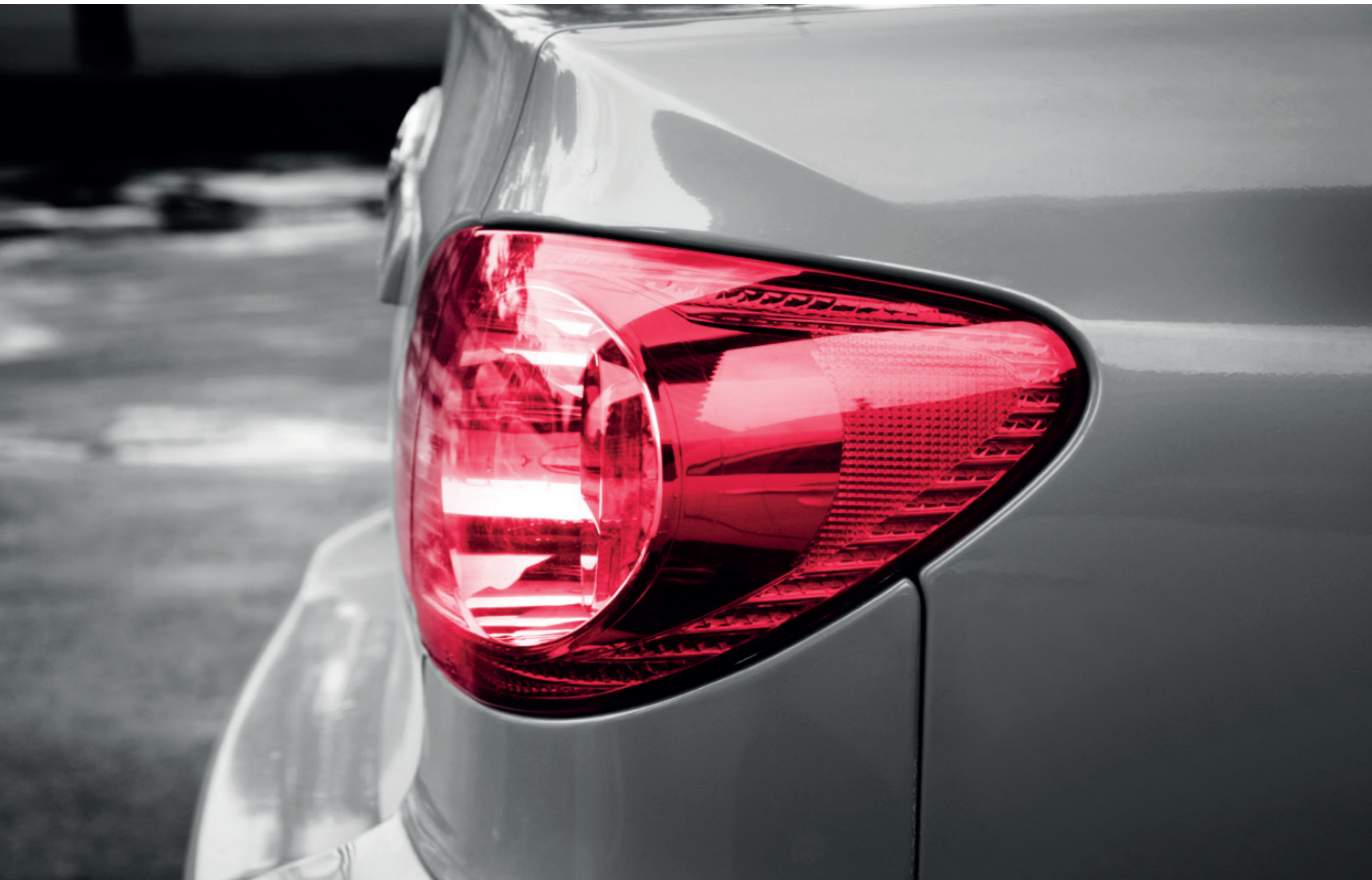
Managing risk, enabling trade

September 2017



market monitor

Focus on on automotive performance and outlook

In this issue...

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

Excellent Good Fair Poor Bleak

Time to rethink

Globally the automotive industry has continued to perform quite well in 2016 and into 2017. Despite the diesel scandal and increased geopolitical volatility, the short-term outlook remains generally favourable. This is reflected in our sector performance assessment which rates all countries covered in this issue of the market monitor between “Good” and “Fair”.

Currently the main potential risks to the automotive industry, with its cross-border supply chains, seem to be protectionism and limitations of free trade triggered by a major shift in US economic policies. However, regardless of political issues and the economic cycle, there are major challenges ahead, which will sooner or later affect the automotive sector.

The global demand for mobility continues to increase, and growing environmental issues, changing consumer demand patterns and political guidelines will lead to increasing demand for hybrid and electric vehicles, while the market share of combustion engine cars will decrease. This shift will be accompanied by the rising use of light metal design/new materials and digitalization.

Within the industry the competitive race for this innovation round is well underway, requiring large R&D spending from original equipment manufacturers (OEMs) and suppliers alike. This poses a major challenge for the bulk of small and medium-sized suppliers who deliver less valuable car components and parts, often heavily dependent on just one OEM and active in a highly competitive environment. Over the last couple of years, smaller businesses with easily substitutable products have already suffered from shrinking margins and lower profits. Financial weakness, together with a lack of access to capital markets and investors, could prevent them from making the necessary investments needed to innovate and climb up the value chain in order to sustain themselves in a comprehensively changing market environment.

We therefore expect that in the coming five years the credit risk of many of those structurally weaker automotive suppliers will increase, leading to strained liquidity, more payment delays and business failures. Mainly affected will be businesses producing/supplying for gearboxes, or those specialized in conventional combustion engines and parts, delivering metal components and components for exhaust systems.

China

- **Growth in 2017 driven by the SUV segment**
- **Payments take 90-120 days on average**
- **Smaller non-core parts suppliers could face problems**

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

According to China Association of Automobile Manufacturers (CAAM), passenger car sales increased 15.3% to 24.4 million units in 2016, while commercial vehicle sales achieved 5.8% growth, reaching 3.65 million units. The key driving force for this sales surge was a tax incentive policy on smaller cars. However, the government has meanwhile replaced the tax incentive by a higher rate. Therefore, total car sales growth slowed down to 3.8% in H1 of 2017, with passenger car sales increasing only 1.6%.

The SUV segment is attracting more and more customers due to persistently low oil prices, while the easing of the one-child policy prompts families to choose large vehicles when they have a second child. SUV sales increased 45.7% in 2016, and their market share increased to 40.5% end of June 2017. Sales of commercial vehicle sales grew 17.4% in H1 of 2017, to 2.1 million units, benefitting from surging commodity transportation demand and more infrastructure projects.

New energy vehicles (electric and hybrid) is a fast growing segment in China. The government has put about CNY 33 billion (EUR 4.3 billion) of subsidies into this segment so far, aiming for sales of new energy vehicles to reach 2 million by 2020 and to account for more than 20% of total vehicle production and sales by 2025. As carmakers rush to enter into this segment, annual capacity is about to exceed 7 million units by 2020. Potential overcapacities aside, fraud is an issue as some automakers have cheated subsidies on unsold or inoperable vehicles. As a consequence, the Chinese government has set several strict regulations, such as raising technology standards to narrow model list.

China: Automotive sector

	2016	2017f	2018f
GDP growth (%)	6.7	6.6	6.3
Sector value added growth (%)	16.1	7.8	3.2

Sector share in the national economy (%)	1.9
Average sector growth over the past 3 years (%)	11.5
Average sector growth over the past 5 years (%)	11.5
Degree of export orientation	medium
Degree of competition	very high

Sources: Macrobond, Oxford Economics, Atradius

We see automotive manufacturers as strong businesses, because of the segment's capital, technical intensity and the growth potential of the Chinese vehicle market. Our underwriting strategy remains open, but we are more cautious towards manufacturers of domestic brands than we are to joint ventures. We look mainly at cash flow and profitability when considering applications for cover.

The majority of core parts suppliers (engines and related equipment) in China are foreign-owned, including many strong businesses (e.g. Bosch, Continental, Magna, ZF Friedrichshafen, Delphi, etc.). The non-core parts segment (lights, meters seats, axles, tyres, etc.) is composed of a variety of manufacturers. When underwriting this segment, we focus on whether they are overly export-oriented, in view of the on-going anti-dumping policies against Chinese enterprises that can lead to export barriers. We also take into account suppliers´ customers, for instance a major brand such as Volkswagen or Ford, and whether the parts supplied are 'core', such as engines or axles, and if a patent or special technique is involved. We are extra careful with smaller companies in this segment because of their poor equity, which could lead to insolvencies. Unlike other manufacturers, businesses in this segment may have difficulty obtaining bank finance.

On average, it takes car manufacturers and suppliers about 90-120 days to collect debts. In the car dealing segment, average creditor days are about 40-60 days. We expect longer payment terms in the future due to increasing liquidity pressure on buyers.

Payment experience has been satisfying over the past two years, and non-payments are not expected to increase in the coming months. The level of automotive insolvencies is low compared to other industries, and business failures are not expected to increase in 2017.

Chinese automotive sector

Strengths	Automotive is a government backed industry
	Rising income and urbanisation will drive demand
	Major players are financially strong. They are usually large corporations with state-owned background or joint ventures with multinationals
Weaknesses	Rising costs for raw materials and labour will squeeze the profit in the sector.
	Potential trade disputes between major economies
	Traffic restrictions and environmental regulations could have negative impact on the market.

Source: Atradius

France

- The rebound in sales and production continues
- Payments take 60 days on average
- Major challenges for the suppliers segment

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

Next to the food processing sector, automotive is the second largest French manufacturing industry, with revenues of more than EUR 101.5 billion. Concentration is high, as automotive accounts for 11.7% of French manufacturing turnover, but only for 0.87% of manufacturing businesses. The two main French car makers alone, Groupe PSA and Groupe Renault account for about 80% of sector revenues. Domestically, the French automotive industry provides about 200,000 jobs, but the number has decreased over the last ten years due to automatization and production relocations abroad.

According to the International Organization of Motor Vehicle Manufacturers OICA, French automotive production increased 5.6% in 2016, while domestic registrations or sales of new vehicles rose 5.7%. French carmakers, which have a 53% market share in France, recorded a 5.1% sales increase, benefitting from growing domestic and international demand.

In H1 of 2017 the robust performance continued, with domestic automotive sales increasing 3%. The utility vehicles market performed well, partly driven by a rebound of the construction sector. French domestic car production is expected to increase 5% in 2017. Automotive parts and components manufacturers' revenues are also expected to increase 2.5% in 2017 after growing 3.3% in 2016.

In 2016 the margins of automotive suppliers benefitted from lower raw material prices. However, we expect this positive trend to end, as metals prices are expected to increase again due to lower global production capacities and current dynamic demand. Structurally the margins of suppliers remain under pressure as the powerful car manufacturers demand greater productivity, coupled with lower prices.

France: Automotive sector

	2016	2017f	2018f
GDP growth (%)	1.1	1.5	1.6
Sector value added growth (%)	4.4	5.4	0.3

Sector share in the national economy (%)	0.6
Average sector growth over the past 3 years (%)	5.8
Average sector growth over the past 5 years (%)	0.6
Degree of export orientation	high
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

A key factor to preserve profitable growth in the suppliers segment is the ability to stay close to the buyers, i.e. to follow large car producers overseas, as original equipment manufacturers (OEMs) tap into dynamic markets and/or outsource their production facilities to places with lower production costs (e.g. Eastern Europe, Turkey, Morocco).

However, this and the shift towards more environmental-friendly engines require large investments in machines, R&D and raw materials, in a segment already highly dependent on bank financing (both short and long term debts). While banks were rather unwilling in the past to provide credit to the automotive suppliers subsector, the on-going rebound has further facilitated increased access to bank loans since 2016.

The French suppliers segment is currently in far better shape than five years ago, and the short-term outlook is rather benign. However, as some major structural issues persist (low equity, high working capital, investment requirements leading to high debt levels and financing needs, coupled with strong competition and price pressure), any demand downturn in the future could seriously affect suppliers, especially those who are highly geared and positioned at the lower side of the value chain.

On average, payments in the French automotive industry take 60 days (end of month) and timely payment is important, there are few protracted delays. Payment delays have decreased in H1 of 2017, and we do not expect any fundamental change in the coming months. We expect insolvencies in the sector to decrease in 2017. The default rate is in line with the overall trend in French business insolvencies, where business failures are forecast to decline 5% this year.

Given the solid performance in 2016 and the positive business outlook for 2017, our underwriting stance for the French automotive industry remains open. However, as in previous years, we continue to closely monitor some weaker players who rank second or third in the subcontracting chain, especially smaller suppliers engaged in foundry work, small stamping and/or producing items with low technology requirements. Businesses in those segments remain susceptible to higher risks, as the trend to outsource production overseas and high competition from foreign companies has led to overcapacity. We also closely observe the development of business margins in the suppliers segment, putting emphasis on the identification of vulnerable companies.

French automotive sector

Strengths	Leading companies in some segments: FAURECIA, VALEO, Plastic Omnium
	Technical knowledge
	Support from the French government with public funds (BPI)
Weaknesses	Overcapacity and low margins in some segments
	Lack of attractiveness for private funds

Source: Atradius

Italy

- **The rebound in production and sales continues**
- **Businesses' profit margins are expected to remain stable**
- **Insolvencies are expected to level off in 2017**

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 2016 the rebound of the Italian automotive sector continued, with a 8.8% production increase year-on-year, according to the International Organization of Motor Vehicle Manufacturers OICA. The surge was driven by increasing domestic demand and buoyant exports (64% of vehicles produced in 2016 were sold abroad). The rebound in domestic demand is mainly due to a modest economic recovery, coupled with low interest rates, lower fuel prices, easier access to consumer credit and appealing promotional campaigns by car manufacturers.

Registrations or sales of new vehicles increased 18.8% to 2 million units, according to the European Automobile Manufacturers Association (ACEA). Growth continued in 2017, with passenger cars registrations increasing 8.1% and commercial vehicles registrations rising 7.8% year-on-year between January and May 2017. The outlook for H2 of 2017 and 2018 remains positive, as there is still future potential for sales growth of new vehicles replacing obsolete models: 47% of cars in Italy still do not meet the Euro 4 emission standards, and the average age of the vehicle fleet amounts to 10.4 years.

However, despite the increase, both production and domestic sales remain below pre-crisis level (in 2008 more than 2.4 million cars were sold). The surge in production and registrations since 2014 must be seen against sharp decreases between 2009 and 2013. At the same time, the economic rebound in Italy remains modest (GDP is forecast to increase 1.1% in 2017 and 1.0% in 2018), and business and consumer sentiment is prone to setbacks due to potential political uncertainty and doubts about the stability of the financial system.

With the steep decline in car sales and production in the years before 2014, many of Italy's manufacturers and car part suppliers recorded decreasing profit margins. Especially smaller busi-

Italy: Automotive sector

	2016	2017f	2018f
GDP growth (%)	0.9	1.1	1.0
Sector value added growth (%)	6.4	10.1	1.8

Sector share in the national economy (%)	0.9
Average sector growth over the past 3 years (%)	12.4
Average sector growth over the past 5 years (%)	3.7
Degree of export orientation	high
Degree of competition	average

Sources: Macrobond, Oxford Economics, Atradius

nesses saw their equity ratios, solvency and liquidity weaken. Thanks to the recovery, the surviving supplier businesses have registered increasing profit margins, which are expected to remain stable in 2017.

On average, payments in the Italian automotive industry range between 60 to 90 and 120 to 150 days, depending on the end-buyer and whether working capital requirements can be obtained from banks or suppliers. Generally, payments are quicker when the end-buyer is a foreign company. Payment experience has been satisfying over the past two years, and non-payments are not expected to increase in the coming months. The level of automotive insolvencies is low compared to other industries, and business failures are expected to level off in 2017.

Considering the good performance of the industry in 2016 and the still favourable outlook for 2017, we have upgraded the automotive sector performance assessment from "Fair" to "Good" in early 2017. Our underwriting stance for the industry is generally open. We are more cautious with components manufacturers, who have low bargaining power against car manufacturers, and with tyre distributors/wholesalers due to increased competition and consolidation in this segment.

Italian automotive sector

Strengths	High degree of internationalisation
	Low insolvency level compared to other industries
Weaknesses	High labour costs affect margins
	Economic growth remains modest

Source: Atradius

United Kingdom

- **Performance, remains robust, but Brexit consequences loom large**
- **Currency volatility is an issue**
- **Payments take 60 days on average**

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

According to the International Organization of Motor Vehicle Manufacturers OICA, in 2016 the UK automotive sector recorded the highest output level since 1999 with 1,816,622 vehicles produced by 15 domestic manufacturers, an 8.0% year-on-year increase. According to the European Automotive Manufacturers Organisation ACEA, new passenger car registrations increased 2.3% and commercial car registrations 1.2% in 2016. Last year a record number of cars (1,354,216) was exported from the UK, amounting to 75% of total production. In H2 of 2016 export growth was mainly sustained by the pound depreciation in the wake of the June 2016 Brexit referendum vote. Exports continued to sustain automotive production growth in H1 of 2017 (up 0.8% year-on-year), according to the Society of Motor Manufacturers and Traders (SMMT).

A major strength of the British car manufacturing industry is its diversity, with a mix of volume, premium and specialist producers. With increasing production, demand from UK car manufacturers for components produced domestically has increased in the last few years. Currently about one third of the components in a UK-built car are domestically sourced.

Given the on-going robust performance of the British automotive sector, any anticipated post-Brexit slowdown affecting demand or insolvencies has not yet materialised. However, according to the SMMT, investments in automotive production decreased sharply in H1 of 2017, to GBP 322 million, compared with GBP 1.7 billion in 2016 and GDP 2.5 billion in 2015, among growing businesses' uncertainty over the Brexit negotiations outcome.

While the proportion of premium and specialist cars, in particular, has grown in the past decade, leading to increasing demand from outside the EU, the EU market still accounts for 56% of UK automotive exports. A "hard Brexit" outcome (ending access to the

United Kingdom: Automotive sector

	2016	2017f	2018f
GDP growth (%)	1.8	1.6	1.4
Sector value added growth (%)	4.4	3.0	-2.3

Sector share in the national economy (%)	0.7
Average sector growth over the past 3 years (%)	6.4
Average sector growth over the past 5 years (%)	6.3
Degree of export orientation	high
Degree of competition	very high

Sources: Macrobond, Oxford Economics, Atradius

single market and customs union) without any interim arrangement would severely hurt producers and suppliers alike. Leaving the EU could mean that increased tariffs would make producing cars in the UK more expensive.

Under World Trade Organization (WTO) rules, there would be a 10% tariff on vehicles and 4.5% on components. The introduction of customs controls would hamper the just in time delivery of parts from EU suppliers, and lead to higher stocks, thereby increasing costs (on average, UK-made cars contain 60% of their components imported from the EU).

In addition to any potential trade disruptions, the sector would lose benefits from EU funds for manufacturing research and development. Foreign-based car producers with operations in the UK could suffer from a deterioration in profits and an impairment in assets.

Currency volatility is a serious issue. While the depreciation of the pound has helped exporters, it has also pushed up the cost of importing both vehicles and components (about 87% of domestic-sold vehicles and 65% of automotive components are imported). Any significant long-term cost increase is likely to have a negative impact on sales, unless dealers and manufacturers absorb a share of this increase, which would negatively impact their margins. At the same time, UK GDP growth is expected to slow down to 1.4% in 2018, which, together with the on-going insecurity over the Brexit negotiations outcome and rising inflation, could slow down domestic car sales and affect car retailers and producers alike.

Payments in the UK automotive industry take 60 days on average. We have recorded an increase in notifications of non-payment over the recent months, mainly due to the fact that a large car part distributor went into administration late 2016, negatively affected by GBP depreciation and seasonal issues. However, compared to other UK industries, the automotive sector's default and insolvency rate is still good, with a stable short-term outlook.

For the time being, our risk underwriting stance remains open towards most parts of the UK automotive sector, given the stable insolvency performance and reflecting the on-going robust car demand in the UK and in the eurozone.

The true implications of the Brexit for the UK automotive sector still remain to be seen. However, we closely monitor the on-going Brexit negotiation process, particularly now that Article 50 has been triggered, as this will surely have an impact on the British automotive sector in the mid-term. Regular management information is obtained from buyers and customers, which enables us to analyse changes in risk dynamic effectively and act accordingly where appropriate.

British automotive sector

Strengths	Strong domestic and global demand
	Engineering excellence
	Many British car makers restructured after the 2008 credit crisis and are - as a consequence - financially more resilient
Weaknesses	High operating leverage magnifies gains and losses, making earnings sensitive to sales
	Skills shortage
	Increased business and consumer uncertainty after the Brexit decision

Source: Atradius

United States

- After the 2016 peak automotive sales have started to decrease
- A Border Adjustment Tax would severely affect the industry
- Payments take 30-60 days on average

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 US automotive sector has steadily rebounded since the severe slump in 2009/2010 triggered by the global credit crisis. According to the International Organization of Motor Vehicle Manufacturers OICA, US vehicle production increased 0.8% year-on-year in 2016, to 12.2 million units. Registrations or sales of new vehicles increased slightly (up 0.1%) to 17.9 million units.

Production and sales of SUVs and trucks continued to grow in H1 of 2017. The US market for smaller and mid-sized passenger cars seems to have already reached its peak, despite robust consumer confidence, readily available consumer credit, a GDP growth forecast of 2.2% in 2017 and gas prices among the lowest levels since 2003. The reasons for the decrease in sales are car life spans which have increased (from an average of 8.4 years in 1995 to an average of 11.4 years in 2014), a glut of nearly-new used vehicles, the rise of car-sharing services, coupled with an uptick in urban living, and a pile-up of inventory, which has been reported at its highest level in over five years. In H1 of 2017 automotive sales decreased by about 2% year-on-year, and higher inventories could potentially impact businesses' short-term profit margins, as production is expected to remain relatively flat in 2017, while the decreasing sales have caused car dealers to increasingly offer large sales discounts. As sales decrease, manufacturers have started to adjust from what has been a growth environment to a more flat market situation, e.g. by starting to shed jobs.

Besides the potential risk of a lasting sales downturn affecting businesses margins along the whole value chain, the economic policies of the Trump administration could pose another potential challenge, especially the announced Border Adjustment Tax (BAT) as part of the administration's tax reform. A BAT would provide tax breaks to US companies that export products, while, at the same time, it would remove tax breaks for US businesses that import goods from abroad. While this is ultimately aimed to protect American jobs and to offset cuts in US corporate tax, the

United States: Automotive sector

	2016	2017f	2018f
GDP growth (%)	1.6	2.2	2.3
Sector value added growth (%)	3.4	0.3	0.3

Sector share in the national economy (%)	1.0
Average sector growth over the past 3 years (%)	6.1
Average sector growth over the past 5 years (%)	6.7
Degree of export orientation	high
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

potential impact on the industry could be significant. Some major US automotive industry stakeholder have publicly spoken out against a BAT introduction, arguing that it would result in higher sales prices for cars and trucks, up to between USD 2,000 and 3,000 per vehicle. It could have a negative effect on automotive sales and hurt the margins of most manufacturers and suppliers alike. The same accounts for a 20% or 30% tariff on goods from Mexico, as there would be high costs for rebuilding production capacities in the US, while the domestic production of smaller vehicles is no longer economically viable for US manufacturers, making offshoring production to countries like Mexico unavoidable.

US automotive businesses tend to be highly leveraged, since the sector is very capital-intensive. Access to external funding has steadily improved since the 2008 credit crisis, due to improved trading conditions within the sector, relaxation within the traditional credit markets and access to funding via government-backed programmes. Banks are generally willing to lend to the industry.

The average payment duration in the US automotive industry is 30-60 days. Payment behaviour in this sector has been satisfying over the past two years. The number of protracted payments, non-payments and insolvency cases has not increased in 2016 and H1 of 2017. Given the stable performance outlook, we expect the current insolvency rate to remain unchanged.

While in H1 of 2017 we have seen some slowdown in the industry, automotive businesses are currently in better position to deal with any deterioration of market conditions, following various re-structuring/cost cutting measures taken during the last recession after 2008. As long as no major downturn scenario (sharp sales downturn/adverse economic policies) materialises, we expect gross margins of automotive businesses to remain stable in the coming months.

Due to the generally satisfying main indicators and a benign credit insurance claims environment we still assess the credit risk and business performance of the automotive sector as “Good”, and our underwriting stance continues to be open. One issue we face is that a large number of automotive companies are privately owned, and therefore not obliged to publically release financial information. As a result, our need for financial disclosure and information is high.

US automotive sector

Strengths	Benign economic outlook and robust consumer demand
	Persistently low fuel prices drive demand
	Many US automotive businesses restructured after the 2008 credit crisis and are consequently financially more resilient
Weaknesses	Increased uncertainty over the future course of economic policies
	Strong USD hampers export performance

Source: Atradius

Market performance snapshots

Germany

- **Some supplier segments could face higher credit risks in the future**
- **Robust solvency, but margins have decreased**
- **Good payment behaviour over the last two years**

German car production and sales continued to increase in 2016 and H1 of 2017, with domestic passenger car registrations rising 3% year-on-year in H1of 2017. However, the diesel emission scandal and allegations of collusion among large carmakers have increased insecurity within the industry.

German automotive suppliers are still making good profits and, in general, their solvency and liquidity are robust. However, margins have decreased for the last couple of years, due to increased material and labour costs, rising competition and pressure on sales prices. At the same time, suppliers have to invest in engineering/production branches overseas in order to be close to original equipment manufacturers (OEM) that have relocated abroad.

There is a large number of small companies in the supplier subsector which could face higher business and credit risks in the future, due to low leverage in negotiations with OEMs or if OEMs stop ordering from them (delisting). At the same time, competition is fierce in some segments. More than 50% of chassis manufacturers and electronic component providers generate revenues of less than EUR 50 million. Many small businesses have difficulties funding the investment necessary for further growth or to climb up the value chain. High capital expenditures in research and development are necessary to stay ahead of competition in new trends and technologies, i.e. electric motors, connected driving, autonomous cars. In order to stem necessary investments, increasingly size matters. Therefore, the concentration process in the German suppliers segment is on-going, while dedicated technology companies are entering the automotive market.

This is exacerbated by the fact that the automotive market performance is highly dependent on volatile factors, such as global political and economic developments (consumer spending and consumption attitudes), raw material prices, and currency exchange rates.

Our view of payment behaviour in the sector has been good over the last two years, with no increase in the number of non-payment notifications in the past 12 months.

However, should the current decrease in Diesel car sales in Germany and Europe continue, it cannot be ruled out that some suppliers of Diesel-related components (such as injection pumps, filter systems, drive shafts, gear boxes and exhaust systems) could face liquidity and payment issues in the coming months.

Given the structural vulnerability of smaller suppliers, we rate the German automotive sector as "Fair". Our underwriting stance remains reasonably relaxed, as it was in 2015 and 2016, especially for larger-sized, well-established suppliers, who usually have good access to capital markets and face a very low default risk.

Japan

- Domestic sales continue to decrease
- Car producers profit margins decreased in 2016
- Payments duration ranges between 30-60 days for manufacturers

The Japanese automotive sector faces decreasing domestic sales due to demographic issues (a decrease in population and a growing share of elderly citizens) as well as tax hikes implemented in 2014 (consumption tax) and 2015 (light vehicle tax). Another hike in consumption tax is scheduled for October 2019.

Japanese car makers profit margins slightly deteriorated in the financial year 2016, mainly due to a Yen appreciation lower demand in North America. That said, the EU is set to eliminate tariffs on auto imports as part of the trade agreement between EU-Japan, which will probably result in improved returns for Japanese carmakers as of 2019.

Capital requirement is high in this sector, but in general Japanese automotive businesses are not overly indebted. Due to the satisfactory business performance, banks are generally willing to provide loans with good financing conditions, which is helped by low interest rates. Additionally, the Japanese government is encouraging banks to support companies with strong financing needs.

The average payment duration in the Japanese automotive industry is around 30 days for car retailers, 30-60 days for manufacturers and 60-90 days for wholesalers. Payment behaviour in this sector has been very good over the past two years. The number of protracted payments, non-payments and insolvency cases is very low, and it is expected that there will be no deterioration in the coming months as the businesses environment is expected to remain stable and banks are willing to lend. However recently the major automotive supplier Takata Corporation went into bankruptcy (see below).

Due to the generally positive indicators, we assess the credit risk and business performance of the automotive sector as stable, and our underwriting stance continues to be very open for large manufacturers and open for car parts suppliers and wholesalers. However, in those latter segments we have adopted a more cautious approach for smaller business, which often have weaker financials than larger businesses and are more vulnerable to sudden changes in the market sentiment. We also take a more prudent approach on car retailers due to the weak performance of the domestic care market.

Additionally, caution is advised with businesses engaged with Takata Corporation, the auto-parts supplier which filed for bankruptcy in Japan and the US after being hit by safety issues with airbags that resulted in the recall of tens of millions cars in the US. Takata will continue its global recall of faulty airbags, but should their financial assets run out some automotive manufacturers and suppliers may be forced to cover the remaining expenses.

Spain

- **Production and car registrations increasing further**
- **Payments take 60 days on average**
- **Solid performance outlook**

Automotive is a key sector of the Spanish economy. Spain is the second largest car manufacturer in Europe, after Germany, and ranks number nine globally. Automotive accounts for 20% of Spanish exports, with 85% of the national production sold abroad. Nine original equipment manufacturers (OEMs) are active in Spain, with a total of 17 production plants. Earmarked investments in new industrial plants in order to expand production of new conventional as well as electronic models amount to EUR 10 billion, with an average annual investment volume of about EUR 1.7 billion. The automotive suppliers subsector plays an important role for the sector´s performance, with more than 1,000 companies, 330,000 employees and generating turnover of more than EUR 32 billion in 2016.

The Spanish automotive sector has benefitted from robust global demand situation over the recent years. Domestic automotive production recorded a cumulative growth rate of 45% in the period 2012-2016. Last year production increased 5.6% year-on-year, to about 2.9 million units, according to the International Organization of Motor Vehicle Manufacturers OICA. The outlook for 2017 remains benign, with growth in line with the Spanish economy and output of more than three million units expected.

Domestic car sales have recorded annual increases since 2012, in line with the rebound after the economic crisis, helped by robust private consumption and a decreasing unemployment rate, increased access to bank financing for consumers and government schemes supporting the renewal of vehicle fleets and purchase of electric models.

The profit margins of Spanish automotive businesses have been good over the past 12 months, and are expected to remain stable in 2017. While external financing requirements and gearing are generally high in this sector, banks are willing to provide credit to the industry, for both short-term financing (working capital management) and long-term facilities (i.e. capital expenditure financing).

On average, payments in the Spanish automotive sector take around 60 days. Payment experience is good, and the level of protracted payments has not been overly high over the past couple of years. Non-payment notifications are low, and we do not expect major increases in the coming months due to the still positive outlook for automotive performance. The level of insolvencies in this sector is low, and this is expected to remain unchanged in 2017.

Our underwriting stance remains open due to the low claims ratio, good payment behaviour and the industry's strengths: a solid industrial base and leading international position, productive and flexible manufacturing plants, a strong and innovative industrial supplier segment, the availability of highly qualified workers at competitive costs as well as significant public and private investment.

Market performance at a glance

Belgium

- The Belgian automotive sector accounts for 1% of Belgium's GDP. While production decreased slightly in 2016 (down 2.4% to about 400,000 units), domestic registrations or sales of new vehicles increased 8.1% year-on-year in 2016, and further growth is expected in 2017 (registrations of new passenger cars increased 4% year-on-year in H1 of 2017 according to the Belgian automotive association FEBIAC).
- Besides several major assembly plants, Belgium hosts a large number of export-oriented, high-value components manufacturers that have good business opportunities given the increasing global demand for car electronics and sophisticated technology. That said, the increasing importance of Big Data and embedded technology/electronics, together with the global consolidation process in the industry, is expected to lead to more merger and acquisition activities of Belgian automotive suppliers in the mid-term.
- Profit margins in the Belgian automotive sector are generally satisfying and expected to remain stable in 2017. While many businesses hold long-term debts, banks are supportive.
- Payment behaviour in the sector has been good over the past two years, and the number of protracted payments and insolvencies is low. Both payment delays and business failures have decreased since the end of 2016, and we do not expect any deterioration in the coming months.
- We assess the credit risk and business performance of the Belgian automotive sector as "Good", and our underwriting stance continues to be open for all subsectors.

Czech Republic

- The automotive industry plays a pivotal role in the Czech economy, accounting for more than 7% of GDP and more than 20% of exports (mainly to EU countries). The Czech Republic hosts three major car production companies Škoda, Toyota Peugeot Citroën Automobile (TPCA) and Korean Hyundai. There are many local suppliers, and the Czech steel/metals and plastics industry depends heavily on the automotive industry´s performance.
- According to the International Organization of Motor Vehicle Manufacturers OICA, in 2016 car production increased 8.3% to more than 1.3 million units. All three major manufacturers grew their production, and output has increased further in H1 of 2017. The outlook remains benign, mainly due to robust demand from eurozone countries.
- Robust sales have kept profit margins of car manufacturers and suppliers stable and these are expected to maintain their current level in the coming months. Payment behaviour is generally good with a low number of non-payment notifications, and this is expected to remain unchanged in the coming months. The insolvency level in this industry is expected to remain low.
- Suppliers generally benefit from long-term contracts with stable payment terms, volumes and margins, while banks are open to provide business loans.
- As a result of increasing orders, growing revenues and low payment default and insolvency cases in this industry, our underwriting stance remains open.

The Netherlands

- The automotive sector is not a major contributor in the Netherlands, accounting for 0.4% of Dutch GDP. In fact, VDL Nedcar and DAF Trucks are the only two car/truck manufacturers active in the Netherlands. According to the International Organization of Motor Vehicle Manufacturers OICA, production increased 0.7% in 2016, to 44,400 units. In H1 of 2017 new passenger car registrations accelerated to 19.9% year-on-year after growing 14.7% in 2016, while commercial vehicle registrations grew 3.6% over the same timeframe. Due to the robust economic performance thus far in 2017 and 2018 the outlook remains favourable.
- The number of Dutch car dealers has reduced considerably since the 2009 economic crisis. Recently a consolidation took place in the wholesale-retail market for car spare parts, with just two large players left (Sator-LKQ and AutoBinck-Parts-Point).
- Profit margins in the Dutch automotive sector are generally good and expected to remain stable in 2017. The financial gearing of most businesses is not overly high, and banks are willing to provide loans to the sector.
- Payment behaviour in this sector has been good over the past two years, and the number of payment delays and insolvencies is low. Business failures have decreased since the end of 2016, and we do not expect any deterioration in the coming months.
- We maintain an open, case-by-case underwriting strategy due to the overall positive performance of the industry.

Sweden

- The Swedish car producer segment is dominated by Volvo Cars in the passenger car segment and by Volvo AB and Scania AB in the truck segment. Those OEMs are mainly export-oriented (the export ratio amounts to more than 85%), and they widely determine the performance of smaller Swedish suppliers.
- In 2016 car production increased 8.7% to 205,000 units, according to the International Organization of Motor Vehicle Manufacturers OICA, and a production growth of 5% is forecast in 2017. Swedish GDP is expected to grow 2.5% in 2017 after increasing 3.1% in 2016, supporting domestic automotive sales.
- Swedish automotive manufacturers are investing heavily in connected vehicle technology and look for new development ideas. In July 2017 Volvo Cars announced that every car it launches from 2019 on will have an electric motor.
- Profit margins are expected to remain stable in the industry. Most businesses should be financially resilient enough to cope with some minor volatility in demand or commodity prices. The current interest rate environment (the Swedish benchmark interest rate remains at -0.5%) favours companies in servicing their debt, and banks are willing to lend.
- Depending on the level in the supply chain, payment duration in the automotive sector ranges between 30 and 90 days. The level of non-payments and insolvencies is low, and this is expected to remain unchanged in the coming months.
- Our underwriting stance remains generally open for this industry, with no restrictions on any subsectors. Due to its high export dependency the automotive sector is exposed to currency exchange risk, as most costs incurred are in Swedish krona. Therefore we observe if businesses take adequate measures to manage this risk.

Industries performance forecast per country

September 2017

	Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction Const.Mtrls	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	⛅	☁	☁	🌧	🌧	🌧	☁

Food	Machines/ Engineering	Metals	Paper	Services	Steel	Textiles
Good	Good	Fair	Fair	Good	Poor	Poor
Good	Good	Fair	Poor	Poor	Good	Poor
Good	Fair	Fair	Fair	Fair	Fair	Poor
Good	Fair	Fair	Bleak	Fair	Poor	Poor
Good	Fair	Fair	Poor	Fair	Fair	Poor
Fair	Good	Fair	Poor	Good	Fair	Poor
Fair	Good	Poor	Fair	Good	Poor	Poor
Good	Fair	Fair	Bleak	Poor	Fair	Poor
Good	Excellent	Fair	Fair	Good	Fair	Poor
Excellent	Fair	Fair	Fair	Good	Fair	Poor
Fair	Poor	Fair	Fair	Good	Fair	Fair
Fair	Fair	Poor	Fair	Good	Poor	Fair
Fair	Bleak	Fair	Fair	Poor	Fair	Fair
Good	Good	Fair	Fair	Fair	Fair	Poor
Good	Fair	Poor	Poor	Good	Poor	Poor
Good	Good	Poor	Fair	Fair	Poor	Poor
Good	Good	Fair	Fair	Good	Poor	Fair
Good	Fair	Bleak	Poor	Poor	Fair	Poor
Fair	Fair	Poor	Poor	Fair	Poor	Poor
Good	Poor	Poor	Fair	Fair	Poor	Poor
Good	Fair	Fair	Poor	Good	Fair	Bleak
Good	Fair	Poor	Good	Good	Poor	Poor
Good	Fair	Poor	Poor	Good	Poor	Poor
Good	Fair	Poor	Poor	Fair	Poor	Poor
Good	Fair	Bleak	Poor	Good	Bleak	Poor
Excellent	Fair	Poor	Fair	Good	Poor	Fair
Good	Fair	Poor	Good	Good	Poor	Fair
Good	Fair	Poor	Fair	Fair	Poor	Fair
Good	Fair	Fair	Fair	Good	Fair	Poor
Fair	Fair	Fair	Poor	Poor	Poor	Poor
Good	Fair	Fair	Fair	Good	Poor	Fair
Excellent	Fair	Poor	Fair	Good	Poor	Fair
Good	Fair	Fair	Fair	Fair	Poor	Bleak
Poor	Fair	Poor	Fair	Good	Poor	Poor

Excellent

Good

Fair

Poor

Bleak

Industry performance

Changes since July 2017

Europe

Austria

Chemicals/Pharmaceuticals

Down from Excellent to Good

While the pharmaceuticals segment still shows a very good performance, the number of defaults in the chemicals segment has slightly increased over the past 18 months.

Construction

Down from Fair to Bleak

Insolvencies in this sector have been on a high level over the last 2-3 years, and the business performance and credit risk situation have not improved in 2017.

Consumer durables

Down from Good to Fair

While segments like furniture or wholesaler still show a satisfying performance, retail and domestic appliances have suffered a steep increase in defaults over the last year. Despite a benign consumer spending, outlook problems will persist, e.g. increasing online competition.

Financial Services

Up from Good to Excellent

Despite a more challenging business environment, defaults have decreased over the last two years.

Czech Republic

Food

Up from Fair to Good

The sector benefits from solid consumer demand and increased sales prices that have improved companies' revenues.

Ireland

Financial Services

Up from Fair to Good

The business performance in this sector has further improved, and due to the Brexit, the industry is anticipated to benefit from the future movement of financial firms from the UK to Ireland.

Italy

Agriculture

Up from Fair to Good

Construction

Up from Bleak to Poor

Machines

Up from Good to Excellent

Metals

Up from Poor to Fair

Paper

Up from Poor to Fair

Steel

Up from Poor to Fair

The business performance and credit risk situation in all those sectors has improved due the domestic economic rebound.

Poland

Consumer durables

Down from Fair to Poor

The household electronics segment is negatively affected by tax authorities actions against "VAT carousels", which can leave businesses bearing significant tax liabilities, leading to liquidity issues and "freezing" of accounts by tax authorities.

Portugal

Automotive

Down from Good to Fair

In the first months of 2017 there was both a decrease in cars acquisitions and a decline in investment in transportation equipment, which has led to some level of uncertainty in the domestic automotive industry.

Consumer Durables

Up from Poor to Fair

Electronics/ICT

Up from Poor to Fair

In both sectors sales increased in 2016 and, to a smaller degree, in H1of 2017, due to higher disposable incomes and the gradual return to economic growth, which bolstered consumer confidence.

Russia

Agriculture

Down from Fair to Poor

The industry is negatively affected by adverse weather conditions, with poor harvest expectations.

Chemicals/Pharmaceuticals

Down from Fair to Poor

The industry is negatively affected by an on-going concentration process and the potential insolvency of a leading player.

Machines/Engineering

Down from Poor to Bleak

Credit risk for businesses in this sector has grown due to the repercussions of the imposed EU/US sanctions.

Slovakia

Food

Up from Fair to Good

The sector benefits from solid consumer demand and increased sales prices that have improved companies' revenues.

Switzerland

Construction

Down from Fair to Poor

The insolvency level was high in 2016, and there was no real improvement in H1 of 2017.

Consumer Durables

Down from Good to Fair

While the general situation of the industry remains stable, domestic appliances and wholesale/retail of household goods) show a declining trend.

Paper

Up from Bleak to Fair

Although the printing sector has been in serious troubles since years due to increasing digitalisation, the default development has generally improved.

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Atradius N.V.
David Ricardostraat 1 · 1066 JS Amsterdam
Postbus 8982 · 1006 JD Amsterdam
The Netherlands
Phone: +31 20 553 9111

info@atradius.com
www.atradius.com