crédito y caución

Atradius Group

market monitor

Focus on chemicals/pharmaceuticals performance and outlook

June 2012

Keeping afloat – and staying alive

This edition of Market Monitor focuses on two related industries – chemicals and pharmaceuticals. While, as our reports show, both are faring better than many other industries, their fortunes are determined by very different factors.

Firstly, chemicals. It's an industry so inextricably linked to everyday life and to other sectors - from agriculture to aerospace, cosmetics to construction, and textiles to tyres – that its wellbeing relies heavily on the performance of those sectors and on the global economy as a whole. This is well illustrated by our report on the US, whose vast chemicals industry remains troubled by both the depressed US housing market and Europe's economic woes. France too is a major contributor to the global chemicals industry. But, from its position of strength in early 2011, the cracks have begun to show as the European debt crisis takes its toll on all its chemicals subsectors.

A common theme throughout our reports is that of rising costs of raw materials and energy, and its effect, especially on those businesses which cannot pass these costs on. Both the Swiss and Swedish chemicals industries were hampered in their export drive by currency appreciation, although the stronger currencies have made imports of raw materials cheaper. Even Germany, undoubtedly Europe's economic powerhouse, is feeling the pinch, with a worsening of the (generally still satisfying) payment behaviour in the chemicals industry.

And then there is the pharmaceuticals sector, which in general continues to prosper while others falter. The reason isn't hard to find. People in developed nations are living far longer than their forefathers, thanks in large part to the development of cures for ailments that in the past would have proved life-shortening. As our US report succinctly observes, it's a 'needs-based business' and people are prepared to pay for that most precious commodity: their health.

In fact, in most of the reports in this month's Market Monitor, pharmaceuticals seem to be bucking the trend of an otherwise downbeat economic environment, with a positive outlook driven by the continuing demand of an ageing population. In Italy, the pharmaceuticals industry has also profited from its sales to China, where consumers are prepared to pay premium prices for goods produced in Europe.

Of course, the sector is not without its challenges. The industry in France is suffering from healthcare cuts, while in Sweden the number of insolvencies in the industry is on the rise. Research and development, indispensable to the industry's future, is a huge expense, while fierce competition is an ever-present factor.

Belgium

Substantial increase in investment and innovation in 2011

The Belgian chemicals, plastics and life sciences sectors continued their good performance of H1 2011 in the second half of the year, albeit at a slower pace. According to the Belgian chemicals association Essenscia, turnover totalled EUR 58 billion (+11% year-on-year) in 2011, due to an increase in volumes as well as higher selling prices. In general the chemicals sector was able to pass on higher raw materials and energy prices to end customers. After the robust increase in 2011 Essenscia expects moderate production growth in 2012.

The Belgian chemicals/pharmaceuticals sectors are heavily dependent on exports (80% of products are exported: mainly to other European countries and the US). After a sharp increase in 2010, the sectors´ exports rose again in 2011, reaching EUR 109 billion. The chemicals/pharmaceuticals industries remain Belgium's leading export sector, with a positive trade balance of EUR 26 billion.

In 2011 investments increased 37% to EUR 1.82 billion, after a net decline in 2009 and 2010, returning to pre-2008 credit crisis levels. This amount accounted for one quarter of all business investments in Belgium. This investment surge in Greenfield, extension and renewal has been seen across all subsectors. At the same time expenditure on research and development (R&D) increased 11%, to EUR 2.7 billion, an all-time high. For the first time since 2008, the recovery has also led to an increase in employment, with the creation of 1,000 new jobs, bringing employment in the chemicals/pharmaceuticals industries to 90,300.

Therefore, it comes as no surprise that, compared to other Belgian sectors, the general equity strength, solvency and liquidity of chemicals/pharmaceuticals companies still remains above average. Payments in the industry currently take around 30 days from invoice date. Payment behaviour has been good in the past couple of months, and we expect it to remain so for the rest of the year.

Insolvency rate below Belgian business average

On average, compared to other Belgian industries, the chemicals default and insolvency rates are also very good – one of the best in the Belgian market - and we see no reason for this to change in the near future unless exceptional circumstances occur. The chemicals sector has one of the lowest claims ratios in Atradius Belgium. This is in contrast to the overall business trend, as we expect Belgian business insolvencies to increase 5% in 2012 following the 6.7% rise in 2011.

As a result, our underwriting stance is relaxed for the time being, with normal monitoring: 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 to obtain interim results. We review sensitive cases or companies that have high exposures 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.

Belgian chemicals/pharmaceuticals sector

STRENGTHS	WEAKNESSES
Belgium is one of the largest chemicals manufacturing countries worldwide. Antwerp is the second-largest chemicals hub in the world	Lack of competitiveness due to the fact that labour costs are the highest in Europe.
High investments and high level of R&D	The majority of the total investment value originates from foreign-based parent companies
Belgium is localised in the heart of Europe; highly export-oriented (80% of production). Positive trade balance of more than EUR 25 billion	Sensitivity to commodity prices (mainly oil and derivatives) and strong EUR against US$ exchange rate. The steady rise in the additional costs for renewable energies threatens international competitiveness. If the current policy is not modified, the additional costs are expected to increase 60% between now and 2020

France

Chemicals performance has slowed since H2 of 2012

The French chemicals industry, comprising 900 businesses and 156,000 employees, accounts for around 4.5% of global chemicals sales. With revenue of EUR 86.7 billion, France is Europe's second largest, and the world's fifth largest, producer.

According to the French Chemicals Association UIC, sales of French chemicals grew 13% in 2011 and production increased 5.9% (compared to 8.9% in 2010). Production levels were high in the first half of 2011 due to strong demand in both domestic and export markets. Demand for manufactured products was robust and stocks were kept low. However, the second half of the year saw most European economies slowing and uncertainties rising as a result of the sovereign debt crisis in the Eurozone. This has led to lower demand from industrial clients, lower production and increasing stock levels. In Q1 of 2012, chemicals production increased 3.5% from the previous quarter, but was down 1% year-on-year. The UIC expects only1% production growth in 2012 and 2% in 2013. This subdued outlook is explained by the uncertainties arising from the Eurozone debt crisis and weaker growth in both France and its EU neighbours. All chemicals subsectors will be affected by the continued deterioration in the EU business climate, but those dealing with industrial clients will be hit worst. Order books for French chemicals companies are expected to decrease in the troubled domestic construction and automotive sectors, but to level off at least in the aeronautic, packaging and food sectors. Beyond Europe, the economic situation is better and demand for French chemicals from Japan, the US and emerging markets is expected to remain strong.

% CHANGE IN PRODUCTION VOLUME	2009	2010	2011	Forecast 2012	Forecast 2013
Inorganic chemicals	-2.1	11.4	6.4	0.8	1.8
Organic chemicals	-8.7	3.6	-1.3	-0.5	1.1
Speciality chemicals	-12.8	4.6	5.1	-1.0	0.8
Soaps, perfumes and household products	-6.7	14.1	10.1	3.5	3.5
CHEMICALS INDUSTRY ex. Fibres	-9.5	8.9	5.9	1.0	2.0

Source : UIC May 2012

Our positive underwriting stance remains

As in 2010, the profit margins of French chemicals companies continued to improve throughout 2011, ending the year in a satisfactory state. The sector is generally characterised by an acceptable level of liquidity. In our experience, payments in the industry take 60 days on average, including payments from abroad: a situation that has remained unchanged since 2010. Despite the slowdown, we do not expect any deterioration in payment behaviour in the coming months.

Compared to other industries, the French chemicals industry has a very low insolvency rate across all subsectors. The total number of French business insolvencies in 2011 was 49,500 cases, of which only about 170 were chemicals businesses. We don't expect any significant deterioration for the sector in the coming months, while we do expect overall French business insolvencies to increase again this year: by 5%.

Despite the more subdued outlook for 2012 and 2013, based on the low insolvency rate and above average financial fundamentals our underwriting approach remains generally positive for the chemicals industry. However, we still closely monitor chemical companies´ capacity to cope with price pressures and to ensure an adequate and constant supply of basic chemical products: both of which are potential hazards for solvency and liquidity, especially for small and medium-sized companies. We also more closely scrutinise highly leveraged companies and businesses dependent on the construction sector.

French chemicals sector

STRENGTHS	WEAKNESSES
Excellent knowledge/leadership position in some key product areas	Continued deterioration of EU business climate
Basic chemicals: world class players	Decreasing demand from the construction sector
Financial flexibility	Threat to competiveness due to Euro exchange rate
Integrated industry in France	Threat from emerging markets competition

France

Pharmaceuticals: lower exports and a difficult market

The French pharmaceuticals industry comprises more than 250 laboratories or drug manufacturers, around 2,800 hospitals or clinics and more than 22,000 pharmacies. It employs around 300,000 people, including 195,000 employed by wholesalers and pharmacies. With EUR 51 billion revenue (47% from exports) the French pharmaceuticals industry accounts for about 4.6% of global drug sales.

Currently, both the French and European pharmaceuticals industries are facing real challenges. Besides additional regulatory hurdles and escalating R&D costs, the sector has been severely hit by the impact of fiscal austerity measures introduced by governments across much of Europe in 2010 and in 2011, leading to cuts in the health sector. According to Le Crédit Lyonnais, overall turnover in the French pharmaceuticals industry grew 2.3% in value in 2011. However, pharmacies´ turnover grew only 0.4%. 2011 was characterised by increasing sales of generic products – which now account for 25% of total reimbursed drugs - and by government pressure on health expenses. Export sales grew just 4%, impacted by a poor economic environment and by the long-term negative impact of the Mediator scandal (the Mediator weight loss and anti-diabetic drug is supposed to have caused between 500-2000 deaths before it was banned in 2009). French pharmaceuticals companies export mainly to Europe and the USA: both mature markets with far lower growth rates (+1.8% and +3.3% in 2010) than those recorded in emerging markets (Brazil: + 20% and China +22% in 2010). In the long term, the geographical balance of the pharmaceuticals market is likely to shift gradually towards emerging markets and French companies will have to follow suit.

The outlook for 2012 is rather downbeat, with only 1.5% growth forecast. In line with austerity policies across Europe, health expenses will be strictly controlled in France, prices suppressed and the list of drugs for which the cost can be reimbursed will be shortened. Export sales are expected to grow only around 3%. Finally, there are for the moment no signs of innovation or new drugs to boost the market. IMS Health anticipates a reduction of 2% in value of the French market for reimbursable drugs (72% of the market). As international players, pharmaceuticals producers are best placed to cope with the increasingly difficult business environment. But domestic wholesalers and pharmacies will continue to be severely affected, with government directives to reduce drug consumption and lower consumer spending both leading to fewer orders. However, as the French pharmaceuticals market is highly regulated, both retailers and wholesalers are at least still well protected from foreign (especially European) competition. The profit margins of the whole pharmaceutical industry are expected to decrease in 2012. French pharmaceutical producers will still benefit from generally strong financial profiles, with robust solvency and liquidity, while wholesalers and drug retailers/pharmacies will fare less well, without the capacity to reduce general and administrative costs and protect their margins. Their financial profile and liquidity situation is therefore expected to deteriorate rapidly. The whole industry has to re-think its model in order to survive and adapt to the shifting market environment.

Pressure on wholesalers and drug retailers/pharmacies will increase

In our experience, on average, payments in the industry are made within 35 days. We saw no worsening of payment behaviour nor any increase in notifications of non-payment in 2011, and do not expect a major change in the coming months. Compared to other industries, the French pharmaceuticals industry has a very low insolvency rate and, despite the unfavourable business environment, the number of insolvencies did not increase in 2011. However, difficulties are now mounting among the weakest wholesalers and drug retailers and this is reason for caution. Domestically, as sales of French pharmaceuticals will continue to be hampered by cuts in the health sector for at least the next two years, turnover growth will remain under pressure and companies will have to adapt even more to the challenges of tight controls over social and health spending, the surge of generic products, increased competition and lower margins. Despite mounting problems, our underwriting stance currently remains positive for the French pharmaceutical industry, as it is still performing well compared to many other trade sectors. However, we will be increasingly cautious regarding drug wholesalers and retailers.

French pharmaceutical producers/laboratories

STRENGTHS	WEAKNESSES
Recognised know-how	Low presence outside Europe (especially in emerging markets)
Sound financial situation	Lack of investment in biotechnology in France
Still comfortable margins	Competition from generic drugs

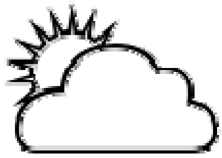
French pharmaceutical wholesalers

STRENGTHS	WEAKNESSES
Highly regulated market	Small compared to European competition
Few players	Low and deteriorating margins
Integrated industry in France	New sources of revenue need to be found

French pharmacies

STRENGTHS	WEAKNESSES
Protected by the state	Too many players
	Costs too high compared with margins
	Further cuts in the health sector to come

Italy



A 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 achieved a less dynamic result in 2011, according to the Italian chemicals association Federchimica. Overall, turnover in this segment decreased 1% year-on-year in 2011. Chemicals exports, at least, continued to show a positive trend (up 3.1% in volume). In the early months of 2012, the chemicals sector has again been helped by an export increase (+2% in volume): lower than the figures recorded in 2011 but still at a positive level.

As in the first half of 2011 pressure from the rising cost of raw materials, both synthetic and natural, persisted in the second half of the year, with prices almost always above their peak 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. This industry is highly energy-intensive and therefore strongly affected by any increase in gas any and fuel costs: while Federchimica forecasts the positive impact in 2013 of a reduction in energy costs, 2012 will be another year of high costs.

Petrochemicals represent 14% of Italy's total chemical production. In 2011, consumption decreased 2% year-on-year (gasoline down 5.5% while diesel consumption rose by 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 had improved and by the end of 2011/beginning of 2012 almost all production had 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 but growth slowed in 2011, especially in the second half of the year, showing an increase of only 1.3%. While for basic inorganics total production in 2011 increased 2%, the plastics subsector recorded a 2% decrease on its 2010 level (which was already significantly lower than 2008 pre-crisis). The fertilizer subsector's level of production was also lower than pre-crisis, while man-made fibres continue their growth path, with an 8% increase in 2011.

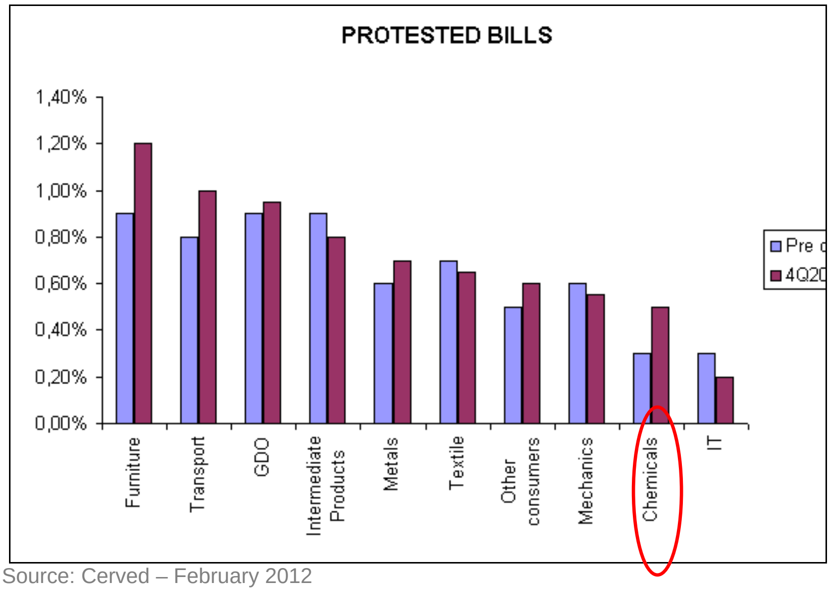
Consumer chemicals (19.7% of production): this segment consists of soap and detergents (12.4% of total Italian chemicals production) and perfumes and cosmetics (7.3%). In 2011, production in the cosmetics segment grew 6% over 2010, thanks in particular to exports (+19%). However, production of soap and detergents decreased 1%.

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%). Turnover of crop protection in 2011 increased 1.6%, thanks to an increase in prices and the absorption of the decrease in volumes by 0.4%. There is also a positive export trend for fine chemicals, despite some concerns about the shortage of raw materials.

Pharmaceuticals: This is a segment of speciality chemicals (see above) which, even in a difficult environment, maintained positive results in 2011. The volumes sold and the overall profitability remained substantially in line with the previous year. Exports were the main growth driver in 2011 and will continue to be so in 2012: especially those to the US and Japan. The Chinese market provides new opportunities and a readiness to pay higher prices for pharmaceuticals goods produced in Europe, in recognition of the higher quality. However, forecasting profitability for this segment in 2012 is difficult because of USD/EUR exchange rate fluctuations and the fact that the pharmaceutical sector exports more than 85% of its total production.

More payment delays in the last couple of months

In our experience, payments in the chemicals sector took, on average, 102 days in 2011: over 10 days more than in 2010. We have seen an increase in the notification of non-payments in the last couple of months but, when looking at the incidence of unpaid/protested bills on industry exposure, it is evident that the sector is still performing better than the Italian industrial average.



Source: Cerved – February 2012

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, the slowdown in economic activity and deteriorating domestic demand resulting from Italy's current problems are likely to affect the chemicals sector. In 2012 we expect that, with ongoing economic problems, domestic demand for chemicals will remain much 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 this year (forecast to decrease 1.7% year-on-year in 2012) and next.

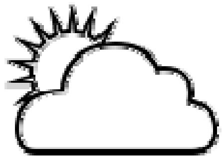
In contrast, energy and pharmaceuticals will perform better than the sector average, thanks mainly to inelastic market demand. In addition, pharmaceuticals provide high market entry barriers for new players, requiring high investments to be profitable.

Although, in the chemicals sector, payment behaviour and insolvency development has been generally satisfactory until recently, we expect a higher number of insolvencies and more payment problems in the coming months. Those mainly affected will be segments directly connected to consumers, such as perfume and cosmetics, and companies reliant on the domestic market. However, the chemicals sector's insolvency rate is below the industry average, as borne out by our claims experience. Overall, we expect Italian business insolvencies to increase 10% in 2012.

With the current political and economic uncertainties, our underwriters are monitoring the chemicals sector closely, anticipating possible defaults and identify the best performing subsectors. 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 adequate self-funding and/or a healthy financial structure, and for absorbing raw material increases by passing them on. That said, our relaxed underwriting attitude towards the pharmaceutical sector remains for now, as its history of non-payment is much lower than the portfolio average.

Italian chemicals/pharmaceuticals sector

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



United States

Chemicals: close links to the conditions of the US economy

Despite signs of improvement in the US economy (expected to grow 2.3% in 2012 after 1.7% in 2011), its chemicals companies are troubled by problems in Europe. High input costs, weaknesses across some key end-markets (such as construction and electronics) and the European debt crisis remain major impediments to growth. However, the industry is well placed to reap the benefits afforded by emerging markets, with Asia offering major opportunities for growth.

The US chemicals industry represents 19% of global chemicals output and employs more than 800,000 people. It contributed 10% of the nation's merchandise exports, totalling US$ 145 billion annually, and another 5.5 million jobs are supported by the industry's purchasing activity.

The rather sluggish US economic performance last year took its toll, as US chemicals production grew just 2.1% (nominal) in 2011, compared to growth in South America and Asia (excluding Japan) of 4.7% and 11.1%, respectively. The US manufacturing sector is the largest consumer of chemical products, and Federal Reserve data shows that overall manufacturing output rose 0.3 % in April 2012, following a 0.5 % increase in March. Output in several key chemical end-use markets increased, including motor vehicles, aerospace, construction supplies, machinery, computers, plastic and rubber products, paper, textile mill products and furniture. Consensus Economics expects overall industrial production to increase 4.3% year-on-year in 2012 after 4.1% in 2011.

In April 2012 total chemical production increased 0.3 % year-on-year, showing improvement except in the Gulf Coast, Mid-Atlantic and West Coast regions. Comparing the first four months of 2012 with those of 2011, chemical production was up 0.5 %, with all regions ahead except the Gulf Coast. Along subsectors the progress of chemical production was mixed. Output slipped in several key segments including organic chemicals, plastic resins and synthetic rubber. Many segments, however, saw rising production, with some of the largest gains in man-made fibres, adhesives, industrial gases, chlorine-alkali and inorganic chemicals.

Some of the key end-markets for chemical products, such as agriculture, are showing an upward trend. However, the US housing sector, a key consumer of chemicals, remains depressed, and will probably continue to be so for the rest of the year. Weakness in the electronics and construction end-markets may weigh on Q2 of 2012 results.

U.S. Chemical Production Regional Index, Percentage Change (Seasonally adjusted, 3-month moving average)	Current Month	Prior Month	Year/Year	Year-to-Date
	Apr 12/ Mar 12	Mar 12/ Feb 12	Apr 12/ Apr 11	YTD 12/ YTD 11
Gulf Coast	-0.5%	-0.3%	-0.5%	-1.4%
Midwest	-0.3%	-0.4%	0.0%	0.1%
Ohio Valley	-0.2%	0.1%	1.7%	1.5%
Mid-Atlantic	-0.3%	-0.6%	-0.4%	0.1%
Southeast	-0.3%	-0.4%	0.6%	0.8%
Northeast	-0.2%	-0.4%	0.6%	1.4%
West Coast	-0.3%	-0.6%	-0.2%	0.3%
U.S. Total	-0.3%	-0.4%	0.3%	0.5%

Source: American Chemistry Council

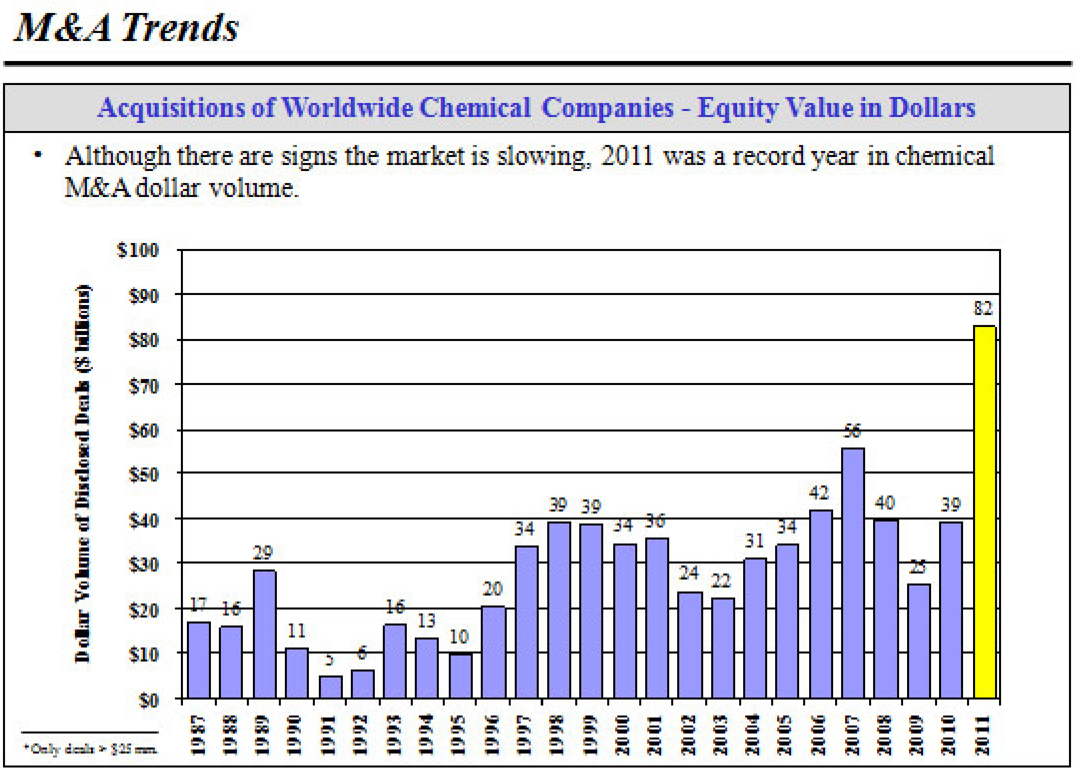
Exports: opportunities and risks

That said, several factors are driving export growth, including favorable energy costs stemming from the abundance of shale gas and strong demand from emerging markets. Affordable natural gas and ethane (derived from shale gas) offer US producers a cost advantage over their global counterparts. Furthermore, cost-cutting measures such as plant closures, aggressive cost containment and production improvement initiatives should yield margin and cash flow improvements. The global nature of the industry puts competitive pressures into sharp focus and US producers have responded by streamlining operations, relocating manufacturing facilities to low-cost regions closer to end-markets, and being more nimble and flexible in responding to market opportunities.

However, given the chemical industry's sensitivity to the global economy, any downturn would be reflected in its prospects. The turmoil in Europe remains a source of uncertainty, with Western Europe posing challenges due to weak demand - particularly in the construction industry and the lingering impact of the debt crisis.

A slowdown in mergers and acquisitions

Mergers and acquisitions (M&A) offer chemicals companies another means to shore up growth. 2011 was an excellent year for chemicals M&A as worldwide deals worth US$ 82 billion were completed – notably 17 deals above US$ 1billion, compared to the norm of seven or eight such deals - easily eclipsing the previous record of US$ 56 billion in 2007 and more than double 2010's result. However, there is clear evidence of an M&A slowdown. While, in June 2011, 23 deals worth US$ 34 billion had been announced, by the end of December the figure had dropped to only 14 deals worth US$ 4.8 billion. One factor is the increasingly gloomy picture for the overall global economic and financial system. Although the chemicals industry is currently enjoying strong profits and cash flow, and is partially cushioned from the effects of a significant downturn by the level of high-capacity utilisation, the customer uncertainty is matched by increasing cautiousness by senior chemicals executives.



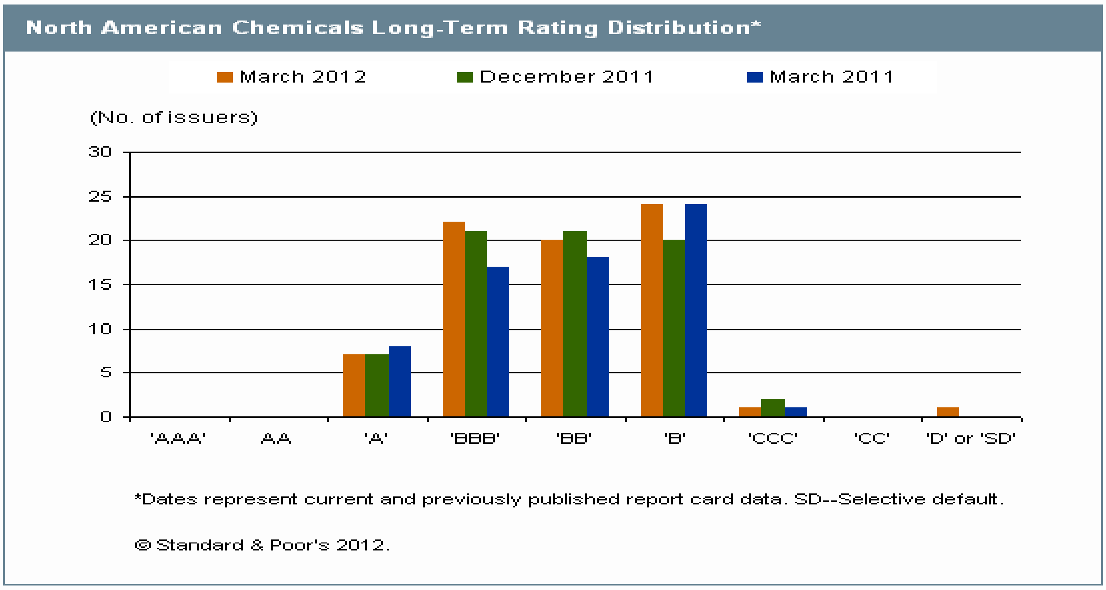
Source: Young & Partners

For 2012, the ACC foresees moderate production growth in US chemicals followed by a stronger recovery in 2013. Output is expected to increase 1.6% in 2012, and then to rise 2.1% in 2013. This outlook depends on certain factors, including strengthening domestic demand and an improvement in overseas exports. Exports increased nearly 11% to US$ 189 billion last year and are projected to surpass US$ 230 billion in 2014.

Payment delays have decreased

On average, payments in the chemicals industry take between 45 and 60 days, and payment delays have decreased since 2008 - a particularly bad year. While we expect fairly steady performance, the sector is cyclical and heavily tied to the overall health and strength of the US economy. Therefore, any deterioration could lead to increased delays. Insolvencies have not increased in the last couple of months and, assuming the situation in the housing and motor industries does not worsen, this should continue. But the recovery remains shaky, and there is still danger of an outright downturn.

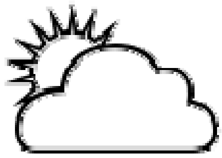
Our underwriting approach to this sector remains cautious. As the sector is highly fragmented, we scrutinise single subsector trends and end-markets. Access to financial information is difficult, but is essential when considering large deals. We review more accounts on a quarterly basis and are adding more buyers to our ‘watch’ list.



US chemicals sector

STRENGTHS	WEAKNESSES
Favourable US$ exchange rates and growth in emerging markets will drive US chemicals exports up	The US housing sector remains a weak end-market
Mergers and acquisitions are an option to grow in the current economic environment	US producers have responded to competitive pressures by streamlining operations. But being more flexible in responding to market opportunities is not easy
Business conditions have improved, with corporate profits and investments rising and production showing solid gains	The recent surge in commodity prices is adding to feedstock costs for many producers and margins will be under pressure
Favourable energy costs	Given the industry's sensitivity to the global economy, growth outlook will be negative, and the recent turmoil in Europe remains a source of uncertainty

United States

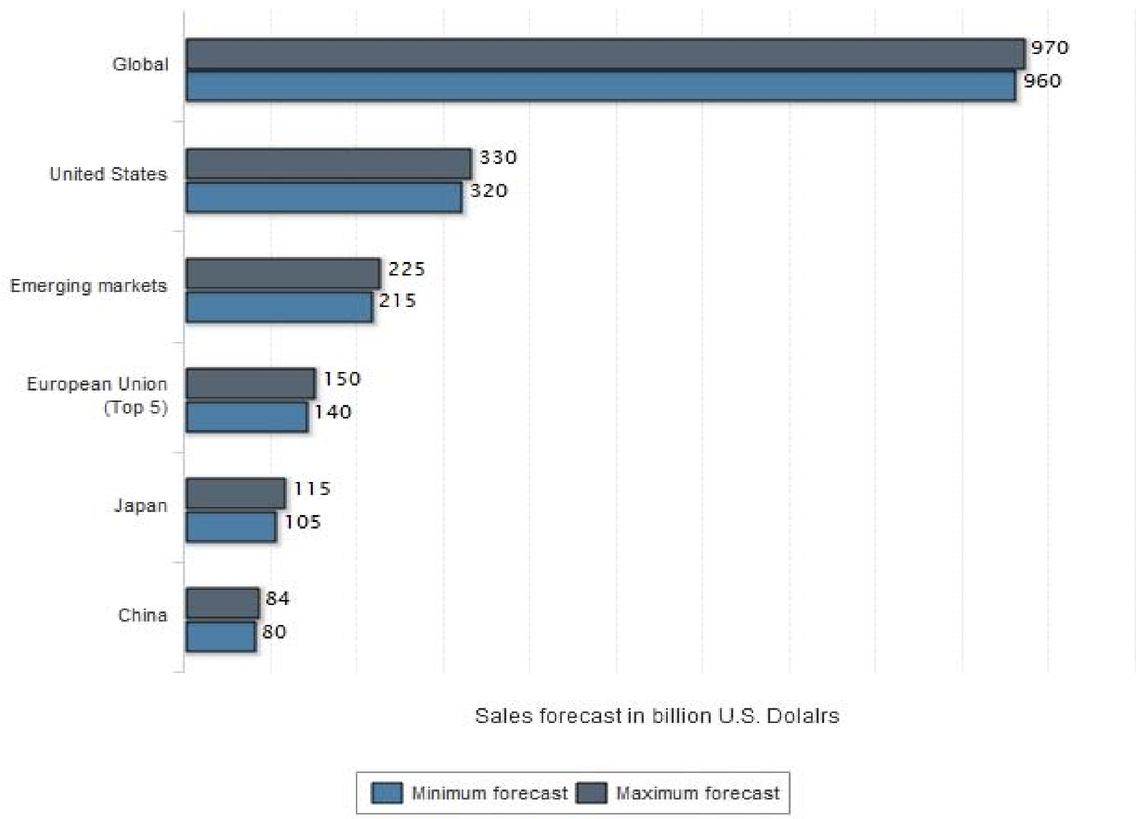


Pharmaceuticals: prompt payments are the norm

The performance of the US pharmaceuticals industry is relatively stable – simply because of consumers' inevitable demand for medical products. We expect revenues to be stable or to improve slightly and margins to level off. We do not expect any major issues in this sector over the next 12 months.

There are no significant pressures on the industry. While the US Government's Medicare & Medicaid programmes will affect consumers, as they will have to pay more for their prescriptions, there will be less impact on manufacturers. Patent infringement issues are rare but patents that expire and are replaced by cheaper generic drugs will, in the short term, affect the companies that developed those drugs. However, this will be compensated by the development of new medicines designed to relieve other ailments.

Sales forecast for the global pharmaceutical industry in 2012, by region (in billion U.S. Dollars)



Worldwide; IMS Health; 2011

Source: IMS Health

© Statista 2012

Payments tend to be prompt in this sector as it is a 'needs-based' business. If invoices are not paid promptly, orders are withheld until payment is made. Generally, terms are 30 days but may increase to 60 days when new drugs are released into the market. We do not expect any increase in payment delays in the coming months.

On average, compared to other US industries, the pharmaceuticals sector's insolvency rate is very good, and we do not expect any short-term change to this situation. Smaller pharmacies will continue to be most at risk as they will find it tougher to compete with larger, national firms such as CVS, Walgreens and even Walmart. However, when they do occur, closures of smaller pharmacies tend to be conducted in an orderly way, with stock and client lists sold to the larger pharmacies, so that producers suffer few, if any, losses. Hospitals need to be more closely monitored due to changes in the Medicare/Medicaid laws which may, in the long term, cause more insolvencies in this subsector.

Stable to strong performance continues

We expect the pharmaceutical sector's performance to remain stable and even strong over the next 12 months. Where patents do expire, to be replaced by generic versions of the drug, there is the potential for loss for the original manufacturer, but the generic manufacturer, consumers and retail outlets will all benefit from lower prices. Consolidation of smaller pharmacies by mergers into national chains will continue at a modest level in the larger metropolitan areas. We will closely watch developments in the Medicare/Medicaid programmes as their impact on hospital operations may in turn affect pharmaceutical purchases.

At present, our underwriting approach to this sector remains positive at the manufacturing level with a slightly more cautious approach at the distribution level. Manufacturers sell most of their products to major distributors such as McKesson, Cardinal Health and AmerisourceBergen: all of which are very strong financially. The distributors then deal with a variety of retail customers and, while some are publicly traded, those in the smaller towns and suburbs may pose a greater risk.

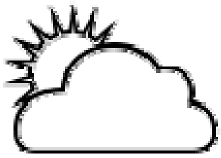
US pharmaceuticals sector

STRENGTHS	WEAKNESSES
Needs-based industry	Generic pricing
Financially strong manufacturers and distributors	Over-development of drugs for same illness causing lower product margins
World leader in pharmaceutical development	

Snapshots

Market performance at a glance

Germany



Payment behaviour worsens, but remains comparatively good

According to the German chemicals association VCI, chemicals/pharmaceuticals performed well in 2011: production increased 2.2% year-on-year in 2011, while turnover rose 7.7%. However, growth slowed down in the second half of the year, and in the final quarter production decreased 4.3% year-on-year, while turnover declined 2.3% on the previous quarter. In the first quarter of 2012 we saw deterioration in payment behaviour and an increase in notifications of non-payment, and expect this to continue in the coming months. However, it should be noted that the German chemicals and pharmaceuticals sector's payment behaviour has always been better than average with no notable payment delays - even at the height of the economic crisis and into 2011.

Both chemicals and pharmaceuticals businesses are generally characterised by strong equity, solvency and liquidity. It is therefore no surprise 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 as long as economic conditions remain stable. In Q1 of 2012, chemicals/pharmaceuticals production rebounded, and for 2012 the VCI expects production to level off year-on-year, while turnover will increase 1%. However, this could be impaired by a worsening of the Eurozone debt crisis and a downturn in the US and Asia. Whatever happens, we expect profit margins in the chemicals sector to stagnate.

Domestically, the pharmaceuticals sector faced a rather difficult year in 2011. The German government has approved several regulatory changes in the health system - including an increased compulsory discount to be granted by the pharmaceuticals industry to statutory health insurance, a freeze on drug prices, and other discount regulations in the health system. This has led to lower turnover and profit margins, especially in the drug retail subsector. This year and in 2013, the pharmaceuticals sector will be affected by the expiry of patent protection of several drugs, leading to decreasing turnover and profits. But, despite all these challenges, the industry looks much more positive and better positioned than one or two years ago. We have noted a good number of new drug developments - some with a peak sales potential of up to US$ 3 billion. Moreover, the German pharmaceuticals sector will continue to profit from increased healthcare spending in emerging markets, thanks to its traditionally strong international position.

The Netherlands

Performing well against the overall economic trend

The Dutch chemicals sector plays a major role in the chemicals cluster of the Antwerp-Rotterdam-Rhine-Ruhr Area (ARRRA). While the Netherlands represents only about 0.2% of world population, it accounts for 2% of global chemicals output. As a result, the Dutch government has designated the industry a national growth sector. According to the National Statistics Office CBS the Dutch chemicals industry’s turnover grew 14% year-on-year in 2011, although production decreased about 2%, as higher commodity costs were passed on in the form of increased prices. Nevertheless, margins were still under pressure, especially as the price of oil rose above US$ 100 a barrel last year.

Despite increasingly difficult market conditions, with lower demand from Eurozone markets and a contraction of Dutch GDP in Q4 of 2011 and Q1 of 2012, the Dutch chemicals industry performed well in the first three months of 2012, with an increase in turnover and production of 6% and 3% respectively, according to BNR Beurs. In view of this notable development, the sector has adjusted upwards its forecasts for the whole year, even though the Dutch economy is expected to shrink 0.7% in 2012.

And, in spite of increased raw materials costs putting pressure on profits, the pharmaceuticals industry also bucked the negative trend in the Dutch economy in the first half of 2011, with turnover growth of nearly 10% and a 5% increase in production. In the future, this sector will also profit from an ageing population – with more need for medical treatment and medication. But at the same time the government and health insurers put more pressure on drug prices to keep health care affordable, and patients will have to pay more for medicine, with more limited reimbursement of medication.

Because 2011 was a good year for both the chemicals and the pharmaceutical sectors, we saw no payment delays, major defaults on payment or insolvencies in the industry. Now, thanks to the positive performance of chemicals in Q1 of 2012, there is optimism for this year too. Against this background, currently we do not expect to have to adjust our current underwriting policy for companies in this sector. Indeed, our credit limit acceptance rate in this segment is slightly above most other sectors. In the case of pharmaceuticals, while future developments in the health care sector are worth monitoring, no major adjustment to our current relaxed underwriting stance is necessary for the time being.

Spain
Many challenges lie ahead

According to the Spanish Chemicals Association Feique (Federación Empresarial de la Industria Química Española), the Spanish chemicals sector comprises more than 3,100 companies, generating 11% of the Gross Industrial Product and employing more than 500,000 people across Spain. The sector is one of Spain's largest exporters.

In 2011, the Spanish chemicals industry's turnover increased 7.7% to more than EUR 57.2 billion, while exports and imports rose 10% and 11% respectively. Persistently weak domestic demand is delaying the recovery of production levels and could well continue into 2013. However, exports will continue to grow, with turnover estimated to rise over 9% this year. That said, higher commodity prices have eaten into margins, which are still steadily declining with no signs of stabilizing.

Commodity price rose again in Q1 of 2012, reversing the downward trend seen in mid-2011, driven mainly by a surge in raw materials for the pharmaceutical and cosmetics industry and for non-ferrous metals. Since these increased costs are hard to pass on to end-buyers, the only solution is to offset them through improved productivity, reduced costs and improved efficiency. Costs are expected to increase further in the coming months.

The Spanish pharmaceutical sector consists of more than 500 companies, laboratories and related concerns, with over 40,000 employees and a total estimated production of more than EUR 12 billion each year.

The sector is a leader in Research and Development (R&D) which accounts for EUR 1 billion annually: 20% of the sector's total expenditure. Exports have increased 50% over the past five years. However, since 2010, the sector has been increasingly affected by government measures to reduce the deficit, i.e. by setting prices and discounts on medicines. Additionally, investment in R&D may decrease this year.

The expiry of many patents in 2012 means that generic drugs will gain market share, forcing a drop in sales of brand name medicines and decreasing revenues. In addition, the Spanish Government is facing difficulties with Autonomous Communities (i.e. Spain's self-governing regions) which are having payment problems with their suppliers. However, the pharmaceutical industry expects there to be a solution to this problem without the need for debt relief.

This sector is responding to its challenges through a process of consolidation, a reduction in operating costs and staff numbers, and an improvement in its debt collection processes. The pharmaceutical industry must restore the productivity of its R&D, while continuing to reduce costs and increase revenue through internationalisation. The preferred route at present is that of merger and acquisition.

On average, payments in the chemicals and pharmaceutical sectors take 60 days and, after a slight increase in payment delays in late 2011, payment times have improved. Overall, payment behaviour in the sector is better than that of the industry in general.

Sweden

Chemicals: decreased profitability in 2011

The profitability of Swedish chemicals businesses decreased in the second half of 2011 and the first quarter of 2012, with overcapacity expected to increase markedly. In 2011, order intake began to decline after a positive first quarter, due mainly to lower demand from abroad hampered by a relatively strong Swedish Krona. At the same time, it has not been possible to pass on all of the increased oil and energy costs to customers. However, following a depreciation of the Krona, export orders rose again in Q1 of 2012. Overall, chemicals producer confidence decreased for four straight quarters from Q2 2011, but seemed to stabilise somewhat in early 2012. Despite these positive signs, the industry is still not optimistic that orders – both domestic and export – will rise in 2012, and output levels for the end of 2012 are expected to remain well below their 2007 peak.

In general, payment behaviour in the chemicals sector is good, with payment delays and notifications to Atradius of non-payments remaining low in 2011 and so far 2012. We do not expect any notable increase in payment delays in the coming months and, compared to other industries, the chemicals sector has a low insolvency rate. However, the number of insolvencies increased to 1% of businesses in 2011, from 0.7% in 2010, and we expect another slight increase over the coming months. In the chemicals sector generally, large established buyers in primary production are strong, while many smaller secondary manufacturers are feeling the effects of increased raw material, energy, and transportation costs, with little opportunity to pass on price increases to consumers. That said, from an underwriting perspective, the chemicals sector is still considered quite healthy.

Pharmaceuticals: adverse domestic market conditions

While pharmaceuticals production increased in 2011, there was a steep decrease in Q1 of 2012. Domestic orders fell in 2011, while export orders increased: a trend that continued in Q1 of 2012 and will do so for the rest of the year. We expect a further decrease in sales prices in 2012, for both domestic and foreign markets. R&D investments in the sector continue to rise, although we have not yet seen the full effect of the closure of AstraZeneca's R&D facility in Södertälje, affecting 1,200 employees.

In general, payment behaviour in the pharmaceuticals sector is good. However, we have received an increasing number of notifications of non-payments and insolvencies in 2011. The market, which was deregulated in 2010, faces many problems - including fierce competition and oversaturation - and is now in the process of eliminating the weaker players. Indeed, we cannot rule out the possibility of one or more of the larger players ultimately failing or withdrawing from the market in the coming years. We expect an increase in insolvencies in 2012, and are therefore exercising extra caution when considering applications for credit insurance cover.

Switzerland
Key strengths despite some export troubles

The Swiss chemicals and pharmaceuticals industry is focused mainly on live science products, which account for more than 75% of the product portfolio. After a strong performance in 2010, with double-digit growth rates, the Swiss chemicals/pharmaceuticals industry was affected last year from weaker demand from EU markets and the appreciation of the Swiss franc, both proving stumbling blocks for an export-driven industry that accounts for more than a third of total Swiss exports. According to the Swiss industry association *scienceindustries*, exports of chemicals, pharmaceuticals and biotech products decreased 1.7% year-on-year in 2011. Pharmaceuticals exports, which account for 80% of total chemicals/pharmaceuticals exports, decreased slightly: by 0.8%). In the domestic market, pharmaceuticals' nominal turnover increased 0.7%, while plastics decreased 7%, after strong growth in 2010.

Short-term prospects for 2012 are for a slight improvement in sales, especially after the introduction of a fixed minimum exchange rate to the euro by the National Bank has reduced currency volatility. Chemicals businesses will continue to feel some pressure on margins due to the still strong Swiss franc but, on the plus side, this makes commodity/raw material imports cheaper. Domestically, chemicals businesses related to construction will benefit from robust building activity in 2012. In their export performance, Swiss pharmaceutical businesses will continue to benefit from the fact that they are internationally highly competitive, due to their leading global position in R&D and high labour productivity. The Swiss pharmaceuticals sector sees growth opportunities in the increasing spend for healthcare in emerging markets (according to *scienceindustries*, exports to the BRIC markets increased 3.7% in 2011, bucking the overall trend).

Domestically drug sales will nominally continue to grow, as healthcare spending is still increasing, but prices are under pressure due to a rising number of generics permitted, as patents expire.

Compared to other Swiss industries, the chemicals and pharmaceuticals sectors´ payment behaviour has always been better than average and has shown comparatively good payment morale. We have seen very few notifications of non-payment and claims in this industry which, compared to other industries, also shows a very low insolvency rate. Due to the overall stable performance and financial health of chemicals and pharmaceuticals companies, we do not expect any notable increase in payment delays or business failures in the coming months. This is in contrast to the overall insolvency development, as we expect Swiss business failures to increase 5% year-on-year in 2012, followed by a 5% decrease in 2013, when economic growth will rebound again, by 1.5% after a 0.8% forecast this year.

In light of these facts and the structural strengths that will drive the performance of chemicals and pharmaceuticals in the mid- and long-term, for now our underwriting stance is relaxed for these sectors.

United Kingdom
Weathering the economic troubles

After decreases in 2008 and 2009 as a result of the global credit crisis, turnover and consumption have increased again in the British chemicals and pharmaceuticals industries. Indeed, over the past decade, the pharmaceuticals sector has generated an ever-widening trade surplus. Currently, in the chemicals sector, demand remains strong across the board and order books are being maintained at decent levels – despite the continuing economic slowdown. Equity strength is healthy throughout the sector and, even where debt facilities are called upon, these are usually well serviced from the borrower's sound profitability. There is no sign of a reduction in bank lending to this sector, in view of the considerable tangible asset bases that can act as security. Many businesses demonstrate good profit-to-cash conversion rates and can therefore generate sound levels of cash from their operations. On the whole, liquidity is considered to be very good. In the pharmaceuticals sector, profit margins are holding up and equity strength, solvency and liquidity are strong. Once a drug has cleared all legislative requirements it often becomes a 'cash cow': providing consistent cash flow. Although the cost of research and development can be large in the initial stages, the drug will continue to generate cash until something better comes along and, in view of the UK's current regulatory requirements of the industry, this can take some time.

As in other markets, the surge in oil and energy prices has affected the British chemicals industry: especially the plastics subsector. Many chemicals businesses have had to absorb increased energy costs as these could not be passed on immediately: there is, at best, a three to six months' time lag before selling prices can be increased. However, because of the sizeable profit margins in the industry, this has not been a problem. That said, because the industry has recognised the volatility of commodity costs in recent years, Contract Price Adjustment (CPA) clauses are now the norm.

On average, payments in the UK chemicals and pharmaceuticals industry take between 30 and 60 days. Payment behaviour is satisfactory, and we do not expect any deterioration in the coming months. Where we have seen instances of non-payment, they are mostly the result of disputes (e.g. over the quality of the delivered products) rather than a buyer's inability to pay. Compared to other UK industries, the chemicals/pharmaceuticals insolvency rate is very good, and we expect this to remain the case. The UK chemicals sector will, in our opinion, continue to perform well in the second half of 2012 and beyond, with both domestic and foreign demand for chemical products remaining robust. The growing focus on food packaging and new technology in plastics is proving a constant driver of this demand, with bio-degradable and environmental concerns creating new opportunities and niche markets. The outlook for the pharmaceuticals industry is also bright. There are no plans in the UK to impose austerity measures on the mainstream health sector, i.e. front line healthcare remains a top priority.

Therefore our underwriting stance for chemicals and pharmaceuticals is currently very positive. In general our risk appetite is high and we welcome new business opportunities. Our main criteria for deciding on cover are the latest filed annual accounts and, in the chemicals sector, the subject's customer base and retention rates. If we are asked to consider large limits that appear out of proportion to the trade creditor's position, we may seek clarification of this and perhaps more up-to-date management accounts.

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