

A Week's Worth of Chemicals

WHAT'S NEWS THIS WEEK | COMMODITY CORNER | INDUSTRY INSIGHT – Ethylene, PE and PVC | RESEARCH ROUNDUP | STOCK PERFORMANCE & CDS SPREADS

WHAT'S NEWS THIS WEEK

- Manufacturing activity slowed in January. China PMI declined to 50.5, in line with market expectations, but the lowest reading in 6 months. US ISM declined to 51.3 from 57 in December and missed consensus of 56.
- Brazil industrial production plunged 3.5% M/M in December, which significantly missed consensus. The declines were broad-based, and Citi's Brazilian economists believe the December contraction could spill over into 1Q14.
- US January auto sales fell 3% Y/Y to 1.01mm units or a 15.2mm SAAR, below expectations, as automakers noted bad weather negatively impacted sales.
- Syngenta management commented on their earnings call they are seeing a slightly more modest pricing environment in the low single digits than the high single digits in previous years, although we believe this could reflect company-specific factors following its seed write-downs last year. This compares to 4-7% pricing guidance from DD and 5-10% from MON.
- **DD** has partnered with DTN/The Progressive Farmer to add to its Ag-tech offering including weather and grain market analysis to more effectively compete with MON's Climate Corp.
- CB&I was awarded a contract to provide pipe fabrication for **DOW's** US Gulf Coast Investment Program which includes a new propylene and ethylene production unit in TX and four new PE plants in TX and LA.
- The NAHB projects that residential remodeling spending on owner-occupied single-family homes will increase 2.5% Y/Y in 2014 and another 1.8% in 2015.
- Solvay plans to increase US natural soda ash production by 150kt (or 6%) at its Green River plant to meet export demand. This is part of the company's plan to expand US production capacity by 12% over three years. Negative for OCIR.
- Citi's Japanese Chemicals analyst noted that Brunei Methanol has been running smoothly since restart in early January. Negative for **OCIP**.
- **AXLL** expects to resume operations at its VCM plant in Lake Charles, LA near the end of 1Q14 following a fire on December 20, 2013. The repairs and lost production will have a minimal impact on 4Q13 financial results, but are expected to reduce 1Q14 operating income by ~\$25mm.
- Mitsui Chemicals plans to close down its 250kt phenol facility at Chiba Phenol (positive for **AXLL**) in September and shutter production at its Kashima TDI

7 February 2014

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Equities

Global

Commodity Chemicals

STOCK PERFORMANCE & CDS SPREADS

Figure 1. Price Performance Year-to-Date

S&P 500	-4.1%	EMN	-3.2%
S&P Chems	-3.2%	APD	-4.1%
DOW	2.7%	ECL	-4.2%
OCIR	2.4%	CYT	-4.3%
TAM	2.4%	PDH	-4.4%
POT	0.9%	PX	-4.4%
ALB	-0.8%	AGU	-5.6%
CF	-1.3%	PPG	-5.7%
LYB	-1.4%	MON	-7.1%
MOS	-2.2%	CE	-8.4%
SHW	-2.3%	OCIP	-10.5%
VAL	-2.4%	HUN	-12.3%
DD	-3.1%	AXLL	-15.2%

Source: Reuters

Figure 2. 5-yr CDS Spreads (50bps = \$50k for \$10mm of protection)

MON	34	POT	75
PX	42	DOW	81
DD	43	EMN	86
PPG	47	CYT	87
ALB	50	ECL	90
SHW	53	VAL	108
APD	62	AGU	110
MOS	69	HUN	266

Source: Citi's Credit Sector Specialist

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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plant by 2016 (longer-term positive for **DOW**).

- **CYT CFO** David Drillock plans to retire from the company effective December 31, 2014. The company has begun the process to identify a new CFO.
- **PX** completed the acquisition of JV Praxair Distribution Mid-Atlantic which had sales of over \$225mm in 2013. Further details were not disclosed.
- US chemical railcar loadings decreased 1.2% for the week ending January 18, compared to -4.3% last week and +2% YTD.

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COMMODITY CORNER

- **US spot ethylene margins** are 36¢/lb for ethane, 6¢ for propane and 13¢ for naphtha.
- **Ethane** - prices at Mont Belvieu increased 4¢ from last week to ~39¢/gal.
- **Propane** - prices at Mont Belvieu decreased 12¢ from last week to \$1.57/gal. Propane inventories fell this week to 30.8mm bbls, down 24mm bbls or 44% Y/Y, and are 3mm bbls below the low end of the 5-year range.
- **Butane** - prices decreased ~10¢ from last week to ~\$1.52/gal.
- US January **ethylene** contract prices settled up 2c M/M to 50.25c/lb.
- **DOW** announced a 6c/lb PE pricing initiative for all grades effective March 1, in addition to previous increases including 4c/lb announced for February 1.
- US February **benzene** contract prices increased 25c M/M to \$5.09/gal on tight supply.

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INDUSTRY INSIGHT – Ethylene, PE and PVC

- Polymer prices continue to move higher in 1Q, with the latest round of **PE** price increase announcements likely to offset recent increases in ethane and propane prices. According to CMAI, **integrated ethylene + PE margins** were roughly 42.5c/lb in November 2013, when feedstock pressure began. Integrated margins then declined 1c in December and another 2c in January. However this margin degradation is likely to be short-lived as PE producers have announced a 4c/lb PE price increase for February following robust demand in January (inventory restock and PE production limitations). In addition, DOW has announced a 6c/lb PE price increase for March, although it is too early to tell if other producers will follow. We continue to believe that recent feedstock pressure from higher ethane/propane prices is a buying opportunity in LYB and DOW. For **PVC**, Asia prices have been rising steadily since November and all US PVC producers have announced price increases of 3c/lb for January, February and March for a total of 9c/lb. US producer initiatives are being fueled by: 1) Tight supply following Axiall's VCM fire at Lake Charles in December and other upcoming planned turnarounds in 1Q14; 2) Higher ethylene prices (+2c/lb in January); and 3) Healthy demand in December, with total demand for 2013 roughly 4% higher than 2012.

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RESEARCH ROUNDUP

LyondellBasell Industries (LYB) — Something for Everyone; Reiterate Buy on Top Pick

North America | Commodity Chemicals | Buy

We remain buyers due to: 1) An attractive FCF profile (total of ~\$7B of FCF after dividends from 2014-16) underpinned by self-funding brownfield expansions; 2) Accelerating share buybacks and balance sheet optionality to take on more debt; 3) A gradually improving global ethylene cycle; and 4) Improving refining profitability, which should gain momentum as additional crude oil supply reaches the US Gulf Coast. We raise estimates for 2014-16 and increase our target to \$95.

P.J. Juvekar

Cytec Industries Inc. (CYT) — Model Update

North America | Specialty Chemicals | Neutral

We update our model following 4Q13 results and raise estimates for 2014 (+5c), 2015 (+12c), and 2016 (+25c). We increase our forecasts for Additive Technologies (higher margins), In Process Separation (faster growth), and Industrial Materials (higher margins), but generally reduce our forecasts for Aerospace Materials (slower growth, partially offset by higher margins given CYT's productivity initiatives). As a result of our raised estimates, our target price increases from \$98 to \$100. Remain Neutral.

P.J. Juvekar

Sherwin-Williams Co (SHW) — Comex Dilution Sets in, but Paint Stores Strong

North America | Specialty Chemicals | Neutral

While the same stores performance of the core Paint Stores group was quite strong in 4Q13 (+9.2%), we think this was trumped by confusion regarding the many moving parts of the dilution impact of the North American Comex business, both in the quarter and in the 2014 guidance. The US housing cycle is going in the right direction and commercial construction is very slowly recovering. However, we see near-term challenges in SHW's South American businesses, driven by currency.

P.J. Juvekar

E I du Pont de Nemours and Co (DD) — Management Visit – Increased Confidence in Wilmington; Buy

North America | Diversified Chemicals | Buy

We sensed rising confidence along with a sense of urgency in Wilmington on our recent DD headquarters visit. Higher confidence was driven by: 1) A good finish to 2013 with a strong 4Q driven by Ag and Safety & Protection, 2) The upcoming spinoff of TiO2 continuing the portfolio transformation, and 3) The new \$5B share buyback following a \$5B reduction in pension liabilities in 2013.

P.J. Juvekar

Petrologistics L.P. (PDH) — Feel the Propane Pinch, but a Healthy Yield Keeps Us Neutral

North America | Commodity Chemicals | Neutral/High Risk

We expect PDH's propane-to-propylene (P2P) spreads will average ~33c/lb in 2014 compared to ~40c/lb in 2013. The expected narrowing spreads in 2014 driven by a tight propene market keeps us Neutral/High Risk on PDH units. We could potentially revisit our thesis on a higher crude price deck or quicker relief of elevated propane prices, all else equal, although we think this is unlikely in the near term as monthly propane exports have outpaced production growth.

P.J. Juvekar

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- **Next Week** – **HUN** and **MOS** earnings on Tuesday, **VAL** on Wednesday, and **OCIR** on Thursday.
- Our current Top Pick in the group remains LYB, and top three include MON and DOW. We are sticking with commodity chemicals for 2014 despite recent increases in raw material prices (natural gas, propane, ethane), and would use the recent pullback as a buying opportunity. Longer-term we expect commodity chemical producers to generate strong cash flows, and valuations remain undemanding. We expect LYB to generate ~\$7B in FCF in 2014-16 with an associated yield of 8%+. We also wrote a detailed note on DOW recently and included our SOTP analysis, which derives a value at the peak in the mid-60s. We think DOW's management and board are likely to maintain a sense of urgency given the activist pressure. ALB remains our least preferred name. Within the group, we expect ALB and VAL to be relative underperformers. We would also point out that in our recent 2014 Chemical & Ag Stock Outlook, we called out ALB and VAL possible takeover candidates partly due to their underperformance. In TiO₂, we now expect pricing in 2H rather than ahead of the painting season, although utilization rates and volumes should continue to improve. DD recently guided 1Q14 TiO₂ earnings down on higher ore costs and lower prices. Some emerging market currency headwinds are intensifying, such as Brazil where the BRL is tracking down 16% Y/Y in 1Q14 and at current exchange rates would be down a similar percentage in 2Q14. In Ag, our preferred names are MON and CF for company-specific reasons, while we remain cautious on the rest of the fertilizer space given negative sentiment around grain prices and new EPA proposal for ethanol. Higher natural gas prices will impact CF, but higher urea prices should provide some margin offset. The recently signed potash contract in China has put a floor under the market, but we still think the long-term potash outlook is cautious underpinned by excess supply.

Figure 3. Citi Research Select Chemical Universe

Company	Symbol	Rating	Price as of 2/6/2014	Target Price	+/- to Target	Market Cap. (mm)	YTD '14 Performance	Net Debt / Capital	EPS 2014E ⁽¹⁾	EPS 2015E ⁽¹⁾	P/E 2014E	P/E 2015E	EV/EBITDA 2014E	EV/EBITDA 2015E	FCF Yield	Dividend Yield	ROC 2014E	ROE 2014E
Commodity Chemicals																		
Axial	AXLL	Neutral	\$40.25	\$51.00	26.7%	\$2,834	-15.2%	33%	\$3.85	\$4.31	10.5x	9.3x	6.0x	5.7x	7.0%	1.6%	7.0%	10.4%
Celanese	CE	Neutral	\$50.67	\$58.00	14.5%	\$7,991	-8.4%	47%	\$5.00	\$5.62	10.1x	9.0x	7.1x	6.6x	6.5%	1.4%	13.1%	31.8%
Dow Chemical	DOW	Buy	\$45.59	\$53.00	16.3%	\$54,758	2.7%	30%	\$3.00	\$3.68	15.2x	12.4x	7.9x	7.1x	6.7%	3.2%	9.3%	13.2%
Eastman Chemical	EMN	Buy	\$78.12	\$90.00	15.2%	\$12,155	-3.2%	51%	\$6.90	\$7.88	11.3x	9.9x	7.6x	6.9x	6.7%	1.8%	11.9%	26.1%
Huntsman	HUN	Buy/High Risk	\$21.57	\$29.00	34.4%	\$5,231	-12.3%	64%	\$2.28	\$2.84	9.5x	7.6x	6.0x	5.1x	6.7%	2.3%	10.9%	26.3%
LyondellBasell	LYB	Buy	\$79.12	\$95.00	20.1%	\$43,912	-1.4%	10%	\$7.50	\$8.65	10.6x	9.1x	6.6x	6.0x	7.4%	2.9%	24.0%	32.6%
OCI Partners	OCIP	Neutral/High Risk	\$24.70	\$30.00	21.5%	\$1,988	30.0%	127%	\$2.51	\$2.97	NM	NM	NM	NM	NM	10.2%	NM	NM
OCI Resources	OCIR	Buy/High Risk	\$20.98	\$24.00	14.4%	\$419	10.4%	18%	\$2.00	\$2.08	NM	NM	NM	NM	NM	9.5%	NM	NM
Petrologistics L.P.	PDH	Neutral/High Risk	\$11.14	\$13.00	16.7%	\$1,550	-4.4%	44%	\$1.70	\$1.55	NM	NM	NM	NM	NM	15.3%	NM	NM
Average											11.2x	9.6x	6.9x	6.2x	6.8%	2.2%	12.7%	23.4%
Specialty/Diversified Chemicals																		
Albemarle	ALB	Neutral	\$62.88	\$66.00	5.0%	\$5,138	-0.8%	27%	\$4.45	\$5.05	14.1x	12.5x	9.4x	8.8x	6.6%	1.6%	15.9%	21.5%
Cytec Industries	CYT	Neutral	\$89.14	\$100.00	12.2%	\$3,253	-4.3%	32%	\$5.70	\$6.25	15.6x	14.3x	9.4x	8.7x	1.1%	0.6%	10.4%	16.3%
DuPont	DD	Buy	\$62.96	\$73.00	15.9%	\$58,864	-3.1%	17%	\$4.40	\$5.05	14.3x	12.5x	8.5x	7.7x	5.7%	3.0%	16.7%	24.9%
Ecolab Inc.	ECL	Neutral	\$99.89	\$101.00	1.1%	\$30,686	-4.2%	50%	\$4.08	\$4.59	24.5x	21.8x	12.7x	11.7x	4.5%	1.1%	9.0%	16.8%
PPG Industries	PPG	Buy	\$178.92	\$224.00	25.2%	\$25,514	-5.7%	28%	\$9.48	\$10.38	18.9x	17.2x	9.6x	9.1x	4.6%	1.4%	19.1%	29.0%
Sherwin Williams	SHW	Neutral	\$179.19	\$192.00	7.1%	\$18,225	-2.3%	27%	\$8.24	\$9.41	21.8x	19.0x	12.8x	12.0x	3.4%	1.2%	21.4%	36.9%
Tamlico	TAM	Buy	\$20.69	\$23.00	11.2%	\$1,383	37.9%	167%	\$0.78	\$0.94	26.5x	21.9x	7.6x	6.7x	10.0%	0.0%	7.3%	9.6%
Valspar*	VAL	Neutral	\$69.60	\$77.00	10.6%	\$6,167	-2.4%	53%	\$4.04	\$4.66	17.2x	14.9x	10.8x	9.7x	5.4%	1.5%	15.0%	30.6%
Average											18.1x	16.0x	10.5x	9.7x	4.5%	1.5%	15.3%	25.1%
Industrial Gases																		
Air Products & Chemicals*	APD	Neutral	\$107.24	\$119.00	11.0%	\$22,982	-4.1%	43%	\$5.80	\$6.35	18.5x	16.9x	11.1x	10.4x	3.0%	2.9%	9.0%	16.5%
Praxair	PX	Neutral	\$124.28	\$143.00	15.1%	\$37,063	-4.4%	54%	\$6.45	\$7.20	19.3x	17.3x	11.3x	10.4x	3.1%	2.1%	11.6%	26.0%
Air Liquide	AIR.PA	Neutral	€94.68	€91.00	-3.9%	€29,619	-7.9%	36%	€5.61	€6.06	16.9x	15.6x	8.9x	8.4x	2.8%	3.0%	10.4%	16.5%
Linde	LING.DE	Buy	€140.05	€170.00	21.4%	€26,000	-7.9%	33%	€8.78	€9.81	16.0x	14.3x	8.2x	7.5x	3.1%	2.1%	7.2%	11.1%
Average											17.6x	16.0x	9.9x	9.2x	3.0%	2.5%	9.6%	17.6%
Agriculture																		
Agrium	AGU	Neutral	\$86.39	\$97.00	12.3%	\$12,699	-5.6%	33%	\$7.94	\$9.56	10.9x	9.0x	7.4x	6.3x	2.1%	3.4%	10.0%	15.0%
CF Industries	CF	Buy	\$229.93	\$267.00	16.1%	\$13,221	-1.3%	11%	\$19.19	\$22.23	12.0x	10.3x	6.8x	7.2x	-7.6%	1.7%	15.1%	22.4%
Monsanto*	MON	Buy	\$108.28	\$133.00	22.8%	\$57,670	-7.1%	-13%	\$5.25	\$6.05	20.6x	17.9x	12.1x	11.0x	3.3%	1.6%	22.8%	23.2%
Mosaic*	MOS	Neutral	\$46.21	\$51.00	10.4%	\$19,736	-2.2%	-21%	\$2.61	\$3.39	17.7x	13.6x	8.8x	8.2x	2.2%	2.2%	8.0%	8.0%
Potash	POT	Neutral	\$33.26	\$35.00	5.2%	\$28,870	0.9%	26%	\$1.55	\$2.19	21.5x	15.2x	12.2x	9.9x	4.5%	4.2%	8.3%	14.2%
Syngenta	SYNN.VX	Neutral	SFr. 309.00	SFr. 340.00	10.0%	SFr. 28,776	-13.0%	20%	SFr. 20.43	SFr. 24.47	15.1x	12.6x	11.2x	9.5x	4.4%	3.0%	15.3%	18.7%
Average											16.3x	13.1x	9.8x	8.7x	1.5%	2.7%	13.2%	16.9%
Select European Stocks																		
BASF	BASF.DE	Neutral	€78.17	€72.00	-7.9%	€71,797	0.9%	37%	€5.43	€6.18	14.4x	12.7x	9.2x	8.3x	4.3%	3.6%	9.5%	15.2%
Bayer	BAYG.DE	Buy	€95.26	€110.00	15.5%	€78,775	-6.6%	32%	€6.55	€7.56	14.5x	12.6x	10.1x	8.8x	4.5%	2.5%	12.3%	19.2%
Akzo Nobel	AKZO.AS	Neutral	€56.35	€48.00	-14.8%	€13,513	0.0%	9%	€2.85	€3.73	19.8x	15.1x	9.6x	8.1x	1.0%	2.7%	7.2%	9.3%
Johnson Matthey	JMAT.L	Neutral	£32.15	£31.00	-3.6%	£6,588	-2.0%	28%	£1.68	£1.80	19.1x	17.8x	12.1x	11.3x	3.4%	2.0%	14.3%	22.8%
Average											16.9x	14.5x	10.3x	9.1x	3.3%	2.7%	10.8%	16.6%
S&P 500	SPX		\$1,773.43	\$1,975.00			-4.1%		\$117.50	\$126.00	15.1x	14.1x						

(1) PDH, OCIR, & OCIP EPS columns represent distributable cash flow per unit.

*Air Products FY ends in September; Monsanto in August; Valspar in October; JMAT in March; Mosaic in May
Note: European coverage in London: BASF, Akzo Nobel, Syngenta, Linde, and Air Liquide- Andrew Benson
Johnson Matthey - Dominik Frauendienst
Bayer - Andrew Baum
Source: dataCentral

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Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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