EUROPEAN CHEMICALS

Key Takeaways from ICIS/European Association of Chemical Distributors Virtual Roundtable

Today (19 June) we attended a Virtual CEO Roundtable hosted by ICIS and Fecc (the European Association of Chemical Distributors). In attendance were Patrick Elie (Chairman of the Board at Equilex), Gina Fyffe (CEO of Integra Petrochemicals), Marcus Jordan (CEO of IMCD - covered by Suhasini Varanasi) and Alan Looney (CEO of National Chemical Co.). With this note we outline our key takeaways from the event.

Overall, the messaging struck a markedly bleak tone on the trading backdrop heading into the second half of the year, with clear signals of value destruction observed alongside seasonal demand weakness. Commentary was consistent in noting that a potential resolution to the Middle East conflict is likely to expose underlying overcapacity, while China's export-oriented pivot over the course of the conflict has effectively extinguished any short-lived hopes of a revival in European competitiveness.

We think the event underscored the strategic importance of well-integrated global suppliers such as BASF, which have served as valuable partners to distributors throughout the conflict, helping them avoid production shortages by leveraging their multi-source supply networks. We note a significant uptick in reformulation activity, which we flag as a structural threat to demand; further downstream, a clear preference for longer-term innovation partners was evident aligned with our Buy ratings for names with a high share of sales from customer specific formulations (e.g. Givaudan - 96% vs. ingredients average of 52%) and high R&D spend (Novonesis 11% of sales vs. ingredients average of 6%).

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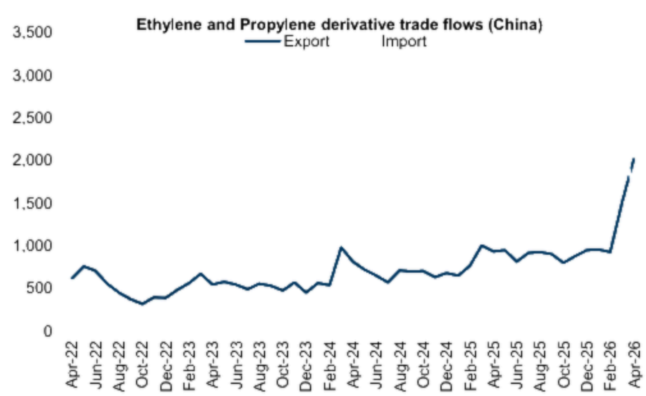
Key Takeaways

1. **Current market conditions reflect genuine value destruction beyond seasonal softness.** While Integra Petrochemicals' CEO acknowledged that emerging demand weakness could partly be attributed to the typical summer lull, it is increasingly clear to her that genuine value destruction is also at play. The CEO cautioned that, even assuming the conflict has ended, normalisation will take longer than expected. Clearing the backlog of ships alone is likely to require around 6–8 weeks. The third quarter is expected to be messy, as buyers fear making decisions and remain uncertain on fair pricing. The messaging was consistent: the end of the conflict is likely to increase exposure to underlying overcapacity, as production returns to normal levels and supply becomes readily available once again. This will be further exacerbated by the release of feedstock currently trapped in the Middle East.
2. **China's positioning during the conflict.** The Chairman of Equilex noted a significant shift in how China has positioned itself to capitalise on the crisis, particularly across intermediates and solvents. With other Asian countries suffering feedstock supply issues and domestic Chinese demand remaining low, he believes excess capacity is forcing product out of China in a manner that has created significant disturbance. ICIS data supports this, with chemical exports from China to the rest of Asia rising 70% in March and April.
3. **Reformulation is accelerating, with some shifts likely to prove structural.** High feedstock prices have driven operators and consumers to reformulate, as expensive inputs can no longer be justified, according to the Chairman of Equilex. While he characterised reformulation as largely a temporary, reversible measure, he acknowledged that some operators may choose to reformulate permanently. The CEO of IMCD confirmed a significant uptick in reformulation demand, viewing it as a positive opportunity for specialty distribution.
4. **Specialty players are prioritising innovation when selecting long-term supplier partners.** The CEO of IMCD emphasised that the further one moves downstream towards specialty chemicals and ingredients, the more focus shifts to long-term suppliers who can lead on availability and price competition but particularly on innovation. He believes that competitive companies must not only price well but also develop products that remain desirable to customers over the long run.
5. **Sourcing is shifting from Europe, yet local production preference is clear.** The CEO of NCC highlighted a marked decline in European sourcing, from roughly 80% three years ago to around 60% today. Customers increasingly recognise the value of European production for European consumption, in his view. Many products are simply unavailable in Europe, prompting customers to actively ask European producers to restart production of certain chemicals.
6. **Customers operating with structurally lower working capital.** Th
Equilex noted that persistent supply chain disruptions have led clier
reduce working capital, requiring distributors and suppliers to beco
smarter on inventories and demand levels. This is where AI can assis
forecasting and inventory optimisation.

7. **Price increases.** The CEO of IMCD observed that suppliers were initially nervous about raising prices too aggressively, wary of losing market share given expectations the conflict might last only weeks. However, the prolonged nature of the disruption ultimately drove one or two rounds of price increases, which have since been implemented. Notably, some increases are still being pushed through even with peace potentially on the cards.
8. **China's move into specialties heightens the need for distributors with European market presence.** China is beginning to lead not only in commodities but increasingly in semi-specialties, compelling distributors to investigate leading Chinese and Asian producers for the future. Significantly, as Chinese producers advance into specialty segments, they increasingly recognise the need for people on the ground in Europe who understand the market and customers.
9. **IMCD have avoided product shortages thanks to flexible, multi-source supply networks.** The CEO of IMCD highlighted that a focus on specialties has provided protection, with many suppliers maintaining multiple manufacturing sources with larger German producers operating plants in both the US and China, enabling them to reshuffle their networks and avoid product shortages despite the disruption.
10. **European production shutdowns.** The CEO of Integra Petrochemicals warned it may be too late, as European plants now shutting down are likely not coming back, some driven by the massive expenditure required as facilities approach carbon limits, others by refinery closures leaving chemical plants exposed on feedstock. The Chairman of Equilex added that losing a principal is highly disruptive, taking 6-8 months to find an alternative and bringing margin erosion via a larger logistics component, alongside supply reliability risks.

Exhibit 1: Under weak domestic demand conditions, better than anticipated feedstock supply and though inventory draw down, China's exports have ramped significantly in April

thousand tonnes per month



Source: ICIS

Exhibit 2: Chinese exports of Methanol were up >200% in April

Source: ICIS

Valuation & Risks

BASF

Valuation

We are Buy rated on BASF, with a 12-month price target of €63. We value BASF using 9.91x EV/DACF. We derive our multiple by applying a factor of 0.99 to the historical EV/DACF multiple of 10.0x. The factor is below 1 as forecast CROCI is lower vs. history.

Risks

Downside risks to our view and price target include:

- Weaker-than-expected demand in key end markets (automotive, construction, consumer goods) amid European recession or prolonged German industrial stagnation.
- Value-destructive M&A if BASF consolidates European chemical assets.
- Chinese chemical producers intensify competition on cost and capacity.
- Chinese monetary and fiscal stimulus fails to support domestic production and domestic chemical demand.
- BASF's Zhanjiang ramp delayed and/or margins at the site remain subdued. This could lead to a lower-than-expected earnings contribution from the new businesses.
- Inability to pass through feedstock cost inflation compressing margins in upstream chemicals.
- Agricultural end markets weaken due to farmer economics and/or trade uncertainty.
- Continued structural erosion of European chemical competitiveness due to energy costs, regulatory burden and capital flight.
- Suez Canal fully reopens, lowering logistics costs and enabling an increase in Asian chemical imports into Europe.

Givaudan

Valuation

We are Buy rated on Givaudan, with a 12-month price target of CHF 3,500. Our price target is derived using a two-stage DCF, assuming a WACC of 6.5% and a 2.7% terminal growth rate.

Risks

Downside risks to our view and price target include:

- Escalation of the Middle East conflict further disrupts supply chains and raw material availability, pressuring both volumes and input costs beyond current assumptions.
- Too much cost extraction/plant rationalisation could limit future organic growth potential.

- Market share loss to new peer combinations with reinvigorated product portfolios.
- A protracted slowdown in Local and Regional customers spills over into MNC demand, compressing the favourable growth differential we forecast.
- A delayed recovery for Taste & Wellbeing if consumers, particularly in EMs, continue to choose cooking at home over eating out of the home.
- A deceleration of Fine Fragrance growth should underlying demand dynamics prove less resilient than 1Q indications

Novonesis

Valuation

We are Buy-rated on Novonesis (on CL), with a 12-month price target of Dkr475. Our price target is derived using a two-stage DCF, assuming a WACC of 7.1% and a 2.7% terminal growth rate.

Risks

Downside risks to our view and price target include:

- Integration issues following the merger, e.g. greater-than-expected costs, or market share loss/deceleration in organic growth while management attention is on the integration.
- A material delay on the synergy delivery timeline.
- Ongoing consumer weakness in China would represent a headwind, particularly to the Food & Beverages division, where the legacy Chr Hansen FC&E business is highly exposed to out-of-home consumption in China.
- Lower oil prices, disincentivising the use of enzymatic alternatives to petrochemicals.
- Slowing consumer interest in dietary supplements or worsening competitive dynamics could cause a growth deceleration in Human Health.
- Ongoing weak demand from the animal nutrition end market in response to soft meat consumption trends and animal culling related to ASF/avian flu could hold back performance in Novonesis' Agriculture, Energy & Tech division.