



# market monitor

Focus on machines  
performance and outlook

# It all depends...

**N***o man is an island*, wrote English poet John Donne in his Meditation XVII, and it's a phrase that applies fittingly to the industry featured in this edition of Market Monitor – Machinery. That's because the fortunes of those engaged in the production and sale of machinery depend crucially on the wellbeing of the businesses and industries for which their machines are designed.

That fact is apparent across all the countries on which we focus. In Brazil, the companies whose machinery is designed for the agricultural, steel and mining sectors, all of which are struggling, are themselves faced with lower profit margins and late payments. Conversely, in Italy agricultural machinery is selling well, while the downbeat construction and automotive sectors are taking their toll on the machinery industry.

In France, the industry has been buoyed by the dynamic performance of aerospace, farming and nuclear energy, while again hampered by problems in construction. The machinery sector in Belgium has its own set of problems, including its lack of competitiveness within the EU. As might be expected, the German industry is well established in major export markets, although sales to one of its main markets, Russia, have been badly affected by the Ukraine crisis.

Elsewhere, we look at the Czech Republic and the UK, where a healthy automotive industry is boosting sales of machines, and Denmark, where SMEs, who make up the bulk of the industry, are finding their exports challenged by low-cost foreign competition.

# Brazil



- Lower revenue in 2013
- Hit by higher interest rates
- Increasing payment delays

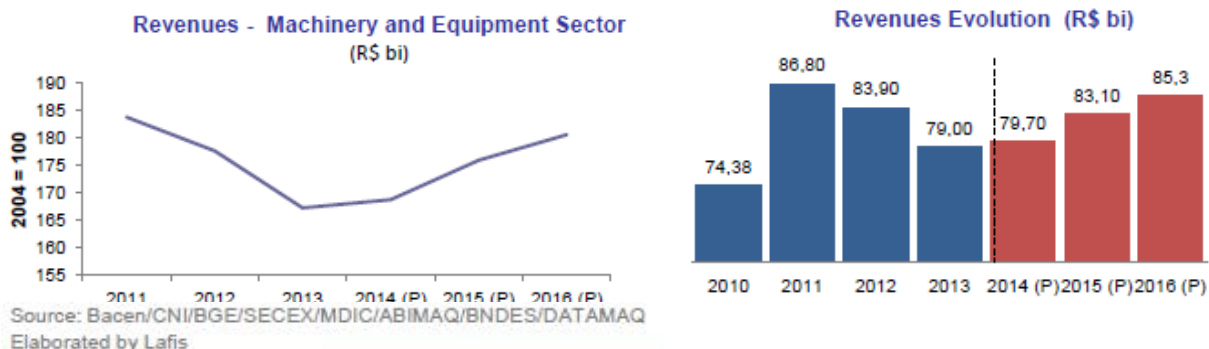
Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months				✓	
Development of non-payments over the coming 6 months				✓	
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the 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 Brazilian mechanical capital goods sector recorded a 5.8% drop in revenue last year. Export of machinery fell 7%, from US\$ 13.2 billion to US\$ 12.4 billion, while imports rose 6.9%, from US\$ 30.5 billion to US\$ 32.6 billion. Revenue is expected to level off in 2014, due mainly to several incentive programmes promoted by the government, and to increase again in 2015 (see chart below), in line with forecast economic growth of 1.9% in 2014 and 2.9% in 2015.



However, adverse impact from the world economy - especially a slowdown in China as the main customer for Brazilian commodities - could lead to stagnant demand and a slower expansion of the domestic industry. This in turn may result in the delay or cancellation of investment, thus hampering further expansion in the industry.

At the same time, Brazil's economic model - based on subsidised consumption - has reached its limits. Instead of boosting GDP this is now creating inflation, which exceeded 6.5% in July this year. Growing inflation - and the measures taken by the Central Bank to contain it - will probably impact investment in capital goods, as higher interest rates make access to credit to fund expansion and modernisation more problematic for both machine producers and their customers. In April this year the Central Bank increased the benchmark interest rate to 11%. The threat of persistently high interest rates may disrupt investment projects and hurt the machinery sector.

Compared to other Brazilian sectors, where businesses are often undercapitalised, the machinery/engineering sector has a robust financial structure with adequate business liquidity. However, profit margins have shrunk and payment delays increased as machinery sub-sectors serving commodities, agriculture, steel manufacturing and mining in particular have been hit by lower demand and a drop in the price of commodities. In recent months we have seen payment deterioration in the agriculture sector - and important buyer of machinery - as many farms have suffered from a drought and, again, the lower commodities prices. We expect more payment delays and insolvencies in the coming months, compounded by the high interest rates that are deterring investment. As a result, we are particularly vigilant when underwriting the machinery/engineering sector. To maximize the level of cover that we offer our customers, we contact them regularly to ensure that our information on their portfolios, receivables and trading conditions is up to date.

### Brazilian machinery/mechanical engineering sector

STRENGTHS	WEAKNESSES
An industry of vital importance to the economy, as the production process of all other industries depends on it.	Production costs in the industry depend largely on imported components, often quoted in US\$, making it difficult to schedule long-term costs.
Huge public infrastructure projects are planned.	The capital goods segment is extremely dependent on credit availability due to the lengthy maturity times of investments.

# Italy



- A rebound in 2014 in exports and domestic market
- Problems in the automotive and construction sectors
- Payment trend generally stable

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 performance of the Italian machinery sector was fairly static, with production of machines for industrial automation decreasing 1% year-on-year. Exports, which account for 76% of machinery production, also experienced a modest year-on-year slowdown. The main export markets are still China, USA, Germany, Russia and France.

Early this year there was a turnaround in performance, in both exports and domestic sales. While export orders continued the positive trend already seen in Q4 of 2013 (up 6% year-on-year), orders from the domestic market rebounded, although from a very low level. We expect the modest positive forecast for Italian industrial production for 2014 (up 1.4%) and 2015 (up 2.5%) to have a direct effect on the development of the machinery sector, the trend of which is linked to the economic cycle. In particular, the sector may benefit from public incentives for small companies to invest in the renewal of their machinery.

However, machinery remains strongly linked to the end-market and therefore we still expect quite a difficult environment for producers of earth moving machines (in line with the poor performance of the construction sector) and automotive machines. Better results are expected in the case of machines for agriculture and some niche subsectors, especially high precision mechanical works.

The payment trend was quite stable throughout 2013 and generally better than the average for Italian businesses. Both the frequency and size of non-payments that we recorded in 2013 and early 2014 are low compared to other sectors.

The number of insolvencies in the machinery sector has remained stable and we expect this to continue. The machinery/mechanical engineering sector is performing better than manufacturing as a whole and, while we expect Italian business insolvencies to increase 5% year-on-year in 2014 - after 2013's 10% rise - there should be a lower percentage increase of failures in the machinery sector because of its relatively good export performance. The exception will be those machinery businesses reliant on troubled domestic sectors such as automotive and construction. Small companies in the machinery sector will be under particular stress due to competition from the Far East for lower value-added productions.

Although the machines/engineering sector remains quite exposed to the general economic trend - and in Italy the recovery is still rather weak and uncertain - the sector is still performing quite well, thanks mainly to some niche export focused subsectors: one of Italy's production success stories. Our underwriting approach for 2014 is more relaxed for those companies in that niche category as they show solid 2013 financials, a good liquidity profile and an increase in their order portfolios amply covered by advanced payments - as well as for subsidiaries of solid international groups that have consolidated their position in Italy.

We are more cautious about companies operating in troubled end-sectors, such as construction and automotive, and small/micro companies that are facing strong competition from the Far East.

#### Italian machinery/mechanical engineering sector

STRENGTHS	WEAKNESSES
Strongly export-oriented.	Dependence on automotive and construction.
High quality in some segments.	Still weak domestic demand.

# France



- **Help from automotive rebound**
- **Machinery businesses related to construction still carefully monitored**
- **Machinery insolvencies expected to decrease in 2014**

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			✓		

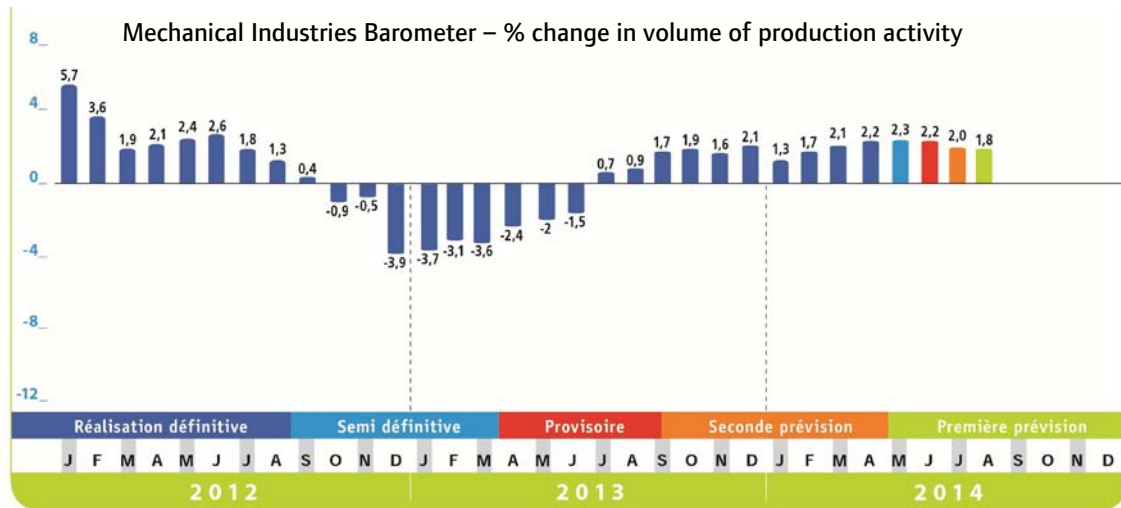
Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector		✓			

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 a slowdown in 2012 and the first half of 2013, due mainly to falling demand from the automotive and construction sectors, the French machinery/mechanical engineering industry seems to have recovered slightly from its difficult times. Aerospace, farming equipment and nuclear energy, as markets for machines, have so far remained dynamic, and automotive has seen a resurgence over the last six months. Since the second half of 2013 machinery production has rebounded. It increased by 1.9% in the period January to May this year, and inventories are back to normal. Order books and exports have both improved: 2013's downward trend in exports has reversed since the first quarter of 2014, when exports to EU members, especially to Germany, rose by 3.1%. However, exports to non-EU countries continued to fall (down 1.6%).

In the long term, overcapacity still remains a concern as, despite the positive trend, demand remains comparatively subdued, with limited investment from the main customer sectors.



Source: FIM

In this capital intensive industry, financing needs are high. As a result, businesses in this sector can incur large debts that weaken their financial structure and overall solvency, putting undue stress on liquidity. However, in many cases advance payments can alleviate suppliers’ cash situation, while banks seem willing to lend.

The number of credit insurance claims that we received in 2013 was stable compared to 2012, and we expect this trend to continue in 2014. Notified non-payments have been low and, in line with the encouraging results of the manufacturing industry during the first half of 2014, we expect insolvencies in the machine sector to decrease this year. In view of the benign conditions and positive outlook, we have relaxed our underwriting stance, especially for small credit limit applications, although we remain cautious about companies selling to more distressed business sectors. For instance, the machinery industry is also still feeling the effects of poor payment behaviour in the construction sector.

Consequently we continue to carefully monitor the more distressed subsectors:

- Manufacturing of metal structures/boiler making, which has a direct link to the construction sector. We have identified the weakest companies by checking their financial commitments, margins, order books and type of construction, e.g. public works, structural works, residential or non-residential.
- Equipment linked to the construction sector, as the expected drop in construction activity in 2014 will have an impact on sales.

### French machinery/mechanical engineering sector

STRENGTHS	WEAKNESSES
Leadership in some key products	Structural overcapacity in some sectors
Diversity of outlets	High financial needs
Technical knowledge	Competition from emerging markets
Good worldwide position (France is the 6th largest world player)	Dependency on export markets



# Belgium



- **The sector is profiting from the economic rebound**
- **Some subsectors still face difficulties**
- **Insolvencies expected to fall**

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

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

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

Source: Atradius

In 2014 the Belgian economy will grow by 1.3%. That's good news for production in machines/mechanical engineering, as this sector is heavily dependent on the performance of other key industries which are finally rebounding. Real fixed investment in Belgium is expected to increase 3.5% in 2014 and 2.1% in 2015.

**Belgium – gross fixed capital formation (in EUR millions)**



SOURCE: WWW.TRADINGECONOMICS.COM | NATIONAL BANK OF BELGIUM

It's a mixed picture. While machinery businesses linked to, for instance, agriculture are performing well, those specialised in materials technology are still struggling because of falling prices. However, this segment is expected to increase sales and production in 2014 following a drop in 2013. Machinery related to automotive will be affected by the closure of Ford's plant in Genk at the end of 2014.

Belgian machinery/mechanical engineering exporters to the EU still suffer from a lack of competitiveness, as Belgian production costs exceed those of its foreign competitors. The government could help to improve competitiveness by passing laws to lower either labour costs or corporate taxes to relieve companies' financial burden. However, exports to markets outside the EU have seen growth above the EU average, as cost plays a less important role. Belgian machinery producers, notably those in the mechatronics subsector, can still play to their strength, with their reputation for innovation and specialisation in particular niche markets. This will help them to stabilise their turnover as exports to China and the Middle East continue to grow.

The Belgian machinery sector is highly dependent on bank finance, but although interest rates are low, banks are still putting stringent conditions on loans. Under pressure to reduce their own risks, banks are less willing to lend to companies for export projects. As a result, technology companies are now borrowing 40% less to finance their projects than they did in 2008, but this capital intensive sector is still characterised by high indebtedness.

On average, payments in the Belgian machinery/engineering industry take 90 days. Over the past six months we have seen a slight worsening of payment behaviour in the sector but we expect the situation to stabilise in the short term. There is little risk of absolute default as payment is normally made in instalments following a down payment at the order stage.

However, one problem is the high number of insolvencies of machinery customers (the number of Belgian business insolvencies increased 11% in 2013) which has led to an increase in the frequency of credit insurance claims in the machines/mechanical engineering sector. The most concerning sectors are construction, retail and services. Nevertheless, we expect overall business insolvencies in Belgium to level off this year, and machines/mechanical engineering business failures to decrease in the coming six months.

Against this backdrop, our underwriting policy for the machines/mechanical engineering sector remains cautious but supportive, given the recovering trend. Close scrutiny of the buyer’s financial strength is essential. We analyse the very latest full year results, interim accounts and, if the buyer is part of a larger group, the consolidated accounts. Indeed, that group perspective can prove valuable in providing cover as, even if a buyer’s finances appear weak, we can often afford cover based on group support.

For the most sensitive cases, we also may request order books, budgets and the treasury plans, and look closely at stock levels, trade creditors, current debts and their maturity, and cash flow. Of course, our customers can help us build an accurate picture of the buyer through their own trading experience and we also take into account the overall performance of the buyer’s sector.

**Belgian machinery/mechanical engineering sector**

STRENGTHS	WEAKNESSES
Strong export performance of some subsectors	Cost structure higher than European competition
International reputation	Stricter lending conditions
High average size of businesses	Dependence on automotive and construction

**Find out more about protecting your business against payment defaults by your machinery customers in Belgium and other markets around the world [at the Atradius website](#). If you have more specific questions, please [leave a message](#) and a product specialist will call you back.**

# Germany



- **More domestic demand but exports are down**
- **The paper/print and solar related subsectors continue to face problems**
- **Machinery insolvencies are expected to decrease**

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)			☑		

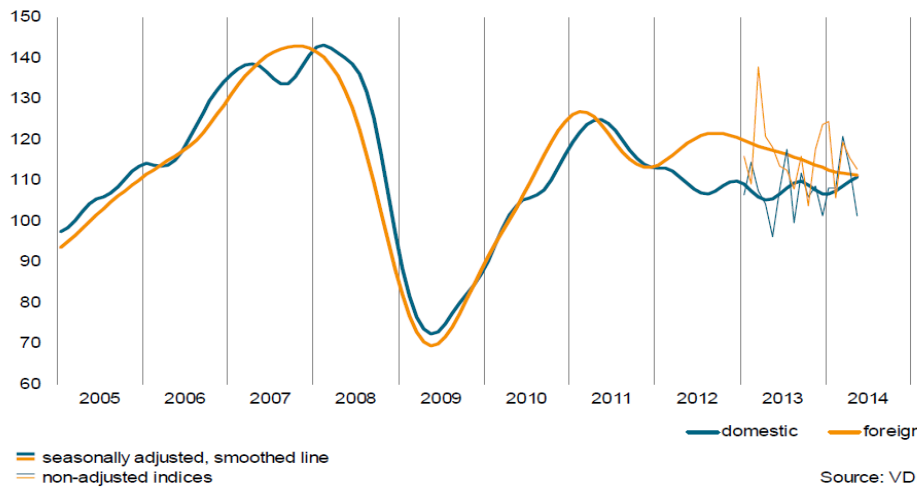
Source: Atradius

While the German machinery/mechanical engineering sector performed well in 2011 and 2012, the sector's production decreased 1% and orders fell in 2013, due mainly to lower domestic and Eurozone demand. According to the German engineering association VDMA, incoming orders decreased 3% year-on-year in the period March-May 2014. Germany's continuing robust economic performance meant that domestic machinery orders increased 9%, but foreign orders decreased 8%. Export volumes decreased 0.9% in Q1 of 2014, although rising exports to the US and EU partly compensated for falling demand from the BRIC countries: especially Russia. Clearly, the Ukraine crisis has hit business with Russia, as it is the 4th largest export market for machines and accounts for 5% of Germany's machine exports. Already decreasing in 2013, exports to Russia decreased 16% year-on-year in January and February this year.



## Incoming orders Mechanical engineering

volume index, turnover 2010=100



Seite 1 • 01.07.2014

However, Germany's machinery performance remains robust despite the difficult economic environment, and German machines/mechanical engineering companies are already well established in long-term growth markets such as China. German machinery businesses generally have little in the way of debt and are therefore not excessively reliant on bank finance. Compared to other German industries, the machinery/engineering sector's payment behaviour and default/insolvency rate is good and, while in 2014 a 2% drop in German business insolvencies is forecast, we expect machinery business failures to decrease even more: by 5%.

Our underwriting approach remains generally relaxed and our exposure to this sector is increasing. We still need to see financial data such as balance sheets, quarterly reports, forecasts and bank commitment when assessing the creditworthiness of buyers in the sector and will sometimes recommend that our clients impose retention of title or other forms of security. That said, caution is advised with machinery businesses involved in the troubled solar-related and paper/print subsectors. Problems in the paper/print segment are structural, as society in general becomes more and more 'digital'. This shift has resulted in shrinking profit margins, and many companies are still restructuring to adjust their production to customer needs.

### German machinery/mechanical engineering sector

STRENGTHS	WEAKNESSES
Comfortable equity position	Subsector print/paper related machines
Low indebtedness	Lack of flexibility
Well established in new markets	

## Czech Republic



- **Production growth on the rise**
- **Less pressure on prices**
- **Suppliers to construction still face longer payment delays**

The Czech machines/engineering industry will profit from the rebound of the Czech economy after its contraction in 2011 and 2012. Economic growth is expected to increase by 2.5% in 2014 and as much as 2.8% in 2015, with investment up 4.6% and 4.1% respectively. The automotive industry, as the main customer for machines, has seen a 17% increase in production between January and May this year. Exports have improved and this will clearly help the very export-oriented Czech machinery sector. So far in 2014, machinery production has grown by between 5% and 10% and new orders have increased significantly.

Throughout 2013 and so far this year, profit margins have remained more or less stable, although there was some pressure on prices last year. However, to improve Czech competitiveness and boost exports, in November 2013 the Central Bank intervened in the currency market by buying euros to weaken the koruna against the euro. This has led to lower price pressure for the machinery sector and should help exporters in the medium term. However, those businesses dependent on imported materials are feeling the negative impact of the koruna's depreciation.

Machinery companies' equity is above the average of all manufacturing sectors. Because Czech banks are quite conservative, few machinery companies are highly leveraged. While dependence on bank finance is average, banks are positive about the sector in general, providing enough liquidity. However, companies with debts in foreign currencies have borne the brunt of foreign exchange volatility.

Payments in the Czech machinery sector take around 40 days, with 'days sales outstanding' (DSO) for smaller businesses of about 50 days. However, machinery businesses focused mainly on the construction sector are still experiencing high DSO and weak liquidity in that market.

We have seen a decrease in the number of notifications of non-payment and credit insurance claims in the sector over the past six months but, compared to other Czech industries, this sector's default/insolvency rate is still good. We expect machinery insolvencies to decrease in the coming six months. As a result, our underwriting approach to the sector is relatively open. When asked by a client in this sector to assess a buyer's creditworthiness, we look at our client's own trading experience with the buyer, check the buyer's key financial figures, distribution of receivables, creditors and stocks to ensure that they are within an acceptable range. However, we still pay extra attention to those machinery companies dependent on the construction industry.

# United Kingdom



- **Rebound based on growth in construction and automotive sectors**
- **Financing conditions still an issue**
- **Machinery insolvencies expected to decrease by more than 3% in 2014**

The situation of the British machinery sector has improved since last year, thanks to the rebound in certain key buyer sectors. In Q1 of 2014 output in construction increased 0.6% compared to Q4 2013, and 5.4% year-on-year. This has helped increase demand for machinery across the sector, as companies who have perhaps delayed their capital spending so far are now ordering new machinery to cope with the upturn. Automotive, another key buyer sector for machinery, is also experiencing an upturn, with new car registrations in June 2014 up 6.2% year-on-year, to 228,291 units. This market has seen continuous growth for the past 12 months and, while this may slow in the coming months, expectations are that manufacturers will continue to offer tempting finance deals to attract customers.

We expect the robust growth forecast for the UK economy - 2.4% in 2014 and 2.7% in 2015 - to be reflected in the performance of the machinery sector. The strength of the pound, increasing levels of production and order books swollen by a further upswing in demand from both domestic and overseas clients bode well for the industry. In addition, job creation in the sector has accelerated to its highest level in over three years and the boost in demand has led to improved profit margins.

However, financing is still an issue for UK businesses - particularly those that may have reduced or delayed capital spending in the downturn. While it may now be vital for a business to update or replace its machinery to take advantage of an improving market, obtaining the necessary bank financing can still prove difficult.

The machinery sector's payment behaviour has been good over the last 12 months and we expect fewer notifications of non-payment in the coming six months. Due to the diverse range of applications of machinery into many customer sectors, we believe that insolvencies should be reasonably stable and better than the forecast national average for overall business insolvencies, i.e. we expect machinery insolvencies to decrease by more than 3% in 2014.

Because the industry is diversified into many sub-sectors and buyers, we underwrite trading risk pretty much on a case by case basis, although our in-depth knowledge of the industry does mean that we can produce an overall strategy for each sub-sector.

Now that the economy is improving, we generally expect businesses that have survived the downturn to begin to prosper. Market information suggests that both volumes and margins are improving and this will be taken into account when underwriting businesses in this sector.

## Denmark



- **Increased orders from wind turbine customers**
- **Agricultural machinery still faces troubles**
- **Insolvencies expected to decrease by 10% in 2014**

The Danish machinery sector was severely affected by the global financial crisis because of its export orientation and the fact that most businesses in the sector are SMEs supplying components. Those most exposed to risks were companies dependent on just a few end customers in troubled industries and/or on project oriented sales with uneven turnover, while burdened by capital intensive production.

After years of cost cutting, scaling back on activities and results 'in the red' the situation began to stabilise in 2012, and orders and turnover generally increased again in 2013. However, for many businesses, profit margins and liquidity are still under pressure despite recent signs of improvement.

Within the Danish machinery sector the wind turbine segment is very important: with their many years of experience, Danish companies have achieved a competitive advantage in this particular industry. Denmark has many SMEs along the whole value chain supplying the large turbine manufacturers - both on-shore and off-shore – and those suppliers are currently enjoying increasing orders. However, they are also heavily dependent on global growth potential. To be able to compete in their most important overseas markets (China, India, and USA) or even just to have a presence there, they face demand for longer payment terms. Except for the off-shore segment, conditions for the wind turbine industry will become more difficult in the coming years and many suppliers will have to re-think their business model if they are to survive in the long run.

Manufacturers/sellers of agricultural machinery and parts belong to a higher risk category, as investments made by agro/farmland customers have been on low since 2008 because of a lack of financing and high indebtedness. Only recently have Nordic farmers begun to invest again but banks remain reluctant to support the agro-industry.

On average, payments in the machines industry take 90-120 days. Machinery business insolvencies decreased last year and we expect a further 10% decrease this year, in line with our forecast for overall Danish business insolvencies. However, despite recent signs of improvement, our underwriting stance remains quite cautious, especially for very small businesses in the so-called 'Maskinfabrikker' engineering segment, where competition from low-cost countries is very high. We are more relaxed with suppliers to the wind turbine industry, due to the improved order situation and increased demand from wind turbine manufacturers located in Denmark and Germany.



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