Cytec Industries

Initiation of coverage

Engineering a transformed mix

Industrial engineering

2012 has been a transformative year for Cytec, with management making bold changes to deliver enhanced shareholder value, focusing the business on structural growth markets where it has a market leading position. The year saw both acquisitions designed to heighten the group's technology, geographic penetration and market access, and divestments of less specialised businesses that have consumed capital while diluting growth. The completion of the $1.1bn divestment of Coating Resins is to be followed by an accelerated $550m share buyback and further corporate activity to build the group's leadership positions. With a sharper focus on allocating capital to the highest growth, margin and return, to drive enhanced ROCE, we believe the share price, long held back by perceived weaknesses in legacy divisions, has the potential to re-rate to its new status as a growth stock given the structural opportunities ahead.

Year end	Revenue ($m)	PBT* ($m)	EPS* ($)	DPS ($)	P/E (x)	Yield (%)
12/11	1,416	119	1.82	0.5	41.2	0.7
12/12	1,708	188	3.13	0.5	23.9	0.7
12/13e	2,036	270	4.86	0.5	15.4	0.7
12/14e	2,205	341	6.74	0.5	11.1	0.7

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Structural growth markets across the group

With 85% of revenues now focused on growth markets, the structure of Cytec has significantly altered. Underlying demand is set to remain strong for the coming decades, with global megatrends supporting end markets such as aerospace and mining. In addition, specific factors such as lightweighting in transport and the strategy to address adjacent markets provide second order effects that support growth in excess of underlying market rates. We believe Cytec has the platform to generate substantial shareholder value as suggested by 55% FY13e EPS growth.

2012 reflected a period of consolidation and growth

The 2012 results reflected a period in which significant change occurred in the portfolio with an agreement to dispose of Coating Resins for $1.1bn and the acquisition of Umeco for $420m. Despite this corporate activity, underlying growth remained strong with continuing revenues up 21% (10% organic), adjusted operating profit up 41% to $218m and fully diluted EPS up 71% to $3.08.

Valuation: Re-rating opportunity with synergies

The completion of the Coating Resins (CR) disposal is a crucial moment in Cytec's transformation and we believe management now has the opportunity to focus capital on driving growth markets where Cytec's technically advanced solutions provide greater value add and hence margin potential. As the group removes the stranded costs associated with CR and gains full synergy benefits from the Umeco acquisition, we believe the current undemanding rating of 15.4x CY13 EPS could improve. Our SOTP-derived fair value is $90/share, equating to 18.5x CY13 EPS.

10 April 2013

Price	**US$77.94**
Market cap	**US$3,492m**
Net debt ($m)	527
Shares in issue	44.8m
Free float	99%
Code	CYT
Primary exchange	NYSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.6)	1.5	28.4
Rel (local)	(1.7)	(5.5)	13.1
52-week high/low		US$78.43	US$55.77

Business description

Cytec Industries Inc. is a global specialty chemicals and materials company. It has four divisions: Engineered Materials (53%); In-Process Separation (22%); Additive Tech (16%); and Umeco (9%). It serves a wide range of advanced industries.

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Q1 results	19 April 2013

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Engineering a transformed mix

Speciality chemicals and materials for niche markets

Cytec Industries is a global speciality materials and chemicals company focused on developing, manufacturing and selling value-added products across end markets including aerospace, industrial materials, mining and plastics. 2012 continuing net sales were $1,708m and continuing earnings were $154m, with the group structured in four divisions: Engineered Materials (53% of 2012 sales), In-Process Separation (22%), Additive Technologies (16%) and Umeco (9% since July 2012). The group has manufacturing and research facilities in 15 countries worldwide.

Valuation: Focus on technically advanced growth markets

We believe that following Cytec's disposal of its commodity based chemicals divisions, its greater focus on growth markets that require technically differentiated products warrants an improved rating. With structural growth markets now accounting for 85% of group revenues (Exhibit 2), our sum-of-the-parts derived fair value is $90. This has potential to rise further as Cytec removes the $66m stranded costs associated with the CR disposal and gains synergies from the acquisition of Umeco. As it delivers upon these two things, we believe that ROCE should improve to 16% and a further re-rating would be warranted.

Sensitivities

Overarching sensitivities are largely linked to the strength of the global economy:

- **Global economic health**. With several of Cytec's end markets driven by the health of the global economy, this provides an overarching sensitivity. Raw material costs also provide positive and negative effects for Cytec, requiring price management to negate increases while also driving demand for Cytec's products that improve efficiency.
- **Safety and environmental.** Given the nature of Cytec's business, operating with industrial chemicals, safety and environmental operations are critical. This extends to specific legislation and regulations relating to the production, transportation, storage, handling and disposal of both the products and waste produced in manufacture.
- **Portfolio management and integration/separation.** The group's ability to effectively manage the portfolio of business within the group is key. This has clearly been demonstrated throughout 2012 and the ability of management to successfully select, acquire and integrate acquisitions such as Umeco will have an effect on the profitability and outlook of the group.
- **Timing and focus of capex decisions.** The timing of investment in new and expanded facilities is crucial: build too early and utilisation rates and profitability suffer; leave it too late and the benefit of increased production will be lost and competitors will have taken the business.

Financials: 2012 underlying growth

The 2012 results highlighted the change in group composition and the increased focus on the growth platforms of Engineered Materials and In-Process Separation:

- **Continuing revenues** increased 21% to $1,708m (2011: $1,416m), driven by 11% from Umeco, 6% due to organic volume growth and 4% due to selling price increases.
- **Underlying operating profit** increased by 41% to $218m (2011: $154m) as a result of Umeco, operational improvements and increased selling prices. Group margins increased by 190bps to 12.8%. With net interest $6m lower, PBT rose 59% to $188m (2011: $119m).
- **EPS.** Reported net earnings increased by 9% to $91.3m (2011: $84.0m), while adjusted net earnings increased by 63% to $144.0m (2011: $88.4m). Following the repurchase of $100m, or 1.45m, of treasury stock, adjusted fully diluted EPS increased by 72% to $3.08 (2011: $1.80).

Speciality chemicals and materials for niche markets

Cytec is a global speciality materials and chemicals company focused on developing, manufacturing and selling value-added products across end markets including aerospace and industrial materials (67% of 2012 sales), mining (16%) and polymers (17%). The group uses its technology and application development to create specially formulated solutions to perform specific, critical functions. 2012 net sales from continuing operations were $1,708m and earnings from continuing operations were $154m. The group has four divisions: Engineered Materials (53% of 2012 sales); In-Process Separation – IPS (22%); Additive Technologies (16%) and Umeco (9% since July 2012). It has with manufacturing and research facilities in 15 countries worldwide.

History of the group

Cytec originated as a division within American Cyanamid and was spun out in 1993 to form Cytec Industries with a focus on the development and sale of speciality chemicals. This originally consisted of chemistry based around Acrylamid, largely targeted at the water treatment industry with some presence in mining and a small resins business. Since then, the company has undergone a number of changes through acquisition and divestment, with the focus of the group having changed to a greater emphasis on value-added technologies. This has seen the group build an Engineered Materials business through acquisition, while its In-Process Separation division has largely been built organically and refocused on the mining market. The remaining Additive Technologies division consists of more traditional legacy products.

Strategy focusing on niche applications, value-added products

Cytec's strategy is clear with management focusing the portfolio to provide enhanced sales growth, minimum operating margins of 10% and improving return on assets, while selectively monetising or exiting non-strategic or under-performing businesses. This being achieved by:

- Focusing the group's activities on structural growth markets, now accounting for 85% of sales.
- Providing technology-based solutions to customers, where design, development and application knowledge provide margin enhancing operations with high barriers to entry.
- Pursuing a capital deployment strategy to drive enhanced returns including appropriate bolt-on acquisitions to enhance technology, geographical presence and market access.

2012 has seen significant transformation with the acquisitions of Umeco (composite and process materials) and the manufacturing assets of Star Orechem International (Indian manufacturing plant for metals extraction chemicals), as well as the disposal of the group's Coating Resins division, which previously accounted for approximately half the group's sales. As a result, the group is now focused on three niche, speciality areas having largely exited commoditised chemicals businesses.

Management: Experienced, but not afraid of change

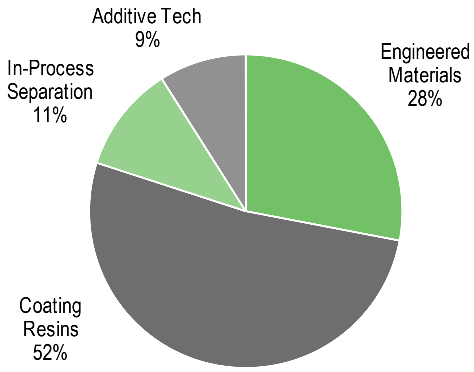
Executive management are long-term Cytec employees; however, what stands out is that the team is not afraid to make bold changes to the strategy, guided by a market-led view. This has been clear over the past two years as the group has re-orientated the portfolio. Top management includes:

- **Chairman, President and CEO Shane Fleming:** Has been with Cytec since 2001 in various roles, including as president of Cytec Specialty Chemicals, chief operating officer and subsequently as CEO since 1 January 2009. He joined Cytec in 1983 and held progressively more senior roles in the Mining Chemicals business before moving into general management.
- **Vice President and Chief Financial Officer David Drillock:** Has been vice president and CFO since 2007, prior to which he served as a VP of Cytec since 2002 and controller since 1993. He began his career at American Cyanamid in 1978 and served in positions of progressively increasing responsibility in the accounting function.

Corporate activity to create a focused, leading player

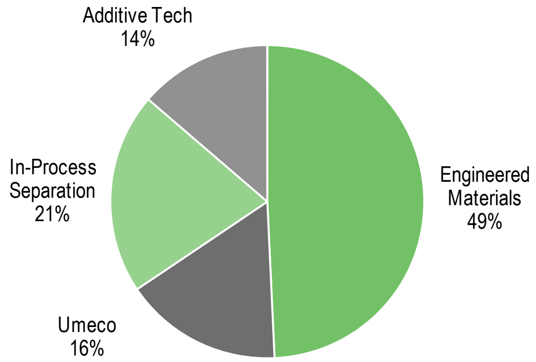
Cytec has reoriented the business to address core growth market opportunities. Moving on from the pivotal year of 2102 with its disposal of Coating Resins, we feel that investors should recognise the clarity that the strategy brings in terms of targeting value creation through growth and enhanced profitability and ROCE. Ultimately, we believe management's bold moves have repositioned the group away from more commoditised businesses to those where technological leadership will translate into higher margins, better returns on capital and less cyclicality, with growth markets accounting for c 85% of revenue. Exhibits 1 and 2 below show the impact of the portfolio changes.

Exhibit 1: Cytec Divisions (2010) – sales $2.7bn



Source: Edison Investment Research

Exhibit 2: Cytec Divisions (2013e) – sales $2.0bn



Source: Edison Investment Research

Divestments to allow allocation of capital for growth markets

Over the past two years, Cytec has significantly reshaped its portfolio with several divestments accounting for some $1.5bn of revenue:

- **Building Block Chemicals (February 2011).** Cytec completed the sales of the Building Block Chemicals business to Cornerstone Chemical Company (an affiliate of HIG Capital, LLC) on 28 February 2011 for a consideration of $180m.
- **Pressure Sensitive Adhesives (July 2012).** The Pressure Sensitive Adhesives business line was sold to Henkel on 31 July 2012 for $105m. This provided Cytec with an exit from this sub-scale business.
- **Coating Resins (October 2012).** Cytec announced the intention to separate its Coating Resins business on 31 January 2012 and the subsequent disposal to Advent International, a US private equity firm, for $1,150m on 9 October 2012, which completed on 4 April 2013.

These divestments have freed capital for re-investment into the growth strategy. $1.3bn of proceeds have been received, with 50% reinvested through acquisition, capex and business development. The remaining $650m will be returned to shareholders through the share buyback programme.

Clear acquisition strategy – technology and geography

In support of the portfolio transformation, Cytec has adopted a clear acquisition strategy in building its exposure to target end markets. 2012's acquisitions both fit into these criteria:

- **SOIL (March 2012):** Cytec acquired the manufacturing assets of Star Orechem International Private Ltd (SOIL) on 30 March 2012 for $37m. This provides manufacturing facilities in India, a 25% increase in available capacity for Cytec's Metal Extraction product line in In-Process Separation and closer access to Asia-Pacific and African mining markets.
- **Umeco (July 2012):** The Umeco acquisition was completed on 20 July 2012 for $423.8m. This acquisition addresses two principal strategic objectives, enhancing the product range and geographic presence, as well as providing Cytec with an inherent capacity increase.

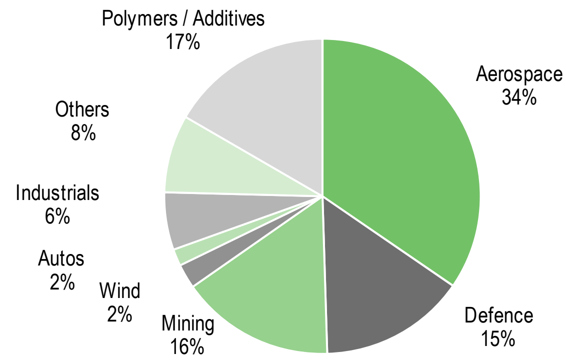
Umeco acquisition provides significant operational, technological and market opportunities

Umeco was formed in 1917 and has operations in the UK, US, Germany, Italy and China. The acquisition was highly complementary to Cytec's existing operations. It expanded the product range to include Process Materials, while providing additional capacity in Europe and China, allowing Cytec to increase efficiency across the group and drive Umeco's margins up from low single-digit to the group target of at least 10%. Cytec is now focusing US capacity on aerospace-grade materials in support of increasing aircraft build rates, while utilising Umeco's European facilities and experience in markets such as Formula One and wind energy to address future high-growth industrial markets.

Market drivers provide structural growth opportunity

Through the significant portfolio reshaping undertaken over the past two years, c 85% of the group is now exposed to structural growth markets. This provides a different dynamic and provides the opportunity for management to deliver substantial shareholder returns through an increasing focus on technical solutions, raising profitability. The fundamental drivers across markets are based around global megatrends: population growth, globalisation, urbanisation and energy.

Exhibit 3: Annualised end market exposure (2013e)

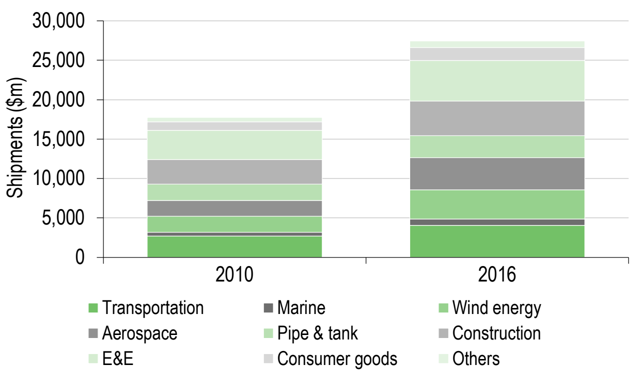


Source: Edison Investment Research estimates

Accessing attractive market growth rates

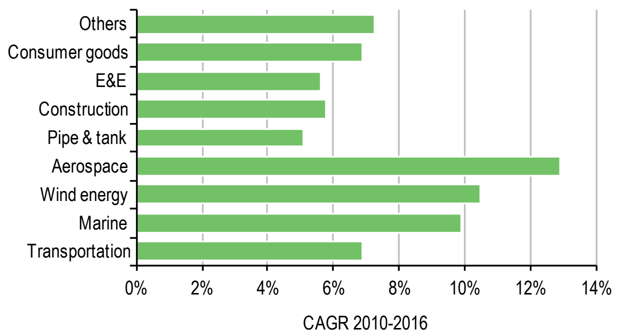
With this end market exposure, Cytec has the ability to focus on those areas that provide the most attractive growth prospects within the composites market, shown in Exhibit 4 below.

Exhibit 4: Global composite materials shipment



Source: Lucintel/UK National Composites Centre

Exhibit 5: CAGR of composites materials market



Source: Lucintel/UK National Composites Centre

While aerospace is clearly the leader in adoption of advanced composites, Cytec also has access to many other long-term growth markets such as wind energy and the emerging automotive market.

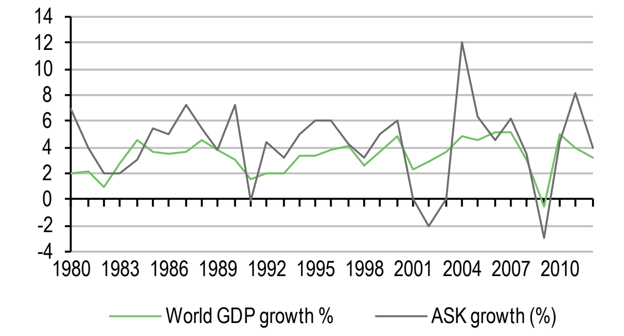
Core near-term structural growth markets – aerospace and mining

Through Engineered Materials, Umeco and In-Process Separation, Cytec has significant exposure to the aerospace & defence and mining markets (65% annualised sales in 2013 – see Exhibit 3). These are both set for sustained long-term growth:

Aerospace – driven by traffic growth and shift of wealth

The driver for the aerospace market is global GDP growth, with long-term traffic measured by available seat kilometres (ASKs) having grown on average by a CAGR of 5% over the last five decades. Through a shift in wealth from West to East, and with the prospect of increased future penetration in emerging markets, we expect that trend to continue. Indeed, Airbus and Boeing predict a global market for larger civil aircraft of between 28,000 and 34,000 aircraft over the next 20 years, driven by this growth as well as replacement demand in more mature markets, as shown in Exhibit 7 below:

Exhibit 6: Global GDP vs air traffic growth (ASKs)



Source: IMF, IATA, Edison Investment Research

Exhibit 7: 20-year forecast civil aircraft demand

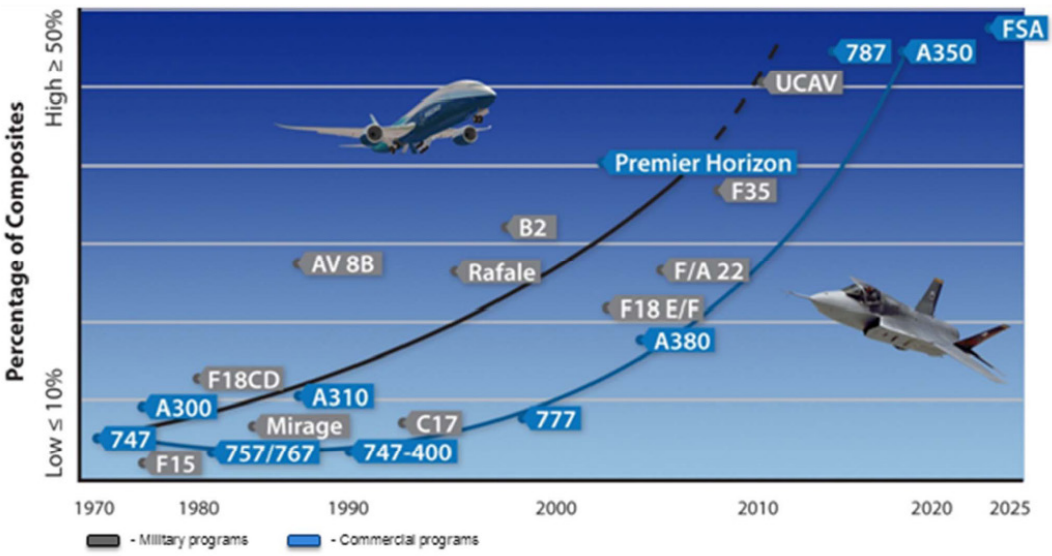
Source: Boeing, Edison Investment Research

Civil deliveries are in the process of increasing steadily, with the current combined backlog at Airbus and Boeing standing at over 8,000 aircraft, equivalent to about eight years of production at current delivery rates of c 1,190 aircraft a year. In addition to production rates increasing on current generation aircraft, such as the Boeing 737, 777, Airbus A320 and A330, new aircraft, such as the Boeing 787 and Airbus A350 as well as re-engined versions of narrow-body workhorses B737 and A320, are also entering production. This supports a forecast 25% increase in annual delivery rates over the next five years.

The case for Engineered Materials – lighter, faster and more fuel efficient

In addition to the fundamental core market growth, a secondary positive effect is the trend to increasing use of composite materials in aircraft, as fuel costs continue to rise, driven by a focus on weight reduction, while maintaining stringent performance criteria. The only current method of delivering a cost-effective solution to this is through the increasing use of composites, initially restricted to non-structural elements, but increasingly for use in structural elements of aircraft, with for example over 50% by weight of the B787 being composite materials as shown in Exhibit 8.

Exhibit 8: Increasing use of composites by weight



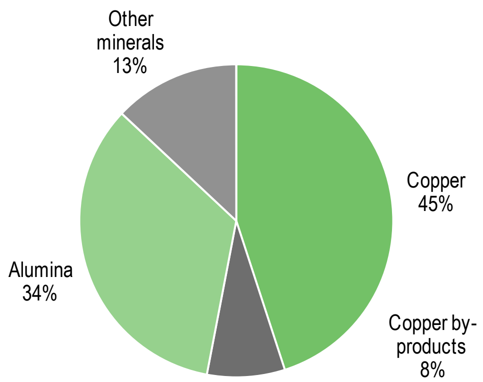
Source: Cytec

Interestingly, Cytec has a relatively small exposure to existing programmes, many of which were originally specified at a time before Cytec existed as a standalone entity. Hence the step-change growth opportunity for Cytec is substantially greater than for many competitors. In addition, with the acquisition of Umeco, Cytec has already broadened its exposure both through product (vacuum bagging of B787 wings for example) and customer, with Umeco having a greater exposure to Airbus with its out-of-autoclave certified materials for that customer. Cytec had already signed several other important deals including a 10-year long-term agreement to supply the majority of high-performance, structural composite and adhesive materials for the Comac C919 and is also providing materials for the Bombardier C-Series. Likewise, with positions providing material to the F-35 lightning and future defence programmes, the ramp-up of these will provide further growth.

Mining: Demand for metals driven by economic growth

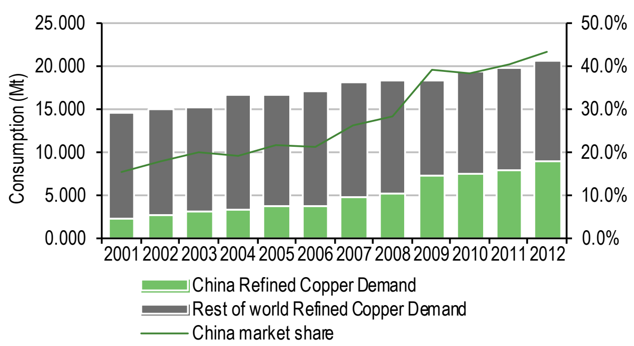
The demand for mining processing chemicals is ultimately driven by market demand and technology improvement. Increasing demand for metals continues as emerging economies fuel a long-term sustained appetite for growth through increasing urbanisation and industrialisation.

Exhibit 9: Metal focus of Cytec's Mining Chemicals



Source: Cytec, Edison Investment Research

Exhibit 10: Global copper demand and impact of China



Source: Edison Investment Research

Cytec's main markets are related to the production of copper and aluminium and long-term forecasts suggest that demand for such metals is set to increase at a CAGR of 3-4% a year over the next decade, a view supported by GDP growth expectations in developing economies. To support such demand, new mines will be opened and ways will be sought to drive the productivity of existing mining operations. These drivers support the increasing use of mining processing chemicals, which enhance efficiency and reduce potential downtime.

Solving mining issues – maximum extraction technologies highly valued

With the keen focus on production costs associated with mining operations, Cytec's ability to innovate and create value-added products to serve the industry is crucial. In this respect, Cytec maintains significant investment in developing new and enhanced products that both drive demand and allow it to drive pricing and margins. The group has been developing mining chemicals since 1915 and therefore has a unique understanding and global network of contacts from which to enable this development effort. It is this history and technical understanding that positions the group uniquely to address the opportunity.

Future market development provides further upside

Within Cytec's other end markets there are various factors that we believe will provide opportunities for further, sustained growth opportunities. While some may not be immediate, their potential scale suggests exciting sustained growth prospects for the group.

Wind energy subdued at the moment but likely to return

Cytec now has the opportunity to play in the wind energy market through various routes, most notably through the process materials business of Umeco, but also as turbines increase in size and complexity, with more advanced composite materials used in manufacture itself. While the current market is subdued, we believe that the longer-term outlook is that growth will return as countries focus on delivering increasing the amounts of carbon-neutral energy. While currently only accounting for c 2% of revenues, we see this as a long-term opportunity as demand returns.

Automotive – goal is middle market and enabling electric vehicle technologies

With a history that stretches into the most demanding areas of motorsport such as Formula One, Cytec has, through Umeco, a provider of high-tech advanced composites materials designed for low-volume, high-variability manufacture. This extends into high-performance supercars where the benefits of light weight and rigidity outweighed the high cost of manufacture. While these particular markets are attractive from a technological standpoint, the related addressable markets remain limited in size and revenues currently account for c 2%. The real prize is mainstream applications:

- **Middle market.** Low-weight structural carbon composites to be utilised in more mainstream manufacture, where volumes are considerably greater, driven by rising fuel costs and CO_2 regulations. With Umeco having already proven a process that is an affordable technology for replacement of certain steel structures in volumes of up to 20k vehicles pa, progress is being made. However, the pace of adoption is likely to rise over the next decade in our view.
- **The advent of electric vehicles.** With durability of use a major issue in the development of the electric vehicle market, an increase in activity in this sector will require lightweight technologies to enhance endurance and range. As in the aerospace market, composites could well provide the solution that enables a step-change in electric vehicle performance, and the challenge again remains in delivering an affordable solution.

Cytec has already made significant progress in entering the automotive market and announced a strategic partnership with Jaguar Land Rover in August 2012 to develop designs, materials and manufacturing concepts for cost-effective production of composites for automotive structures.

Other adjacent markets provide niche opportunities

Cytec is also clear about the opportunities to take its core products and market knowledge, and expand into adjacent markets on a broader scale. Within In-Process, this includes expanding the set of metals for which its separation technology is designed to encompass other mining opportunities such as industrials minerals and platinum group metals, as well as adjacent markets such as recycling and waste recovery.

Divisional breakdown – growth market exposure

Cytec reported 2012 results under four divisions: Engineered Materials; Umeco (as of July 2012); In-Process Separation; and Additive Technologies. It is currently undergoing a change in divisional structure to consolidate the Engineered Materials and Umeco businesses by the end markets of Aerospace Materials and Industrial Materials, effective Q113.

Exhibit 11: Cytec divisional structure, results and outlook

Division (% sales 12/13e)	Description	Products	2012 results	Outlook
Engineered Materials (53%/49%)	Designs, manufactures and distributes advanced materials for aerospace, high-performance industrial and various other end markets for demanding applications.	Advanced aerospace qualified composites and structural adhesives. High performance industrial composites and materials; and high performance carbon fibres.	■ Revenue $903m up 14% (+11% vol, +3% price) ■ Op profit $165m up 32% ■ Op margin 18.3% (2011: 15.8%)	Strong demand from core aerospace markets are set to continue as key civil programmes ramp up, while recovery in other markets such as regional aircraft will increasingly translate to recovery in production rates. With improving volumes providing a positive pricing environment, we forecast margins to steadily increase from current levels. We view Engineered Materials as a division with sustainable growth characteristics.
Umeco (9%/16%)	Designs, manufactures and distributes advanced materials: end markets spread across aerospace, high end automotive, wind power and other high-tech industrial. Significant overlap with Engineered Materials segment.	Structural materials: advanced composite materials for aerospace and industrial applications. Process materials: consumable materials used in forming infusion and curing of composites structures.	■ Revenue $150m (since 21 July 2012) ■ Op profit $7m ■ Op margin 4.4%	2013 will be heavily influenced by integration with Engineered Materials. Aerospace facing portions of Umeco will continue to benefit from the growth in build rates, particularly in process materials and composite interiors. We anticipate that the wind energy market will remain depressed in the short term but will provide a long-term opportunity, while 2013 is likely to see an improvement in high-end automotive and motorsport. We forecast a steady improvement in underlying operating margins over the next few years. Cytec is considering strategic options for the lower-margin GRPMS chemicals distribution business, equating to c $50m of revenue, excluded from our forecasts.
In-Process Separation (22%/21%)	Designs, manufactures and sells various specialist chemicals for use in mineral separation and processing of copper, alumina, cobalt, nickel and other minerals.	Flotation promoters; collectors; frothers; dispersants and depressants; solvent extractants; flocculents; filter and dewatering aids; antiscalents; and defoamers. Also produces phosphines for use in the pharmaceutical, chemical and electronics industries.	■ Revenue $384m up 13% (+6% vol, +7% price) ■ Op profit $92m up 32% ■ Op margin 23.9% (2011: 20.5%)	With mining markets remaining a key driver, we expect that Cytec will generative further additional growth in In-Process and we forecast a 10% increase in revenue driven by a combination of price and volume improvement. We expect margins to moderate slightly from the high level achieved in 2012. In the long term we believe that the In-Process business has the potential to become an even greater contributor to group profitability. It is an area of the business that is generally less well understood by investors and is somewhat of a hidden gem.
Additive Technologies (16%/14%)	Manufactures a wide range of specialist chemicals used in a variety of industries such as plastics, textiles and non-wovens.	Polymer additives, speciality additives. Formulated resins for the bonding and sealing of electrical and electronic components.	■ Revenue $270m, down 6% (-7% vol, +3% price, -2% FX) ■ Op profit $37.9m down 4% ■ Op margin 14.0% (2011: 137%)	We forecast a small improvement in revenues in 2013 with price increases adding to a largely flat volume outlook. We also forecast a largely static operating margin at c14% for the foreseeable future until the global economic outlook improves. Longer-term we view Additive Technologies as potentially non-core to the group and would not be surprised to see it exited following completion of the Coating Resins disposal and once the integration of Umeco is complete and reaping benefits.

Source: Edison Investment Research

Forecasts reflect growth and focus

Exhibit 12 below shows our forecasts at a divisional and group level. It highlights the benefits of the focus on growth markets, the efficiencies we anticipate will be achieved following the formal completion of the Coating Resins disposal, and the synergies achieved from the Umeco integration.

Exhibit 12: Cytec divisional and group forecasts

	2011	2012	2013e	2014e	2015e
Sales					
Engineered Materials	789	904	1,003	1,123	1,292
Umeco	0	150	332	343	365
In-Process Separation	340	384	423	461	502
Additive Technologies	287	270	279	279	281
Total	**1,416**	**1,708**	**2,036**	**2,205**	**2,440**
Operating Profit					
Engineered Materials	125	165	191	219	258
Umeco	0	7	16	19	22
In-Process Separation	70	92	97	108	120
Additive Technologies	39	38	39	39	40
Corporate & Unallocated	-80	-84	-62	-31	-18
Adjusted Operating Profit	**154**	**218**	**281**	**354**	**424**
Net finance charge	-36	-30	-11	-13	-15
Adjusted PBT	**119**	**188**	**270**	**341**	**409**
Tax	-28	-37	-67	-85	-102
Exceptional Tax	4	-5	0	0	0
Minorities	-3	-2	0	0	0
Net Income	91	144	203	256	307
Diluted Average Shares Outstanding (m)	49	47	43	39	39
Adjusted EPS	**1.8**	**3.1**	**4.7**	**6.6**	**7.9**

Source: Edison Investment Research

Sensitivities largely linked to economic growth

Given the nature of Cytec's business, the overarching sensitivity is largely linked to the strength of the global economy and Cytec's ability to deliver the appropriate level of product for the prevailing conditions. In particular, we highlight:

- **Global economic health.** With several of Cytec's end markets driven by the health of the global economy, this provides an overarching sensitivity. Global GDP growth is forecast by the IMF to be 3.5% in 2013, followed by 4.1% in 2014.
- **Raw materials costs.** There is a linked effect of global growth related to commodity prices. Increases provide a pressure through rising raw material prices, which is managed through price negotiation by Cytec, which will be driven by the value-added nature of the product at the time of sale. Increasing commodity prices will serve to stimulate further demand for Cytec's products, whether that be to encourage more mines to operate, or through a drive for lighter weight materials to reduce fuel consumption in transport markets.
- **Safety and environmental.** Given the nature of Cytec's business, operating with industrials chemicals, meeting safety and environmental regulations are key. This extends to specific legislation and regulations relating to the production, transportation, storage, handling and disposal of both the products and waste produced in manufacture.
- **Portfolio management and integration/separation.** One of the key sensitivities is the group's ability to effectively manage its portfolio of business. This has clearly been demonstrated throughout 2012 and the ability of management to successfully select, acquire and integrate acquisitions such as Umeco will have an effect on the profitability and outlook of the group. Likewise, effective portfolio management relating to disposals will also have an impact, releasing capital to invest in the growth platforms.
- **Timing and focus of capex decisions.** As had previously been witnessed with the false start of the Boeing 787 programme, timing of investment in new and expanded facilities is crucial: build too early and utilisation rates and profitability suffer; leave it too late and the benefit of

increased production will be lost and competitors will have taken the business. Cytec suffered previously from such delays and paused increased capex in the carbon fibre line in South Carolina. The investment has now resumed and the build has recommenced, providing double the capacity for PAN based carbon fibre, due for completion in 2016. Overall capex is anticipated to trend around the $250m pa mark.

With the transition of the business to more growth-orientated divisions, and with many of the industries served having long-term resilience built into demand, we feel that Cytec has been able to improve the balance of risk from those where it has little or no control towards greater controllable risk and opportunity management.

Financials demonstrate benefits of the strategy

2012 has been a year of substantial change for the group, however despite the corporate activity, results provided a glimpse of the future opportunities for the group.

2012 results – significant underlying growth

The 2012 results highlighted the change in group composition and the increased focus on the growth platforms of Engineered Materials and In-Process Separation:

- **Continuing revenues** increased by 21% to $1,708m (2011: $1,416m), driven by an 11% contribution from Umeco, a 6% increase due to organic volume growth and 4% due to selling price increases. Sales at Engineered Materials and In-Process Separation grew by 13% and 14% respectively, while Additive Technologies declined by 6%.
- **Underlying operating profit** increased by 41% to $218m (2011: $154m) as a result of Umeco, operational improvements and the benefit of increased selling prices. Group operating profit margin increased by 190bps to 12.8%. With a decrease in net interest payments of $6m to $30m, PBT rose by 59% to $188m (2011: $119m).
- **EPS and DPS.** The effective tax rate increased to 28.4% (2011: 24.7%) largely due to the decision to no longer permanently re-invest unpatriated earnings of certain foreign subsidiaries. Reported net earnings on continuing operations increased by 9% to $94.1m (2011: $86.0m), while adjusted net earnings increased by 63% to $144.0m (2011: $88.4m). Following the repurchase of $100m, or 1.45m, of treasury stock, adjusted fully diluted EPS increased by 71% to $3.08 (2011: $1.80). During 2012, Cytec paid four quarterly dividends of $0.125 per share, equating to an overall payment of $22.9m.
- **Cash flow and net debt.** Cytec generated operating cash flow from continuing operations of $208m, or c 95% cash flow conversion of adjusted operating profit. Net debt increased throughout 2012 as a result of acquisitions, capex and a $100m share buyback. However, this will reduce again in 2013 with the proceeds of the Coating Resins transition now received.

Coating Resins was reported as a discontinued operation in 2012 and with completion of the disposal finalised, we have restated results and future forecasts to exclude this business.

Delivery of synergies will further support margin expansion

Following the completion of the CR disposal, Cytec has c $66m of stranded costs associated with the overheads of supporting the CR division that will not transition in the transaction and remain with Cytec. Management is targeting a reduction of two-thirds of those costs within the 90-day period post completion, followed by a reduction of 85% within two years. The remaining costs will remain within the remaining divisions to support the growth profile of the group, which will provide Cytec with the flexibility to support growth without the addition of significant new cost. While this will have a short-tem impact on profitability, it will provide a longer-term benefit.

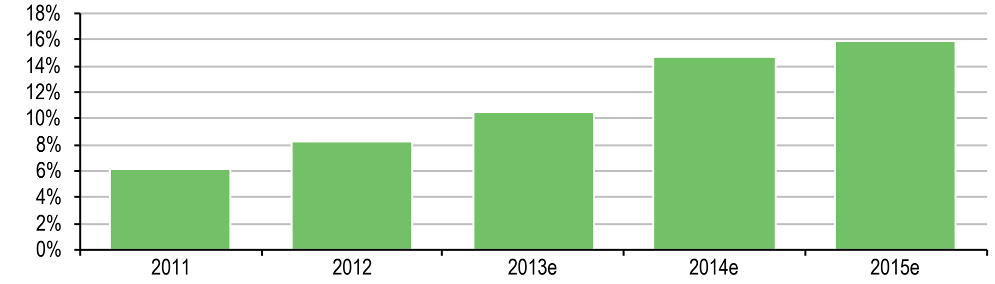
CR completion to accelerate 2013 share buyback

At the time of the announced disposal of Coating Resins, Cytec increased its share repurchase authorisation from $100m to $650m and announced that it will return $550m of the sale proceeds through an accelerated share buyback programme. This is targeted to be complete by a 90-day period post closure, which will see a reduction of approximately 7.5m shares in issue, the full effect of which will be felt in 2014 results. This follows the purchase of $100m of shares during 2012 and highlights that Cytec is following a balanced cash deployment strategy of investing in capex, R&D, acquisitions and returns to shareholders. We anticipate this strategy will continue with management balancing investment requirements with providing enhanced shareholder returns.

Improving return on average capital employed

Through the actions to improve operational efficiency, enhance margins and improve the capital structure, Cytec is driving its return on capital employed in a positive fashion towards a level approaching 16% by 2015, as shown in Exhibit 13.

Exhibit 13: ROACE progression



Source: Edison Investment Research

We believe that this will be a key value driver over the coming years and management has demonstrated that it has a clear focus on driving returns across the group. With the opportunity to better load the business to increase utilisation, we believe further progress will be made.

Balance sheet strengthened and flexible

Following the completion of the Coating Resins disposal, Cytec has a strong balance sheet. Even following the proposed share buyback, net debt will stand at just $300m, providing significant scope for further corporate activity and ample headroom to continue the growth profile of the group through further organic investment. The group's recent refinancing of the 2013 debt has also provided good balance sheet visibility, with no material refinancing required until 2015.

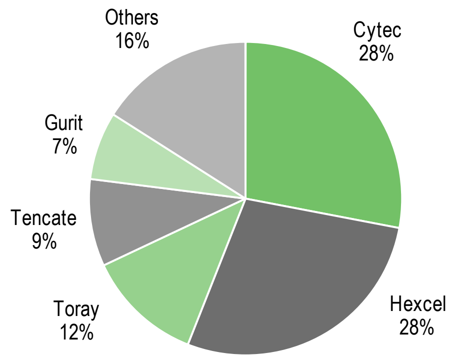
Valuation driven by refocused growth prospects

We believe that through the divestment of Coating Resins and the acquisition of Umeco in 2012, Cytec should be viewed as a growth stock with further opportunities for value creation through synergies, removal of stranded cost and improving operational efficiencies.

Competitiveness improved – broader capability in targeted markets

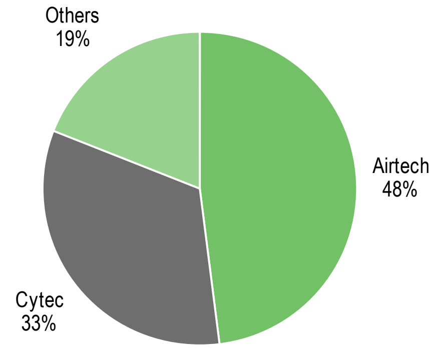
With the acquisition of Umeco, Cytec gained a wider range of certified products, allowing it to gain access to new programmes and markets, as well as increasing exposure in core areas. Our estimates of the various market shares in composite materials are as in Exhibit 14 and 15 below.

Exhibit 14: Competitive position – structural materials



Source: Edison Investment Research estimates

Exhibit 145: Competitive position – process materials



Source: Edison Investment research estimates

We believe that Cytec has now gained a leadership position in structural materials and effectively a duopoly position in process materials markets. Exhibit 16 below highlights the main quoted competitors in terms of scale, exposure and market focus, along with relative ratings:

Exhibit 16: Relative positioning of Cytec's quoted composite peers

Company	Mkt cap ($m)	Sales ($m)	Op margins (%)	P/E rating (CY13)	Material focus	End market/product split	Geographic split
Cytec (US)	3,492	1,708	12.8	15.4	Advanced composites, mining chemicals and additive technologies	Commercial Aero 34% Defence 15% Industrial 18% Mining 16% Polymers/Additives 17%	US 49% EMEA 30% Asia-Pacific 13% LatAm 8%
Hexcel (US)	2,938	1,578	15.1	16.5	Advanced composites	Commercial Aero 60% Space/Defence 22% Industrial 18%	US 46% Europe 39% RoW 15%
Toray (JP)	10,400	15,866	6.8	18.3	Diverse chemicals and materials company	Fibres/Textiles 40% Plastics/Chemicals 25% IT-related 15% Carbon Fibre Composites 4% Environment/Engineer11% Life Science 4% Other 1%	Japan 55% China 13% Other Asia 18% US/Europe 14%
Tencate (NDL)	629	1,342	5.0	9.6	Broad brush textiles, composites and geosynthetics	Textiles/Composites 44% Geosynthetics/Grass 49% Other 7%	US 42% EMEA 39% Asia Pacific 16% LatAm 3%
Gurit (CH)	193	369	7.7	12.8	Lower-grade composite materials, mainly wind energy focus	Wind Energy 58% Transportation 17% Industrial and Marine 16% Tooling 7% Engineered Structures 1%	Europe 47% Asia 16% Americas 31% RoW 6%

Source: Company reports, Edison Investment Research, Bloomberg

As can be seen, within the engineered materials space, there are several key quoted peers that provide some overlap with Cytec. The purest play of these is Hexcel and we view this as a useful comparator to the group. Many of the others provide a much greater array of products and are more diverse in nature and we feel that Cytec's transformation into a global growth play should be recognised. With the addition of Umeco, the group now has the potential to take the technology and approach of Cytec to a wider customer base. Within in-process separation there are few pure-play peers, while Additive Technologies operates in the more general speciality chemicals environment.

Valuation driven by refocusing and synergies

We are valuing the group based upon a sum-of-the-parts methodology to capture the growth prospects and competitive position of each division as shown in Exhibit 17 below.

Exhibit 17: Edison sum-of-the-parts valuation ($m)

	2013e EBITA ($m)	2014e EBITA ($m)	Tax Rate	2013e NOPAT ($m)	2014e NOPAT ($m)	2013 P/E	2014 P/E	Value 2013 ($m)	Value 2014 ($m)	Basis
Engineered Materials	191	219	25%	143	164	16.5	14.6	2,362	2,400	Hexcel (16.5x CY13)
Umeco	16	19	25%	12	14	14.3	12.0	169	168	Average of Hexcel, Toray, Tencate and Gurit (14.3x)
In-Process Separation	97	108	25%	73	81	20.0	18.0	1,458	1,461	High-growth, high-margin operations.
Additive Technologies	39	39	25%	29	29	12.0	10.0	353	295	More commoditised speciality chemicals
HQ & other	-62	-31	25%	-46	-23	15.0	11.0	(696)	(254)	Discounted at current rating
Net debt								(230)	(292)	Forecast FY13 and FY14 net debt
Equity value								**3,416**	**3,778**	
Shares in issue								38.0	38.0	Estimated year-end shares in issue post buyback
Implied fair value per share (US$)								**89.9**	**99.4**	

Source: Edison Investment Research

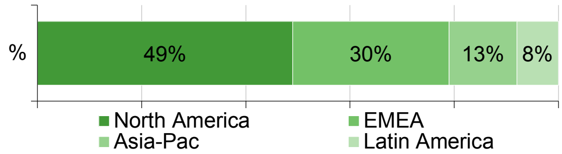
We believe that as the group removes the stranded cost associated with the Coating Resins disposal and achieves the benefits of the Umeco integration in terms of improving operating margins, the value creation opportunity over the next 12-18 months provides an interesting entry point for those investors willing to take a medium-term view. This is further enhanced by the growth focus of the group, which provides a sustainable long-term opportunity as highlighted by our three-year forecast EPS CAGR of 38% and the increasing ROCE towards 16%.

The Coating Resins disposal has acted as a catalyst to highlight this shift away from commoditised businesses to value enhancing, growth businesses and, as such, we feel a fair value of $90 per share is appropriate. This equates to 18.5x CY13 EPS, a c 12% premium to Hexcel at 16.5x CY13 EPS, falling to 13.3x CY14 EPS, cf Hexcel at 14.6x CY14 EPS. This reflects the greater transition potential of Cytec in our view and the opportunity provided by the substantial structural change programme being introduced by management.

Exhibit 158: Financial summary

US$m	2011	2012	2013e	2014e	2015e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	1,416	1,708	2,036	2,205	2,440
Cost of Sales	(992)	(1,182)	(1,441)	(1,564)	(1,736)
Gross Profit	424	527	594	641	704
EBITDA	199	277	341	416	488
Operating Profit (before amort. and except.)	154	218	281	354	424
Intangible Amortisation	0	0	0	0	0
Exceptionals	1	(54)	(2)	(2)	(2)
Other	(5)	(2)	0	0	0
Operating Profit	150	162	279	352	422
Net Interest	(36)	(30)	(11)	(13)	(15)
Profit Before Tax (norm)	119	188	270	341	409
Profit Before Tax (FRS 3)	114	131	268	339	407
Tax	(28)	(37)	(67)	(85)	(102)
Profit After Tax (norm)	88	144	203	256	307
Profit After Tax (FRS 3)	86	94	201	254	305
Average Number of Shares Outstanding (m)	48.4	46.0	41.8	38.0	38.0
EPS - normalised (US$)	1.82	3.13	4.86	6.74	8.07
EPS - normalised and fully diluted (US$)	1.80	3.08	4.76	6.61	7.90
EPS - (reported) (US$)	1.78	2.04	4.81	6.69	8.02
Dividend per share (US$)	0.5	0.5	0.5	0.5	0.5
Gross Margin (%)	29.9	30.8	29.2	29.1	28.9
EBITDA Margin (%)	14.1	16.2	16.7	18.9	20.0
Operating Margin (before GW and except.) (%)	10.9	12.8	13.8	16.1	17.4
BALANCE SHEET					
Fixed Assets	2,249	2,705	1,973	2,155	2,274
Intangible Assets	327	709	799	783	766
Tangible Assets	725	835	1,075	1,273	1,409
Investments	1,198	1,161	99	99	99
Current Assets	1,288	1,217	846	916	991
Stocks	187	267	297	337	382
Debtors	213	303	313	343	373
Cash	416	179	179	179	179
Other	473	468	57	57	57
Current Liabilities	(521)	(807)	(536)	(505)	(477)
Creditors	(518)	(668)	(397)	(366)	(338)
Short term borrowings	(4)	(139)	(139)	(139)	(139)
Long Term Liabilities	(1,322)	(1,310)	(815)	(877)	(828)
Long term borrowings	(636)	(567)	(270)	(332)	(283)
Other long term liabilities	(686)	(743)	(545)	(545)	(545)
Net Assets	1,694	1,805	1,468	1,690	1,960
CASH FLOW					
Operating Cash Flow	130	208	311	316	383
Net Interest	(36)	(30)	(11)	(13)	(15)
Tax	(33)	(10)	(60)	(85)	(100)
Capex	(76)	(145)	(300)	(260)	(200)
Acquisitions/disposals	118	(365)	900	0	0
Financing	(38)	74	(520)	0	0
Dividends	(27)	(26)	(23)	(20)	(19)
Net Cash Flow	39	(294)	297	(62)	49
Opening net debt/(cash)	264	224	527	230	292
HP finance leases initiated	0	0	0	0	0
Other	2	(10)	0	0	0
Closing net debt/(cash)	224	527	230	292	243

Source: Edison Investment Research, company accounts. Note: Continuing operations only.

Contact details	Revenue by geography
5 Garrett Mountain Plaza Woodland Park New Jersey, 07424 United States 973-357-3100 www.cytec.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 11-15e	44.7%	ROCE 2013e	10.4%	Gearing 13e	17.5%	Litigation/regulatory	●
EPS 13-15e	28.8%	Avg ROCE 11-15e	13.3%	Interest cover 13e	27.3x	Pensions	◖
EBITDA 11-15e	25.1%	ROE 13e	15.3%	CA/CL 13e	1.8	Currency	◖
EBITDA 13-15e	19.6%	Gross margin 13e	29.1%	Stock days 13e	55.8	Stock overhang	○
Sales 11-15e	14.6%	Operating margin 13e	16.1%	Debtor days 13e	56.7	Interest rates	◖
Sales 13-15e	9.5%	Gr mgn / Op mgn YY	1.8x	Creditor days 13e	24.5	Oil/commodity prices	●

Management team

Chairman, President & CEO: Shane Fleming

Shane Fleming has been with Cytec since 2001 in various roles, including as president of Cytec Specialty Chemicals, chief operating officer and subsequently as CEO since January 1, 2009. He joined Cytec in 1983 and held progressively more senior roles in the Mining Chemicals business before moving into general management.

Vice President & CFO: David Drillock

David Drillock has been vice president and CFO since 2007, prior to which he served as a VP of Cytec since 2002 and controller since 1993. He began his career at American Cyanamid in 1978 and served in positions of progressively increasing responsibility in the accounting function.

Principal shareholders	(%)
Passport Capital LLC	7.49
Fidelity Management & Research Co	6.36
The Vanguard Group, Inc	5.27
BlackRock Institutional Trust Co, N.A.	4.99
TIAA-CREF	4.76
OppenheimerFunds, Inc	3.79

Companies named in this report

Boeing; EADS; Bombardier; Hexcel; Toray; TenCate; Gurit

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