Atradius Group

market monitor

Focus on construction performance and outlook

February 2013

Still on shaky foundations

It has often been said that the construction industry is an accurate barometer of a country's economy, and that certainly seems to be the case in this month's Market Monitor reports.

Take the USA. There are signs of a slow improvement in the US economy, and this has been accompanied by increased activity in new house building. While starting from a low base, this trend is set to continue in 2013. Against this backdrop, our underwriters have been able to raise their assessment of the US construction's performance from 'poor' to 'fair'.

In the UK, house sales rose last year, helped by the Bank of England's 'Funding for Lending' scheme. But elsewhere, signs are less positive, with public sector construction continuing to bear the brunt of the government's austerity measures and the hoped-for rise in private sector activity yet to materialise. Even the largest players are now bidding for small contracts that in the past they would have passed on, and it is SMEs that are suffering as they lack the working capital to compete. The German economy has fared better than its European neighbours and that's also true of its construction industry. In fact, the problems elsewhere in the Eurozone have boosted Germany's residential subsector, which is seen by international investors as a safe bet.

The 'barometer' effect is very evident in France, where the expected GDP growth of just 0.2% this year will be reflected in the construction market. It's a familiar story: public budget cuts, low investment, cautious and cash-strapped consumers and scarce bank loans. The construction industry in France's immediate neighbour Belgium is following the economic trend too.

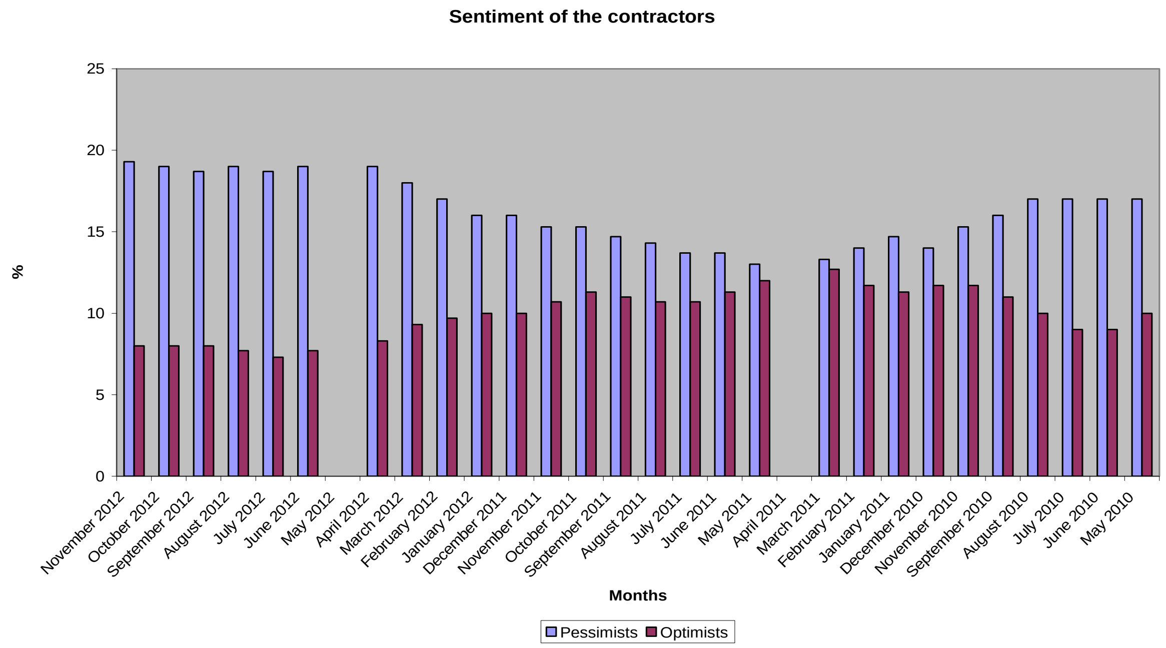
In other reports, Turkey and Hungary both find their construction industry in crisis: in the case of Turkey, we have had to revise our sector performance assessment from 'fair' to 'poor'. Interestingly, Turkey's problems are less about the overall economy – which is performing quite well – but the result of a surplus of stock and the deterrent effect of a hike in VAT on new houses. And, while in Mexico the outlook for construction is good, there is still need for diligence because the country's economy is vulnerable to external factors – especially the economic fortunes of the US. In Brazil, the main cause for concern is the possibility of a housing price bubble.

Belgium

Construction follows the overall downward trend

According to the Belgian Construction Federation, activity in the Belgian construction sector is expected to have decreased 1.5% year-on-year in 2012 (compared to 4% growth in 2011). This would mean that the construction sector will post zero growth for the period 2009-2012. The 2012 dip in performance follows the trend for the whole Belgian economy which, after 1.8% GDP growth in 2011, is expected to shrink 0.2% in 2012 and 2013. Based on the level of permits granted in 2011, the construction of new houses and apartments is expected to have decreased 4.5% in 2012. The decline in renovations is expected to be even more pronounced for 2012 (down 8%) following the ending of financial benefits for investment in energy saving improvements. This trend is confirmed by the Belgian National Bank, which has reported that households are spending less of their income on either new housing or renovations. Last year the spending power of Belgian households decreased for the third year in a row, and consumer confidence is exceptionally low. Another factor is the reluctance of banks to provide loans. In contrast, the non-residential construction subsector is expected to have grown 3-4% in 2012, despite post general elections local government spending being less evident than usual.

In general, construction companies' profit margins and equity remain weak and pressure on prices is extremely high, with most businesses working with break-even or below break-even prices, due to fierce competition. Construction prices have decreased 5% in real terms since 2008, as the nominal price increase of just 0.9%, has been countered by a 6% rise in inflation. Construction companies are forced to improve quality at lower prices: a challenging task since they are subject to increasing regulation, such as energy-saving requirements for buildings. As the current construction downturn follows rapidly on that of 2008, companies have not had time to rebuild sufficient cash and capital reserves. This is reflected in the opinions of construction companies on the economic situation: the following chart shows that since January 2011 most of them have held pessimistic views.



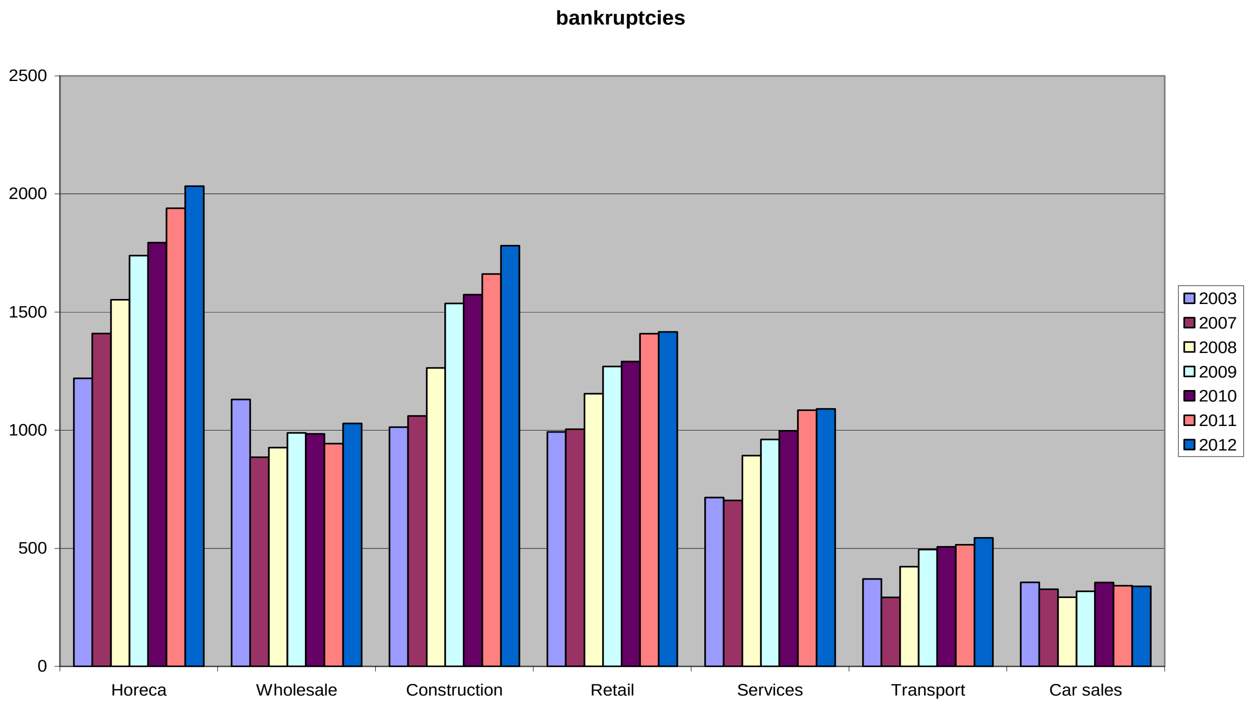
Source: Belgian Statistics Office

In the residential construction subsector, the trend in the number of permits indicates that the situation should improve in 2013, but not greatly. The expectations of commercial construction companies for 2013 remain subdued as, in the current environment, companies are shying away from major investment. The same goes for public construction, as local, regional and state government have to address public deficits.

Expectations for renovations are better, and most companies involved expect a levelling-off or increase in their work volume. The need to make houses and other buildings more energy-efficient should provide enough business opportunities for this market segment in the years to come. However, the market still depends on governmental incentives, and the sudden expiry of the federal tax reductions at the end of 2011 and the absence of an immediate valuable regional alternative have put many investments on hold. To reach the 2020 targets in CO_2 emissions, further subsidies for energy saving measure are necessary.

On average, payments in the construction industry take 60 to 90 days and we have seen increasing payment delays in the last couple of months: a trend that will probably continue, in view of the sectors' overall weak prospects. According to the Flemish federation of the SMEs in the construction sector, Bouwunie, 40% of construction companies are encountering more problems with poor payers. While the payment behaviour of the federal government has generally improved, that of regional and local governments has deteriorated. On 21 December last year, the government decided to change the execution rules for governmental assignments and this will lead to a lengthening of payment periods. While the old regulations envisaged a maximum term of 60 days with no extension, the new ones provide for 30 days verification plus 30 days payment terms - and both terms can be prolonged.

Belgian business insolvencies per sector



Source: Belgian Statistics Office

Our underwriting stance remains cautious

Belgian business insolvencies rose 5% in 2012 and are expected to level-off in 2013 after yearly increases since 2007. In line with the overall trend, construction insolvencies increased in 2012 (see chart above). While residential construction businesses were most affected in the past, we have seen a shift to the building completion sector - especially plastering. The expiry of tax reduction schemes will have a severe impact on carpentry businesses in particular, since they have experienced a steep reduction in their business since mid-2012. With these subdued prospects, we maintain a cautious underwriting policy towards the construction industry. In terms of subsectors we performed special reviews for:

- plastering
- manufacture of metal structures/parts,
- construction of roof coverings/frames
- civil engineering
- installation of electrical wiring/fittings
- joinery installation
- wholesale wood/construction materials

In general, we still focus on the following criteria for underwriting construction:

- the type of business, to predict level of activity and competition
- dependence on one type of business or diversification
- concentration of risk towards a single customer
- most important ongoing projects and most important projects in the order portfolio
- issues with projects (delays, technical problems)
- market position, networking qualities, skills/reputation/experience
- financial standing: liquidity, solvency, rotations, cash flow
- sufficient working capital to cope with slow payments from government, disputes.
- financial policy: profit reservation

Belgian construction sector

STRENGTHS	WEAKNESSES
Demographic evolution	Fierce competition
Energy saving investments	Tight market
Niche sectors development	Weak financial structures
	Difficulty to keep/find good workers

France

The slowdown continues into 2013

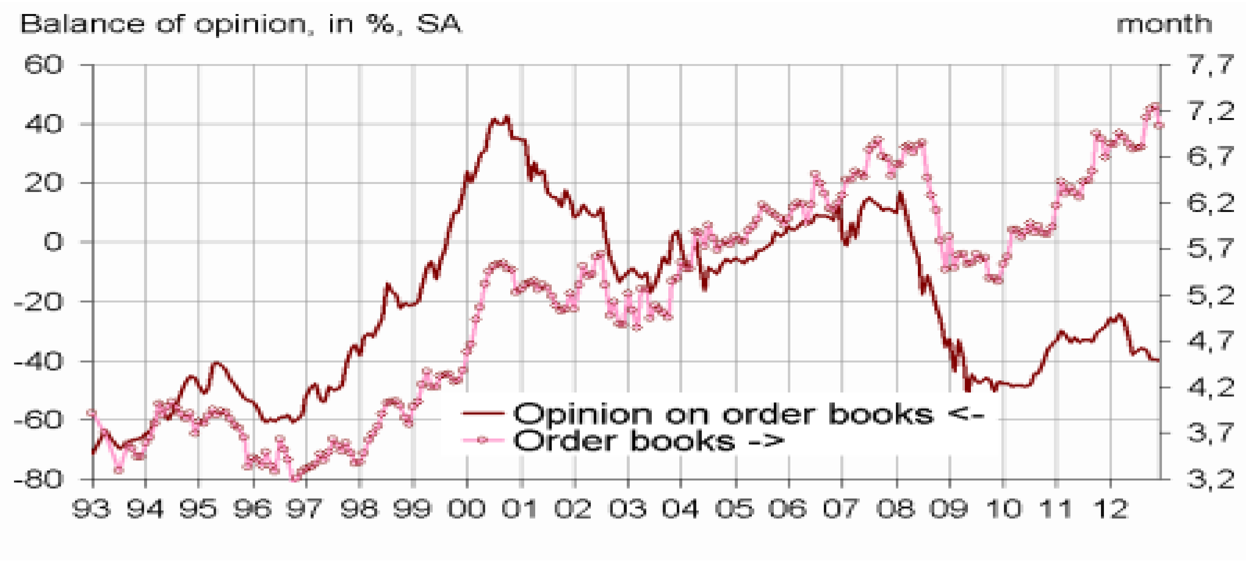
After 2011's modest rebound, in 2012 France's construction industry reverted to the downward trend seen between 2008 and 2010, with building activity down 1.2%. The residential subsector suffered most: according to the Fédération des Promoteurs Immobilière (the French real estate federation), sales of new private housing fell 27% year-on-year in the period January to September 2012.

With GDP expected to grow just 0.2% this year, this ongoing stagnation in France's economic performance will drag its construction market down further. Investment in residential construction will be hit by the cut in tax incentives, as steps are taken to reduce the budget deficit, and by low consumer sentiment, decreasing household spending power, rising unemployment and more restricted access to bank loans. Investors will need several months to assess the benefits of the new tax abatement scheme 'Loi Duflot' which seems less attractive than the former 'Loi Scellier', so the real impact will not be seen before 2014. In this context, the French building federation expects the volume of new houses to decrease 8.9% in 2013.

Generally, long-term investments are also discouraged by the unfavourable business environment as companies become increasingly cautious about committing to new offices and industrial buildings. This year the volume of non-residential construction is expected to decrease 4.4%. Public works will be affected by lower government orders: according to the Fédération Nationale des Travaux Publics (the federation of public works), construction activity will decrease 2.5% in value.

In an odd way, the renovation and remodelling markets will actually be helped, at least in the short term, by an expected VAT increase for construction works, from 7% to 10%, to be introduced in 2014. To avoid this hike in VAT, work planned for 2014 and beyond may be brought forward to 2013. However, volume in this subsector is still expected to decrease 0.5%. Construction materials will also see lower volume, with activity decreasing 5%, according to the construction materials association FNBM.

Overall, the volume of building construction - residential, non residential and renovation and remodelling markets - is expected to decrease 3.5% in 2013. This challenging situation will have an immediate impact on construction businesses. Replenishing order books will become tougher, especially for small and medium-sized companies. They have to compete with the major builders like Bouygues and Vinci, which price aggressively to preserve their advantage in a shrinking market. Apart from steel, construction commodity costs increased throughout 2012, putting margins in the sector under pressure.



Source: INSEE

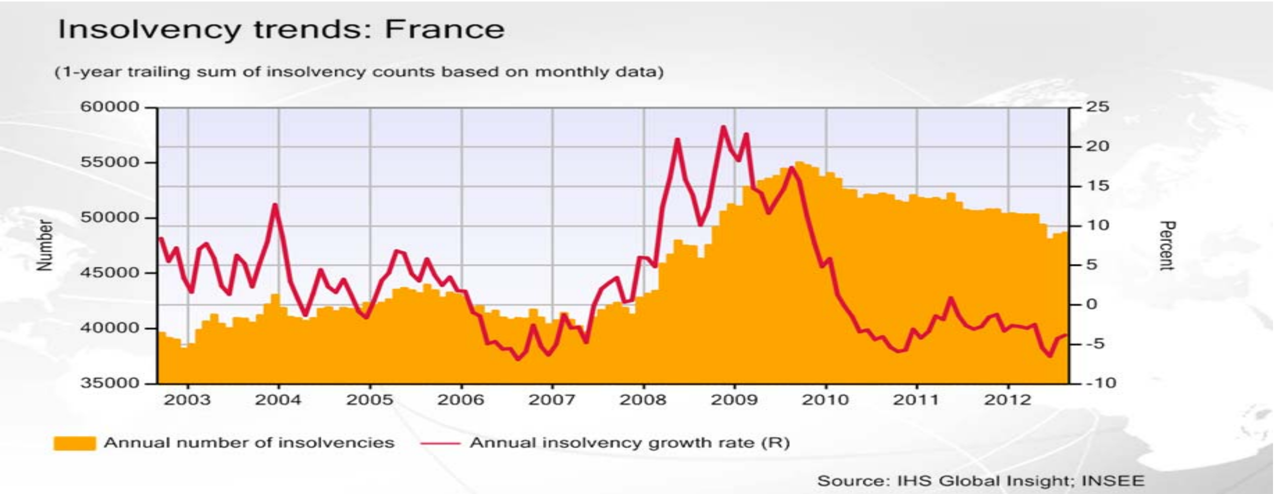
Payment delays and insolvencies will increase

On average, payments in the French construction industry take 60 days. Generally, the introduction of the law of economy modernisation (LME) that prescribes fixed payment terms has not led to an improvement in building companies´ finances. Small and medium-sized buyers, which make up 98% of companies involved in construction, are often forced to respect the delays imposed by suppliers. Public buyers and large companies seldom respect fixed payment terms and continue to prolong payment delays. This imbalance has a major impact on the cash situation of many businesses, with 25% of insolvencies caused by customers´ overdue payments.

We expect payment delays to increase in 2013, as most French building companies have begun the year with weakened cash reserves. The forecast decrease in activity will heighten competition between firms and hurt margins and treasury. As in 2012, banks will remain selective, and SMEs in particular will find it more difficult to obtain loans.

Construction accounts for 25% of the total insolvencies in France. While in the first half of 2012 construction insolvencies decreased slightly, because of the healthy level of orders in hand from 2011, this changed in the second half of the year. In Q3 of 2012, the number of insolvencies increased 6% year-on-year, while the number of businesses active in the sector rose just 3.5%. This dynamic – and volatile – state results from the many small businesses that are set up with little issued capital and a high risk profile.

We have seen rising credit insurance claims in the construction sector since the first half of 2012, both in number and value. Smaller companies are not the only ones affected: larger, established construction companies have also been weakened, and the number of insolvencies in that segment is increasing significantly. The subsectors most affected are real estate, characterised by low equity and margin levels and thus vulnerable to market changes, and masonry, which has been hit by the decrease in new house construction. In view of the deterioration in the second half of 2012, we expect construction insolvencies to rise in 2013, by between 4% and 8%, as problems persist. This is against the overall trend in France, where we expect business insolvencies to level off in 2012 and 2013 after decreases in 2010 and 2011 (see chart overleaf).



Our underwriting stance – intensified monitoring

Given the negative forecast, together with the increasing number of insolvencies, the level of claims received - including those on established companies - and the pressure on treasury for a large number of companies, we will maintain a cautious underwriting stance. This is especially the case for buyers that show weak net worth, decreasing operating margins, low cash flow generation, high dependency on bank credit facilities, and thin order books.

As in 2012, we will intensify our monitoring of this sector, especially the structural work subsector (including masonry, construction of roof coverings and frames) which will be immediately affected by the expected decrease in activity. We will also pay close attention to the joinery and electrical wiring and fittings sectors, as they will feel the impact of the reduction in tax incentives in 2013.

We will make regular contact with buyers in the weakest subsectors, to update our information and gain insight into their 2012 figures, order books, cash situation and budget, and with our customers for information on their trading experience.

French construction sector

STRENGTHS	WEAKNESSES
Structural deficit of houses	Weak GDP growth
Still low level of interest rates	Rising unemployment
Demographic evolution	Government measures to reduce sovereign debt
	Costs rising quicker than prices

Germany

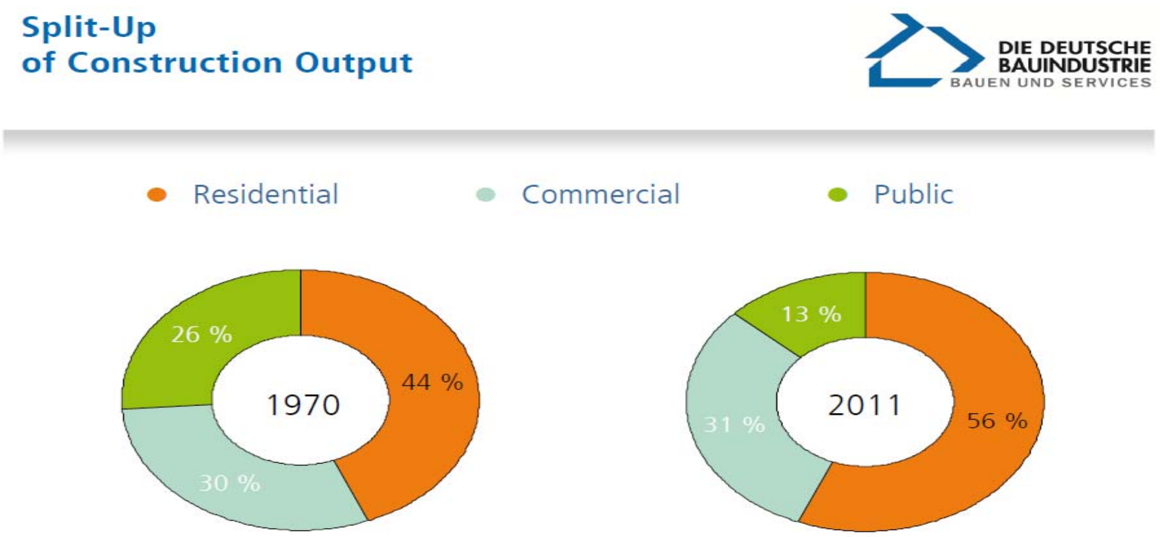
A positive outlook for 2013

Despite the uncertainties created by the Euro debt crisis, the German construction industry developed positively in 2012 and the outlook for 2013 remains fairly optimistic. It is expected that total construction turnover will have grown by a nominal 3% (real growth of 1%) in 2012 after its nominal 9.5% growth (real growth of 6.5%) in 2011, as it recovered from the slowdown in earlier years. New orders and construction permissions increased 6.5% year-on-year in the first 10 months of 2012 and, in some metropolitan areas, those increases were much higher: reaching as much as 70%. Because steel price increases were moderate in 2012, price pressure on construction remained manageable. According to the German Builders' Association, nominal turnover will grow 2% in 2013.

The strongest growth in 2012 was seen in residential construction, with nominal growth of 8%-9 %. As in 2011, this segment attracted investors looking for a stable capital investment while the Euro crisis continues. This year an above-average nominal growth rate of 3%-4% is expected.

In the industrial construction segment, total turnover increased a nominal 4-5% in 2012. However, with the euro crisis deterring the investment plans of many industries, industrial construction has seen a reduction in its orders. Therefore, market participants expect growth of no more than 1% in 2013.

Public construction has faced problems too. After slight turnover growth of a nominal 4% in 2011, turnover fell around 6% in 2012, due mainly to the need for consolidation of public bodies. For 2013 a slight improvement is expected, with nominal growth of around 1.5%, as public bodies have benefited from record levels of tax income.

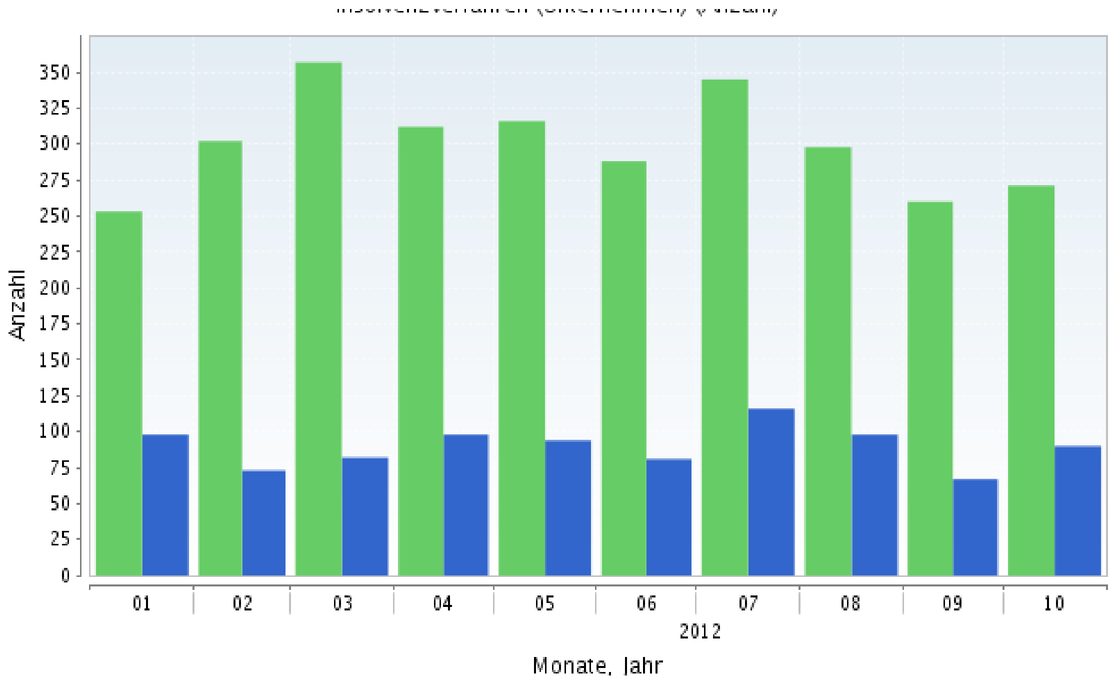


Source: German Builders´ Association

After a general increase in 2011, the profit margins and equity bases of many German construction businesses remained stable in 2012. On average, payments in the German construction sector continue to take about 45-50 days. We saw a slight decrease in the number of reported non-payments over the last 6 months and do not expect any major change in payment delays in the coming months as the overall outlook for the industry is generally positive.

According to the German Statistics Office, the number of insolvencies in the construction industry decreased from around 5,100 in 2010 to 4,800 in 2011, with a further decrease expected for 2012. From January to October 2012, 3000 insolvency proceedings were initiated (see chart below). But, although insolvencies in the construction sector have fallen over the last few years, the rate is still higher than the average for the whole of German industry. With lower growth expectations in 2013, we expect construction insolvencies to level off or to increase slightly.

Construction sector: insolvency proceedings January-October 2012



Green: insolvency proceedings initiated

Blue: insolvency petition dismissed for lack of assets

Source: German Statistics Office

A relaxed underwriting stance – but we monitor developments closely

In view of the improvements in recent years and the still satisfactory performance and outlook for the German construction and construction materials sectors, our underwriting approach remains quite relaxed. However, we continue to monitor developments closely because of the current economic uncertainties in the Eurozone, which could have an impact on the sectors´ performance if the situation worsens.

In general, we scrutinise construction businesses´ operating results, equity, liquidity and financing (e.g. ratio of work in progress/advanced payments) and orders in hand.

We are generally very cautious about construction/construction materials businesses that have operated for less than one year, unless they are part of larger groups or spin-offs. While we normally hold annual reviews, in more problematic subsectors (e.g. businesses focused solely on public clients) we hold additional reviews. Where we identify negative creditworthiness and negative operational results, our underwriting stance is naturally very restrictive.

German construction sector

STRENGTHS	WEAKNESSES
Strong in technical innovations esp. in the area of energy-efficiency	Huge number of small companies active in this sector
Partially high grade of specialisation, especially in construction services	Limited access to international capital markets
	Partially high dependency on public works (e.g. road and railroad construction)

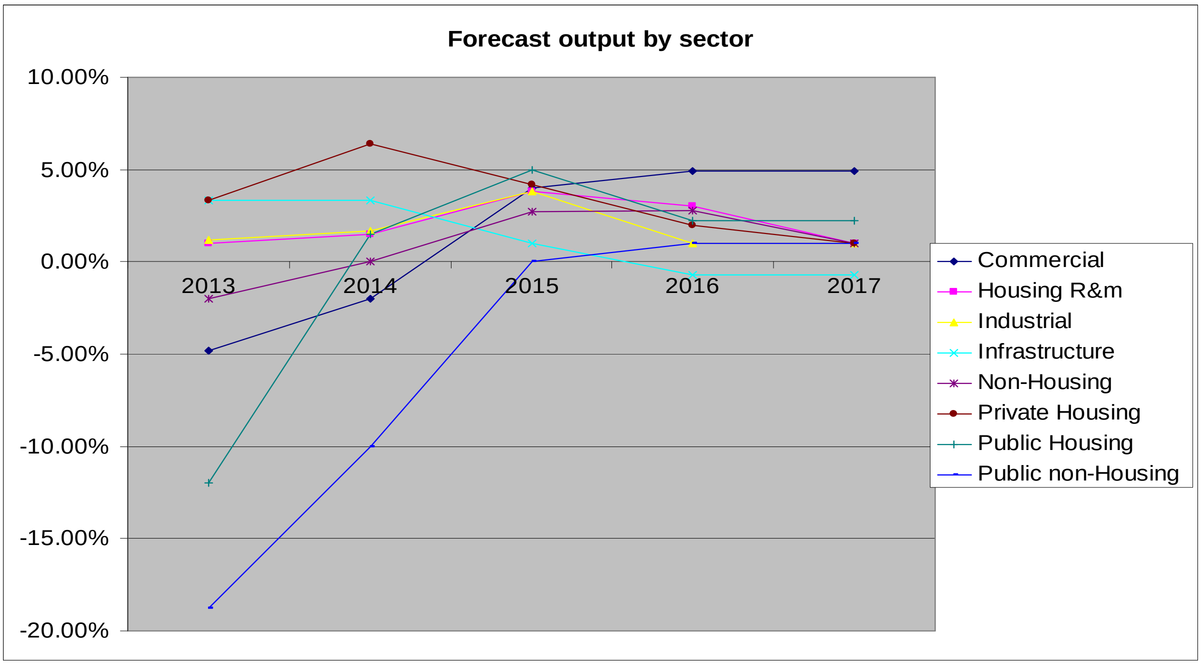
United Kingdom

House sales buck the downward trend

According to the Office of National Statistics, in the period from September to November 2012 the volume of construction output decreased 9.1% year-on-year. Moreover, in Q3 of 2012, new orders decreased 6.7% year-on-year. The private commercial building subsector is the industry's largest contributor, accounting for around 22% of total output, but its output decreased 16.2% in the period September to November 2012. Public housing decreased 19.5% and other public building work 17.2%. Public sector construction continues to bear the brunt of the government's austerity drive and has shrunk 15% over the last two years. Unfortunately, growth from the private sector - which the government hoped would compensate for this decline in public sector activity - has not materialised.

House sales in the UK rose 5% last year: to 932,000 from 885,000 in 2011. This revival has been due partly to the Bank of England's 'Funding for Lending' scheme, which has boosted the flow of mortgage funds and made mortgages cheaper. The scheme began to take effect in the final quarter of 2012, with the number of new home mortgage approvals rising by 54,036 in November: the highest November figure for three years.

The Construction Products Association expects the construction materials market to have contracted 8.8% in 2012. The outlook for 2013 is even bleaker, with a decline of 2.2% now expected instead of the 1.4% predicted last October.



Source Construction Skills Network

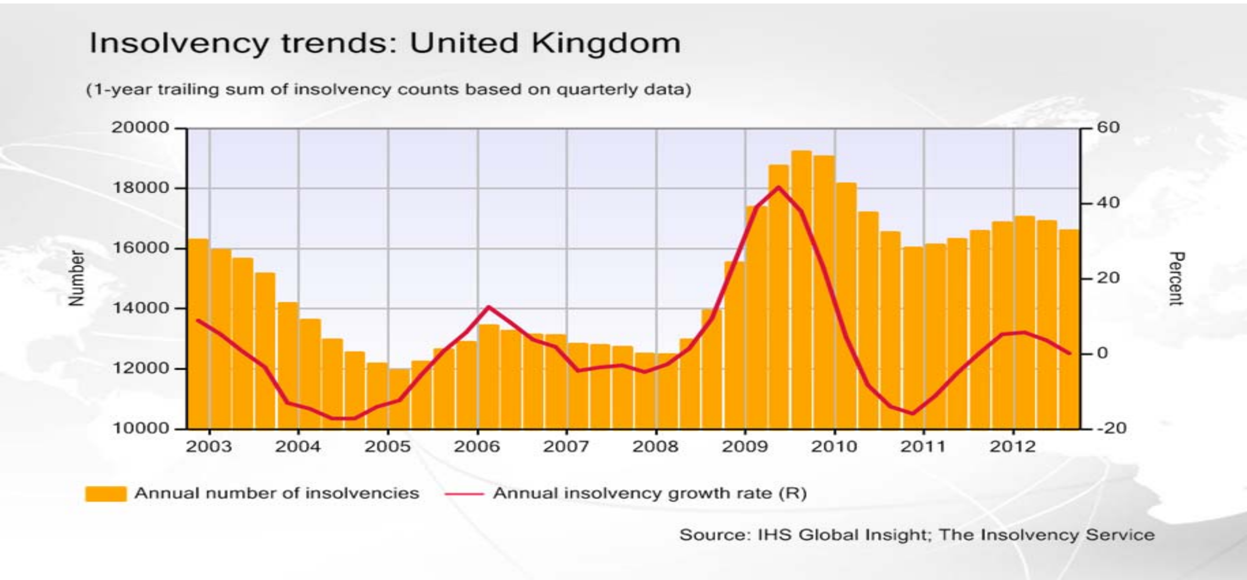
As this chart shows, commercial building and non-housing construction will shrink further in 2013, with the public construction subsector faring worst. Over the following years only a modest rebound is expected.

With restrictions on both public and private spending, and a drop in the value of contracts, there is less volume in the marketplace. Margins have been eroded as businesses reduce their tender prices in an attempt to win contracts. We are seeing some of the larger players in the market bidding for contracts that in better times would be too small in value, just to maintain turnover levels. Moreover, since these larger companies benefit from economies of scale, this has had a knock-on effect on the supply chain. Inevitably the smaller players have suffered most: a pattern that will continue this year.

SMEs suffer from payment delays

On average, payments in the UK construction industry take 45-60 days. Payment delays have generally increased, with some major tier 1 contractors insisting on longer payment terms from their suppliers. Despite legislation and repeated calls for the industry to improve payments within its supply chain, the practice continues, hurting those smaller suppliers without the financial means to function on payment terms that can sometimes exceed 60 days. In effect, this means that smaller SMEs are helping to fund the working capital of much larger and more powerful businesses. As economic uncertainty continues, the pressure on the supply chain will intensify, and that could manifest itself in further payment delays – especially during the winter months.

According to PwC, in Q3 of 2012 construction insolvencies fell 4% on the previous quarter and 10% year-on-year, to 631 cases. However, construction still has a higher level of insolvency than other sectors because of severe pricing and cash flow pressure. Since Q3 of 2010 nearly 6,200 construction insolvencies have been registered: mainly in general construction and civil engineering. We expect more in Q1 of 2013, as the end of a calendar year is traditionally difficult for the sector, followed by a bottoming out in the second quarter. For all UK trade sectors we expect insolvencies to decrease by 10% this year.



Help is at hand for 2013

In the current economic climate, the construction industry is particularly vulnerable to both macro and micro economic factors, and therefore as underwriters we have to be cautious. However, a number of schemes have been and are being introduced to help the sector in 2013 and beyond. And the industry is helping itself: there are many strong businesses in the industry that are focused on cutting costs and improving efficiencies to cope with the problems in the marketplace.

By obtaining up to date information and holding regular discussions with buyer companies, our underwriting decisions remain well informed and accurate. It is also essential that we understand the external factors that may affect the sector's performance. We have seen businesses fail, despite having healthy order books and solid contracts, because they have not been able to access cash when they need it. That can be their downfall: access to finance and controlling working capital are essential in this sector.

There have been notable failures in the mechanical and electrical subsectors, where margins are cut-throat and work has been taken on at break-even prices simply to generate turnover. We are therefore particularly vigilant in these subsectors.

British construction sector

STRENGTHS	WEAKNESSES
Pick up in activity in the South East, particularly London	Public spending cuts
New initiatives being introduced to stimulate the sector, such as the Funding for Lending scheme	'Suicidal' bidding causing an erosion of margins
Major projects such as Crossrail and Sellafield	Limited access to finance

United States

A slow rebound driven by residential construction…

Residential and non-residential construction, together with the construction materials segment, saw some buoyancy throughout 2012 after years of distress. The key issues for these sectors were, and will continue to be, the ongoing home mortgage crisis, tight credit, raw material and energy costs, interest and mortgage rates, consumer confidence, federal stimulus spending, moderate capital spending, and unemployment.

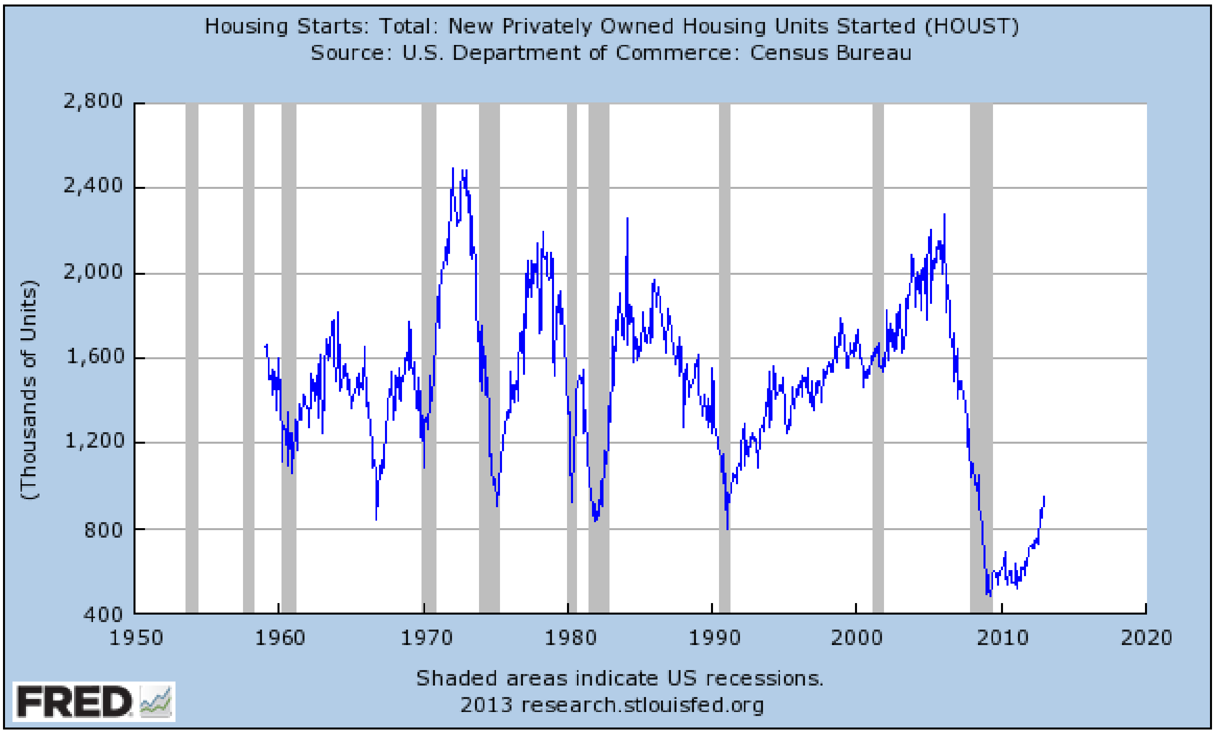
In the residential construction subsector, business showed solid increases throughout the year, for both housing starts and completions. Although new homes represent less than 20% of the housing sales market, they have an immense impact on the economy. Each home built creates an average of three jobs for a year and generates about US$ 90,000 in tax revenue, according to the National Association of Home Builders.

Compared to residential construction, commercial and public construction activities were still rather stagnant in 2012. Countless public projects have been postponed or cancelled as many municipalities struggle with budgetary problems. Additionally, industrial production was weak and commercial property equity values declined. Therefore, while we are seeing more turnover and production in the residential housing market, new commercial construction projects are still slow to start.

With the price of construction materials rising, some construction companies and contractors are realising smaller profit margins, although in many cases increased revenues can offset higher costs. Gradually, signs of very slow, concentrated growth are appearing in this sector.

…will continue into 2013

Construction industry forecasts for 2013 are for some modest improvements. Most forecasters are cautiously optimistic, as funding for construction projects is still a major - and unpredictable - factor affecting commercial projects. According to McGraw-Hill, total US construction starts in 2013 will rise 6%, to US$ 483.7 billion: slightly higher than the 5% increase, to US$ 458 billion, estimated for 2012. Single-family housing starts will increase more than 20% year-on-year, to US$ 150 billion, while the multifamily housing subsector will increase 16%. Commercial building starts are expected to double their 2012 rate, rising 12%. Hotels, warehouses, and office construction will probably not achieve many new starts, but should see an increase in upgrades, energy efficiency improvements and refurbishment. Despite the rather high growth rates predicted for 2013 one has to bear in mind that those are coming off historically low numbers. Overall, most industry experts predict a slow turnaround in 2013.



While indices show that the construction sector may be stabilising, far more improvements need to be seen before the industry can be said to be stable. Since 2009, foreclosure rates have decreased significantly - which is a good sign - and yet in some states still about 1 in every 325 homes is foreclosed. California, New York, Florida, Illinois, New Jersey, and Nevada show serious signs of struggle in the residential construction industry. However, at least interest rates are at an all-time low.

Decreasing insolvencies - but numbers remain high

On average, payments in the US construction industry take 30-60 days. We are still seeing a mixture of prompt and slow payment trends, depending on the specific industry subsector. Private construction companies and general contractors typically experience most of the slow payments, together with companies that sell and lease construction machinery and equipment. But, overall, the number of notifications of late payments that we receive has decreased since the beginning of 2012.

We expect incidents of late payment to slowly improve and insolvencies in the sector to decrease in 2013, as the economy gradually improves. However, many companies will not recover from the prolonged downturn and therefore, despite that improvement, we still expect to see a fair number of construction businesses going bust. While construction is showing more optimistic trends, compared to other US industries it has had a higher rate of defaults and insolvencies since 2009. Private residential contractors, public and private commercial contractors, and hardware stores have seen slightly more insolvencies, worsening the industry average, due to a lack of consumer confidence, federal funding cuts and increased material prices coupled with lower demand.

In summary, the construction sector is enduring a slow recovery but major construction markets will not regain their 2007 peak figures until 2015 at the earliest.

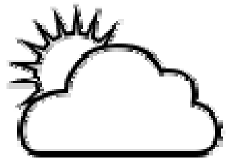
There are many variables involved in underwriting the construction sector, such as location and subsector. Over recent years we have been fairly cautious as the industry was among the hardest hit during the recession and the slowest to recover. However, as we are seeing signs of modest recovery, there is scope to consider new cover for the sector. We still need to remain vigilant in terms of securing financial insight for larger requests for cover, but generally our view is more positive than it has been for several years. Therefore we have upgraded our construction industry performance assessment from 'Poor' to 'Fair'.

Our guidelines for underwriting buyers in these sectors are:

- Cover will be granted only on sight of favourable trade, financial statements or other credit/financial insight.
- Cover will be reduced on, or withdrawn from, buyers that show significantly worsening results, including losses, heavy debt levels, and working capital, cash flow or liquidity issues.
- Before agreeing to credit limit requests, we will analyse financial statements for indications of progressive and profitable operations, positive working capital and cash flow, and satisfactory debt to net worth leverage.
- We also take into account less measureable aspects such as goodwill, health/pension liabilities and litigation issues.
- We consider alternative methods of risk mitigation such as UCC filings, letters of credit, increased co-insurance and decreased indemnification, and shortened terms of sale.

US construction sector

STRENGTHS	WEAKNESSES
We are seeing the biggest monthly increases in private single-family and multi-family housing categories, and in public office, health care and power construction projects. This is a sign of the start of a slow industry turnaround and recovery	Consumers are still reluctant to spend money
The pace of economic growth is maintainable and should not peak and then crash in a short period of time	Materials and building costs have risen in nearly every category
There are signs of a weakening link between residential and non-residential construction, which is a sign of hope for the economy. Demographics are driving demand for health care, education and improving infrastructure, which all offer opportunities for growth in non-residential construction	Federal government budget cuts, payment delays and constraints have hurt commercial contractors and infrastructure projects



Brazil

Activity driven by infrastructure projects

The Brazilian construction industry has been growing faster than GDP over recent years and this trend is forecast to continue in 2013 and 2014, due mainly to infrastructural needs. In 2013 the economy is expected to grow by around 3.3%, driven by domestic consumption and increased public and private investment, including the completion of infrastructure projects. In recent times, the heavy construction segment has prospered from new Petrobras refineries, large mining projects, stadiums and government spending on road building. In June 2012, the Federal Government also announced that it will allocate R$ 15 billion to basic sanitation works and urban paving within the Growth Acceleration Programme (PAC). All these projects represent a major boost to the construction sector.

However, the picture is somewhat different in residential construction. In 2012, the value of mortgage loans increased 3.6%, while the number of houses sold decreased 8.1%: to 453,200 units. In 2013 mortgage loans are expected to increase 15% and, in April last year, President Dilma Roussef announced an increase in the number of homes to be built under the 'Minha Casa, Minha Vida' (my home, my life) programme: from 2 million to 2.4 million by 2014. However, as prices remain high, many people still cannot afford to buy property. A real estate bubble has emerged, which could have a negative effect on construction businesses that are active in this subsector. The lack of a skilled workforce is the main obstacle to the expansion of the sector: in particular engineers and the construction managers who play a major role in avoiding delays and keeping costs under control. Competitiveness in the construction materials industry is affected by high tax burdens, which increase building costs by 20%. In addition, in many cases labour costs represent another obstacle to greater growth in the subsector's revenue.

On average, payments in the Brazilian construction industry take 60 days, and we do not expect any increase in payment delays or defaults in the coming months. In view of the overall positive performance, our underwriting strategy for this sector is generally relaxed. When assessing a company's creditworthiness we focus mainly on:

The level of bank indebtedness / cash flow / the cost of debt / the ability to control those costs that erode profitability /the level of inventory /sales performance and customer profile / the extent of cancelled sales / new project launches.

Efficiency and cost control are the key challenges for builders and, despite our positive perception, we are cautious about some house builders as the market may have entered a speculative bubble. When assessing construction materials businesses, we put emphasis on financial capacity indicators such as cash generation, cash flow, the level of capitalisation, bank indebtedness, age of debts, and the capacity to repay loans.

Hungary

In crisis for the past six years

Although it seemed by Q3 of 2012 that, after six years of decline, the Hungarian construction industry had bottomed out, it continues to contract: by 7% in 2012. Orders had begun to rise at the beginning of 2012, but started to fall late in the year.

The main subsector in crisis is residential construction, where orders fell 24% year-on-year in 2012. The construction materials subsector is also in deep trouble, with prices at a record low. In the non-residential subsector we are seeing stagnation. Government orders are the main drivers of output, with road construction projects postponed while the focus shifted to railway reconstruction and large sewage and environmental projects. The aim is to maximise the use of EU funds to enhance the financing of central building projects. However, state projects of this kind are known for their extremely long payment times, creating a domino effect of late payment throughout the supply chain and yet another problem for the industry.

With some projects started but shelved, only those that have been largely 'pre-sold' are now under way. Investment projects are likely to stabilise at a very low level in the coming years. Barriers to the commencement of new building projects include low demand, bank financing bottlenecks, a lack of investor confidence and payment default by buyers. Based on the most recently available financial information on Hungarian companies (year-end 2011) average capitalisation in the construction sector is 17.8%, compared to 31.5% in industry as a whole.

It is no surprise that payment delays are very frequent in this sector and will increase further in 2013. The latest statistics, from November 2012, show 707 insolvencies: a record monthly number for the sector. The reason for this is that the courts have begun using a 'forced dissolution' tool, introduced in March last year, to clear insolvency cases without the time-consuming liquidation process. In the last few months the number of insolvencies has been more than double the number of newly established construction businesses, although we expect insolvencies in the sector to level off in 2013.

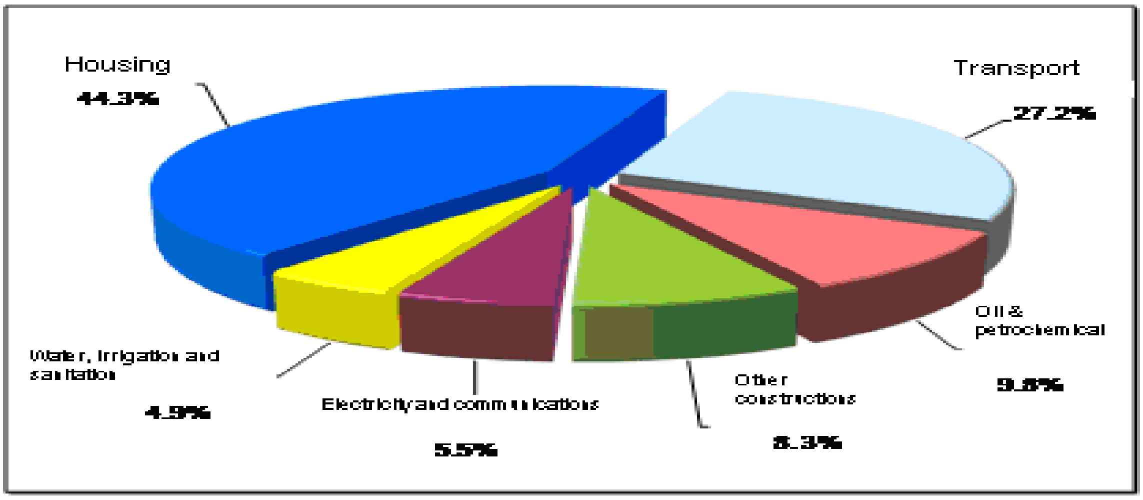
Construction and construction materials are among the highest risk sectors in Hungary. Not helped by the general scarcity of bank financing, these sectors have, as we have already said, been on a downward trajectory for more than five years. Large infrastructure projects are on hold, house and apartment building is minimal, and only industrial plant construction is bucking the trend. The sector is generally overcrowded with the highest number of company liquidations in Hungarian industry.

To underwrite buyer risk accurately, we require the 2011 financial figures at the earliest and preferably interim 2012 figures, especially for higher exposures. It is important to have sight of the project lists of larger buyers and information on orders, buyers and bank loans. We also ask for payment experience more frequently in the case of larger credit limit requests. Supply chain debt within the industry is widespread, because of the many levels of subcontracting and slow payments from to state projects.

Mexico

Good prospects but dependent on external events

The construction industry is fundamental to the Mexican economy. It directly impacts 37 subsectors including cement, wood, steel, electric equipment, metal structures, non-ferrous metals and other mining products, chemical products, and glass products. From January to October 2012, production grew 1.1% year-on-year compared to 3% in 2011. In the first ten months of 2012 contracted construction work was shared between the public and private sector by 51.1% to 48.9%. Construction of houses, schools, hospitals and buildings for the manufacturing and service sectors contributed 44.3% to total construction work, while 27.2% came from infrastructure and 28.5% from the energy industry and water projects (see chart below).



Source: INEGI

Mexico does not currently suffer from the macroeconomic structural weaknesses affecting other advanced economies. The public deficit has remained under control in recent years and investment in the construction industry should be given a boost by the recent adoption of the Law on Public-Private Partnership. The Mexican Chamber of the Construction Industry's forecast is positive and reflects moderate but positive growth for both domestic economic activity and the construction sector. It is expected that the construction industry will see average yearly growth of 3.8% in the period 2013-2016. However, if the new government launches an infrastructure programme as part of its development plan, the growth of construction activity could increase substantially in the coming years.

On average, payments in the construction industry take between 45 and 120 days. It is common for payments from buyers in this sector to be slow because some depend on the duration of work in progress and, in the case of infrastructure projects, on public resources. Despite what appear to be good prospects for the sector, our underwriting approach remains conservative for the time being: basically because any deterioration in the global economy or the economic situation in the USA would have direct repercussions on the Mexican economy and thus on the construction sector. For cross-border transactions in any sectors we recommend that our clients obtain a Pagaré (promissory note), preferably guaranteed by the owner of the company, to protect them from potential currency volatility and the possibility of a buyer’s liquidity problems. Without a Pagaré, the buyer would give priority to local suppliers, paying them first.

Turkey

More troubles ahead for residential construction

Construction is one of the key sectors in Turkey and one of the main drivers of both private and public investment. With its developing infrastructure, growing population and rising national income, Turkey has established a large and strong construction industry. Rebuilding efforts after two major earthquakes of 1999 and 2011 have boosted domestic construction and increased demand for new higher quality houses from the growing number of upper-middle class Turks. On average, around 400,000 to 450,000 new homes are sold every year. The country's strong economic growth has also led to demand for more office and hotel facilities in many cities. Suppliers to the construction sector have also benefited from the upward trend of the last ten years: posting soaring revenues and high profits.

However, according to local government occupancy permits, in the first nine months of 2012 there was a decrease in the following aspects of construction:

Occupancy Permit, total of months January - September

	Indicators			Ratio of change by the first nine months of the previous year (%)	
	2012	2011	2010	2012	2011
Number of Building	63 076	69 632	57 183	-9,4	21,8
Floor Area (m²)	69 477 070	75 241 656	58 954 090	-7,7	27,6
Value (TL)	46 115 436 692	47 179 565 318	32 504 768 769	-2,3	45,1
Number of Dwelling Units	363 502	391 471	294 368	-7,1	33,0

Source: Turkish Statistical Institute

Profit margins began to narrow in 2012 as a result of higher competition among construction companies and rising unsold stocks of real estate. In the second half of the year, we saw an increasing number of construction companies with solvency and liquidity problems. Residential and non-residential construction activity will slow in 2013 and 2014, with an expected annual average growth rate of around 3.8%. Besides the current real estate surplus, construction activity will be hampered by a rise in VAT on new houses licensed from the beginning of this year, which will lead to an increase in house prices of up to 15%. However, Istanbul continues to be the focus of growth and investment, with a number of high-profile commercial, residential and tourism-related projects already launched in the city.

Payment delays rose in the second half of 2012 and will continue to do so this year, as the new tax law impacts sales. Together with the increasingly competitive environment, this will lead to more insolvencies in 2013, mainly affecting the housing construction subsector. Because of this, we have adopted a more cautious underwriting strategy, and have downgraded our construction industry performance assessment from 'Fair' to 'Poor'.

Crédito y Caución
Paseo de la Castellana, 4
28046 Madrid
Spain

creditoycaucion.es