthcare.
- Foreign pharmaceutical businesses dominate the market for patented drugs, and have invested more than USD 1 billion to build factories and in clinical research. However, foreign players continue to face significant competition from domestic companies like Kalbe Farma, Tempo Scan Pacific and Kimia Farma. Those local firms are well established with significant activity across various subsectors, including logistics, consumer healthcare and prescription drugs.
- Due to the recent currency depreciation we expect the profit margins of manufacturers to deteriorate in the coming months, as a large percentage of raw materials for pharmaceutical production has to be imported. However, the impact should be partly mitigated by higher sales prices.
- In general, banks are willing to lend to the sector due to the positive performance trend and growth prospects. Gearing tends to be generally lower in manufacturing, but higher in the distribution segment, due to working capital purposes.
- On average, payments in the Indonesian pharmaceuticals sector take 30-60 days. The number of non-payment notifications and insolvencies was low in 2017, and no substantial increase is expected in 2018. Due to this and the favourable growth prospects our underwriting approach to the pharmaceuticals sector is generally positive.
- Our underwriting stance for the basic chemicals and petrochemical subsectors is neutral. Petrochemicals has developed only slowly in recent years, with most players lacking value chain integration (i.e. operating in either the upstream segment or the downstream segment only). While basic chemicals show stable growth rates (mainly driven by construction, automotive, increased urbanization and a growing middle class), inefficiencies and red tape remain stumbling blocks.

Indonesia: Pharmaceuticals

	2017	2018f	2019f
GDP growth (%)	5.1	5.2	5.2
Sector value added growth (%)	7.1	7.5	6.7

Average sector growth over the past 3 years (%)	11.7
Average sector growth over the past 5 years (%)	8.1
Degree of export orientation	low
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals

Source: Atradius

Mexico

- The Mexican chemicals industry is expected to record value added growth of 1.7% in 2018 after increasing 0.3% in 2017, driven by higher sales volumes and higher (often dollar denominated) prices. However, the peso depreciation against the USD and the Euro (a large number of chemical businesses depend on basic chemicals and/or refined oil product imports from abroad, mainly the US) and the liberalisation of fuel prices largely impact businesses results. Profit margins decreased in 2017, and further decline is expected in 2018.
- More than 80% of chemicals businesses in Mexico are small or medium sized, and banks often show only a moderate appetite to provide loans. The main funding vehicles in the industry are supply chains; even for larger businesses that have good access to bank credit to fund projects.
- The common payment terms in the industry are between 60 and 90 days. Payment delays have not increased in 2017, despite many chemical businesses suffering from decreased liquidity due to higher import prices for commodities. Higher prices were able to be passed on to clients and end-consumers. A substantial increase in payment delays and defaults is also not expected in 2018.
- Despite higher pressure on businesses margins we maintain a neutral underwriting approach on the petrochemicals and basic chemicals segments for the time being, taking into account the robust performance seen over the the past couple of years. However, taking into account exchange rate volatility and dollar denominated prices for commodities, we closely monitor every single buyer's performance (especially cash generation capability, leverage profile and the foreign debt/dollar denominated turnover structure).
- Our underwriting stance is also neutral to the pharmaceuticals sector. While businesses in this segment are usually financially robust and well eatablished, final customers such as consumers and public health institutions are susceptible to adverse economic developments.
- We are very restrictive on the energy and fuel sectors (gasoline, diesel, fuel distributors) due to high credit insurance claims in 2017 and early 2018. The black market for fuel trading is growing further, increasing the risk for businesses that even unknowingly buy fuel from doubtful sources. They could face problems with the authorities or become engaged in commercial disputes when the origins of the product has to be verified for tax reasons.

Mexico: Chemicals

	2017	2018f	2019f
GDP growth (%)	2.3	2.2	2.4
Sector value added growth (%)	0.3	1.7	2.1

Average sector growth over the past 3 years (%)	0.0
Average sector growth over the past 5 years (%)	0.4
Degree of export orientation	low
Degree of competition	average

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals

Source: Atradius

Poland

- According to the Polish Central Statistical Office, chemicals production grew 4.6% in 2017, with rubber and plastics production even increasing 9.5%. In 2018 further production growth is expected, although at a slower pace, supported by GDP expansion forecast of more than 4%.
- Many players have strong market positions, domestically as well as in Central and Eastern Europe. This enables them to focus on innovations (more than 20% of the existing patents in Poland stem from the chemicals sector) or to expand into new market segments with mergers and acquisitions.
- Chemicals businesses' profit margins are expected to remain stable in 2018. Gearing in the Polish chemicals sector is average, and many companies use investment credits in order to finance their investment projects for innovations. Polish banks are generally willing to provide loans to the industry. The Polish benchmark interest rate has remained low at 1.5% since March 2015, and the subsequent low interest rates for credit has spurred chemicals businesses to use bank loans to finance their investments.
- On average, payments in the Polish chemicals sector take 30 to 60 days, but can take 180 to 240 days for seasonal products (e.g. fertilizers). Payment behaviour has been good over the past two years, and the number of non-payments and insolvencies has been low. Given the solid performance of the chemicals sector, no major increase in business failures is expected in 2018. However, in early 2018 we noticed several payment delays in the fertilizer distributors segment.
- Our underwriting stance remains generally open for the chemicals sector. However, we are restrictive on fuel wholesalers and smaller fuel station chains in the petrochemicals subsector due to a grey economy in fuel trade in the past, which has led to increased VAT and excise tax controls.
- Our underwriting stance for the pharmaceuticals segment is neutral, with a more cautious approach concerning drug wholesalers, as the government heavily regulates the market. New regulations on the concentration of pharmacies (e.g. restrictions on pharmacy ownership) and drug distribution could influence performance and results of all market players.

Poland: Chemicals

	2017	2018f	2019f
GDP growth (%)	4.5	4.2	3.5
Sector value added growth (%)	3.2	3.4	2.7

Average sector growth over the past 3 years (%)	2.8
Average sector growth over the past 5 years (%)	1.0
Degree of export orientation	medium
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals

Source: Atradius

Turkey

- Turnover in the Turkish pharmaceuticals sector is expected to grow in 2018, supported by price hikes passed by the government in 2017 and early 2018. Therefore, profit margins of businesses are expected to increase this year. Competition in the pharmaceutical sector is not overly high as the market is well regulated (all prices and margins are set by the government).
- Among other subsectors the basic chemicals segment has been impacted by a slowdown in construction activity, less demand from plastics and textiles buyers and economic volatility ahead of the June 2018 general elections. Margin deterioration cannot be ruled out, as the import-dependent chemicals sector has been affected by the sharp Lira depreciation against the Euro and the USD. Most impacted by commodity price volatility and currency volatility is the oil-dependent petrochemical sector.
- In contrast to pharmaceutical businesses, many chemical companies are holding bank loans in foreign currency, making them susceptible to foreign exchange risks.
- On average, payments in the Turkish pharmaceuticals sector take between 90 days and 120 days, in the chemicals sector the range is 100 days to 180 days. As the Turkish Social Security Institution (SSI) is the main customer of the pharmaceuticals sector with a share of about 90%, non-payment risk is muted.
- That said, in 2018 both non-payment notifications and insolvencies are expected to increase in the chemicals sector, as lower sales and lira depreciation since the end of 2017 negatively affect the liquidity of businesses and their payment behaviour. Pressure on the financial strength of chemical businesses is exacerbated by several interest increases to combat inflation leading to higher borrowing costs, while banks are generally reluctant to lend to the chemicals industry.
- Our underwriting stance for pharmaceuticals remains neutral for the time being, due to persistent growth and increased profitability, triggered by recent price increases. However, due to public price regulation there is the potential risk that the government lowers purchasing prices in order to reduce budget expenditures.
- Due to the current issues, our underwriting stance for all chemicals subsectors has generally turned to restrictive, unless buyers are part of a big group and/or provide their most recent financial information.

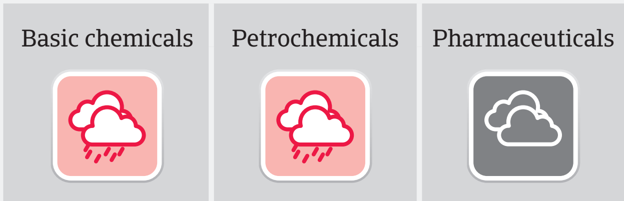
Turkey: Pharmaceuticals

	2017	2018f	2019f
GDP growth (%)	7.3	4.4	3.1
Sector value added growth (%)	-0.3	3.0	3.4

Average sector growth over the past 3 years (%)	4.2
Average sector growth over the past 5 years (%)	5.2
Degree of export orientation	low
Degree of competition	average

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors



Source: Atradius

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United Kingdom

- The British chemicals and pharmaceuticals industries add about GBP 18 billion of value to the UK economy every year, and combined they are the largest exporter of manufactured goods. The chemicals segment accounts for 6.8% of UK gross value added manufacturing, whilst pharmaceuticals contributes 7.7%. Chemicals and chemical products account for about 4.5% of exported goods, while pharmaceutical products represent 8.2% of goods exported. Compared to other sectors business investment is high, at about GBP 4.3 billion in 2017.
- The chemicals and pharmaceuticals industries mainly comprise small to medium Enterprises (SMEs) and microbusinesses, while a number of major firms are headquartered in the UK. The majority of businesses are mature with a stable customer base, as high entry barriers protect the industries (regulatory requirements and required high capital expenditure).
- Chemicals contribute to a range of sectors such as aerospace and automotive through the provision of coatings, adhesives, rubbers and plastics. It also provides intermediary ingredients to pharmaceuticals, cosmetics, agrochemical, personal care, paint and home care sectors. The pharmaceutical sector is part of a global industry in which the UK is a leading European market and producer.
- A large number of chemicals businesses rely on asset-based finance for financing. In most cases profit levels are sufficient to cover the interest. Bank financing facilities are adequate, and business refinancing does not appear to be a problem.
- On average, payments in the British chemicals sector take between 60 days and 90 days. Payment experience has been very good over the past couple of years, and the level of protracted payments is low. The number of non-payment and insolvency cases was low in 2017 and 2016, and this trend should largely remain unchanged in 2018.
- For the time being our underwriting approach to the chemicals sector remains generally positive for all major subsectors (basic chemicals, petrochemicals, fine and specialty chemicals). The same accounts for the pharmaceuticals industry.
- However, the potential repercussions of Brexit on the domestic economy pose a downside risk for businesses profitability and payment behaviour in the mid-term. Both chemicals and pharmaceuticals are part of a tightly integrated EU supply chain that relies on friction-free transfer of ingredients and finished products. At the same time, the EU accounts for 60% of British chemicals and pharmaceuticals exports.

UK: Chemicals

	2017	2018f	2019f
GDP growth (%)	1.8	1.7	1.7
Sector value added growth (%)	2.6	3.2	1.4

Average sector growth over the past 3 years (%)	1.3
Average sector growth over the past 5 years (%)	1.5
Degree of export orientation	high
Degree of competition	very high

Sources: Macrobond, Oxford Economics, Atradius

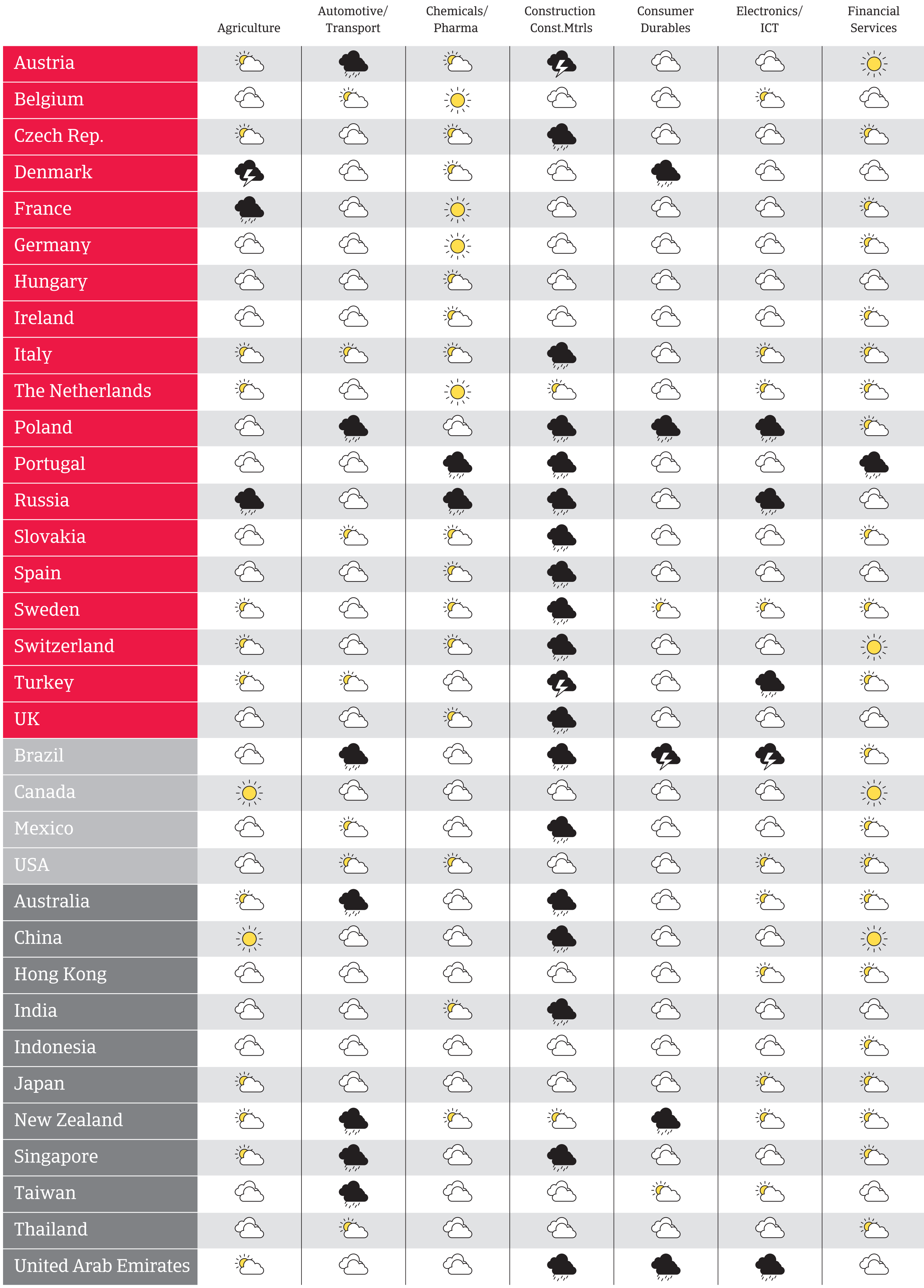
Performance forecast along subsectors

Basic chemicals	Petrochemicals	Pharmaceuticals

Source: Atradius

Industries performance forecast per country

July 2018



Food	Machines/ Engineering	Metals	Paper	Services	Steel	Textiles
Good	Good	Fair	Fair	Good	Poor	Poor
Good	Good	Fair	Poor	Poor	Good	Poor
Good	Fair	Fair	Fair	Fair	Fair	Poor
Good	Fair	Fair	Bleak	Fair	Poor	Poor
Fair	Fair	Fair	Poor	Fair	Fair	Poor
Fair	Good	Fair	Poor	Good	Fair	Poor
Fair	Good	Poor	Fair	Good	Poor	Poor
Good	Fair	Fair	Bleak	Fair	Fair	Poor
Good	Excellent	Fair	Fair	Fair	Fair	Poor
Excellent	Good	Good	Fair	Good	Fair	Fair
Fair	Poor	Fair	Fair	Good	Fair	Fair
Fair	Fair	Poor	Fair	Good	Poor	Poor
Fair	Bleak	Fair	Fair	Poor	Fair	Fair
Good	Good	Fair	Fair	Fair	Fair	Poor
Good	Fair	Fair	Poor	Good	Fair	Poor
Good	Good	Poor	Fair	Fair	Poor	Poor
Good	Good	Fair	Fair	Good	Poor	Fair
Good	Fair	Bleak	Poor	Poor	Fair	Poor
Fair	Fair	Fair	Poor	Fair	Fair	Poor
Good	Poor	Poor	Fair	Fair	Poor	Poor
Good	Fair	Bleak	Poor	Good	Bleak	Bleak
Good	Fair	Poor	Good	Good	Poor	Poor
Good	Fair	Poor	Poor	Good	Poor	Poor
Good	Fair	Poor	Poor	Fair	Poor	Poor
Good	Fair	Bleak	Poor	Good	Bleak	Poor
Excellent	Fair	Poor	Fair	Good	Poor	Fair
Good	Fair	Poor	Good	Good	Poor	Fair
Good	Fair	Poor	Fair	Fair	Poor	Fair
Good	Fair	Fair	Fair	Good	Fair	Poor
Fair	Fair	Fair	Poor	Poor	Poor	Poor
Good	Fair	Fair	Fair	Good	Poor	Fair
Excellent	Fair	Poor	Fair	Good	Poor	Fair
Good	Fair	Fair	Fair	Fair	Poor	Bleak
Poor	Fair	Poor	Fair	Good	Poor	Poor

Excellent

Good

Fair

Poor

Bleak

Industry performance

Changes since June 2018

Europe

Portugal

Textiles

Down from Fair to Poor

Sales have declined in the first month of 2018, affecting both retailers and textile producers.

Spain

Transport

Down from Good to Fair

Increased oil prices have negatively affected margins, especially in the road transport segment. While growing online sales have increased demand for last mile delivery this requires management of more low volume deliveries, leading to rising costs.

Metals

Up from Poor to Fair

Most metal companies have performed rather well in 2017 and early 2018, and the outlook seems stable despite some uncertainty caused by US punitive tariffs. Nevertheless, caution is still advised as prices can fluctuate rapidly.

Sweden

Construction/Construction materials

Down from Fair to Poor

Sector performance is negatively affected by deteriorating house prices since H2 2017, while the number of sold units in bigger cities has fallen significantly.

Turkey

Construction/Construction materials

Down from Poor to Bleak

Demand for construction is decreasing, while prices for building materials have increased. Competition is fierce, with substantial pressure on business margins. The high indebtedness and weak liquidity of many construction businesses pose a substantial downside risk.

United Kingdom

Agriculture

Down from Good to Fair

Sector performance is negatively affected by increased feed and energy costs, while lingering uncertainty over the final Brexit outcome has dampened business sentiment.

Americas

Canada

Metals

Down from Fair to Bleak

Steel

Down from Fair to Bleak

Both sectors are severely impacted by US tariffs, as Canada is the largest exporter of both steel and aluminum to US industries. The estimated loss for Canada amounts to USD 3.2 billion annually, with about 6,000 jobs at stake.

United States

Metals

Down from Fair to Poor

Steel

Down from Fair to Poor

It is likely that the tariffs on steel and aluminum imports will have just a minor effect in the short short-term, as most products are purchased 2-3 months in advance, but there will be negative effects in the long-term should the tariffs remain in place. The biggest importers of steel are US steel companies themselves, as they import "semi-finished" steel and turn them into finished products for reselling. That is in part because some of the biggest US steel mills are not capable of making the specific types of steel that go into high-grade technology and aerospace products.

Asia/Oceania

Thailand

Financial Services

Up from Fair to Good

Bank loans continue to grow and asset quality has stabilised since the end of 2017, while the banking system also recorded increased operating profit year-on-year in Q1 of 2018. Loan loss provision and capital funds remain high.

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