



# market monitor

Focus on construction industry  
performance and outlook



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## In this issue...

<b>Introduction</b>	<b>Shaky foundations remain</b> .....	<b>4</b>
<b>Full reports</b>		
<b>Belgium</b>	<b>Payment delays increased in 2014</b> .....	<b>5</b>
<b>France</b>	<b>Output decreased by more than 4% in 2014</b> .....	<b>7</b>
<b>The Netherlands</b>	<b>A less gloomy performance outlook</b> .....	<b>9</b>
<b>United Kingdom</b>	<b>Payment delays remain high</b> .....	<b>11</b>
<b>United States</b>	<b>Growth continues in 2015</b> .....	<b>13</b>
<b>Market performance snapshots</b>		
<b>Brazil</b>	<b>Subdued prospects in 2015</b> .....	<b>15</b>
<b>Germany</b>	<b>Poor payment behaviour of public buyers remains an issue</b> .....	<b>16</b>
<b>Mexico</b>	<b>Major public investments planned</b> .....	<b>17</b>
<b>Market performance at a glance</b>		
	<b>Australia, India, Japan, Turkey, United Arab Emirates</b> .....	<b>18</b>
<b>Overview chart</b>	<b>Industries performance per country</b> .....	<b>20</b>
<b>Industry performance</b>	<b>Changes since December 2014</b> .....	<b>22</b>

On the following pages we indicate the general outlook for each sector featured using these symbols:



Excellent



Good



Fair



Poor



Bleak



# Shaky foundations remain

The outlook for the construction industry in most countries covered by this Market Monitor issue remains muted in 2015. In many markets public budget cuts, low investment, cautious and cash-strapped consumers and scarce bank loans are adding to the persistent problems in the building sector.

Due to the subdued economic performance our underwriters have recently lowered their assessment of France's construction performance from 'poor' to 'bleak'. Even if there is a modest rebound (like in the Netherlands and the UK), the number of construction insolvencies and payment delays is expected to remain high, and the overall picture of both pressure on margins and cash flow problems remains. Among the advanced economies covered in this report only Germany, Japan and the US show solid construction performance, but even there problems persist either for certain subsectors or small players in the market.

In the emerging markets featured in this Market Monitor only the United Arab Emirates shows performance still labelled "Fair", but there decreased oil prices will have a negative impact on public spending. Turkey's construction sector suffers from increased non-performing loans, while in India and Mexico building businesses face an improved outlook for 2015, but still have to deal with structural constraints. In Brazil, which was not so long ago labelled one of the world's most promising construction markets, the sector performance has been hit by the economic slowdown and a major corruption case.

# Belgium

- Zero growth expected in 2015
- Payment delays increased in 2014
- No major decrease in insolvencies expected in 2015



## Overview

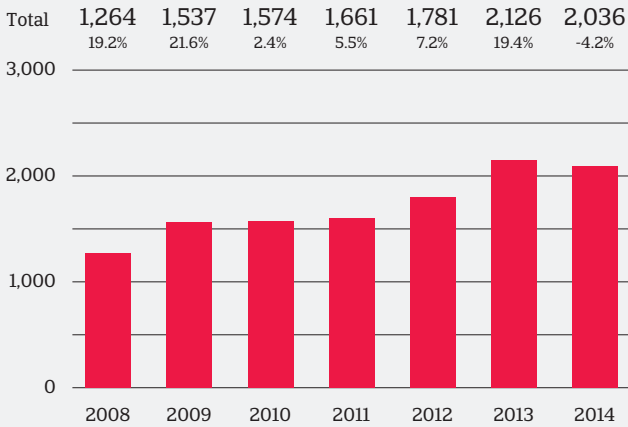
Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months				✓	
Development of insolvencies over the coming 6 months			✓		
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector				✓	
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)				✓	

Source: Atradius

The Belgian construction sector has gone through difficult times since mid-2012, and this continued in 2014. There is still no real rebound in sight, with poor demand, job losses, on-going pressure on prices and a high number of insolvencies. Banks are still cautious when providing credit to the industry.

The time horizon of construction businesses' order books has become much shorter, as customers tend to delay their investment decisions – impacting business volumes even when the order portfolio seems to be sufficient. The only good news in 2014 was that business was aided by favourable weather conditions at the beginning of the year. After a 1.3% contraction in 2013 construction is expected to have grown 2% in 2014, but this is forecast to be followed by zero growth in 2015. Prospects for the renovation business are – as in previous years - slightly more positive.

In the residential subsector the number of building permits was up in the first half of 2014 as many households had filed requests before the end of 2013 in order to avoid stricter energy regulations. However, this one-off effect faded by May, and resulted in a lower than usual level of permits in H2 of 2014. The planned downward adjustment of tax incentives for house ownership ('Woonbonus') should have a supporting impact on the subsector's performance in 2015. Therefore, the short-term perspectives for residential construction should not be that bad. However, in the medium and long term residential construction could be impacted by the decreasing ability of households to finance new houses (due to stricter energy regulations, lower fiscal advantages, and more restrictive bank lending). The subsector will probably need to address this issue by offering less expensive and more compact alternatives.

**Belgium: construction insolvencies**

Source: Belgium Statistics Office

In the new non-residential construction sector we have noticed a year-on-year increase in the number of permits in the period September 2013-September 2014, but a decrease in volumes in 2014. The non-residential renovation business recorded a downward trend with primarily construction businesses working for local governments (mostly road works) facing decreasing order books.

Payment terms of "60 days end of month" are very common in the sector. Recently we have been informed that certain buyers have even adjusted them unilaterally to "90 days end of month". Cash payments with discounts are common. It is also common that businesses ask suppliers for longer payment terms if they themselves are waiting for overdue payment, e.g. from public bodies with their lengthy payment procedures. Overall, we observed an increase in payment delays in 2014. Given the difficult market conditions the number and amount of notifications of non-payments is expected to remain high.

In 2014, 2,036 construction companies went insolvent: a 4.2% year-on-year decrease. Construction accounted for 18% of all Belgian business insolvencies. We expect no major improvement in this situation in 2015. That said, our prudent underwriting stance should allow us to maintain our current level of engagement.

**Belgian construction sector**

Strengths

Demographic evolution

Aged real estate stock,  
need for infrastructure improvements  
(schools, hospitals, roads)

Current low interest rates



Weaknesses

Competition from Dutch builders

Low level of government investment

High labour costs

Source: Atradius

# France

- Output decreased by more than 4% in 2014
- High level of payment delays
- Insolvencies expected to increase further in 2015



## Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months					✓
Development of non-payments over the coming 6 months				✓	
Trend in insolvencies over the last 6 months				✓	
Development of insolvencies over the coming 6 months				✓	
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector			✓		
Willingness of banks to provide credit to this sector					✓
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)				✓	

Source: Atradius

In 2014 the performance of the French construction sector deteriorated compared to 2013, due to a sharp decrease in housing starts and permits, postponement of public works due to municipal elections and the failure of the Duflot tax exemptions program to boost real estate investments. According to the French builders association FFB (Federation Française du Bâtiment), construction output decreased 4.3% in 2014 (in December 2013 the forecast had been a modest 0.4% contraction).

In the residential construction subsector, new housing starts decreased almost 10% year-on-year in 2014, mainly due to a sharp deterioration in the one family dwellings segment (down 12.9%), while permits decreased 9.7%. The real estate sector also recorded deteriorating sales. Mainly due to the decrease in new housing starts finishing work activities continued to suffer, with activity decreasing 1.5% in 2014 after a 3% slump in 2013, according to the trade association CAPEB (Confédération de l'Artisanat et des Petites Entreprises du Bâtiment). Renovating activities de-

creased 0.5%. It is worth noting that that renovating activities and new housing account for 55% and 45% of the residential construction market revenue.

At the same time the non-residential construction market did not fare much better, as new building starts in this segment decreased 10%, mainly due to less construction of private offices and public buildings. Permits decreased 8%. Public works were negatively affected by the March 2014 municipal elections in France, because public building activities usually grow in the year ahead of an election (as majors want to finish their projects before the vote), and decrease after the election. According to the building association FNTP (Federation Nationale des Travaux Publics), public construction output decreased more than 13% year-on-year in 2014. The construction materials sector also suffered, recording a production decrease of 4.5%.



Given those figures, the poor construction performance and low demand in previous years it comes as no surprise that French construction businesses face many difficulties. Revenues and investments are low, competition is fierce, and prices and profitability are both being squeezed. Major players keep on putting pressure on their subcontractors, and banks remain very selective with their loans, making access to short-term credit difficult. Additionally, the financial situation of construction businesses is often impacted by the “scissor effect” of low margins and long payment delays. Since July 2014 we have registered a significant increase in notifications of non-payments in value as well as in frequency, and we expect this trend to continue in the coming months.

Construction insolvencies account for more than 30% of all business insolvencies in France, and we expect a 3%-4% increase in 2014. Mainly (about 85%) affected are smaller businesses with 1-5 employees, but we also observed more bankruptcies of medium-sized construction companies with immediate liquidation (i.e. without entering judicial restructuring process). While French business insolvencies are forecast to level off in 2015, it is expected that construction business failures will further increase in the first three quarters of 2015 due to the low economic growth forecast for France (up only 0.8% in 2015). The impact of recently passed government measures to support the sector (tax exemptions and reductions for real estate investors and first-time buyers and VAT reduction for finishing) will probably not be felt before the end of the year. In 2015 the FFB expects modest growth of 1% (to 303,000 units) and 2.6% (to 401,000 units) respectively in new housing starts and permits for the residential construction market. However, in the non-residential segment permits are expected to decrease again, by 6.9%. Public works will likely continue to suffer from poor investments: The funds allocated by the government to local authorities will probably decrease in the coming years in order to tackle the public deficit issue.

In this difficult context, we must remain cautious in our underwriting stance, but we still provide cover to our customers wherever it is reasonable and prudent to do so. We closely monitor and review buyers to anticipate potential high risks to our customers.

- We focus on the cash situation and loan facilities available to buyers, especially smaller and mid-sized companies
- Several key financial indicators must be analysed: the level of activity, margins and ability to fund working capital requirements. High financial costs are a key indicator of potential pressure on cash

We require additional information on construction buyers (business plans, treasury plans, interim financial statements). Additionally we undertake special reviews of buyers active in the construction of single family housing and in public works.

### French construction sector



Strengths

**Structural lack of housing due to the demographic development (growing population)**

**Still low interest rates**



Weaknesses

**Weak economic growth and measures to curb the high public deficit**

**Rising unemployment**

**Costs rising faster than prices**

Source: Atradius



# The Netherlands

- A less gloomy performance outlook
- High level of payment delays
- Insolvencies expected to increase further in 2015



## Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months		✓			
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months			✓		
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector					✓
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)			✓		

Source: Atradius

Despite some positive developments (increased sales of and higher prices for private homes sold and increased building permits in Q4 of 2014) the Dutch construction market remains weak, as demand is still very low compared to the (pre-crisis) period before 2008. Due to continued tight mortgage lending practices and banks' restrictive loan policies towards construction companies we do not expect a robust rebound in the short-term, despite signs that the deterioration has bottomed out.

The immediate outlook for residential and both private and public non-residential construction is less gloomy than in the past. However there is still overcapacity in office buildings. At the same time construction businesses dealing with utility and public works still show no improvement. Businesses active in the utility construction subsector still show decreasing revenues with strong pressure on their margins, while specialised construction companies record stable revenues at least. The persistent low construction volumes and subdued private spending

still affect the construction materials segment, and we expect many businesses in this subsector to report negative results for 2014. However, as many companies have anticipated the difficult business circumstances expected in 2014 and 2015 and have reorganised accordingly, they could report better results in 2015.

We have seen a deterioration of payment behaviour over the last few years, especially during the significant performance downturn in 2012 and 2013. Due to the adverse economic situation and more restrictive bank lending, payment periods in the sector have increased to an average of 60 days. In 2014 we noticed that some of the larger Dutch construction businesses took advantage of their market position by stretching payments to their suppliers. However, we have recorded a decrease in notifications of non-payments over the past six months and expect payment behaviour to be stable in 2015.



As in 2013 and 2014, fierce competition means that the Dutch construction sector is still affected by price wars, leading to on-going pressure on margins. The liquidity of many companies has weakened due to losses and impairments, straining both solvency and liquidity. As a result, businesses' focus is still on cash flow and working capital - and on tighter credit management.

In 2014, 1,062 construction companies became insolvent, a 34% year-on-year decrease after massive increases in previous years. Mainly carpentry companies, electricians, painters and other specialised construction companies recorded decreases. However, despite this decline we noticed that several large (top 10) construction companies had more financial troubles than in 2013. In 2015 we expect construction insolvencies only to level off, in line with the overall Dutch business insolvency development. The GDP growth forecast of 1.3%-1.6% does not seem to be enough for another substantial decrease in insolvencies this year. Despite the fact that many Dutch construction businesses went bankrupt in the last couple of years there is still overcapacity in the market, and a consolidation has yet to take place.

When assessing a buyer's creditworthiness, we require up-to-date financials, and details of the 2015 order book and payment experience. Additionally we seek details on the company's financing (covenants/securities) and the maturity dates of bank loans. Our aim is still to maximise the insurance cover we can give our customers, and in this respect third party securities, if available, can help. Compared to 2013, our risk acceptance of buyers in the Dutch construction sector already increased in 2014.

### Dutch construction sector



Strengths

Flexible work force (cost structure)

Enhanced working capital management

Demographic development



Weaknesses

Overcapacities and pressure on margins

Restrictive bank lending

Cost cutting measures of the government

Source: Atradius

# United Kingdom

- Output continues to grow in 2015
- Payment delays remain high
- Bank financing remains an issue



## Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months				✓	
Development of non-payments over the coming 6 months				✓	
Trend in insolvencies over the last 6 months			✓		
Development of insolvencies over the coming 6 months			✓		
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector				✓	
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)			✓		

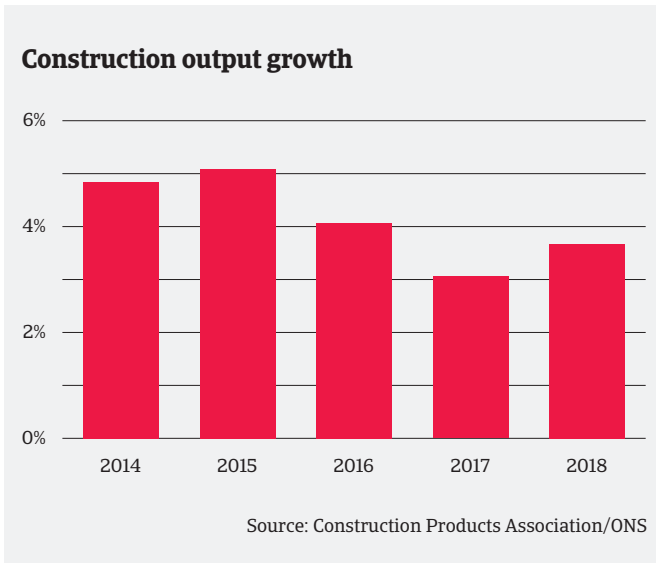
Source: Atradius

Output in the UK construction industry increased 5.8% year-on-year between January-November 2014, with both new construction as well as repair and maintenance increasing (up 5.7% and 0.1% respectively). Within new construction there were increases in new housing (up 21.9%) and private industrial construction (up 8.8%). Construction activity has continued to broaden out beyond house-building. Demand for housing has softened over the last couple of months and has become more aligned with supply. According to the Office for National Statistic's House Price Index, house price inflation decreased to 10.4% in October 2014, from 12.1% in September 2014.

It is expected that construction output growth will continue in 2015 and also continue to broaden out beyond house building. According to the Construction Products Association output will increase 5% in 2015, followed by 4.2% in 2016. House builders have not scaled back their build programmes in late 2014 and early 2015, but this is expected to happen in the course of 2015

in response to some softening in housing demand. Growth in the commercial construction subsector is expected to increase (e.g. out-of town-shopping and big city projects and factory expansions). Office development had also picked up. A proportion of this was however deemed to be speculative in nature. Infrastructure projects are also expected to increase in 2015 and beyond.

Despite the rebound, the construction sector is still affected by trailing effects of the past recession. This became evident in 2014, with a high number of profit warnings, senior management changes and reported losses. The on-going problems are particularly noticeable in the tendering process, as during the downturn construction companies took on contracts at conditions that were no longer sustainable in 2013 and 2014, due to raw material price increases and higher labour costs. Companies still have to find a balance between taking on work and managing costs, particularly on fixed-price contracts on which they are experiencing cost price inflation since winning the tender. This



has been particularly apparent in the mechanical and electrical construction sectors.

Overall there is the perception that credit conditions have improved, however this accounts only for banks competing hard for lower risk business with larger, asset rich construction companies. For many smaller businesses access to bank finance has remained difficult or subject to unattractive terms. There is evidence that non-bank alternative funding sources have grown, however the market is still difficult to tap for smaller businesses. This lack of funding will affect companies that may need to resume investment, particularly in capital expenditure to cope with a growing market as volumes increase again.

Payment delays were still high in 2014 as some of the major tier-one contractors pushed their payment terms out to 90 days and in some instances even to 120 days. However with volume returning to the market the dynamic has changed somewhat as sub-contractors are now able to be more selective in choosing which contracts to tender for and therefore have more influence on the payment terms. This could have an impact on the major tier 1 and tier 2 companies as they may have to negotiate with their sub-contractors on tighter payment terms than they had previously. However, we expect the number of payment delays to remain high in the coming months.

That said, construction insolvencies continued to decrease in 2014. We expect construction insolvencies to level off in 2015, as lack of demand – a key driver behind insolvencies - is less likely next year, however access to finance, raw material costs and delayed payments will still be issues for the sector in 2015. Therefore our underwriting approach will remain cautious for the time being.

#### British construction sector



Strengths

Whilst a slowdown is expected in the house building sector, output still expected to grow by 10% in 2015.

Volumes increasing across the industry.

Solid growth expected in commercial construction.



Weaknesses

#### Late payments in the sector

Raw material cost inflation and the lack of skills that is now evident as work volumes pick up.

Access to finance remains an issue for businesses that need it. Also supplier support remains a big problem for those further down the supply chain.

Source: Atradius

# United States

- Growth continues in 2015
- Payments take between 30-60 days on average
- Smaller businesses generally pay later



## Overview

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months				✓	
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months			✓		
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector			✓		
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)		✓			

Source: Atradius

In 2014 the US construction sector continued its rebound that started in 2012, with increases in both employment and reported billings. According to the Dodge Construction Outlook total construction starts increased 4% in 2014, and a 9% increase is forecast for 2015, while the vast majority of construction and design firm executives believe the market is stable or growing. Due to the positive development we have steadily increased our cover for this industry over the past few years. However, it must be said that the construction market rebound still lags behind the overall economic recovery that began in 2009.

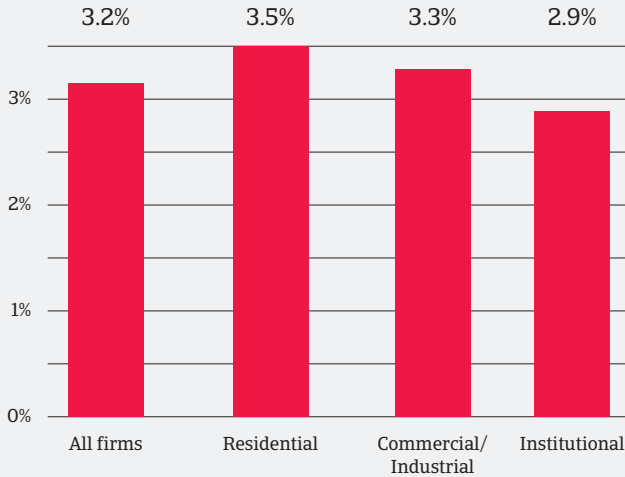
In early 2014 adverse weather conditions triggered a rocky start for construction and the US economy, affecting job growth, homebuilding, manufacturing and spending. That said, in the course of the year consumer confidence grew, job creation resumed, and GDP increased as the year progressed, to 2.2% in 2014.

In the residential construction subsector home prices increased in 2014, although not as sharply as they did in 2012 and 2013. In 2014 foreclosures decreased 30% year-on-year. First-time buyers benefitted from a decrease in investors buying single-family homes, which created less competition for lower-priced inventory, although strict credit standards led to fewer than expected first-time buyers. New-home starts only marginally increased in 2014. Mortgage rates decreased below 4% by the end of 2014 and the inventory of property for sale is growing, which is leading to rising home values. It is estimated that mortgage rates will settle between 4%-6% in the mid-term, beginning around mid-2015. However this increase is not predicted to have a major impact on home sales. The 2015 Dodge Construction Outlook forecasts an 11% increase in single-family housing units and a 7% increase in multi-housing starts.



## Residential firms somewhat more optimistic about prospects for 2015

Units: Current projection for change in gross revenue at firm in 2015 compared to 2014



Source: American Institute of Architects

Commercial building output increased 14% in 2014, and is estimated to increase at roughly the same pace in the coming year. 2014, like in 2013, saw massive growth in manufacturing plant construction due to the start of chemicals and energy related projects. Last year there was a moderate upward trend in institutional building which is expected to continue through 2015, aided by financing available for K-12 school construction. Healthcare facilities showed diminished activity in 2014, though that is expected to improve. After a 9% decline in 2014 public works is expected to rebound by about 5% in 2015, mainly due to highway and bridge construction.

Payments in the US construction industry still take 30-60 days on average, while 90 day terms are not uncommon. While the overall number and value of the notifications of late payments we received in 2014 has increased, this was primarily due to a solid increase in our exposure to the sector. It is also partially a function of the industry with payments coming from the general contractor to sub-contractors and then in some cases to the underlying supplier. If one company in the chain does not pay, rarely will the others.

Despite the rebound in recent years the downward pressure on revenue has not significantly changed since the 2008/2009 downturn. Additionally increasing salaries, healthcare costs for staff and miscellaneous expenses continue to tighten margins. At the same time tougher credit standards have required higher equity from construction businesses. Banks are principally willing to lend to the construction industry, but only for viable and promising projects. However, as the commercial and residential development markets strengthen, the construction sector's financing climate is improving. Given the positive growth prospects for the industry, we expect notifications of late payments to level off in 2015. Construction firms hope to increase bid prices in 2015, which are driven by material costs, which are also ex-

pected to increase. In 2013, approximately 60% of construction firms were in "very good" or "good" financial health, up from 50% in 2012. This further increased to 66% in 2014.

Construction insolvencies have continued to improve overall in the US last year. However, small businesses in the industry are generally still paying later and have higher bankruptcy rates and delinquent debt than other industries (construction sector small business national average bankruptcy rate was 2.3% in 2014). But the decreasing trend is expected to continue throughout 2015.

In summary, we assess buyers in this sector in this way:

- Cover will be considered if we can see evidence of favourable trade history, financial statements, or other credit/financial insight.
- Reduction or withdrawal of cover is considered if the buyer shows significantly worsening results, including losses, heavy debt levels, problems with working capital, cash flow or liquidity, or deteriorating payment trends.
- Where financial information is required, we will look for signs of progressive and profitable operations, positive working capital and cash flow, and satisfactory debt to net worth leverage. We also take into account less measureable aspects such as goodwill, health/pension liabilities, and litigation issues.
- We consider whether other forms of risk mitigation - such as Uniform Commercial Code (UCC) filings, letters of credit, increased co-insurance and decreased indemnification, and shortened terms of sale - will assist us in agreeing to cover.

### US Construction Sector



Strengths

Construction input prices, especially in non-residential construction, have been steadily declining throughout 2014.

Construction benefits from accelerating job growth and decreasing unemployment.

Builders are expected to increase the pace of new-home construction in 2015.



Weaknesses

Downward pressure on revenues has continued.

Many prospective workers lack the necessary skills to fill various openings, creating skill mismatches.

Home ownership for US citizens under 35 years old reached record lows in 2014. Rising home prices and tight lending standards create a prohibitive environment for first-time home buyers.

Source: Atradius

# Market performance snapshots

## Brazil

- **Subdued prospects in 2015**
- **Payment delays and insolvencies expected to increase sharply**
- **A major corruption scandal shakes the industry**



The Brazilian construction sector has been negatively affected by a slowdown in economic growth (GDP contracted 0.1% in 2014 and is expected to grow only between 0.5% and 1% in 2015). Another stumbling block is higher interest rates, as the Central Bank has repeatedly raised the Selic benchmark interest rate since December 2014, to the current 12.25%. This together with banks being less willing to provide credit, makes commercial loans more expensive, slows construction sales and reduces the number of new building projects launched. At the same time it is expected that government investment in infrastructure projects will decrease because the budget deficit needs to be reduced. We expect the government will be more restrictive in approving new expenses, which could result in longer delays in awarding contracts to general contractors. After modest growth of 0.5% in 2014, construction output is only expected to grow at more or less the same level in 2015.

Construction businesses' profit margins are forecast to deteriorate further this year, and it is expected that both payment delays and insolvencies will increase sharply in 2015. Due to those developments our underwriting stance is currently restrictive.

Since the end of 2014 the Brazilian construction sector has been shaken by a massive corruption case: State prosecutors alleged that nine of the leading construction businesses (Odebrecht, Camargo Correa, Queros Galvao, Engevix, OAS, UTC, Mendes Junior, Galvao Engenharia, IESA) paid bribes to the state oil company Petrobras and certain politicians in return for contracts. Pending further inquiries into the scandal, Petrobras has barred those construction businesses and some other companies from bidding for project work with it and suspended payments for on-going projects. Additionally banks have stopped providing loans to those leading construction businesses. As a consequence the large construction company IESA has filed for Chapter 11, while OAS has defaulted on two major payments to its bond holders.

## Germany

- Lower growth in 2015
- Poor payment behaviour of public buyers remains an issue
- Decrease in insolvencies slowing down



In recent years the performance of the German construction and construction materials sectors has improved, and the outlook for 2015 is positive. As a result, our underwriting view of the industry is quite relaxed.

The performance of the German construction sector was generally positive in 2014. Especially in H1 of 2014 new orders, order backlog and turnover of German construction businesses were clearly above the 2013 level. However a cooling down was noticed in H2 of 2014, mainly in the public construction segment, due to lower investment. It is expected that nominal turnover grew 4% in 2014, and for 2015 a 2% growth rate is forecast by the German Builders Association. Residential construction is forecast to increase 3%, commercial construction 1.5% and public construction 1%.

Although the construction materials subsector is naturally highly dependent on construction performance, its development is varied: construction materials subsectors engaged in reconstruction and modernisation have performed better than those active only in new building. Despite the industry's overall satisfactory performance, the sawmill/wood machining subsector continues to face problems, despite a global increase in demand for sawn timber products. The reasons are the high price of German round timber, high production and financing costs, overcapacity, and a disconnect between prices for log wood and sawn timber. Therefore, and in contrast to other construction/construction materials subsectors, our underwriting stance remains very restrictive in this segment.

On average, payments in the German construction sector take around 45-50 days. Instances of payment default decreased again in 2014. However, the poor payment behaviour of public buyers remains an issue, as it puts a strain on suppliers' liquidity.

In general, when assessing buyer risk we take into account operating results, equity, liquidity and financing (e.g. the ratio of work in progress/advanced payments) and orders in hand. Despite our broadly open stance, we still consider construction to be a riskier sector than other industries, although credit insurance claims have decreased over recent years. Many construction companies – especially smaller ones – traditionally have weak equity ratios (the proportion of equity used to finance a company's assets) and limited financial scope. The average equity ratio in the German construction industry has improved slightly in recent years: reaching around 12-13% in 2014. According to Creditreform, construction insolvencies decreased by more than 5% in 2014, to 3,450 cases. However, the proportion of insolvencies in the sector is still higher than in other industries (95 insolvencies per 10,000 firms compared to 42 per 10,000 in the manufacturing sector). In 2015 we expect construction insolvencies to decrease further, by 3%, which is less than in 2013 and also less than the 5% decrease forecast for business insolvencies overall in Germany.

With less background information to work with, we are naturally very cautious when assessing the creditworthiness of construction/construction materials businesses that have operated for less than one year, unless they are part of, or a spin off from, a larger group.

While we normally review buyers annually, in more problematic subsectors (e.g. businesses focused solely on public clients) we hold additional reviews. Where we identify poor creditworthiness and negative operational results, our underwriting stance is naturally very restrictive.



# Mexico

- Major public investments planned
- Construction is forecast to grow 4% in 2015
- Payments take between 45 and 120 days



The Mexican construction sector suffered a downturn in 2013 as production decreased 4.5% year-on-year. However, in April 2014 President Enrique Peña Nieto announced a National Infrastructure Plan, to be implemented between 2014 and 2018. This new program aims to invest approximately USD 415 billion (5.7% of Mexico's GDP) in more than 1,000 projects in the transportation, water management and energy sectors, as well as in housing and urban development.

After three consecutive quarters of decline, Q4 of 2014 showed a significant improvement in construction performance, and the Construction Chamber expects the industry to have grown 2% by the end of 2014. In 2015 non-residential and public construction growth is expected to be mainly driven by the National Infrastructure Plan and supported by investments triggered by recent reforms in the energy and telecom sectors.

The expectations for the housing construction sector are cautiously optimistic. Just as in the non-residential segment, growth is expected to be generated by the National Infrastructure Plan that has budgeted approximately USD 95 billion for housing and urban development, including financial assistance for home ownership (subsidies, mortgage financing) and renovation of existing houses. Growth is expected to be driven by smaller players, which have a stronger market position following the bankruptcy of some larger companies in 2013.

On average, payments in the construction industry still take 45 to 120 days. It is common that buyers in this sector pay slowly, especially in the case of public infrastructure projects.

In 2015 the Mexican construction industry is forecast to grow 4%, however this would, among other things, require the federal government to accelerate the bidding process for the planned construction projects from the beginning of this year and to speed up advance payments for the completion of the projects. Taking those elements of uncertainty into account, the construction industry could face significant challenges again. Therefore we maintain our 2015 performance outlook of "poor" for the time being.



# Market performance at a glance

## Australia



- Residential construction performance is expected to improve in New South Wales and Queensland due to low interest rates, population growth and increasing building approvals.
- Commercial construction is expected to be further affected by the reduction in mining investment and resource related work.
- However this will be offset to some extent by increased growth in telecommunications infrastructure and transport infrastructure.
- Payments in the construction sector take between 90-120 days on average. Notifications of non-payments have increased and the current level is high.
- Construction insolvencies are expected to level off in 2015, but the overall level remains high.
- Our underwriting approach remains cautious as the residential and commercial construction sectors struggle to fill the gap left after the mining-boom ended in Australia, and increased competition leads to margin erosion (especially for new and small businesses).

## Japan



- The general outlook for the Japanese construction sector is positive as the industry benefits from an increase in public works and credit easing measures by the government.
- Construction insolvencies decreased 18% year-on-year in 2014 and are expected to level off in 2015.
- There was no increase in payment delays in 2014, and we expect no increase in 2015.
- That said, construction businesses face some difficulties due to a lack of workforce, leading to higher labour costs.
- Another issue is rising material prices due to the depreciation of the Yen.
- Smaller construction businesses with weak financials could face some difficulties in 2015.

## India



- The Indian construction sector has been facing challenging times in recent years due to political uncertainty, weak investment cycles, subdued business confidence, and delays in land acquisition/clearance processes.
- The outlook for 2015 has improved due to a better business environment and large infrastructure projects launched by the new government.
- However, on-the-ground recovery is expected to be a gradual process as the sector still deals with structural constraints.
- Construction companies remain highly leveraged, and obtaining financial support for projects remains a challenge. However, banks have increased loans to the sector.
- Payments in the construction sector take between 90-120 days on average.
- We continue to maintain a cautious approach in underwriting this sector.
- Besides financial information, we assess trading experience with buyers and monitor any changes in payment behaviour. We also assess the strength of the customer-buyer relationship.
- We would generally not encourage customers to lengthen their normal terms of payment.

## Turkey



- Turkish construction growth slowed to 2.9% in Q3 of 2014.
- International projects of Turkish builders decreased due to the ongoing conflicts in Iraq and Syria and the downturn in Russia.
- In 2015 investment in public construction is expected to increase ahead of the June general elections and due to some large infrastructure projects.
- Despite persistent growth, risks in the construction sector are increasing as many businesses are highly indebted and non-performing loans are rising.
- High interest rates hampering business performance.
- Bankruptcy protection requests are increasing.

## United Arab Emirates



- The sharp decrease in oil prices having a negative impact on the economy, and is also affecting real estate and construction.
- Payments in the construction sector take between 90-120 days on average. However, payment is often delayed up to 180 days or even longer, especially when government departments are involved.
- Due to the current challenging economic environment (probable overcapacity, reduced oil prices, less government spending) we are now more cautious in underwriting construction businesses.
- Payment behaviour is expected to deteriorate and insolvencies to increase in the coming months.
- Prudent cash flow management and continuation of bank facilities will be key to sustaining business in 2015.

# Industries performance forecast per country

February 2015

	Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction Const.Mtrl	Consumer Durables	Electronics/ ICT	Financial Services
Austria							
Belgium							
Czech Rep.							
Denmark							
France							
Germany							
Hungary							
Ireland							
Italy							
The Netherlands							
Poland							
Portugal							
Russia							
Slovakia							
Spain							
Sweden							
Switzerland							
Turkey							
UK							
Brazil							
Canada							
Mexico							
USA							
Australia							
China							
Hong Kong	N/A						
India							
Indonesia							
Japan							
New Zealand							
Singapore							
Taiwan	N/A						
Thailand							
United Arab Emirates							

TABLE OF CONTENTS

FULL REPORTS

MARKET PERFORMANCE  
SNAPSHOTS

MARKET PERFORMANCE  
AT A GLANCE

OVERVIEW CHART

INDUSTRY PERFORMANCE

Food	Machines/ Engineering	Metals	Paper	Services	Steel	Textiles

Excellent

Good

Fair

Poor

Bleak

TABLE OF CONTENTS

FULL REPORTS

MARKET PERFORMANCE  
SNAPSHOTS

MARKET PERFORMANCE  
AT A GLANCE

OVERVIEW CHART

INDUSTRY PERFORMANCE



# Industry performance

## Changes since December 2014

### Europe

#### Belgium

##### Food



Up from Fair to Good

Payment defaults and credit insurance claims have decreased.

##### Metals



Up from Fair to Good

Payment defaults and credit insurance claims have decreased. While margins remain under pressure due to low raw material prices, many companies are better suited to control their working capital requirements.

##### Textiles



Up from Bleak to Poor

While clothing retail still suffers from weak private consumption local producers increasingly move to "niche" products with better margins.

#### Ireland

##### Automotive/Transport



Up from Bleak to Fair

In 2014 passenger car sales increased 30% and commercial vehicle sales rose 51%.

##### Construction/Construction materials



Up from Poor to Fair

Construction rebounded in 2014, although from a very low level. The Purchasing Managers Index point to a solid rebound.

##### Consumer durables



Up from Bleak to Fair

Higher consumer confidence has led to increased household spending in Q4 of 2014.

#### Italy

##### Metals



Up from Bleak to Poor

The market is still weak in terms of sales volume and price, but it has stabilised, evidenced by fewer credit insurance claims.

#### Portugal

##### Consumer durables



Up from Poor to Fair

Consumer confidence and consumption have increased in the last couple of months. Consumer expenditure has been directed especially towards durable goods, benefiting the sector. Payment experience has also improved.

##### Food



Down from Good to Fair

Deflation of food prices has become a problem for the sector, and payment delays have increased in both production and distribution.

#### Russia

##### Chemicals/Pharmaceuticals

##### Financial Services

##### Paper

##### Services



Down from Fair to Poor

##### Agriculture

##### Automotive/Transport

##### Consumer durables

##### Metals



Down from Poor to Bleak

All these sectors are negatively affected by the sharp downturn in Russian economic growth, Rouble devaluation, sanctions and mounting difficulties in the banking system.

#### Spain

##### Financial services



Up from Poor to Fair

While challenges remain, Spanish banks met the ECB stress tests and do not need to raise any new capital. Spanish banks now face the future with healthier balance sheets and a sound solvency position.

## The Americas

### Sweden

Automotive/Transport  
Construction materials  
Consumer durables  
Electronics/ICT  
Paper  
Textiles



Up from Poor to Fair

All these sectors have shown an improved performance in 2014, and therefore our underwriting stance has been relaxed.

### United Kingdom

Chemicals



Down from Excellent to Good

The sharp decrease in oil prices is expected to have a negative impact on oil drilling and ancillary industries.

### Canada

Chemicals



Down from Good to Fair

In the Canadian oil industry the sharp decrease in oil prices has led to decreasing investments and rising insolvencies, with more business failures expected.

### Mexico

Chemicals



Down from Good to Fair

Lower oil prices will have a mixed effect on the sector. While some businesses will benefit from lower prices, for others it implies higher costs which will be hard to pass on to their customers, while margins are already thin.

### USA

Textiles



Up from Poor to Fair

Clothing sales are increasing, and businesses show sound cash flow generation and improved balance sheets. The sector is expected to benefit from decreasing cotton prices.



## Asia/Oceania

### China

#### Consumer durables



Down from Good to Fair

The sector has been negatively affected by the expiry of previous subsidies and weaker demand for home appliances. There is fierce competition between online stores (which sacrifice margins to push sales and invest in logistics) and offline stores (which feel heavy pressure on prices and have high operating costs).

### Thailand

#### Construction/Construction materials



Down from Good to Fair

The sector has been negatively affected by the lack of clear project outlook for public building by the government so far.

#### Financial Services



Down from Good to Fair

Increasing non-performing loans in the consumer loans segment affect banks' margins.

#### Machines/Engineering



Down from Good to Fair

Capacity utilisation has decreased in 2014.



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