crédito y caución
Atradius Group

market monitor

Italy and Spain: steel/metals and food
Austria, Slovakia, Turkey, China: steel/metals

April 2011

Introduction

Europe’s steel/metals industries have had a rollercoaster of a ride over the past two years. The economic crisis hit those traditionally major users of steel/metals: the construction and automotive industries. Since then, the steel/metals industries across Europe have taken different paths, depending in large part on how their home markets have fared and how prepared the steel/metals industries in each country has been to capitalize on export opportunities.

For instance, the Austrian steel/metals industries were able to take advantage of rising demand for steel from Germany in 2010, while Slovakia too has profited from increased foreign demand for its steel and metals, especially from the European automotive sector, as well as from its own domestic motor industry: per capita, Slovakia leads the world in car production.

In contrast, the growth of Spain’s steel/metals exports, vital to compensate for poor domestic demand, still needs time to become firmly established. Moreover, even focusing on export markets is not a guarantee of success: Italy is one country finding export opportunities to be limited by the global overcapacity of steel.

That overcapacity is having repercussions well beyond EU boundaries, as our report on the fortunes of China’s steel sector demonstrates. As the Chinese government takes steps to cool down its economy, overcapacity and huge stockpiles of steel have become a real problem.

Low demand and overcapacity aren’t the only challenges facing steel. The price of commodities vital to the industry, such as iron ore and coal, is rising. While those steel producers who have maintained healthy demand for their products, like those in Austria, can pass the additional cost on to their customers that may prove more of a problem for producers in Spain and Italy.

II. The EU Steel Market

Overview Steel Using Sectors

Development of the main steel using sectors – EUROFER forecast January 2011
% change year-on-year in the SWIP (Steel Weighted Industrial Production) index

	% share in total Consumption	Q110	Q210	Q310	Q410	Year 2010	Q111	Q211	Q311	Q411	Year 2011	Year 2012
Construction	27	-8,3	-1,0	0,5	-0,8	-2,2	3,4	-0,4	0,7	3,1	1,6	2,3
Structural steelwork	11	-8,1	1,7	7,2	1,3	0,6	2,5	0,6	0,5	4,9	2,0	2,6
Mechanical engineering	14	-3,2	11,1	15,9	13,8	9,3	11,2	7,7	6,5	4,5	7,3	5,2
Automotive	16	30,3	24,9	11,5	10,4	18,7	8,9	5,4	5,6	3,5	5,7	2,7
Domestic appliances	4	4,9	1,3	3,8	-0,2	2,4	3,5	4,0	3,9	6,1	4,4	3,9
Shipyards	1	-21,0	-20,8	-20,5	-9,3	-18,4	-2,7	-3,1	2,3	7,1	0,6	1,9
Tubes	12	-4,8	15,7	17,8	15,1	10,1	9,4	7,0	4,0	4,2	6,3	5,3
Metal goods	12	2,3	10,9	9,2	7,5	7,4	5,5	4,3	4,0	4,3	4,6	4,2
Miscellaneous	3	2,4	3,0	6,7	6,8	4,7	5,2	5,3	3,3	4,6	4,7	4,3
TOTAL	100	0,0	7,5	7,4	5,6	5,2	6,2	3,4	3,1	4,0	4,1	3,4

Source: Eurofer

Italy: steel/metals

No full-scale recovery in 2010

In 2010, Italy was the world's 11th largest steel producer. According to the World Steel Association, Italian steel production increased 29.7% year-on-year in 2010 - to 25.8 million metric tons - after a sharp drop of 35.5% in 2009. While output has not yet regained pre-crisis levels (31.6 million metric tons in 2006 and 2007), last year turnover in the Italian steel and metals sectors together rebounded strongly, by about 90%, mainly in the first half of 2010. This compares well with the 50% decrease in 2009, and was achieved despite weak apparent demand in some key buyer sectors such as construction (2010: 3.5% year-on-year production decrease in 2010), public works (-2.8%), and shipbuilding (-9.4%). The renewed demand for steel was driven mainly by the need to replenish flat stocks at distributor and end-user sites, following their massive destocking operations in 2009. Industry-wise domestic appliances and export-oriented sectors such as automotive have increased demand for steel and metal products.

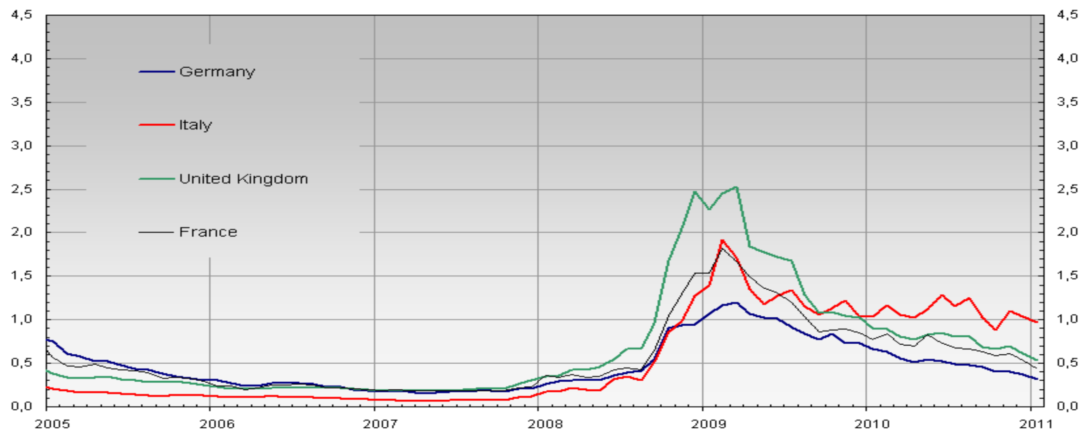
At the same time, Italian steel/metals producers, distributors and service centres were able to pass on increased producer prices, caused by rising commodity prices, to customers. Currently, the steel and metal sectors are back in profit, or at least breaking even, after their losses in 2009, and in part thanks to reduced personnel costs helped by government initiatives (the so-called 'unemployment state benefit'). Both liquidity and solvency have improved, and many companies have pursued a prudent purchasing strategy to avoid damaging margins and to control their working capital requirements.

In general, Italian steel/metals producers have strong equity and significant fixed asset value, as is needed in their industry. However, distributors and service centres usually show only moderate equity strength, although family businesses typically plough earnings back into equity.

Improved payment performance

On average, payments in the Italian steel/metals industry take 90 to 120 days. However, payment periods are longer (180 days) for steel/metal products linked to construction (excluding round bars for concrete, tubes) and to the automotive sector. Credito y Caución saw payment behaviour improve in 2010 following its deterioration in 2009, and the trend has stabilised into 2011. Nevertheless, payment defaults still occur, and some steel/metal businesses focused on supplying the public construction subsector are still requesting payment plans for rescheduling their payments. However, in general, our experience is that many of our customers and their buyers in the steel/metals industries are now less worried about clients´ late payment and default than in the past. Although we don't expect a significant worsening this year, we do expect some ongoing difficulties for this sector's links to construction, which is suffering from a lack of public funding.

While overall corporate insolvencies in Italy increased 10% year-on-year in 2010, following the extreme 40% in 2009, Crédito y Caución forecasts a 5% decrease in 2011. Despite this, business failures will still be on an elevated level because of the steep rise over the past two years. This is reflected in our Expected Default Frequency (EDF) indicator for listed companies in Italy. In January 2011, the EDF for Italy stood at 97 basis points: 74 points below its peak of February 2009. However, compared to the overall decreasing trends of other major European economies, the Italian EDF has remained volatile (see chart below).



Source: KMV Credit Monitor and Atradius Economic Research

Crédito y Caución expects overall insolvencies in the steel/metals sectors to decrease slightly or level off in 2011. However, companies dependent on the construction sector are more exposed than others, especially those SMEs with low equity and limited access to bank loans. The same goes for foundries, which, due to high structural costs, have incurred financial debts to meet their working capital needs, and late payments have already suffered increased insolvencies numbers.

Outlook with downward risks

In 2011, Crédito y Caución expects turnover and profitability in the steel/metals sectors to follow the path of 2010, while revenues will still not return to pre-crisis levels. Stocks are currently kept at a minimum with goods purchased only on receipt of clients' orders. A full recovery is still hampered by modest growth prospects (1.1% GDP growth) and the subdued outlook for construction in Italy. According to ISTAT, construction output decreased 3.4% quarter-on-quarter between November 2010 and January 2011. Additional government stimulus to support the economy is not expected in 2011. On the contrary, the government recently announced cuts in public funds for solar energy development, which will have negative consequences for some aluminium and steel producers.

Italy: steel/metals

There are export opportunities to other European countries, but these are limited because steel demand in many EU markets is saturated and they too have low economic growth expectations in 2011. Moreover, the current crisis in North Africa is endangering alternative export opportunities for Italian steel and metals, and, while the domestic market is mature, global overcapacity has become a structural problem for the sector (see the China report in this Market Monitor). At the same time, the volatility of commodity prices will increasingly become an issue, with uncertainty hampering business planning. Prices for copper, aluminium and nickel are being driven upwards by international demand and speculative action, and steel producers are facing difficulties coping with the three month iron ore price contracts imposed by the major mining companies.

Against this challenging backdrop, Italian the steel/metal sectors face a structural weakness. As many businesses are family-owned, especially in the distribution subsector, this prevents the mergers and acquisitions that would strengthen their bargaining power with producers. Therefore, the high fragmentation in the distribution segment means continuing price problems.

Our underwriting approach remains cautious. With uncertainty about future demand and price volatility, Crédito ty caución is paying closer attention to companies´ stock management and short-term financial indebtedness. In particular, we are closely monitoring foundries, which represent the weakest buyers in the sector because of a rigid cost structure: already last year two large insolvencies have occurred. We are also keeping a close eye on those steel and metals companies supplying the construction industry, as payment problems from public bodies, including hospitals and municipalities, are being past onto suppliers.

Italian steel/metals sectors

Strengths	Weaknesses
• Long experience of entrepreneurs • Capacity to manage stock adequately • Production output is partially focused on special steels with higher margins • Good equity strength, with the exception of distributors • Unemployment state benefits extended to 2011 to cut staff costs	• High fragmentation of the distributors subsector • Rigid cost structure of producers • Insufficient M&A • Scarce transparency towards third parties (excluding banks)

Italy: food

Increasing international competition for some subsectors

According to the Italian Statistics Institute (ISTAT), turnover in the Italian food industry increased 2% year-on-year in 2010 and 3.8% in January 2011, with orders remaining steady. Food retail turnover decreased 0.3% year-on-year in 2010, with small and medium scale distribution recording a 1.4% decrease, while large scale distribution increased by 0.4%.

Most Italian food subsectors have quite low profitability. Of these, operating results in the beverages sector are better than in others, but are penalized by the higher incidence of financial charges for bank loans to support the slower credit cycle, especially in wine production. The fruit & vegetables and dairy sectors have lower solvability, mainly because of the high number of wholesalers characterized by a fragile family-based structure. Low margins normally imply poor equity due to low retained earnings and the need to keep return on investment at a reasonable level. In the food industry as a whole, investment in working capital and tangible assets is relatively low compared to other sectors.

Italian food companies (median values)

Sectors /median values	Gross Margin	EBIT	Solvability	Gearing	Current Ratio*	Quick Ratio**	Debtor days***	Stock days****	Creditor days*****
Fruits/vegetables	9,0	1,4	14	107	1,04	0,90	71	12	74
Meat	10,5	1,7	19	131	1,09	0,87	80	22	68
Beverages	15,9	2,8	28	99	1,15	0,72	122	117	128
Diary	12,1	2,0	17	126	1,09	0,86	85	31	87
Food Retail	11,5	1,6	23	91	1,02	0,80	47	31	88

Source: Atradius, data as of 31 December 2010

*current assets/current liabilities **current assets – stocks)/ current liabilities ***average collections from clients (days) ****rotation of stocks (days) *****average payments to suppliers (days)

Some food subsectors are increasingly struggling with international competition and rising imports, which threaten to gain further market share. Milk, beef and pork are cheaper in, for instance, Eastern Europe than in Italy, making market conditions for Italian farmers and animal feed producers increasingly difficult. At the same time, business size is an increasing challenge, as many Italian food companies are quite small. It is clear that increased market consolidation and mergers are needed to achieve economies of scale and improve export performance. For the time being, Crédito y Caución does not believe that rising commodity prices will have a serious impact on the Italian food industry, but we are closely monitoring the price development of the following commodities: Wheat (with consequences for the pasta industry), Fertilizers (for fruit & vegetables), Sugar (for beverages), Corn (for meat), and Milk (for cheese and pastry/cakes).

The best and worst subsectors in the food industry: December 2010

Best Subsector (sales)	Share % on Total Sales	VAR quantities 2010/2009	VAR prices 2010/2009
Fruits & Vegetables (packed)	0.8	8.0	-2.7
Alternative products of bread	1.7	4.3	-1.1
Olive Oil	1.1	4.1	-5.6
Pastry/Cakes	3.6	3.1	-1.7
Chicken	1.9	2.7	-5.0
Grana Padano	1.0	2.2	6.8
Milk	2.3	2.2	-3.7
Yogurt	2.8	1.8	-5,5
Eggs	0.9	1.0	0.2
Milk UHT	2.2	0.9	-4.9
Frozen Vegetables	1.1	0.4	-4.5
Pork Meat	2.2	0.3	-1.2
Worst Subsector (sales)	**Share % on Total Sales**	**VAR quantities 2010/2009**	**VAR prices 2010/2009**
Preserved Fish	1.4	-0.5	-2.2
Wines	2.8	-1.3	-2.1
Preserved Tomato	0.8	-1.7	-3.7
Fruit & Vegetables (raw)	5.8	-1.8	3.4
Pasta	1.7	-1.8	-7.5
Bread	4.2	-2.7	0.7
Hams	0.8	-2.7	-1.0
Apples	0.9	-3.1	1.5
Parmigiano	1.0	-5.2	10.9
Red Meat	6.0	-5.3	0
Pears	0.5	-6.3	-1.2
Turkey Meat	0.5	-8.1	-0.6

Source: ISMEA (Italian Food Association)

To a certain degree, the food industry can count on public support. Last year the state supported Parmigiano cheese producers in financial difficulties purchasing from the market 150.000 whole cheese: the effect was an increase in sales prices (see chart above).

Further decreasing payment delays, but price-related risks remain

On average, payments in the Italian food industry take 90 days, and Crédito y Caución has noticed that payment delays have decreased in the last couple of months. In view of the rising turnover trend and steady level of orders compared to a year ago, we do not expect the sector to suffer significant downturns in 2011. The extent of capital expenditure for fixed investments will most likely be the same as in 2010 (which was higher than 2009), as business confidence remains high. This in turn should lead to a continued decreasing trend in payment delays over the next six months. However, a sudden sharp increase in raw material prices could create liquidity problems for some subsectors, resulting in increased payment delays and defaults.

Our underwriting approach remains moderately cautious. The agriculture/food industry is quite complex, as it consists of very different subsectors: from animal breeding to meat production and sales, and from corn growing to pasta production, so that a distinct and individual assessment of single subsectors is required. Crédito y Caución is more carefully monitoring companies in those subsectors that are structurally weak because of increased international competition (e.g. farmers, meat) and the potential repercussions of the volatility of raw material prices on their liquidity.

For those selling to the food sector, Crédito y Caución recommends a focus on each buyer's cash flow, credit cycle and short-tem liquidity. Deterioration in payment experience should immediately alert sellers, especially those with payment terms of close to 100 days. As already said, a further possible risk to company liquidity is the unexpected volatility of some raw materials prices. Finally, sellers should keep in mind that the risk of fraud is always relatively high on food products. We recommend a conservative approach to new customers, particularly operating in the southern regions of Italy.

Italian food sector

Strengths	Weaknesses
• Italian food sector enjoys a good reputation • Good opportunities in niche markets and exports • Public financial support when needed (e.g. as in the case of the Parmigiano Reggiano cheese crisis)	• Quite fragile family based structure of many companies • The size of the average company is small-medium only • Higher competition from foreign players

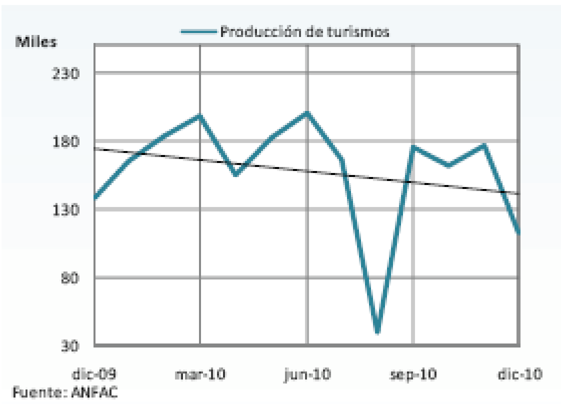
Spain: steel/metals

Domestic demand remains subdued

2009 was a bad year for the Spanish steel and metals industries, because of the real estate crisis and consequent decreasing industrial production. Demand from two of steel's key customer segments - construction and automotive – declined steeply, with both sectors particularly hard hit by the economic downturn. According to the World Steel Association, Spanish steel production dropped 23.3% year-on-year in 2009. However, 2010 brought a turnaround for some subsectors, due mainly to a recovery in the automotive sector and increased foreign demand, with steel production increasing 13.6%: to 16.3 million metric tons. Rolled steel production increased 7.1% year-on-year, while flat steel rebounded by a sizeable 29.2%, thanks to demand from the automotive sector. In relative terms, steel/metals demand from the tubes industry was even higher than from the automotive sector. By contrast, long steel products, used mainly by the construction sector, recorded a 1.8% decrease, and demand for domestic appliances and building metals was also subdued, although this did pick up in later 2010 only to decrease again in December.

Overall, the recovery appears uneven, with market conditions for Spanish steel and metals better in the first half of 2010 than in the second half, except for certain export-driven sectors. While the domestic market increased just 4.2%, exports to the EU increased by 19.1%, underlining the importance of export for the recovery of the Spanish steel sector at a time of poor domestic demand. The rebound of the automotive industry in early 2010 led to increased demand for flat steel and other metal products, but this fell back in the second half of the year, as stimulus measures expired and car production declined again (see chart below).

Spanish passenger car production



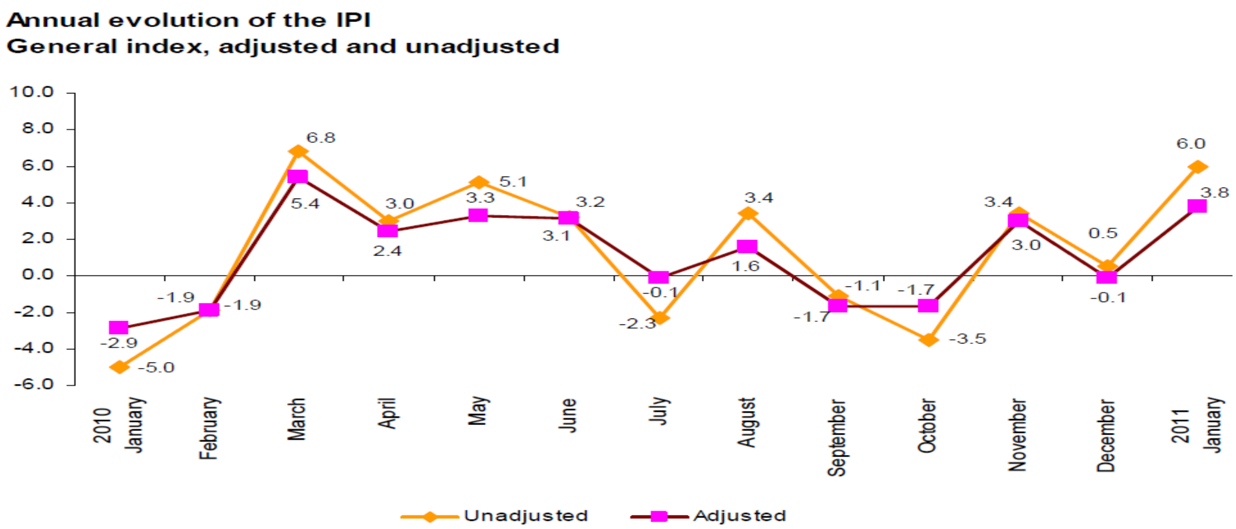
Source: ANFAC

Spain: steel/metals

In our experience, payments in the steel and metal industries take 88 days on average but, while we have seen deterioration in payment behaviour since summer 2010, Crédito y Caución expects this trend to level off in the coming months. The insolvency rate in these industries is higher than in other Spanish sectors: steel and metal company insolvencies increased 11.3% - to 157 cases - in 2010, and we have also seen a slight increase in credit insurance claims in the last six months. The metal alloy and metal building subsectors were particularly badly hit by insolvency.

No strong rebound in sight

The steel and metal sectors' expectations for future development can be described as 'neutral' at best, as they depend, to a large extent, on an overall recovery of industrial activity. However, Spanish industrial production has exhibited recent signs of improvement, with growth recorded in three consecutive months. The Spanish Industrial Production Index (IPI) has shown a generally increasing trend in the last couple of months (see chart below). The index of industrial new orders received has also recovered in recent months: up 12.6% year-on-year in January 2011.



Source: Statistics Spain (INE)

While industry indicators in Spain currently show a slight recovery, many problems and downside risks persist, including difficulties in obtaining bank loans, more payment delays, higher prices for energy and commodities and the continuing problems for construction, all of which could hamper a full-scale recovery of Spanish steel and metals. In 2011, most steel/metals operators expect increasing producer prices, despite only a slight increase in demand. Therefore, businesses are currently buying in vital commodities, as they expect prices to rise by between 5% and 10% compared to 2010. As it will be difficult to pass the full amount of higher prices to customers while demand remains low, this will negatively affect many companies´ margins. The growing internationalisation of both industries is intended to compensate for the collapse in domestic demand. However, this process will take time and, while some steel and metal companies with a healthy financial structure and good market penetration have actually become stronger during the crisis, many of those reliant on construction have fallen by the wayside.

Crédito y Caución expects SMEs focused on the domestic market in particular to face problems in 2011. Despite a slight increased in overall industrial demand, they - and their clients - face a restrictive credit environment, which may hamper a rebound of activity in the course of the year. As a result, our underwriting stance for steel and metals remains cautious, with a special focus on financials, dependency on bank loans, client structure/buyer sector and the potential for export sales. We are keeping a close watch on the metal building, fabrication and alloys subsectors because of their higher default rates.

Spanish steel/metals sectors

Strengths	Weaknesses
• High concentration • Multinationals • Strategic sector	• Weak internal demand • Dependence on external financing (bank loans) • Outsourcing

Spain: food

A key sector for economic recovery?

Food is one of the most important Spanish industries: at the end of 2009 accounting for 8% of GDP. The industry consists of 30,000 companies, employing almost 500,000 people (17% of industrial employment), achieving 14% of industrial sales, and a trade balance surplus of Euro 764.6 million last year. It is also one of the main sectors for foreign investment, attracting around Euro 225 million in 2009.

Between 2000 and 2010, the value of production rose from Euro 55,700 million to Euro 85,100 million (57.2%), while, between 2004 and 2010, exports grew around 32%, from Euro 12,455 million to Euro 16,776 million. After a sharp downturn in 2009, the value of exports increased 9.1% year-on-year in 2010, and foreign sales are now back at their 2008 levels. Mainly thanks to this strong export performance, turnover in the industry decreased only 0.9% year-on-year in 2010, so that the results of many food companies remain stable.

Overall, while not immune to the economic slowdown (e.g. the declining value of production) the food sector has shown some resilience: because it is an essential basic need, inelastic demand makes it less vulnerable than other industries. Therefore, it is no surprise that the Ministry of Industry has identified food as one of the seven strategic areas of the Spanish economy on which recovery will depend.

Fruit and vegetables

Spain is a leading exporter of fruit and vegetable products. In absolute terms, Spain is the second largest European fruit and vegetable producer after Italy. Much of this is exported, representing 41% of total Spanish food exports. In 2010, this subsector’s exports were worth Euro 8,636 million, a year-on-year increase of 10.5%, although export volume was slightly down (-0.2%).

Meat

Meat accounts for 20.1% of total food sector turnover. Most companies in this subsector are small companies, with an average workforce of 11 employees. The economic crisis triggered a steep fall in national consumption as well as restrictions on credit. In 2009 meat production and manufactured meat products dropped 8% and 4% respectively. Costs have increased in recent years as a result of rising commodity prices and higher energy bills, with a direct impact on profits. Together with longer payment terms, tough competition and generic brands growth, this has put increased pressure on the subsector’s margins.

Beverages

The alcoholic beverages subsector represents 0.12% of Spanish GDP and has created 170,000 jobs directly and indirectly. In the 6 years to 2008, consumption of alcoholic beverages declined at rates of around 1% to 2%. However, from 2008 this decrease accelerated, with a decline of 11% that year and 12% in 2009, making the value of the market Euro 1,765 million, down 10.6% on 2008. The downward trend in consumption is the result of the overall impact of the economic crisis and the consequent declining number of tourists. Estimates for 2010 indicate another decrease of 10% with the market now worth Euro 1,515 million. In 2011 a more moderate 5% decline is expected.

Dairy

Since late 2009 and throughout 2010, lower production costs (especially of raw materials) allowed price reductions, resulting in an increase in the number of units sold but a fall in total revenue. The average reduction in the price of dairy products was 6% and, despite a 1% increase in consumption, the market shrank 4.9% in value. Moreover, as a result of the economic crisis, the industry has seen a trend of 'downtrading', with consumers choosing distributors' own brands at the expense of 'name' brands. Furthermore, the impact of the crisis has led to reduced margins and the loss of those operators who could not withstand the strong competition. In 2011, in line with current trends in the Spanish food market, price will remain the decisive factor for the dairy subsector.

Food retail

For the first time since the beginning of the financial crisis, the retail sector (food, drug stores and perfumery) has shrunk: down 1.1% in volume and 2.8% in value in 2010. Private consumption fell, as households tightened their spending, and generic brands have achieved a record market share in 2010.

Increasing price pressures

In recent months, the Spanish food industry has suffered from a price war in many areas. Growing exposure to international competition and the lack of flexibility in framing labour relations have resulted in a loss of competitiveness with those European countries and other foreign competitors that have lower production costs. The food industry needs to gain labour flexibility if it is to reduce labour costs and remain competitive. At the same time, manufacturers specialising in big brand label products are losing ground to food multinationals, as consumers increasingly choose lower priced alternatives.

Spain: food

Until 2011, the rise in the international market price of raw materials needed for food production had not affected consumers in Spain, as players in the market have chosen to reduce their margins rather than further depress consumption. However, Crédito y Caución expects that a further increase in raw material prices will now lead to more expensive food on Spanish shelves. Already, in February this year, food prices rose 1.5% year-on-year: the highest rise of the past two years and a turnaround in the strategy adopted by farmers, producers and distributors not to pass on price increases.The extent of the fall in food companies´ turnover will depend on three factors: the relative muscle of suppliers and distributors, brand strength and customer sensitivity to price.

Stable payment behaviour

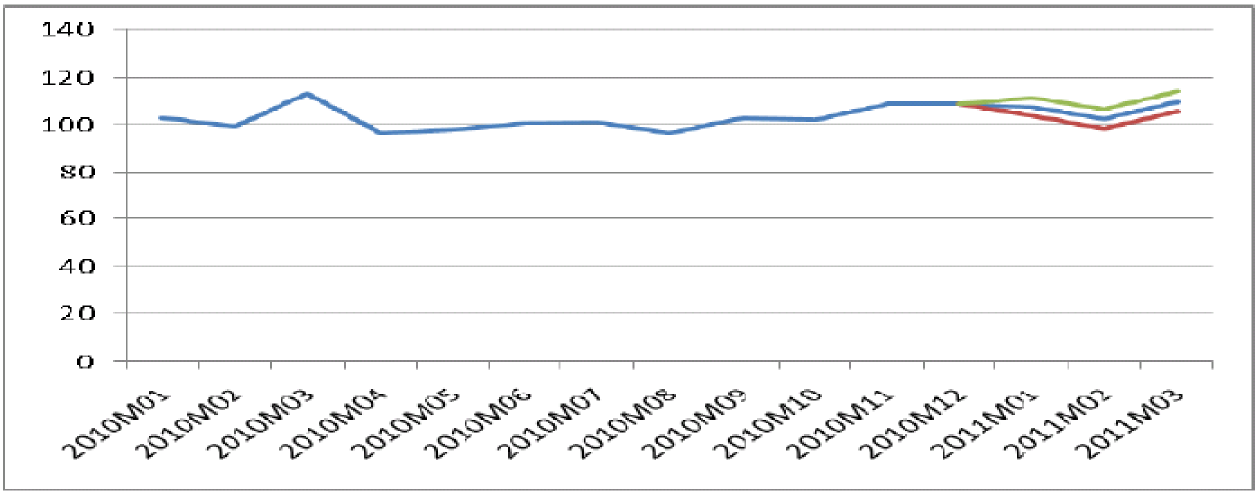
Companies operating in the food industry in general have a good financial structure. The sector is characterized by high equity strength and a healthy level of liquidity and solvability compared to other industries. In our experience, on average, payments in the food industry take between 90 and 120 days, and even shorter in the case of perishable products, for which average payments take around 30 days. We have not seen any deterioration in the payment behaviour of companies in the food sector – either late or non-payments – in the past six months. Crédito y Caución expects this stable trend to continue in the coming months. The insolvency rate in the Spanish food industry is on a par with other industries, and we have noted a slight increase in the level of credit insurance claims in the last six months. Crédito y Caución does not foresee any significant increase in defaults or insolvencies in the sector in the next six months, provided that there is no major deterioration in buyer markets and the price of commodities remains manageable. However, we will give particular attention to subsectors like beverages and meat, where Crédito y Caución expects an increase in liquidity problems.

Challenges ahead

The food sector faces more challenges, as consumer spending is unlikely to pick up in the short term, while companies have already implemented most of their cost-cutting plans. The decrease in consumption, especially in the Hotel/Restaurant/Catering (Horeca) channel, will continue. The sector will also have to contend with higher quotas of own-brand products: The market share of those own-brand products reached 41.6% 2010, a 1.7% year-on-year increase and, already this year, sales of own-brand products have increased by 5.8%, while ‘name’ brand sales have fallen by 1.1%. In spite of these challenges, the food sector will remain one of the main engines of the Spanish economy. The Food Industrial Production Index ended last year with a positive annual average of 2.1%. While it has shown a slight decrease so far in 2011 (-1.1% in January and -4.7% in February, see chart below), an upward trend for the coming months is expected.

Spain: food

Food Industrial Production Index



Figures expected under the likely scenario (blue), pessimistic (red) and optimistic (green)

Source: Statistics Spain

In our opinion, this year will see many mergers and acquisitions of food companies, as the market is still fragmented and offers good business opportunities. Venture capitalists are emerging as the most active investors in this sector.

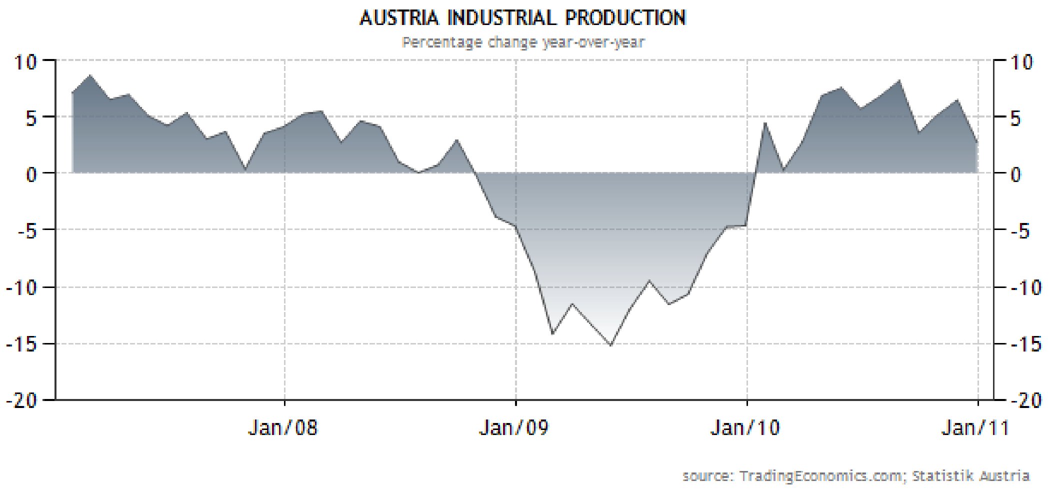
Access to financing has become a key issue for companies, and we will always take into consideration their level of indebtedness when underwriting cover for our clients. It is of course also important for those supplying to companies in the food sector to understand and monitor the level of their buyers' debts and the schedule for clearing those debts, as any further fall in household spending or profitability due to the price war can affect their ability to pay.

Spanish food sector

Strengths	Weaknesses
• The first industrial sector of Spanish economy • Inelastic performance • Positive trade balance • Good business opportunities for M&A	• Price wars can hamper margins • Uncertainty about commodities and oil prices • Unstoppable growth of own brands • Expected drop in consumption

German capital goods industry drives the Austrian steel sector

After a 3.9% contraction in 2009, Austria recorded GDP growth of 1.8% in 2010, with the domestic economy improving again, and exports rebounding particularly well: increasing by more than 16% year-on-year. In 2009 both steel and metal producers suffered from high inventories caused by low demand, with a consequent negative effect on their liquidity. However, in 2010, the Austrian steel/metals sector took advantage of resurging industrial production (see chart below), especially in core buyer sectors like construction, automotive and mechanical engineering, as well as rising demand from Germany. This led to a general improvement of steel/metal businesses´ cash flow as inventories declined.



* The table above displays the monthly average.

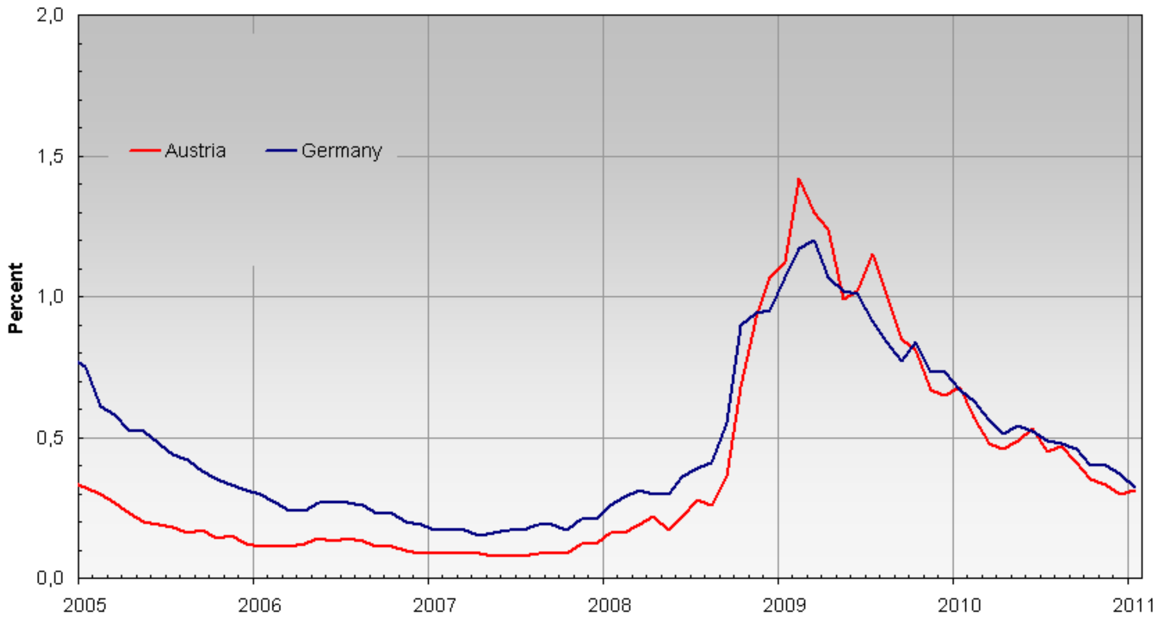
Last year, Austrian steel production recorded its largest increase in more than 20 years, due mainly to strong demand from the blossoming German capital goods industry, but also from the domestic automotive and construction sectors. According to the World Steel Association, production increased 27.3% year-on-year in 2010 after a 25.4% decrease in 2009, and recovered markedly from the liquidity squeeze suffered during the economic crisis. Production of metals other than steel grew 7% last year after a 16.5% drop in 2009, according to Statistics Austria While growth cooled towards the end of the year, it has picked up again since the beginning of 2011.

Austria: steel/metals

Although production is still below pre-crisis levels, orders recovered in 2010 and are now back to normal levels. Both steel and metals have been affected by the rising price of iron ore and coal. However, a concerted purchasing approach by the Austrian steel industry is unlikely, as the larger companies are opposed to this. While, last year, rising commodity prices had a negative effect on margins, steel companies are now able to pass on price increases to customers. Nevertheless, steel traders, who constitute a major part of the steel sector, also continue to suffer from higher fuel prices.

Corporate insolvencies will decrease 5% in 2011

According to credit agency KSV, the payment morale of Austrian companies is good: average credit terms are 26 days, while invoices are settled after 32 days. Our experience is that payment morale in the steel/metals sectors is more or less in line with this average and Crédito y Caución expects this trend to continue. Overall corporate insolvencies in Austria decreased 7.8% year-on-year in 2010, to 6,366 cases, and Crédito y Caución expects a further 5% decrease, to 6,047 cases, this year. Steel/metals insolvencies are below the industry average and will remain so in 2011. This overall improvement in the insolvency situation is also reflected in our Expected Default Frequency (EDF) indicator for listed companies in Austria. In January 2011, the EDF for Austrian companies stood at 31 basis points, 111 points below its peak in February 2009 and almost back to pre-credit crisis levels (see chart below).



Source: KMV Credit Monitor and Atradius Economic Research

Austria: steel/metals

According to Bank Austria, the steel sector will see 7% growth in 2011, with steel traders continuing to pass on higher commodity prices to their buyers. Not surprisingly, the sector perceives the shorter duration of commodity contracts as negative, as this can upset businesses´ planning. Steel traders will also try to pass on higher fuel prices by raising supplements on freight charges. While production in the steel sector will return to pre-crisis levels this year, the metals industry will need another 12 months to compensate for the slump experienced in 2009. However, growth of 8% year-on-year will be achieved in 2011. Business sentiment is currently strong, and order books are full.

Austrian steel/metals sectors

Strengths	Weaknesses
• Increasing demand from capital goods sector • Strong demand from abroad (especially from Germany) • The overall good competitiveness of businesses	• Rising commodity prices • In the medium term, slower growth in the steel sector

Slovakia: steel/metals

Exports and automotive drive recovery of steel and metals sectors

Slovakia was hit hard by the global economic crisis, with real GDP contracting 4.7% and exports declining 16.5% in 2009. However, the recovery has exceeded earlier expectations, with real GDP growth forecast to be 4% in 2010, due mainly to a rebound in exports - up 22% year-on-year in the period January to November 2010 - and the loose fiscal policy of the previous administration. The industrial production index (IPI) has increased 18.9% year-on-year in 2010. On the negative side, private consumption is hampered by the high unemployment rate - 14.1% in Q3 of 2010 - and the reluctance of the banking sector to grant new loans.

The Slovakian steel/metals sector's recovery since 2010 has been driven by domestic and foreign demand (both from Western and Central Europe), especially from the EU automotive sector, which recorded output growth of 18% year-on-year in 2010. Slovakia has become the world's top supplier of cars per capita (VW, Kia, Peugeot, and Citroën), and the subsequent strong rebound of Slovakia's automotive sector has raised demand for steel/metal components. Overall, Slovak steel production increased 22.5% year-on-year in 2010 after a 16.5% contraction in 2009, according to the World Steel Association. Statistics Slovakia reports that the turnover of basic metals and fabricated metal manufacturers increased 24% year-on-year in 2010, to Euro 8409 million, with stable profit margins, adequate equity strength and improved solvability and liquidity in the industry.

We have not noticed any deterioration of payment morale in the last six months, and do not expect to do so in the months ahead: on average (when compared to other Slovak industries) the steel/metal sectors´ default rate is relatively low. However, we have seen a higher share of defaults among those steel/metals companies focused on supplying to the construction industry, which comes as no surprise given the sharp drop in construction activity during the economic crisis and the sluggish recovery since then.

Recovery in construction industry will have a positive impact

Our outlook for steel/metals is positive as long as the situation of key buyer markets remains favourable (i.e. Western Europe and, mainly, the automotive sector). We are also seeing a recovery in the construction market, which should also have a positive influence on the industries. Overall, Crédito y Caución expects increasing demand in 2011, albeit more modest than in 2010. Our underwriting policy remains positive, although we are, in general, more cautious with steel/metal companies closely connected to the construction sector. Our main criteria are knowledge of the buyer's sector (e.g. automotive, construction), the level of stocks, gearing levels and margins/turnover development (i.e. the ability to re-enter the market following the recession)

Slovakia: steel/metals

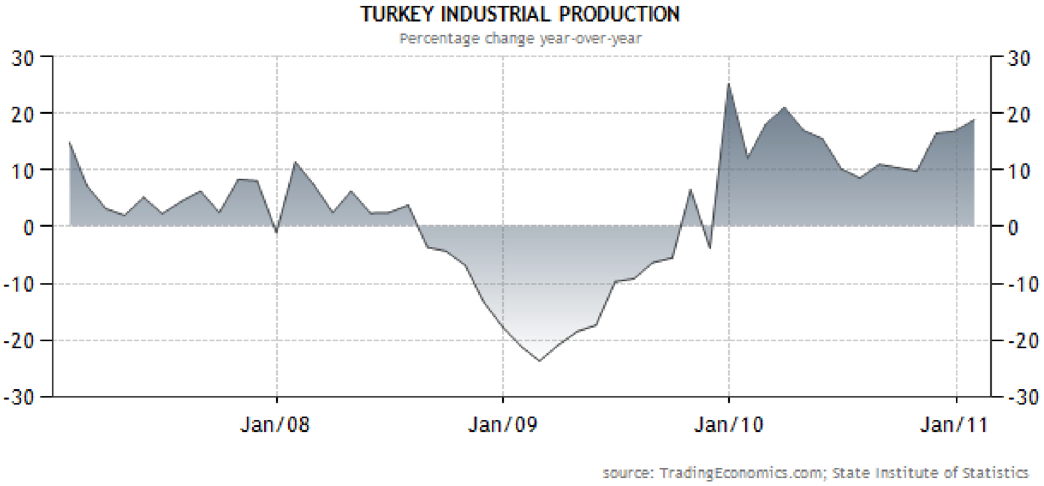
Slovakian steel/metals sectors

Strengths	Weaknesses
• Geographically close to automotive producers • Eurozone member • Lower operational expenditures compared to EU competitors	• Dependence on export demand • Increasing commodity prices

Turkey: steel/metals

Recovery owed to rebound in domestic key industries

Turkey is the world's tenth largest steel producer, with 29 million metric tons produced in 2010. Steel production has increased significantly since 2001 (15 million tons), driven mainly by domestic consumption. The Turkish economy has recovered strongly from the recession. After the dip in GDP of 4.7% in 2009, 2010 saw renewed growth with quarterly output increases of more than 10% year-on-year in Q1 and Q2, although growth slowed to 5.5% in the third quarter. Industrial production rebounded in 2010 and had risen 18.9% year-on-year in January 2011 (see chart below). Construction output also recovered strongly throughout 2010, recording a notable 24.6% year-on-year increase in Q3 of 2010.



Last year, both steel and metals generally benefited from the recovery in key Turkish industries such as automotive, construction and textile, with their consequent increased demand for steel/metals products. Overall, both turnover and production in the steel/metals sectors increased on the back of higher prices and output. According to the World Steel Association, steel production alone rose by 14.6% year-on-year in 2010, after a 5.6% decline in 2009, and this good performance has continued into 2011. According to Turkish Steel, steel exports grew substantially in the early months of this year (63% year-on-year in February), while in January Statistics Turkey's monthly industrial turnover index for the manufacture of basis metals recorded its thirteenth year-on-year increase.

Increasing revenues in 2011

Profit margins in the steel/metals sector improved greatly last year, with strong demand and higher prices, and this trend is expected to continue in 2011, despite higher commodity prices. The industry's general equity strength, general solvability and liquidity are traditionally robust.

Turkey: steel/metals

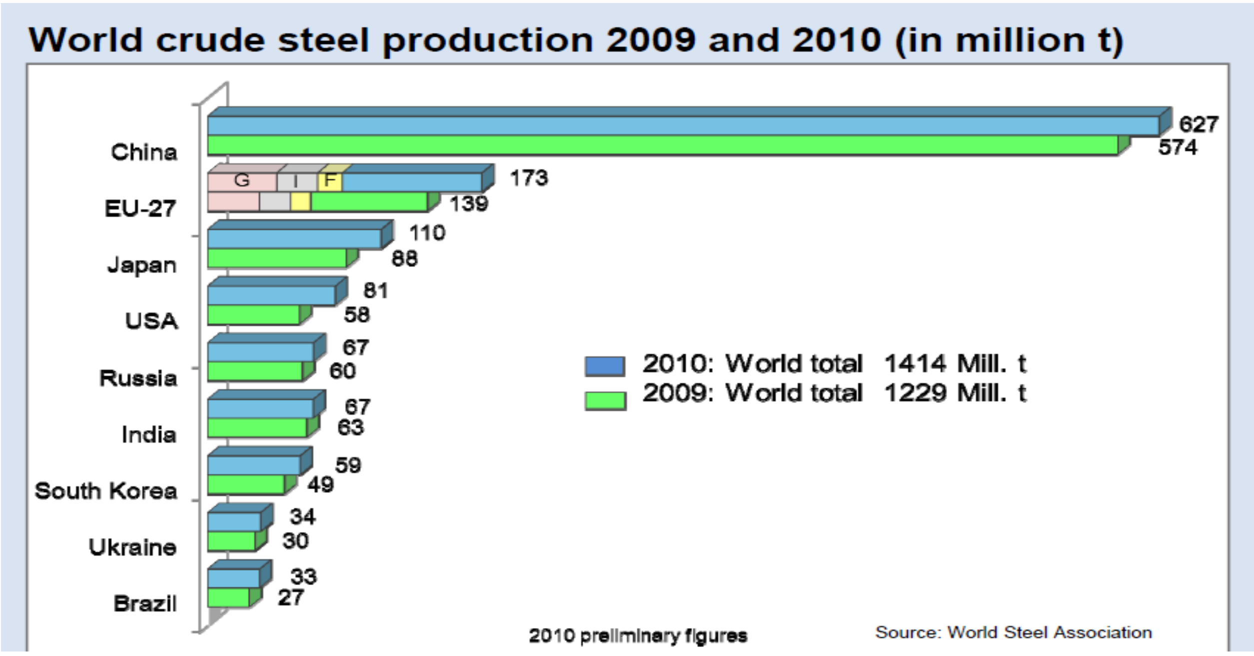
On average, payments in the Turkish steel/metals industry take 45 days, and Crédito y Caución expects payment delays to remain low in the coming months. Compared to other Turkish industries, the steel/metals sectors´ default and insolvency records are good, with the low rate of business failures expected to stay unchanged this year. Overall economic growth, forecast to be more than 5% for 2011, and the continuing rebound in related sectors such as automotive, will support the industries´ expansion, leading to increasing revenues and healthy profitability. Therefore, our underwriting stance for both steel and metals remains positive, with the main criteria being shareholder structure, equity level and cash position.

Turkish steel/metals sectors

Strengths	Weaknesses
• Supplying to several sectors avoids single-sector risk • The strong financial structure of most of the companies operating in the sector • Low competition due to high demand, difficult entry (because of the high investment needed)	• Price sensitive • Continuous investments for capacity and modernisation needed • Emerging China as a competitor for the future (until recently a customer)

Steel: overcapacities after strong growth

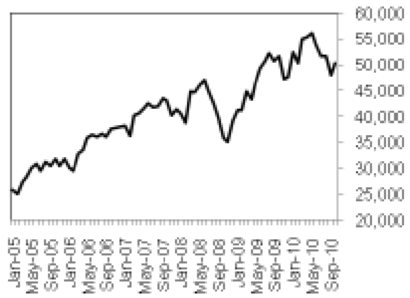
The Chinese steel sector has expanded in the last couple of years, largely as a result of the massive government stimulus package introduced in 2008 to boost construction activity and counter the effects of the credit crisis. According to the World Steel Association, China recorded a 9.2% increase in apparent steel usage (i.e. excluding changes in stock levels) in the period January to August 2010, driven mainly by the inventory cycle and public investment. Shipments for the whole of 2010 are expected to be in excess of 500 million tonnes, a year-on-year increase of around 10%. China’s crude steel output increased 9.3% year-on-year in 2010: to 626.7 million tonnes, after a 13.5% increase in 2009 (China was the only major steel producing country that recorded an increase in 2009).



However, overcapacity and huge stockpiles have now become major challenges, as steel consumption has shown a decreasing trend in late 2010 and early 2011 as the Chinese government takes steps to cool down economic growth (especially the overheated real estate and construction sector, which accounts for 50% of Chinese steel consumption) and to tighten control of production. Capacity growth has slowed because of the government’s energy saving and emission reduction initiative, requiring steel mills to suspend production and close down outdated capacities, launched in September 2010. This has had a significant impact on some small mills in a number of regions, particularly the provinces of Hebei and Jiangsu, eliminating 44 million tonnes of outdated iron and steel production in late 2010.

Despite this, output was still higher than the government had hoped for, partly because some steelmakers are concealing their capacity expansion. For instance, some private mills have reportedly eliminated small-scale facilities under the capacity eradication programme only to replace them with larger mills at a later stage. Moreover, individual provinces have resisted reform to retain market share and protect taxes and jobs.

China's Monthly Steel Output
2005-2010 ('000 tonnes)



f = forecast. Source: World Steel Association, BMI

According to the Chinese Ministry of Industry and Information Technology (MIIT), steel companies overall achieved profits of Yuan 89.7 billion (US$ 13.64 billion) in 2010. However, most enterprises recorded meagre profits or even losses, and total profitability in the sector is far from good. This is due mainly to the substantial increase in raw material costs (e.g. iron ore and coking coal) eating into margins, while steel prices are rising at a slower rate and are thus insufficient to offset the higher cost of raw materials. In the first 11 months of 2010, the industry as a whole had to absorb an additional US$ 26.1 billion of iron ore prices, and statistics showed that the steel industry's profit ratio in 2010 was 2.9%: much lower than the 6.2% industrial average and the lowest of all Chinese industries. The government is trying to force consolidation in the steel sector as a way of eliminating the surplus capacity that is behind the price increase in iron ores and which has dragged down steel prices. So far, we've seen a number of successful consolidations, with large state-owned steel enterprises taking over smaller private or state-owned mills.

Steel makers usually have a long credit cycle, due to the long production periods in the industry. Stockpiles and increased raw material costs have tied up considerable working capital and, while bank loans were in the past the most common way of easing capital pressure, in 2010 banks began to restrict new loans to assist government efforts to slow the economy. This policy will last throughout 2011, placing great pressure on steel makers - especially SMEs.

Crédito y Caución expects demand in China's steel market to decrease further this year because of the brakes on growth imposed by the government. With further rising prices for iron ore, China's steel producers will continue to achieve only low profitability, while trade barriers from overseas markets are proving a real obstacle to Chinese steel exports.

Metals: impressive performance in 2010, but many structural problems

China's metal capacity has continued to rise, maintaining the country's ranking as the world leader in the output of aluminium, lead, zinc and tin, with 2010 another record year for the production of all base metals:

- Refined copper production stood at 4.79 million tonnes in 2010, up 12.2%, and this may reach 4.9 million tonnes in 2011.
- Output of refined nickel surged 24%, to 214,086 tonnes, and is expected to rise by more than 8% in 2011.
- Growth in refined tin production was up 11.6%, to 164,399 tonnes, in 2010 but will probably be less this year due to limited growth in the supply of raw materials.
- Primary aluminium output appreciated by 19.9%, to 15.7 million tonnes, because of expanded capacity.
- The extra output from new capacity in other provinces, such as Inner Mongolia and Xinjiang, boosted aluminium production in December and offset the lower production from existing capacity that resulted from problems in local power supplies caused by freezing weather.
- Refined zinc production reached 5.27 million tonnes, an increase of 19.7%, and refined lead output rose 9.8% to 4.32 million tonnes.
- In 2011, the output of lead may rise 9% and zinc 4%.

In 2010, the industry performed impressively in terms of foreign trade, surpassing expectations. Starting from the low base of 2009, export demand improved, driving up prices. Better than expected growth in imports was attributable mainly to the strong recovery of the domestic economy. Total trading volume rose 43.7% year-on–year, to US$ 120.34 billion, with imports up 38.5% and exports soaring by 63.7%.

During the period from January to November 2010, the main revenues of the country's nonferrous metals companies (excluding solely gold producers) surged 45.7% year-on-year to reach Yuan 2712.24 billion (US$ 412.8 billion). According to MIIT, the industry earned profits of Yuan 114.55 billion (US$ 17.4 billion), up 89.1% year-on-year.

While those figures are impressive, they must be seen in context. The recovery in metal sales started from the very low 2009 base, the result of the economic crisis, and was driven mainly by the government's stimulus package, which is soon due to expire. Despite further growth in the production of base metals this year, the metals sector faces problems similar to those of the steel industry:

- Overcapacity, leading to price fluctuation
- Government interference, e.g. to control pollution
- Lack of funding, with banks restricting new loan
- Industry consolidation led by large state-owned enterprises, encouraged by the government.

As with the steel industry, the government is pursuing a policy of restructuring and upgrading, with the aim of controlling the blind expansion of smelting capacity, and eliminating outdated production capacities.

Steel/metals: rising insolvencies and SME company closures

On average, payments in the Chinese steel and metal industries take 90 days. Crédito y Caución expects this to worsen in the coming months, due to increased liquidity pressures in both sectors, and for the number of insolvencies and company closures to rise. Many privately-owned SMEs have already been forced to close down due to losses resulting from high production costs, the government-imposed cuts, and lack of funding. Smaller privately-owned steel mills in particular may not have sufficient capital to survive, even in the short term, because of the impact of lower profits, expiring stimulus measures and the volatile global financial market. The closure of small mills with outdated capacities will continue: there are plans to shut down all blast furnaces with capacities less than 400 cubic metres by the end of 2011. Crédito y Caución is also seeing more difficulties for export-oriented smaller steel traders and businesses in the scrap metal subsector. However, large state-owned steel makers remain relatively strong, and continue to absorb SME businesses through consolidation, with the encouragement of the government.

Due to the structural problems in both the steel and metal sectors, We are maintaining a very cautious underwriting approach, closely monitoring shareholder background, business portfolios (i.e. goods and services supplied), financial performance, payment terms, and trading history.

Chinese steel sector

Strengths	Weaknesses
• A central pillar of Chinese industry, with major players: strong state-owned enterprises with government support • China is the largest steel production base in the world. Three of the world's top five steel makers are based in China • Consolidation is likely to lead to the elimination of surplus capacity which is dragging down steel prices, with smaller mills likely to close • The recent earthquake in Japan may increase demand in the short-term (for reconstruction)	• The industry faces the serious issue of overcapacity, which affects prices of both steel and raw materials • The increased cost of raw materials is eating into margins • Still weak overseas demand, and an increasing number of trade barriers • Challenges from government regulation to achieve energy efficiency and pollution reduction targets, in terms of cost increase and production cuts • Restrictive bank policies

Chinese metals sector

Strengths	Weaknesses
• An important industry in China, discussed in the 12th Five-Year Plan • China is one of the largest production bases in the world, and the world's leading copper and aluminium consumer • Consolidation is likely to lead to the elimination of surplus capacity • The recent earthquake in Japan may increase demand in the short-term (for reconstruction)	• Overcapacity for most basic metals and low self-sufficiency in raw materials • Challenges from the government regulation to achieve energy efficiency, pollution reduction targets, in terms of cost increase and production cuts, etc. • Restrictive bank policies