market monitor

Focus on consumer durables/non-food retail sector performance and outlook

March 2014

Better sales – but lower profits

As signs of economic recovery surface, people naturally begin to regain confidence in their own personal circumstances: and that confidence is often manifested in increased sales of items such as household appliances and electronic gadgets. For at least some of the countries featured in this Market Monitor, that seems to be happening. But it is also evident that businesses within the consumer durables/non-food retail sector have to stomach increased costs and lower margins to maintain their sales. That could be a risky path to tread.

For instance, a rise in consumer confidence in Germany appears to be good news - but increased sales are achieved through price cutting, while higher input costs are proving a headache for manufacturers. Japan too has seen healthy growth in the sale of white goods, energy efficient appliances and personal computers, although operating profit has not kept pace with this sales growth.

In Spain, the worst seems to be over for the consumer durables industry. Though consumer confidence has yet to materialise to any great extent, there are grounds for optimism later this year, when a recovery in demand for housing is anticipated. The outlook in Italy for 2014 is also brighter than in 2013, with insolvencies expected to level off after years of increases.

Increasing urbanisation and personal wealth in China, especially among young professionals, are fuelling demand for household appliances and furniture. But, as elsewhere, tough competition is putting pressure on margins.

We also look at the industry in the UK, Canada and Brazil, each of which tells a different story. In the UK, the resurgence of the housing sector should prove a spur, and there is some cause for cautious optimism. Canada is still dogged by concerns about the economy and the job market. And in Brazil the industry is faced by a ‘double whammy’ of rising costs, to meet new energy efficiency standards, and the ending of fiscal incentives designed to stimulate domestic demand.

Brazil

- New energy efficiency standards increase producers costs
- Sales hit by the expiry of incentives
- Weaker currency puts pressure on margins

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months					✓
Development of non-payments over the coming 6 months				✓	
Trend in insolvencies over the last 6 months				✓	
Development of insolvencies over the coming 6 months				✓	

Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector			✓		

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)				✓	

Source: Atradius

Both retailers and producers in the Brazilian consumer durables sector are facing increasing challenges, despite the domestic white and brown goods industry benefiting from a three-year investment programme (2012-2015) by the state-owned investment bank BNDES to develop local production. Non-payments and business insolvencies in the industry have both increased, and are expected to continue to do so in 2014. Therefore our underwriting policy has become more cautious.

Since last year, Brazilian consumer durables producers have been affected by new energy efficiency standards applicable to all devices. The new regulation requires additional investment by producers and, together with rising raw material prices, e.g. for plastic and steel, this has an impact on margins. In addition, at the end of last year the fiscal incentives for purchasing most white goods, except washing machines, expired. This has had a dampening effect on sales.

The increased exchange rate volatility seen in 2013 is likely to continue in 2014, having a significant impact on retailers selling imported consumer durables goods. The weaker currency puts pressure on the margins of those businesses that need to maintain a high volume of sales to support their highly leveraged financial structures. Moreover, persistently high inflation of 5%-6% has forced the Central Bank to raise the benchmark interest rate (Selic) to 10.75% from 7.25% in January 2013. This has dampened business and consumer sentiment and will discourage consumer durables sales. High inflation, coupled with increased interest rates eat into households´ disposable incomes.

Over the past couple of years, the personal credit market has grown in popularity in Brazil, with banks releasing millions of credit cards and turning instalment sales into a common consumer habit. Retailers have been using this credit to collateralise and expand their debt. Margins have been gradually moved from operational to financing activity. Almost all the main players have developed their own credit card in joint ventures with the main banks.

The Brazilian economic model had been based on subsidised consumption, aimed at stimulating the economy through domestic demand, but this model is now reaching its limits. While programmes are still running, they have been less than successful thus far: triggering high inflation and failing to adequately stimulate local production, which also suffers from inadequate local infrastructure: particularly transport facilities.

In view of this, the 2014 outlook for the consumer durables/non-food retail sector is subdued. While Brazil has developed a consistent retailers' network, including large listed local an international players, the county's many smaller and medium-sized consumer durables producers and retailers will probably feel the pinch.

With the assistance of our customers in the consumer durables/non-food retail sector, we are able to identify in advance those buyers that may face major problems due to the current market deterioration. We have seen a slowdown in sales and a growing trend of late payment recently. As interest rates rise, we are also focusing our attention on cash flow debt level and interest coverage.

Brazilian consumer durables sector

STRENGTHS	WEAKNESSES
Large end user market	Highly leveraged
Potential benefits of local investment plans	Exposed to exchange rate volatility
Many large and listed local players	Lack of transparency in the SME sector

China

- Still high growth rates
- Profit margins remain under pressure
- Smaller businesses monitored more carefully

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months			✓		
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance			✓		
Overall indebtedness of the sector				✓	
Willingness of banks to provide credit to this sector			✓		

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)			✓		

Source: Atradius

IHS Global Insight forecasts China's real GDP to grow 7.5% in 2014 after 7.9% in 2013. China's economic rebalancing will be a slow and painful process and, as a result, its headline growth will continue to wind down over the coming years. However, population expansion and increasing individual wealth are essential to ensuring substantial continued growth in China's retail sales of consumer durables. That said, the sector is very competitive and many businesses´ profit margins remain under pressure. Therefore, while our underwriting stance remains generally open, we pay extra attention to smaller businesses in this sector.

The outlook for China's future retail growth remains positive, with a double-digit rise in annual sales expected (see chart below). Regulatory reform, following China's accession to the World Trade Organisation (WTO) in 2001, has allowed foreign retailers to make considerable inroads into the market, satisfying demand from young and aspirational consumers and contributing to a trend that is likely to see the value of the retail segment increase significantly.

Table: China Retail Sales Indicators, 2010-2017

	2010	2011	2012e	2013f	2014f	2015f	2016f	2017f
Retail sales, CNYbn	15,889	17,943.2	20,502.9	23,113.7	26,150.1	29,460.9	33,032.4	37,001.3
- US$bn, fixed 2009 foreign exchange rate	2,326	2,627	3,001	3,383	3,828	4,313	4,835	5,416
- US$bn, forecast foreign exchange rates	2,347.2	2,775.7	3,249.5	3,728.0	4,167.3	4,639.5	5,121.3	5,649.1
Retail sales as % GDP	39.4	38.5	39.8	40.6	41.8	43.3	44.7	46.0
Retail sales per capita, CNY	11,845.4	13,315.3	15,147.0	17,003.2	19,160.8	21,508.4	24,036.7	26,845.8
- US$	1,733.9	1,949.1	2,217.2	2,488.9	2,804.8	3,148.4	3,518.5	3,929.7
Total retail sales growth, CNY	26.8	12.9	14.3	12.7	13.1	12.7	12.1	12.0
Per capita retail sales growth, CNY	26.2	12.4	13.8	12.3	12.7	12.3	11.8	11.7
Private final consumption, CNYbn	14,025	16,224	17,995	19,979	22,285	24,787	27,493	30,494
- real growth % y-o-y	15.8	15.7	10.9	11.0	11.5	11.2	10.9	10.9
- US$bn	2,072	2,510	2,852	3,222	3,551	3,904	4,262	4,656

Source: BMI

Household appliances

In 2013 sales turnover in China's household appliances retail market increased 14.2% year-on-year, to CNY 1.284 trillion (EUR 153 billion) spurred by the developments in real estate. China's subsidy policy for energy-saving appliances, which ended in May last year, delivered marked growth in the domestic household appliances in first five months of 2013. However, in the second half of 2013 the whole market saw weaker profits, especially those businesses selling white goods such as air-conditioners, refrigerators and washing machines.

Fierce market competition in the Chinese home appliances industry has also affected retailers' profit margins. The price war between several of China's consumer retailers has led to massive discounts, putting price pressure on suppliers upstream. The growth of internet shopping is also fuelling competition and eroding profit margins. With higher labour and property costs, profits have been hit by the increased percentage of expenses to revenue. In addition, capital intensive e-commerce business has also challenged the leading retailers in the market.

Nevertheless, the general equity strength of household appliance manufacturers is still relatively sturdy, as most are quite large corporations. But many low-end consumer durables manufacturers have been forced to increase prices to maintain their profit margins and counter the higher production costs that result mainly from rising labour costs.

In 2014 export growth must depend more on product mix improvement. Industrial upgrading and technological innovation will play an increasingly important role in sustaining development of the home appliance industry.

Furniture

According to the Ministry of Industry and Information Technology, turnover in the furniture industry increased 13.6% year-on-year between January and November 2013. As in previous years, with continuing improvements in household living standards and rising disposable incomes, Chinese consumers are buying more furniture. Moreover, demand for furniture is closely related to the development of the Chinese real estate market: China's top economic planners are encouraging local governments to continue to boost affordable housing development, and public financial support for affordable housing increased in 2013. However, China's real estate market growth rates for residential housing have slowed amid government efforts to rein in speculators and control prices, and the situation will not change much in 2014. In contrast, the recent construction boom in many major Chinese cities has led to a significant growth in office space - and a consequent demand for office furniture as companies upgrade both their offices and their office furnishings. This has provided a boost to the middle and upper-end office furniture markets. In addition, the development of the tourism industry has led to the construction and refurbishing of hotels, creating a healthy market for the hotel furniture segment.

Customised furniture is growing in popularity in China, although it still accounts for only 10% of the overall furniture market. Since furniture of this kind normally attracts high prices, it contributes much more profit per unit to a company than off-the-shelf articles. Moreover, bespoke furniture is much in demand by younger people who want furniture of a unique style and size, and therefore the market is expected to keep growing. Some sizeable manufacturers have already equipped themselves with professional teams to offer such a customised service.

On average, payments in the consumer durables retail industry take 45-90 days and we do not expect any significant increase in payment delays in the foreseeable future. Even when payment delays occur, this is often as a bargaining ploy rather than because of cash or liquidity issues.

The consumer durables retail sector's default/insolvency rate is relatively low compared to other Chinese industries, and we do not expect this to change. However, as e-commerce continues its rapid development in China, we need to monitor those businesses with small scale sales and equity but large investment in their online platforms, as this could lead to significant funding pressure and, in the worst cases, to insolvency if no timely and effective action is taken.

We assess buyers in the consumer durables/non-food retail sector on a case-by-case basis. Our main criteria are a business´ shareholding background, business portfolio and financial performance. While there are fewer restrictions on our underwriting of large companies, strong groups and state-owned enterprises with sufficient capacity, we do need to see supporting trading experience to agree to large credit limits if there is a doubt about their capacity. We are more cautious in the case of small and medium-sized enterprises with high external borrowings, because of concerns about tight banking policies.

So that we can maximise the cover we provide, we collect additional information that helps us assess a buyer's strength. If we have to make any restrictions, we explain our concerns to our customers and see if we can reconsider the credit limit based on any additional information that they can provide, e.g. a buyer's updated internal financial accounts, trading record for recent months and orders on hand.

Chinese consumer durables sector

STRENGTHS	WEAKNESSES
China's vast population makes it an attractive target for international retailers, and the lifting of foreign direct investment restrictions has prompted an investment boom	China is still classified by many of its major trading partners as a non-market economy
GDP per capita is forecast to increase steadily, reaching US$ 8,907 in 2017	The Chinese market remains highly fragmented, with small, independent retailers throughout the country serving a population of approximately 1 billion people who buy goods at around subsistence level
The value of the retail segment is forecast to increase 60%, to US$ 5.41 trillion by 2017	

Germany

- Robust domestic demand in 2014 will help the sector
- Margins still under pressure
- No negative trends in payment delays and insolvencies

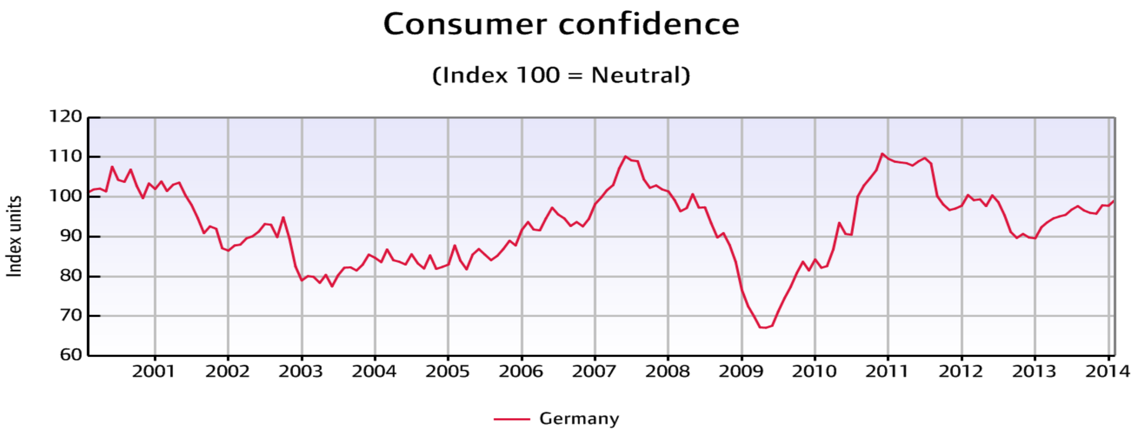
Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months			✓		
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance			✓		
Overall indebtedness of the sector			✓		
Willingness of banks to provide credit to this sector		✓			

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)			✓		

Source: Atradius

After growing 1.0% in 2013, German private consumption is expected to increase 1.4% in 2014, according to Consensus Economics. Consumer confidence has picked up in 2013 and early 2014 (see chart overleaf) and, at first sight, this seems to be very good news for the German consumer durables sector. However, in the second half of 2013, German consumers focused their spending more on leisure, travel and consumer electronics than on white/brown goods or furniture. While profit margins continue to show a decreasing trend, the sector is still quite resilient with no negative developments for payment behaviour or insolvency expected this year. Across all its subsectors, we still see consumer durables/non-food retail as a medium-risk sector.



Source: ICON; IHS Global Insight

In 2013, sales of electronic household appliances increased 1% year-on-year. In the first half of the year, sales of larger appliances increased 2%, while sales of smaller appliances grew even faster, driven by consumers´ increasing demand for energy-efficient tools.

According to the German association of furniture industries VDM, in 2013 domestic sales of furniture decreased 3.1%, to EUR 16.1 billion, while export sales decreased 4.1%, due mainly to weaker demand from Eurozone neighbours such as France and the Netherlands, while exports to the US and China achieved high double-digit increases. In 2014 a levelling off or even a small increase in overall sales is expected, as the German furniture sector expects an additional boost from the current rise in German construction activities.

Furniture producers have regularly tried to pass on rising input costs for energy and raw materials. However, success is limited by the bargaining power of the large and powerful German purchasing associations. The ten largest furniture retailers hold 44% of market share, and this percentage is growing as the trend of consolidation progresses. It is mainly smaller and mid-sized furniture retailers that suffered from last year's drop in sales, and they are now facing additional pressure from online retailers, which increased their market share to 4% in 2013.

As in 2012, higher energy and commodity prices have increased the production costs of all consumer durables segments, and these cannot be passed on in full to retailers. Likewise, in the current competitive environment, retailers cannot pass all the higher producer prices that they incur on to customers. Price transparency, made available to consumers by online retailers, maintains pressure on margins along the whole value chain.

Payment behaviour in the German consumer durables sector has so far remained both good and stable, and we expect no major changes as the general outlook for all subsectors is positive. However, when businesses cannot pass on increased costs to customers/consumers or compensate for this with savings elsewhere, they might demand extended payment terms. We monitor payment behaviour closely in all subsectors and inform our customers immediately of any deterioration.

In line with the overall trend in German business, failures in the consumer durables/non-food retail sector decreased last year. As for our credit insurance claims experience, the industry performed well compared to other sectors in 2013. We do not expect any major changes in the consumer durables insolvency environment in 2014.

We maintain close contact with consumer durables buyers, with whom we have built good relationships over recent years. Generally, our emphasis is on inspecting financial results shortly after completion (annual results, interim results, latest budget and liquidity plans), especially if we are to cover larger exposures. We do not cover newly established firms during their first year of business unless they are members of a well known group or have branched out from an established company.

When customers ask us to cover larger exposures, we try to persuade buyers to agree to retention of title in the sales contract, as this gives us more flexibility in our credit limit decisions. If we cannot agree a credit limit application in full, we will explain our decision clearly to our customers, helping them to maintain good business relationships with their buyer.

German consumer durables sector

STRENGTHS	WEAKNESSES
Many long-established, financially strong family businesses	Small and mid-sized businesses lack access to international capital markets
Experienced and reliable management	Highly dependent on consumer sentiment

Italy

- Recession seems to have bottomed out in some segments
- Insolvencies expected to level off in 2014
- Smaller players still face higher risk

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months			✓		
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance			✓		
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector			✓		

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)				✓	

Source: Atradius

In 2013, the ongoing economic depression and uncertainty about the recovery continued to deter private consumption of consumers durables as in 2012, with the number of units sold down 1.4% and turnover down 3.8%. Sales were also hit by the general downward trend in prices due to tough competition and a dearth of new technologies. However, the drop in sales was lower than in 2012 (when the number of units sold fell 5.5%), and there are now modest signs of a rebound in private consumption and a return to economic growth in 2014, which should sustain the consumer durables industry. Non-payments and insolvencies are expected to level off, but smaller businesses in particular remain exposed to higher risks.

The household appliances subsector includes consumer electronics, major domestic appliances (white goods) and small domestic appliances. Sales kept falling in 2013 in most subsectors, but with at different rates.

Consumer electronics recorded a year-on-year drop in turnover of 22.5% in 2013, due mainly to the definitive end of the switch to digital TV and the lack of new technologies from large producers. TV remains the main segment in this subsector, accounting for more than 80% of value. Overall, the highly competitive sales environment resulted in a decrease in average prices and in the overall value of sales in the sector. Our review of 2013 Christmas business shows a subdued peak season for consumer electronics, despite major discounting and promotional campaigns.

Major domestic appliances: in 2013 the decline in demand for large white goods slowed, both in terms of value and units sold. The government's fiscal incentives, together with market orientation to new energy-saving devices and improved technologies, have sustained the sector. The contraction in sales in 2013 reduced to 0.2%, after two years of major declines (down 7.8% in 2012 and 9.3% in 2011). Positive results were recorded in the washing/drying and refrigeration segment.

Major domestic appliances (white goods) sales 2003 – 2013

Source: Findomestic monitoring

Small domestic appliances: this segment is quite diversified in terms of both products and performance. However, the general trend remained negative (a 1.3% year-on-year sales decrease in 2013), although this decline was less steep than in previous years.

Telephones: this segment, valued at around EUR 3.8 billion in 2013, recorded the best performance of all consumer durables sectors, with a robust increase in volume sold (up 32.4% compared to 2012) fully offsetting the general drop in prices (down 17.2%). In particular, new innovative smartphones continue to replace old technology phones, covering more or less all price ranges and sustaining sales.

The outlook for 2014 remains cautious for most household appliance segments and we anticipate a stable trend. We have moderately positive expectations for the mobile phone sector, high tech white goods and some subsectors of small domestic appliances.

The Italian **furniture** market performed poorly in 2013 in terms of volume (down 6.7%) as a result of the ongoing slump in real estate. The furniture market remains highly fragmented and suffers from pressure from a few large distribution companies which operate with very low prices.

Furniture sales 2003 -2013

Source: Findomestic monitoring

We do not expect any substantial recovery in this segment in 2014, as there will be no real rebound in the real estate sector. More difficulties are likely for smaller operators, while the position of large distributors appears to be more stable. However, export-oriented businesses will be better off, thanks to increasing foreign demand and the high international appeal of Italian-made furniture

On average, payments in the consumer durables/non-food retail industry range from 60 to 120 days, depending on the subsector: with furniture businesses seeing the longest durations. The number of non-payment notifications in this sector finally started to decrease in late 2013, while the average value remained quite stable. However, continuing weakness on the demand side and a lack of access to bank finance are affecting payment behaviour.

Our expectation in 2014 is for a stable level of non-payments as there are signals of a slight economic rebound. Consumer durables insolvencies levelled off in 2013 after reaching a peak in 2012. The rate of insolvencies was on a par with other sectors in the Italian economy, although rates in subsectors such as furniture and general retail were higher. The trend is expected to remain stable in 2014, but with smaller players weakened by their limited capacity to take advantage of the first signs of recovery. We have noted a trend of more cooperation and mergers between businesses in the distribution sector in response to the adverse market environment. Reaching a critical mass seems to be the key to taking full advantage of a rebound, while small and weak businesses will continue to be exposed to poor demand and limited access to loans.

Our underwriting approach is prudent with strict monitoring of more sensitive risks. We focus on the detection of weaker buyers so that we can anticipate when to review any that appear at risk in the short-term. Our approach to risky companies includes requesting the most current financial information and holding ore regular meetings with them. We also seek information about their managerial skills in times of difficult market conditions.

When analysing balance sheets, we assess cash generation capacity in the context of financial debt maturity and composition. In this sector, key factors in reading the financials are the management of working capital, the credit risk and strategies to keep stocks under control.

We continue to adopt a cautious approach to buyers in the furniture and kitchen sector, and the distribution of consumer electronics: a sector currently in the process of consolidation, which will have a bearing on the competitive environment.

For less risky buyers we adopt less conservative strategies provided that fundamentals remain acceptable during tough times, but we keep a close eye on customer quality.

Italian consumer durables sector

STRENGTHS	WEAKNESSES
Aggregation processes strengthen the distribution channel in consumer electronics	Overcapacity and a high number of distribution networks
Brand awareness and 'Made in Italy' appeal	Reduction of average margins due to tough competition
Exports partially compensate for the decline in the domestic market	Dependence on troubled sectors (e.g. real estate)

Japan

- Strong sales growth in 2013 and early 2014
- Insolvencies will continue to decrease
- Impact of planned consumption tax increase will be limited

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months		✓			

Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector		✓			

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)		✓			

Source: Atradius

The sales performance of the Japanese consumer durables/non-food retail sector has been robust in 2013 and early 2014. However, growth in operating profits has not kept pace with sales growth, and businesses´ margins are expected to be tested even more following a consumption tax increase in April 2014 and rising input costs. However, the sector still shows solid fundamentals, and therefore our underwriting stance remains relaxed.

Since early 2013, consumer durables have profited from the rebound of the Japanese economy. Private consumption increased 1.9% last year, particularly in urban areas, ahead of a rise in consumption tax from 5% to 8% due in April this year. As a result, the consumer durables retail sector achieved quarterly gains in sales in 2013.

The household appliances subsector has rebounded strongly. Rush demand ahead of April's consumption tax increase has been a major factor, with white goods in particular in heavy demand. According to GfK Japan, sales of refrigerators alone rose 53% year-on-year in January 2014, while air conditioner sales increased 54%. Personal computers have also seen an upturn in sales, spurred by the ending of Windows XP support in April 2014. Finally, higher energy costs, resulting from the weaker yen and the shut down of all nuclear power reactors, has led to increased demand for energy-saving appliances.

Besides increased private consumption, higher turnover growth in this sector has resulted from the strategy adopted by many businesses of increasing market share through low pricing and expansion (i.e. opening more sales outlets). In this way, those businesses aim to maintain demand in the tougher business environment that will surely follow April's consumption tax hike. However, while operating profits grew in all four quarters of 2013, this has not kept pace with sales growth, as the weaker yen has led to higher operating expenses (e.g. for imported oil and raw materials) and thus to tighter margins. Those margins will be tested further after the expected decrease in sales from April 2014, coupled with the continued impact of cost inflation - primarily for personnel, distribution, and utility costs. In 2014 hourly wages are expected to rise for part-time workers, who make up 80-90% of retail store personnel, and prices for imports will continue to rise. All this will force consumer durables/non-food retail firms to review their cost control plans and their current pricing strategies. Those businesses that can implement effective cost management and reduce their reliance on low pricing, while still offering consumers value-added products, will fare best in the second half of 2014.

However, despite the challenges ahead, the Japanese consumer durables/non-food retail sector has some underlying strengths. In general, businesses´ equity strength is stable, as there are relatively few newly established companies in this sector. This has allowed firms to build up their reserves and retain their earnings balance over time. As bankruptcy and restructuring are viewed very negatively in Japan, financial management tends to be conservative. The sector's general solvency and liquidity situation is stable: since 2009, business insolvencies have decreased year-on-year, and we expect this trend to continue in 2014. Bank lending is widely available and used, due to the high domestic savings and low interest rates. To spur economic activity and maintain the economic recovery, the Bank of Japan has put in place measures to stimulate demand for credit and to encourage banks to lend. As a result, Japanese companies are typically highly geared, but this should not be taken as a sign of poor financial strength.

While there is some concern that the sales tax hike could seriously dampen private consumption, we expect the Bank of Japan to take more measures to maintain their support for domestic demand. Moreover, there are growing export opportunities for consumer durables. For instance, many of the large furniture manufacturers and retailers, such as Kokuyo, Nitori, and Itoki, have identified areas of overseas expansion, specifically in Asia, as the key to growth following the consumption tax rise.

Despite the expected drop in sales and more pressure on profitability, our underwriting policy towards the sector remains relaxed. Our portfolio payment experience over the past two years has been good, and we do not expect any changes in the coming months, as the Japanese government has already taken steps to stimulate bank lending and support the economy.

Besides financial information on buyers, our customers' trading experience gives valuable insight into their buyers' payment behaviour and their trading relationship: an important issue as Japanese firms put great store in long-term trade relationships.

On occasion, a lack of financial information may mean that we cannot approve an application for credit cover in full. In those cases, we will explain this fully to our customers and let them know that, if financial information or trading experience becomes available in the future, we will be happy to review our decision. If a buyer is financially weak, we may be able to extend cover on receipt of a guarantee from a stronger associated company. Generally, to encourage insured trade in this sector, we try to avoid adding restrictive conditions to our credit limit approvals.

Japanese consumer durables sector

STRENGTHS	WEAKNESSES
The market is dominated by large, well established retailers unlikely to become insolvent	Highly competitive business environment
Private consumption has rebounded	Mature domestic market
Good access to bank financing and good payment behaviour	Decreasing margins

Spain

- The worst seems to be over
- No insolvency increase expected in 2014
- Still higher risk profile for domestic appliances and furniture manufacturers

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months		✓			
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months			✓		

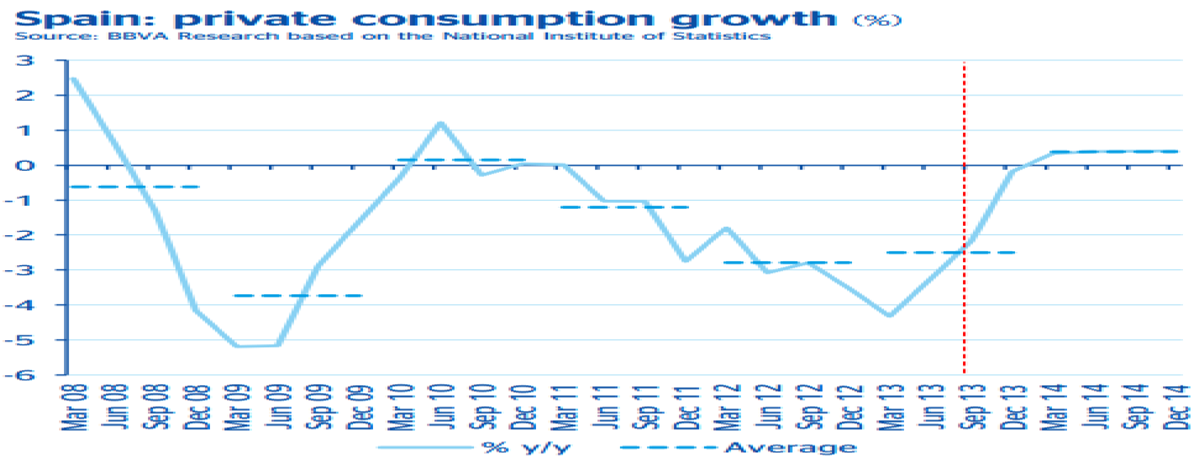
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector					
Willingness of banks to provide credit to this sector		✓	✓		

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)		✓			

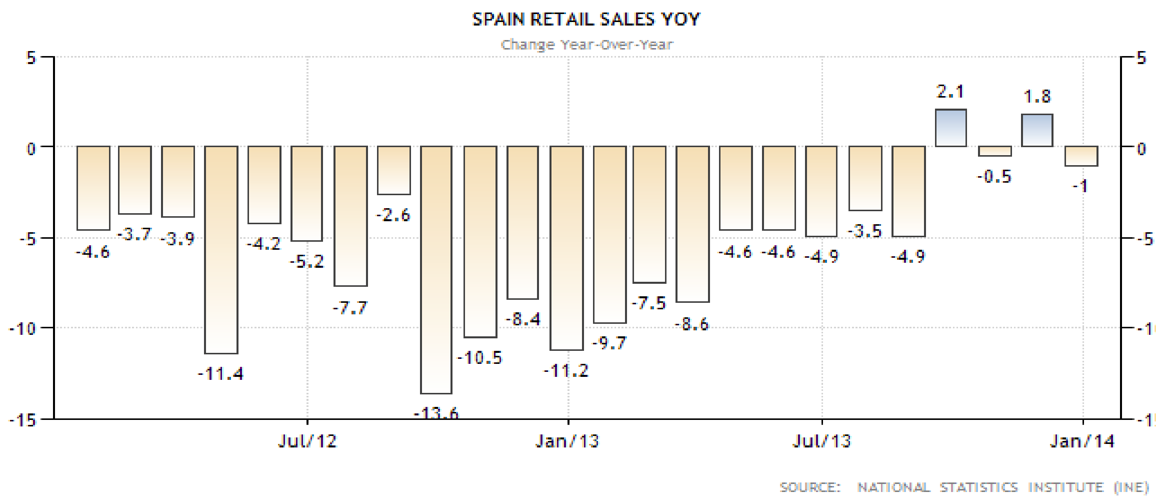
Source: Atradius

In Spain, the worst of the consumer durables/non-food retail sector's problems seem to be over. The Spanish economy began a moderate rebound in the second half of 2013, supported essentially by exports but also by private consumption - especially of durable goods. Private consumption is expected to increase 0.5% in 2014 after three years of contraction but, while payment behaviour has improved and insolvencies in the consumer durables/non-food retail sector are not expected to increase this year, our underwriting stance remains generally cautious because of persisting problems.

In 2013 private consumption in Spain contracted 2.5%, due to the effect of the VAT increase introduced in September 2012 and the overall weakness of the economy. The performance of consumer durables is closely linked to sectors that are still in crisis, such as the real estate and housing industry. Consequently, the consumer durables sector suffered greatly from the reduction in household purchasing power, so that the share of durable goods in the private consumption basket continued to fall in 2013. As a whole, retail sales contracted 3.9% year-on-year.



According to the National Institute of Statistics, production of durable goods decreased 12.1% in 2013. However, due to the expected economic rebound in 2014 there is light at the end of the tunnel for some consumer durables subsectors.



Vehicles: sales pattern are shaped by the PIVE (Efficient Vehicle Incentives Programme), which has limited the impact of the 2012 VAT increase.However, this programme has not prevented the continued ageing of the vehicle fleet (52.3% of private cars are 10 years old or more). The growth in car registrations in 2014 will depend on whether the PIVE is maintained or suspended, but also on the extent of the economic rebound (increase of GDP per capita, unemployment decrease) and fuel price development.

Furniture: the expected recovery in housing demand in H2 of 2014 will help to encourage higher furniture sales.

White goods: there are positive signs as in 2013. Although sales were lower in all electrical appliance categories, the dip was less than in 2012 (except fridges and freezers).

Brown goods: demand is still sluggish, as the market is still digesting the purchases that were brought forward to avoid the 2012 VAT increase. However, there has been a robust increase in the sale of mobile devices: tablets (up 16.3%) and mobile telephones (up 96.1%) in 2013.

An important factor for the 2014 rebound is the more favourable pattern of consumer financing. Lately, financial institutions have had a greater willingness to grant loans to small businesses and to households for consumption. New consumer credit operations grew in 2013 (mainly in the second half of the year) due to the increase in mid- and long-term financing. This helped to trigger the increase in domestic demand already seen in late 2013.

On average, payments in the consumer durables retail industry take around 60-90 days. The recent change in the trend of private consumption and a new law on payments have had a positive impact on the payment behaviour of consumer durables producers and retailers since the second half of 2013. We expect this trend to continue as the general outlook is improving. We have seen a decline in credit insurance claims from this sector in the last six months, and we do not expect any major changes in this trend in the coming months. We monitor payment behaviour closely in all subsectors and inform our customers immediately of any deterioration. Currently, domestic appliance and furniture manufacturing are the segments with higher risk profiles within the consumer durables/non-food retail sector.

Our underwriting approach is still cautious and we assess buyers in the consumer durables sector on a case-by-case basis. We focus particularly on small and medium-sized companies that have high external borrowings, because of concerns about still tight banking policies, while we have fewer restrictions in our underwriting of large companies and strong international groups. We seek to anticipate risks as soon as possible by collecting financial figures: regularly reviewing buyers in this sector based on specified risk indicators and available rating and scoring models, updating information and adjusting underwriting strategies accordingly. Naturally, we pay closer attention to those buyers who appear to be getting into financial difficulties.

Generally, our emphasis is on inspecting financial results shortly after completion (annual results, interim results, latest budget and liquidity plans), especially if we are covering large exposures. A key factor for our analysis is a focus on businesses´ short-term financial debt, the maturity of long-term debts, stock levels and cash flow generation as well as sales and margins performance. We maintain close contact with buyers and meet them as often as possible to fully understand their situation and to get their feedback on the market. We will continue to pay particular attention to the underlying trends that could signal potential future difficulties, such as high leverage, adverse key figures performance against budget and erosion of profit margins.

Spanish consumer durables sector

STRENGTHS	WEAKNESSES
The importance of the sector within the Spanish economy	Strong competition, pressure on margins and high dependence on consumer's credit
Household consumption showed signs of recovery in H2 of 2013 and growth is expected in 2014	Highly dependent on troubled sectors (e.g. real estate and housing)

Canada

- Lower household debt boosts retail sales
- Payment delays have increased since late 2013
- Improved management of inventory and oversupply

Our underwriting stance has become more relaxed as performance in the consumer durables sector has been stable over the last couple of months. However, we closely monitor potential issues that could derail this performance, e.g. increases in unemployment, exchange rate volatility that would weaken the Canadian dollar, or adverse economic trends in major export markets.

In 2013 Canadian retail trade grew 3.1% (to C$ 481.7 billion), following growth of 2.5% in 2012. Furniture and home furnishing retail showed a modest gain, growing 1.3% (to C$15.42 billion): a similar growth pattern to 2012. Electronics and appliances retail recorded acceptable growth of 3.5%, to C$ 14.6 billion. Sporting goods, hobbies, book and music store retail continued to show a downward trend, declining 4% in 2013, to C$ 10.8 billion).

At the end of 2012, caution about high debt levels had restrained household spending. However, since mid 2013 household debt levels have improved, resulting in higher retail sales. Consumer durables performance is expected to be stable in 2014, mirroring the overall Canadian economic growth (forecast 2.3% by the Bank of Canada). According to the Conference Board of Canada, consumer confidence appears to be improving again but some concerns remain about the state of the economy in general and future job creation.

Payment delays in the consumer durables retail subsector have shown some recent increases in late 2013 and early 2014, as retail performance in Q4 of 2013 was down compared to the same period of 2012. Retailers are still trying to move away from advanced payments to a 'pay when sold' term of sale from suppliers. This change of payment terms could lead to increased payment delays. However, as many retailers have managed their inventory levels and oversupply issues more tightly, payment re-scheduling is not yet problematic. According to the Office of the Superintendent of Bankruptcy, overall business retail insolvencies decreased 7.5% year-on-year in 2013: from 571 to 528 cases. However, we expect insolvencies to level off or increase slightly this year.

Our customers selling into this sector typically have longer risk horizons (terms of sale) and seasonality issues. For buyer risks where the credit and/or financial information is not fully supportive of the cover requested, the quality and capabilities of our customer's credit department is taken into account: as effective credit management, coupled with products that are in high demand, can be meaningful loss mitigating factors. To assist customers dealing with this sector, our underwriters make themselves as available as possible so that they can clearly explain to customers the reasons for their decisions.

United Kingdom

- Some cause for cautious optimism
- Insolvencies down by around 5% in 2013
- Problems for 'Pound shops' ahead?

The British economy has seen a robust rebound in 2013, with higher private consumption – up 2.3% year-on-year – playing a pivotal role, and this has certainly helped the consumer durables sector. Our outlook for the next six months is cautiously optimistic. With the post-Christmas period - traditionally a time for retail failures - behind us, we have seen just a few of them recently. Poor weather conditions or unexpected economic shocks could fundamentally change the outlook, but at present the picture is an improving one. While still cautious, since the sector has endured massive problems in recent years, compared to a year ago we are now more open for new cover for the foreseeable future.

The consumer durables market saw positive growth in the months up to Christmas 2013. After a subdued performance during the past three years the consumer electronics subsector enjoyed growth for the first time in two years, thanks to the launch in November of the PS4 and Xbox One. This has the potential to be a boon for the next 18 months. Elsewhere, 50″ flat screen TVs, sound bars and wireless speakers were big sellers over the Christmas period. The small domestic appliances subsector performed positively throughout 2013, right up to Christmas. These small ticket items are always popular over the festive period as gifts and again, with the improving housing market, they should continue to record growing sales. The initial signs for 2014 are already promising with the BDO High Street sales tracker reporting like-for-like sales (excluding non-store) up 8% in January 2014. However, the impact on retail of February's adverse weather conditions has yet to be seen. Furniture traders saw strong demand towards the end of 2013 and the first few weeks of 2014 with sales for December reported to be up 3.5% year-on-year, according to the Office for National Statistics (ONS). Indeed, furniture traders have seen growth in nine of the last twelve months. Sales prices have been maintained, showing that discounting has not been essential to achieve this growth. There is real optimism about the next twelve months as a buoyant housing market should drive this subsector forward. By July 2014 we should have a pretty good idea of whether furniture has really managed the turnaround.

Insolvencies in the consumer durables/non-food retail sector decreased by around 5% in 2013. However, compared to other sectors, the insolvency level is still high. While not forecasting sharply increasing growth rates or improvement in margins for consumer durables retailers, we would expect most to trade well and insolvency rates to level off over the coming six months. Despite the current rebound, some businesses will still face financial difficulties - be it from mismanagement or a change in the way their particular markets operate. One example of the latter could be 'pound shops', where perhaps the improvement in consumers' personal circumstances could reduce the number of customers and therefore profits. 2014 will also see further store closure programmes both within and outside of formal insolvency processes, as the growth of online shopping continues to take its toll on 'bricks and mortar' retailing.

Our meetings with many buyers have helped to give us a sound grasp of the sector and, for those who are prepared to provide sound financial information we are able to continue our support. With each passing year, the level of disclosure improves, allowing us to maintain a good risk appetite. In the main, problem areas have been addressed and more intensive monitoring is in place where required. Cash flow, stock management and store portfolios continue to be key issues.

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