



Benelux Chemicals

Fighting the two headed dragon



Executive Summary

We recommend to further reduce weighting in chemicals

In our view, investors should lower their weighting in the chemical sector for 5 reasons: 1) Low factory utilization rates will likely result in a lack of pricing power in the chemical sector. 2) We see an increasing risk that several chemical companies will write down on goodwill due to expensive acquisitions in recent years. 3) Interest costs for chemical companies will remain high due to the perceived risk increase of chemical companies. 4) Earnings will weaken significantly in 2009 and 2010. History shows that earnings momentum is an important driver of share price performance. 5) Chinese manufacturing overcapacity and rising protectionism could be the next nasty surprise.

Earnings will decline in 2009 and will level off in 2010 at best

Following a reasonably resilient 2008 with a sharp decline in demand in Q4, we expect that the demand/supply balance will soften further in the course of 2009. This will depress capacity utilization rates into the foreseeable future, thereby virtually erasing pricing power in the chemical sector. Although some large scale restructurings in the sector are inevitable and happening at this moment, it is yet unclear if any capacity will be shrunk and taken of the market. Main risk to the demand side is a continued worsening of the economy possibly in combination with increased protectionism.

Solvay is our top pick

Within our Benelux Chemicals universe, Solvay is our top pick for 3 reasons: 1) Solvay has the best earnings momentum during 2009-2010E, as it will be the least affected by the economic downturn. 2) Solvay has a strong balance sheet (just like all other Benelux chemical companies) and 3) Cash flow from the pharmaceuticals division should provide the opportunity for Solvay to acquire assets in the plastics or chemicals area at once in a lifetime valuations. Finally a potential sale of the pharmaceuticals division would give Solvay approximately 4-5bn in cash, resulting in even more leeway to foster this recession. On the back of this corporate action we have increased our PT to EUR 75 per share and stick to our Buy rating.

Our recommendation on DSM stays on Hold, as we fear that during the second half of 2009 pricing in nutrition could weaken, which combined with persistent weakness in almost every other division will likely hit earnings significantly going forward. Our 2009 EBIT and EPS estimates are ~30% below consensus. We lower our PT from EUR 19 to EUR 18 per share but stick to our Hold

AkzoNobel is excellently positioned to survive the current downturn as its cash position is large and debt has been refinanced towards a longer maturity. We question if earnings will prove to be so resilient going forward and believe there is downside risk to our estimates as operational leverage could surprise to the downside. Therefore we stick to our Hold rating and PT of EUR 26.

We also reiterate our Reduce rating and PT of EUR 15 per share on Tessenderlo as we see significant earnings risk in the fertilizer division. Last year approximately 80% of EBIT was due to strong agricultural markets driven by high agricultural commodity prices. As agricultural commodity prices have come down significantly during 08Q4, farmers are clearly less eager to maximise production and pay a high price for fertilizers. Therefore we see continued downside risks to fertilizer prices and specifically potash and phosphate prices.