crédito y caución
Atradius Group

market monitor

Focus on consumer durables retail - current performance and outlook

March 2012

In this issue…

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

Excellent **Good** **Fair** **Poor** **Bleak**

Still open for business?

In many countries, the retail industry - especially that part of the sector dealing in consumer durables like kitchen white goods, furniture, electronic entertainment and communications - is in trouble.

As this edition of Market Monitor shows, across Europe the consumer durables retail sector is grappling with the toxic combination of higher costs, lower margins, and ferocious competition for dwindling consumer demand. There is now also a real danger of rising inflation adding to the pressure on consumers and retailers alike. Our report on Ireland sums up the core problems succinctly*: 'Unemployment remains high… and the government's austerity measures are limiting disposable incomes… putting pressure on retailers and consumers alike'.*

It's the same story in Spain, with high unemployment, falling disposable income, austerity measures and a reluctance of banks to grant loans. As our report on the Netherlands notes, the fate of some facets of the industry is linked closely to that of the housing market, while our report on France makes the point that even success stories, like that of the tablet computer, erode market share for PCs and thus for those retailers focused on that segment. Competition from online sales also challenges the traditional high street – a signal for retailers to adapt their strategies.

There are some exceptions to the gloomy trend. Unsurprisingly, of all the European markets that we review, demand for consumer durables in Germany is showing healthy growth. And, in the US, a rebound of existing home sales could stimulate the sale of household appliances and furniture. However, in both markets persistently higher inflation driven by rising energy prices could dissuade consumers from purchasing durable goods.

Brazil is confirming its status as a leading emerging market, as all its consumer durables indicators register robust growth, reflecting the country's overall economic performance and rising household incomes – and that could also spell good news for foreign exporters targeting Brazil.

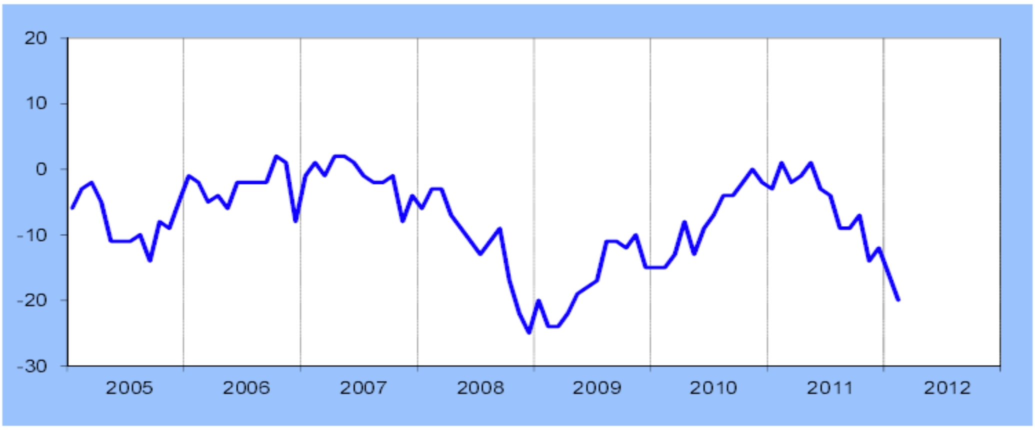
Back to contents page

Belgium

Turnover expected to decrease in 2012

Belgium's economic activity is again slowing down. After a 1.9% year-on-year GDP growth in 2011, in early March 2012 the National Bank of Belgium forecast contraction of 0.1% in 2012. Private consumption is expected to decrease 0.2% this year after 0.8% growth in 2011. Belgian households are affected by weakening purchasing power (down 3% since 2009), with unemployment rising and wage increases failing to keep pace with inflation. This is also reflected in consumer confidence, which in February 2012 fell to its lowest level since April 2009 (see chart below) as consumers' concerns, about unemployment and the general economic climate, heighten.

CONSUMER CONFIDENCE INDICATOR



Expectations for the next twelve months

Source: National Bank of Belgium

This development does not bode well for the consumer durables retail sector, which is facing a significant decrease in turnover. To date, the sector's equity strength is satisfactory, apart from that of the typically weaker wholesalers. Solvency strength is also good, in general, but pressure on profit margins is mounting as retailers have to increase sales volumes to compensate for decreasing prices. In the domestic appliances subsectors in particular, smaller and independent retailers face tough competition from the larger players, which adds additional pressure on their margins.

Belgian business insolvencies will increase in 2012

On average, payments in the consumer durables retail industry take around 50 days, with about 80% of invoices paid on due date. In the wholesale subsector payments take, on average, 70 days, with only 70% of invoices paid on due date. The deteriorating economic situation has had a negative impact on the payment behaviour of consumer durables retailers in the recent past, and we expect this trend to continue in the coming months. We have seen a significant increase in credit insurance claims from this sector in the last six months, with retail much riskier than furniture and domestic appliances manufacturers. We expect insolvencies to increase in 2012, with retail sales (food and non-food), according to IHS Global Insight, forecast to fall 2.3% after a 2.0% decline in 2011. Overall, we expect Belgian business insolvencies to increase 5% this year after 2011's 6.8% rise.

Against this backdrop, our underwriting stance for the consumer durables retail sector is cautious. With economic activity slowing, businesses may face cash tensions unless their stock management is efficient. Household appliances retail is the most sensitive subsector, as in general are independent and/or smaller retail stores whose financial structure is more vulnerable during an economic downturn.

Our underwriters seek more interim figures from, and regularly visit, those companies in the sector identified as particularly sensitive. Our focus is on cash flow, net cash position, and terms of payment - especially with newly established and smaller retailers.

Belgian consumer durables retail sector

STRENGTHS	WEAKNESSES
Consolidation with larger groups emerging	The first sector impacted by the decrease of household consumption
Good capitalisation	Pressure on prices and margins

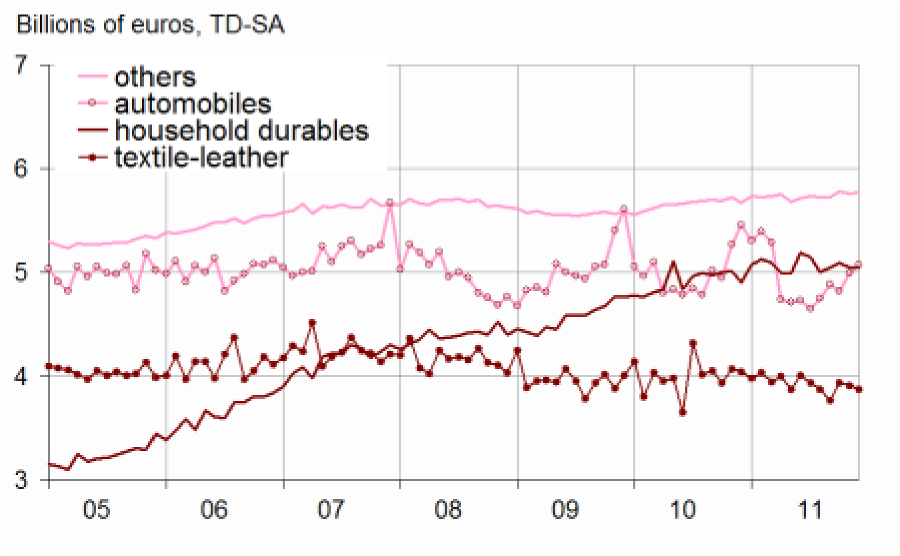
Back to contents page

France

Low private consumption continues to hit performance

According to the Statistical Office INSEE, in the last quarter of 2011 French household consumption expenditure increased 0.2%, after a rise of 0.3% in the previous quarter. In the same period household consumption of durable goods increased 4.2% on the previous quarter. However, excluding car sales, household durables consumption then levelled off, as Christmas sales could not counter the overall downward trend in retail in an increasingly pessimistic private consumption environment. In January 2012, consumer durables consumption decreased 1.5% on the previous month.

Household consumption of goods



Source: INSEE

Generally, those in the consumer durables sector are posting tiny margins - with operating margins often below 5% - and competition is tough in each subsector. In terms of equity strength, retail and furniture usually perform well, while wholesalers are generally weaker. On average, in the household appliances industry, non-current fixed assets account for 40% of total fixed assets. As for solvency and liquidity, each subsector has its own credit cycle and consequently liquidity differs significantly from subsector to subsector. Wholesalers hold a controlled amount of stock but have limited cash positions, while stores structurally have negative working capital requirements thanks to payments in cash. However, it is often the case that furniture buyers hold heavy amounts of stock.

With low added-value generating small margins, many retailers and wholesalers have to maintain high sales volumes to remain profitable. Thanks to healthy levels of private consumption in 2010 (+1.3% year-on-year) this strategy proved successful at that time. However, household consumption growth slowed in 2011, to 0.3%, and French consumers appear to be more pessimistic than their European neighbours, paying close attention to the rising unemployment rate (10% in January 2012) and consumer price inflation (up 2.3% in February 2012, due mainly to higher energy prices).

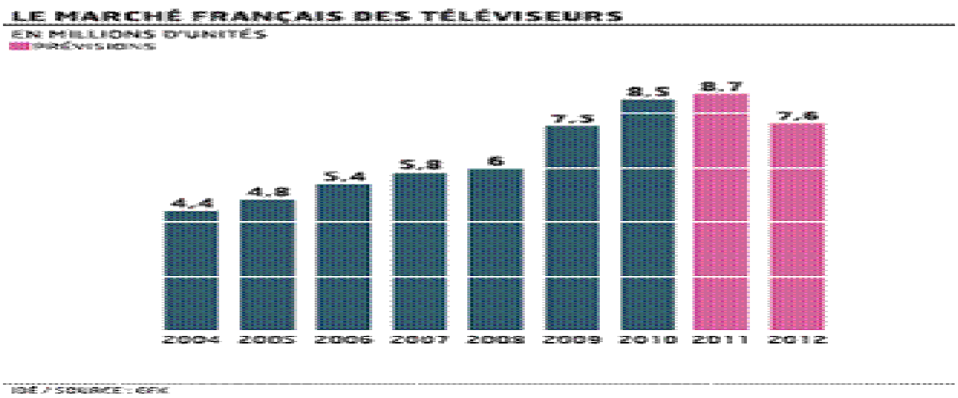
French consumer confidence

Source: INSEE

Consumer durables sales have been directly affected by this adverse sentiment, and this year consumer durables retail will be hampered by zero economic growth and the very low increase in private consumption (0.2% according to Consensus Economics' March forecast). While this affects the entire consumer durables retail sector, individual subsectors have shown variations in performances over the past year and will continue to do so in 2012.

According to GFK, consumer electronics sales decreased 4.7% year-on-year in 2011, after modest growth in 2010, with a steeper decrease observed in the second half of the year - and especially in the last quarter. The trends observed in 2010 continued into 2011, as tablet and PC sales largely supported the market (+5%) while TV sales rose only slightly and are expected to decrease in 2012 (see chart below). Other brown goods, like video games and music or DVD related goods, are also likely to face challenging times as long as the economic situation remains uncertain.

French television sales



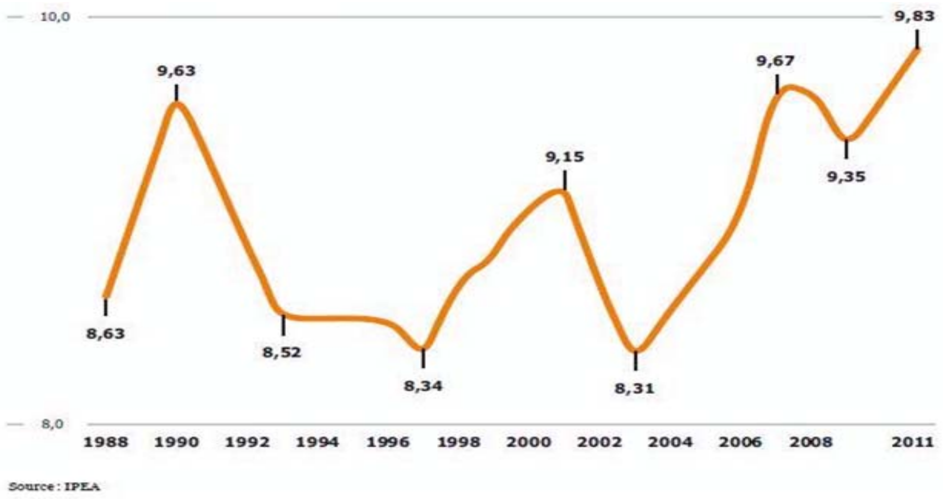
Source: GfK-Gifam; Les Echos

Tablet and PC sales have supported the market for several years now, but whether that will remain the case is questionable. For the moment, growth is still strong but largely dependent on innovation. Moreover, tablets are progressively eating away PCs market share and so, while the high range product segments will continue to perform satisfactorily, sales values of lower priced PC goods could come under pressure: a problem for those sellers focused on this segment with extremely narrow margins and especially those who don't manage their working capital requirements efficiently.

White goods sales grew 1% in 2011, after 1.5% in 2010, confirming that this subsector is structurally less volatile than brown goods. Small appliances still constitute a very dynamic market, and one that benefited from 3.3% growth in volume and 2.3% in value in 2011. That segment's performance will remain stable in 2012.

The furniture market achieved record sales in 2011, reaching EUR 9.83 billion (see chart below). Kitchen equipment and related products were the main drivers of this upswing, with specialist businesses outperforming generalists (+3% sales growth against -1%). In this segment, consumers´ buying patterns are expected to remain stable in 2012.

Furniture sales in France (EUR billion)



Source: IPEA

Online shopping is becoming the biggest long-term challenge to 'brick and mortar' retailers. According to the Banque de France, in 2011 the number of French people shopping online increased 11% year-on-year, with spending up 22% to EUR 37.7 billion. Online sellers benefited from the Christmas period with turnover increasing from EUR 6.3 billion in 2010 to 7.6 billion in 2011.

Payment delays and insolvencies continue to rise

We have seen a general increase in payment delays in the course of 2011, with days sales outstanding (DSO) of around 30 in the electronics, computing and other appliances subsectors: above the manufacturing industry average. Additionally, towards the end of 2011, more consumer durables retailers faced cash tensions as they bought in large amounts of goods in anticipation of Christmas demand, some of which remained unsold but still had to be financed.

Many used their maximum credit facilities, and sometimes delayed payments to suppliers to ease their cash positions, resulting in a significant increase in payment delays and payment plan requests during the Christmas period. Consequently, the coming months will be critical as some retailers are at their weakest cash point.

We have received a rising number of credit insurance claims from the consumer durables sector since the beginning of the year and, indeed, since the autumn of 2011 the frequency and intensity have been increasing. Those mainly affected are retailers dealing extensively in the electronics/brown goods segment and we foresee this high level of claims continuing in the coming months. Many of these claims relate to small buyers, while wholesalers are also at high risk because of the problems caused by their mounting unsold stocks. Even some businesses whose performance was satisfactory in 2010 have gone bankrupt in the last couple of months, as a result of their rapid financial deterioration, especially in the second half of 2011: an indication of how quickly cash shortfalls can emerge.

We expect consumer durables retail insolvencies to increase further in 2012, along with a general increase in French business insolvencies (up by 5% year-on-year). In view of the growing economic uncertainties and lower consumer spending, businesses' liquidity and solvency may worsen, fuelled by banks which are reducing unused cash facilities and are reluctant to provide new loans. Those mainly at risk are small consumer durables businesses which are poorly capitalised and already weakened by the 2009 crisis, while major businesses generally are better able to adapt their cost structures and stocks to market changes. The electronics/brown goods subsector will remain most at risk, due to the weak performance forecast. As specialist businesses selling only a specific product range (furniture, PC, small appliances, white or brown goods) are quite rare in France (except for a few big players) and most businesses sell a wide range of consumer durables, their product-mix will be decisive for their resilience in 2012. Size also matters: the smaller the company, the more vulnerable it will be. The keys to success for a business in consumer durables are flexibility in the choice of goods sold, responsiveness to market price evolution, and the maintenance of a strict stock management policy.

Since the beginning of 2011, our underwriting approach to all consumer durables subsectors has been, and remains, cautious. We anticipate risks as soon as possible by collecting financial data on the weakest companies: those facing decreasing market volumes and volatile economic conditions. We recently reviewed a large number of companies involved in this sector based on specified risk indicators - updating information and adjusting underwriting strategies accordingly.

French consumer durables retail sector

STRENGTHS	WEAKNESSES
Innovation can fuel demand	Poor consumer confidence and inflation could weaken demand
Buyers are used to adapting their stocks during hard times	Bank lending may decline with stock market fluctuations
Mature and locally established businesses are often well capitalised and can absorb a short recession	Price wars and deflating prices of goods are putting pressure on turnover and margins

Back to contents page

Germany

Further growth in 2012 - but slower than in 2011

The German retail federation HDE reported nominal turnover growth of 2.4% in 2011 (1.8% in 2010) for the retail sector (excluding car retail, filling stations and pharmacies), and price-adjusted sales increased 1.2%. The German Statistics Office recorded a real growth of 1.6% in the non-food retail sector for the same period. This good performance was a product of Germany's economic growth of 3.1% and the upswing in private consumption (up 1.5% in 2011 compared to just 0.6% in 2009).

The furniture retail subsector saw an increase in turnover of 2.5% last year, after a 1% increase in 2010. The 20 largest furniture retailers hold around 50% of market share, and this percentage is growing as the trend of consolidation progresses. That leaves small and medium-sized enterprises struggling to compete with the fast growing market leaders, while furniture manufacturers are finding it hard to pass on rising commodity prices to the retailers, who are organised in powerful purchasing syndicates.

According to the German Electrical and Electronic Manufacturers´ Association ZVEI, domestic sales of household appliances rose 3.5% in 2011 (2% in 2010), to EUR 12 billion. Turnover in major appliances (white goods such as washing machines and refrigerators) rose 4% last year (2% in 2010), while turnover in small appliances increased 3% (4% in 2011). Overall, the ZVEI expects domestic sales of household appliances to increase 1-2% in 2012.

According to the German Association for consumer electronics, gfu, sales in that segment increased 4.5% in 2011, to EUR 18.3 billion. This was driven mainly by smart phone sales, which rose 126%: from EUR 1.5 billion in 2010 to EUR 3.4 billion in 2011. However, mobile phone sales decreased 52%: from EUR 1.2 billion to EUR 0.6 billion. Having been a driver of growth in the past, the TV-segment had to bear a decrease in turnover of 7.3% to EUR 4.1 billion. The gfu expects overall domestic sales to increase 4% in 2012, with continuing high demand for smart phones and tablet PCs. Demand for digital satellite/set top boxes will also rise as, at the end of April, the analogue satellite programme will be switched off in Germany. Another positive factor will be the UEFA European Football Championship and the Olympic Games in London in the summer of 2012.

As everywhere in retail, size matters in this subsector, and the best way for small retailers to survive in this highly competitive market is by joining one of the big purchasing groups.

No increase in insolvencies

The concerns expressed in our last Market Monitor analysis in October 2011 - that the payment behaviour in this sector could deteriorate towards the end of the year as the Eurozone's troubles affect German businesses - have not materialised. On the contrary, the improvement in payment behaviour seen throughout the first nine months of 2011 continued in Q4, with most businesses paying their bills on time.

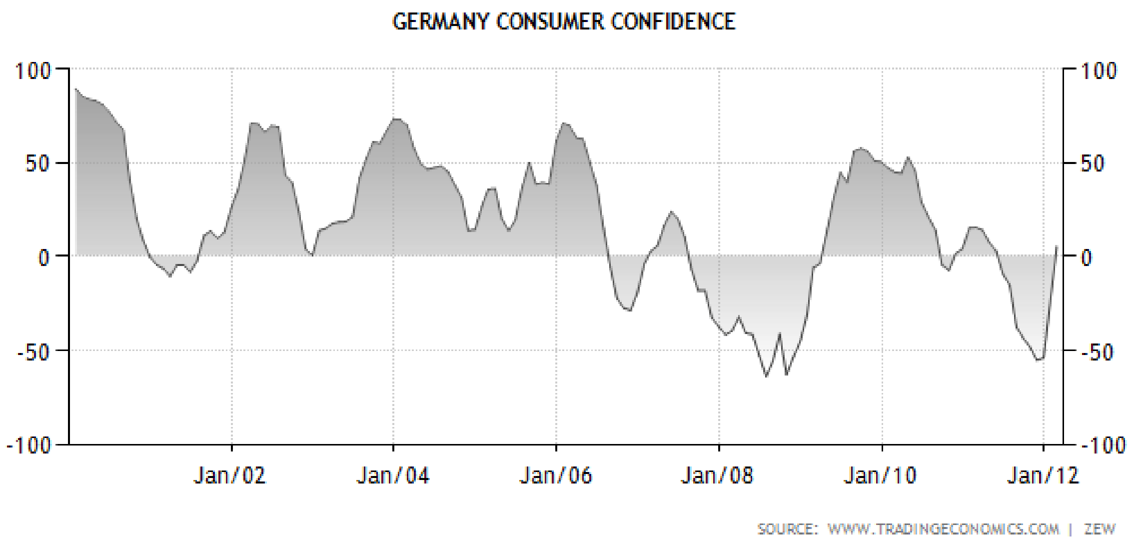
According to the March 2012 forecast by Consensus Economics, economic growth (0.6%) and private consumption (1.0%) will slow down compared to 2011, but will remain positive: reflecting Germany's economic resilience. Overall, the retail federation HDE expects sales of consumer durables to remain quite stable in 2012, and forecast nominal growth of 1.5% in 2012 (0.5% price-adjusted).

Business Situation and Expectations

February 2012; balances, seasonally adjusted

Source: Ifo business survey

German consumer confidence has recently begun to pick up again (see chart below).



However, two factors in particular could negatively affect consumers´ sentiment and behaviour: a serious deterioration of the Eurozone crisis and higher inflation. In February 2012, consumer prices increased 2.3% year-on-year (2.1% in January) due to higher energy/fuel prices (triggered by the Iran nuclear conflict, a lower euro exchange rate against the US$ and steady demand from emerging markets). Persistently higher energy prices would not only hurt consumption of consumer durables, but also hit retailers in the form of higher overheads and producers trying to pass on price increases. Early March 2012 the European Central Bank revised its 2012 inflation expectations in the Eurozone upwards, to 2.4%.

Provided that these risks do not materialise, we expect consumer durables retail to develop satisfactorily and payment behaviour to remain very positive in early 2012. In the first half of 2011 we saw a substantial year-on-year decrease in credit insurance claims from the consumer durables sector, with no significant change in the second half of the year, thanks to good payment behaviour and economic growth. We expect this to remain the case over the next couple of months. Likewise, business insolvencies in the consumer durables retail sector will probably not rise, due to the modestly positive business outlook for the sector.

Across all its subsectors, we still view consumer durables as a medium-risk sector. We maintain close contact with buyers, with whom we have built good relationships over recent years. Generally, our emphasis is on inspecting annual results shortly after completion. If we are to cover larger exposures, we require more detailed financial information, e.g. interim reports and the latest budget figures, and we pay closer attention to any buyer who appears to be getting into financial difficulties. We do not cover newly established firms during their first year of business, unless they are members of a well known group or have spun off from an established company.

German consumer durables retail 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

Back to contents page

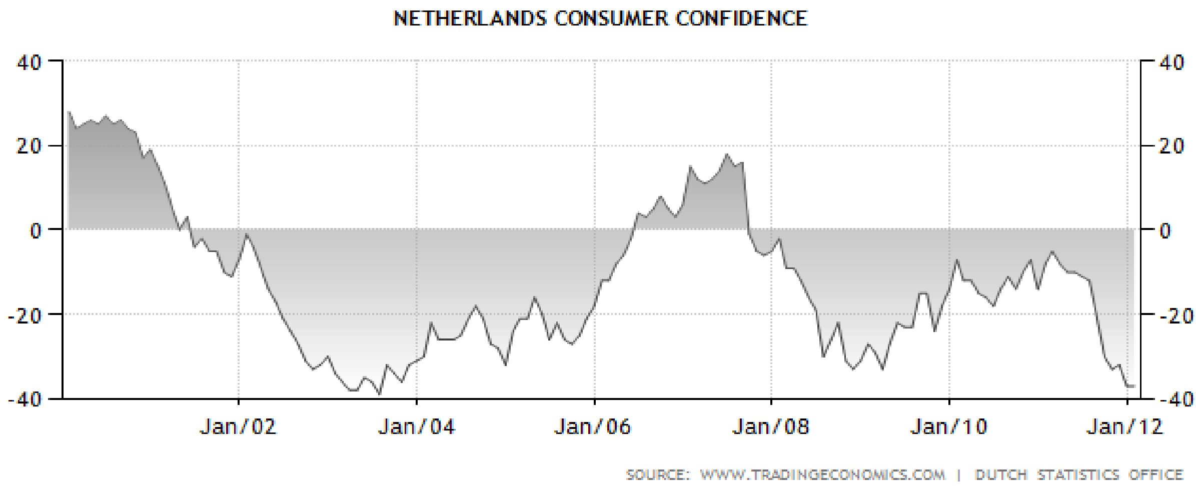
The Netherlands

The Dutch economy is in recession

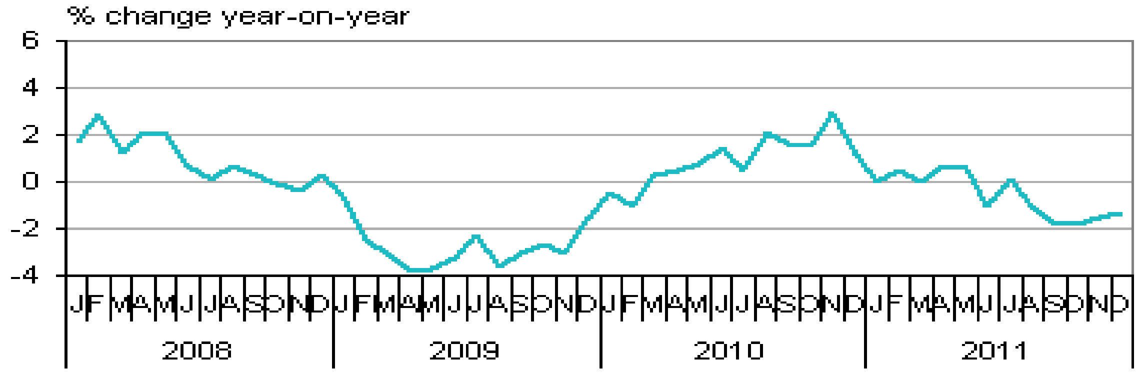
The performance of the Dutch economy is rapidly declining - and worse than neighbouring countries like Germany. According to the National Statistics Office CBS, the Netherlands has officially entered recession, after 2 consecutive quarters of GDP contraction: in Q3 of 2011 GDP shrank 0.4% on the previous quarter and in Q4 by 0.7%. This contraction results mainly from a significant decline in consumer spending – down 1.8% in Q4 of 2011 - and so far the Dutch government has been unable to successfully counteract this weak economic performance. It needs to cut public spending significantly over coming years to meet EU budget deficit regulations and, in addition to the already announced cutbacks of EUR 18 billion, analysts now predict that the Netherlands will have to cut another EUR 16-19 billions to meet the EU's targets.

According to Consensus Economics' March 2012 forecast, the Dutch economy will shrink 0.7% this year, with private consumption expected to decrease further (-0.8% year-on-year in 2012 after -0.9% in 2011). The only positive aspect is that unemployment is still quite low - 6% in January compared to the European average of more than 10% - and is expected to increase only slightly this year.

Given this current economic environment, it comes as no surprise that Dutch consumer confidence is at a very low level (see chart below). The economic trend is one of deterioration, and the negative sentiment, pessimistic economic news and expectations of further austerity measures mean that it is highly unlikely that households' confidence will improve in the near future. It is very noticeable that, since the second half of 2011, Dutch consumers have been saving much more and postponing expensive purchases.



Domestic household consumption (volume, adjusted for shopping-days)



In our last July 2011 Market Monitor analysis of the Dutch consumer durables retail sector, we have already observed that, despite better performance and more positive growth forecasts, this sector was in difficulty due to pressure on margins from higher costs and the declining purchasing power of consumers. It is now evident that those troubles are increasing. According to CBS, household consumption of consumer durables decreased 0.8% year-on-year in 2011, with a downward trend in Q3 of 2011 (-2.9%) and Q4 (-2.5%) that does not bode well for the future. According to Eurostat inflation was at 2.7% in February 2011, above the Eurozone level. Higher prices for energy (up 7.8%) year-on-year are also an impediment to more consumer spending on durable goods.

Dutch retail sales

	2011	% change 2011	% change 2012
Total turnover retail trade NL (EUR billion)^	80.2	0.0%	0.4%
Food	36.5	0.8%	0.6%
Groceries	31.9	1.5%	1.0%
Specialist food stores	4.6	-3.5%	-2.0%
Non-food	43.7	-0.6%	0.2%
Clothing and textiles*	9.5	-1.5%	-2.0%
Shoes	2.0	1.5%	-0.5%
Furniture	7.6	0.0%	-1.5%
DIY	4.5	0.0%	-1.5%
Electronics	5.1	-2.0%	-2.0%
Personal care **	4.2	0.5%	-0.5%

^excluding cars and petrol stations

*incl. textile supermarkets and fashion stores ** drugstores and perfumeries

Sources: ABN AMRO, CBS, HBD, GfK, ING

Overview by segment: current pressure on margins may increase

Overall turnover in the **textiles and clothing** segment in 2011 decreased 1.5% (see chart on previous page) despite forecasts in May 2011 that it would grow by 1% in 2011 and 2% in 2012. The sector witnessed increasing average selling prices, but poorer sales. Q3 of 2011 in particular was disappointing, with a 3.6% decrease in sales volumes: the result of the relative warm start to the autumn season and adverse consumer sentiment. At the same time, higher production costs, caused by the appreciation of the Yuan and wage increases in China, continued to have a negative effect on selling prices. Although price increases were partially passed on to consumers, they still had a negative impact on margins. Total retail turnover in this subsector is expected to decrease further in 2012: by 2.0%. Online sales have, however, increased, as almost all retail chains have opened shopping websites that are gaining in importance and popularity. According to the Dutch Trade organization for Retail ('HBD') and the trade organization for internet shops ('Thuiswinkel.org'), online sales of clothing and shoes reached EUR 300 million in the first half of 2011, compared to EUR 270 million a year earlier. As the second half of the year usually contributes to the majority of total sales, we expect total online sales in 2011 to be considerably higher than in 2010.

Unlike the textile and clothing segment, the performance of the **footwear** sector in 2011 was satisfactory. First half results were positive and, overall, the sector grew by 1.5% in 2011. However, in 2012 a slight decline of 0.5% in total sales is expected (compared to the May 2011 forecast: +2%).

The **furniture** segment has performed quite poorly for some years. However, in 2011 this subsector profited to some extent from fiscal measures (decrease of transfer tax) that led to a temporary increase in house sales. In 2012, as house sales are not expected to recover, furniture sales are forecast to fall again.

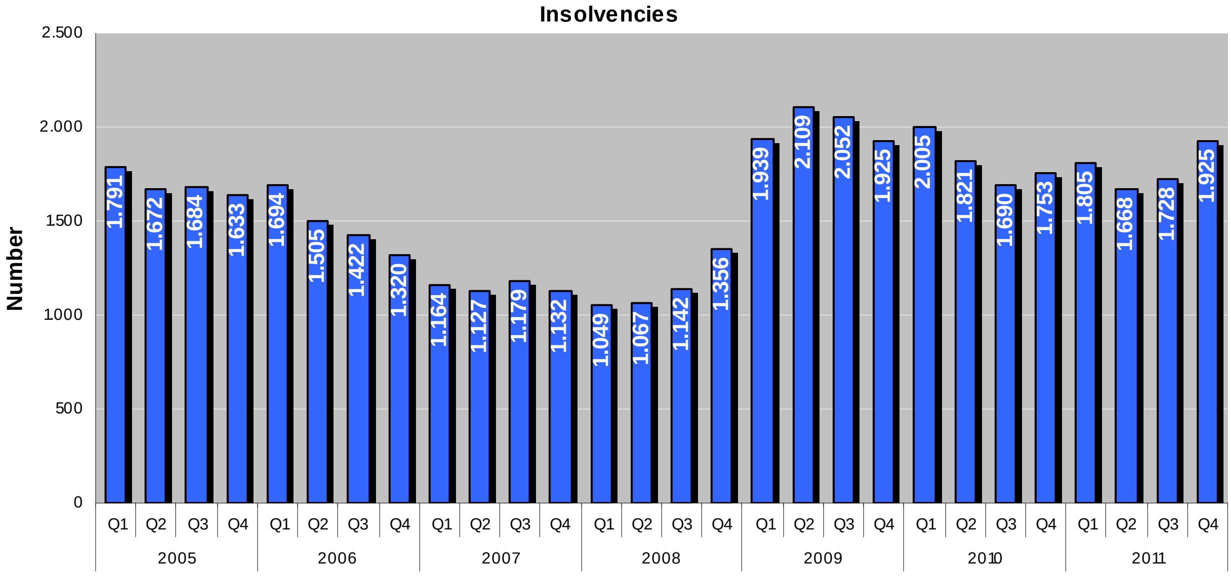
Do-it-yourself stores (DIY) are closely linked to the performance of the housing market and the economy. Following a slight increase in sales in the first half of 2011, the sector has witnessed a sharp decrease in sales since last summer. In 2012, a 1.5% decrease in sales is expected.

Electronics is a market still characterized by consolidation, innovation, fierce competition (discounters) and high market transparency. This segment saw sales rise by 0.3% in 2010, but decline by 2.0% in 2011. With ongoing pressure on prices, the sector can only realise an increase in profits by pushing up sales. Consequently, margins in the sector are decreasing. Other important trends in the sector include the immense popularity of the tablet (which is seriously harming the laptop market), the unexpected lack of success of the 3D market and the further shift to online sales. In view of the poor consumer confidence and expected lower consumer spending, 2012 will be an extremely difficult year for this subsector. Turnover is likely to decrease, by 2%, (compared to May 2011's expectations of 1.5% growth in 2012) and only the European Football Championships and Olympic Games can be expected to have some positive effect on sales.

More business insolvencies in 2012

In the main, most retail trade consists of small and medium-sized enterprises (SMEs). Solvency is on average 21%, which is reasonable although low compared to other sectors. Liquidity is mainly down to higher stocks while cash is locked up and may therefore weaken as unsold stock becomes obsolete. Compared to other industries, the sales process is rapid. That means that debtor and creditor days are generally low, payments are made on a cash rather than a credit basis and the frequency of stock turnaround is high. In view of the economic uncertainties (falling demand, lower consumer expenditure) liquidity and solvency may deteriorate again.

Dutch business insolvencies



Source:CBS

The overall number of insolvencies in the Netherlands in 2011 was more or less the same as in 2010. In the retail sector, we actually saw a slight decrease of 3%. However, the trend (both in general and for the consumer durables retail sector) is negative, as the number of insolvencies increased again in the second half of 2011 (see chart above). We expect business insolvencies in the Netherlands to increase by 5% in 2012.

With very low consumer confidence and an expected drop in consumer spending in 2012, this will be a difficult year for the sector as a whole. Margins are increasingly under pressure, which could lead to liquidity problems. Therefore, we will continue to closely monitor the progress of companies in this sector and we will be very cautious in our underwriting policy, especially in the segments most affected (DIY, furniture and electronics). The same goes for newly established businesses throughout all subsectors.

Thanks to our good relationships with many well-known suppliers as Atradius customers, we often have access to additional information - and buyers are more willing to share preliminary information with us. This is valuable for our underwriting process and helps us to maintain a satisfactory level of cover.

Dutch consumer durables retail sector

STRENGTHS	WEAKNESSES
In general, the sector is still liquid and solvent and companies are able to absorb setbacks	Consumer confidence is at a very low level
Companies active in e-commerce will benefit from the further shift to online sales	The Dutch economy is in recession and GDP is expected to contract in 2012. Recovery is not expected until 2013
Larger companies: order portfolios are still reasonably well filled / diversified activities	Strong competition and pressure on margins

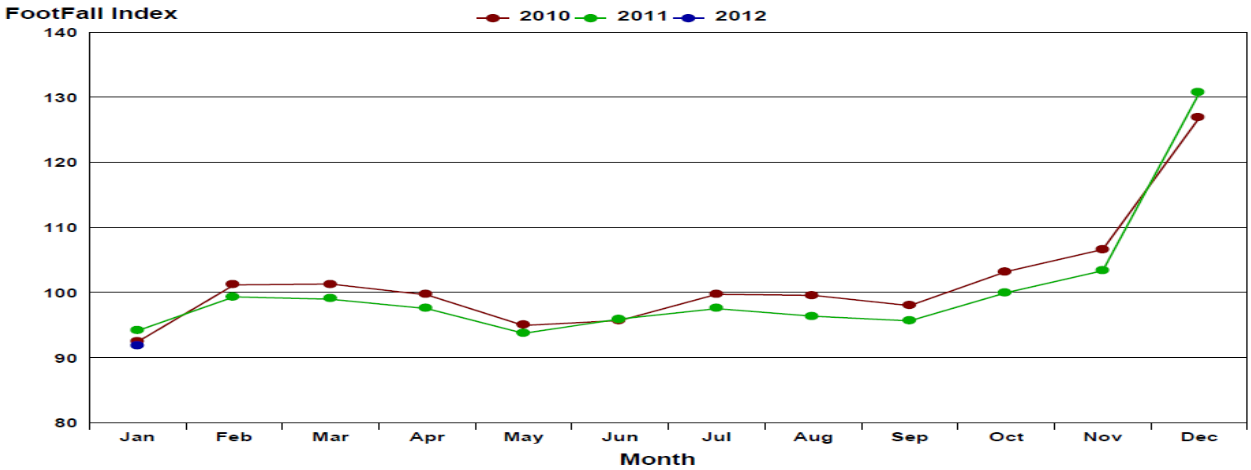
Back to contents page

United Kingdom

After a drop in 2010, insolvencies are rising again

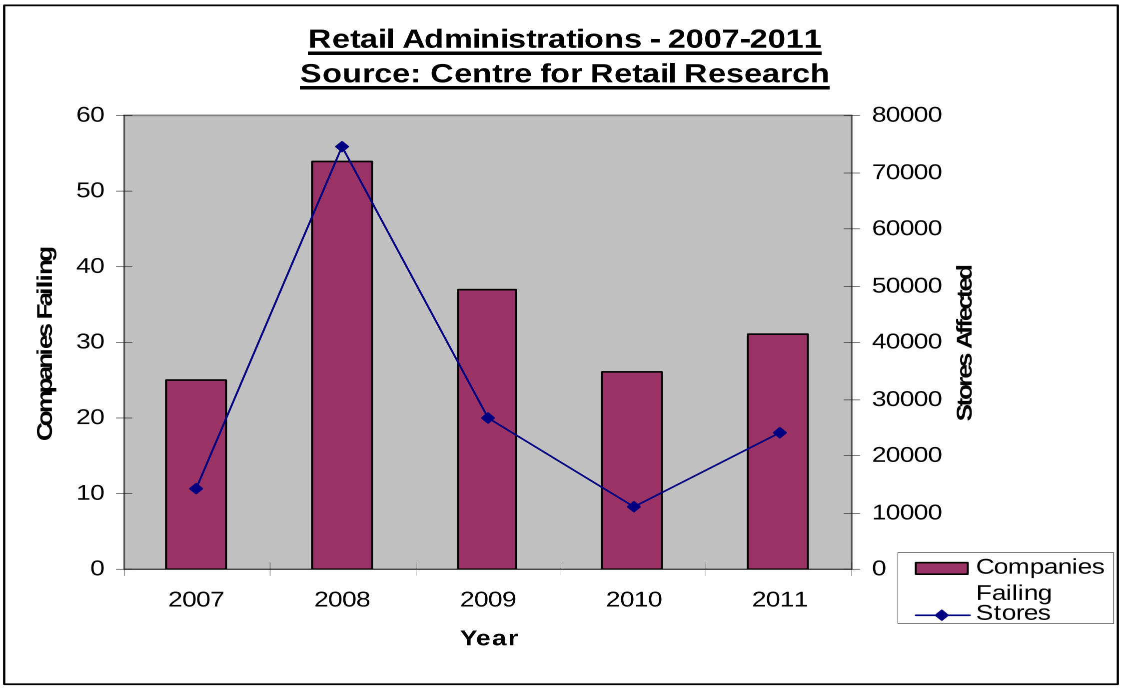
When we last reviewed this sector, in the July 2011 Market Monitor, we raised concerns that the impact of reduced competition – from which the sector had benefited since the insolvencies of 2008/9 had led to a marked reduction in capacity - was beginning to diminish. Those concerns have proved to be well founded: notably in the last quarter of 2011, when we saw many high profile insolvencies, including Barratts (shoes); Peacocks (clothing) and Blacks (outdoor clothing). In fact, no subsector has been immune and, while there have been few failures in domestic appliances, the sale of consumer electronics retailer Comet by electrical retailing group Kesa for £1 is clear evidence of the trading difficulties within this sector.

While each of last year's insolvencies had their own idiosyncrasies, most shared the same trading characteristics. 2011 was a year of ever-increasing competition across all subsectors and, in an effort to protect footfall levels and revenues, sustained price discounting was commonplace. As the graph below shows, while this discounting continued throughout the year, it did little to encourage footfall and consistently tracked behind 2010.



Source: Experian

Logic dictates that, when businesses generate lower levels of revenue and reduced profit margins because of price discounting, they will eventually experience difficulties in their bottom line profitability. The problem that those businesses have faced is that of servicing their fixed costs - whether those are simply energy and store rental costs or, for highly leveraged companies, the servicing of substantial bank and shareholder debt. The end result has been a renewed increase in insolvencies in 2011 (see chart overleaf).



In 2011 electrical household appliances suffered a 9.1% year-on-year decrease in the value of goods sold - a reduction for the 4th consecutive year. Prices and margins continued to decrease. Entertainment goods like gaming, music and films are under pressure due to falling demand as consumers increasingly tend to download such items, affecting high street retailers and online sellers alike. At the same time manufacturers are increasingly bypassing retailers when selling those goods.

Fashion retail saw a tough year with the disappearance of some big names. The subsector suffered from higher commodity prices (cotton), while discounts to drive footfall have put margins under pressure. The saturation of the market is likely to result in either a reduction in store portfolios or more insolvencies. Only furnishings recorded an increase (4.1%) in the value of goods sold in 2011 after three consecutive years of decrease.

On average, payments in the consumer durables retail industry still take around 60 days, and we have seen a continuing increase in notifications of non-payment since the end of 2010. Year-on-year there was a near 50% increase in 2011 and, while there is no discernable trend to show whether performance was weaker or stronger at any particular time during the year, the overall steady stream of non-payment notifications that we have received is certainly of concern and requires careful monitoring.

The resilience of companies within the sector has been tested

On a positive note, many businesses in the sector are now placing greater emphasis on their working capital management: in particular, keeping a tighter rein on stocks. This has reduced companies' exposure to short-term cash crunches which can often be fatal. Despite the entrepreneurial spirit of management in this sector, further insolvencies are inevitable - at least in the short term - as the problems (fierce competition, pressure on margins, overhead costs) remain and the economic situation remains tense. According to Consensus Economics, Britain's GDP will grow just 0.6% in 2012 after increasing 0.8% in 2011, while private consumption will recover only modestly (0.4% in 2012 after a 0.8% decrease in 2011). At least consumer price inflation could decrease to 2.7%. The role played by landlords, private equity investors and banks should not be underestimated and is very much under the spotlight, as often their attitude in support of business is crucial.

The biggest threat to traditional store-based retailers of consumer durables continues to be the increasing popularity of online shopping. The UK is by far the most mature market for online retailing in Western Europe, as shown by the graph below:

Source: ONS

Over recent years, we have seen an increase in the range of products that people are willing to buy online and in the value of purchases that they are prepared to make, with significant growth in online sales of clothing and big-ticket electrical appliances. The biggest overhead cost that traditional high street retailers need to reduce to be able to compete with purely online retailers is that of their real estate/store portfolios. Many multiple store retailers have begun strategic reviews this year but, due to the relatively long store leases that they are tied into, they have little flexibility to actively manage these portfolios. Compared to the low cost-base of their online rivals, this is a considerable competitive disadvantage.

Action plans put in place

Our UK consumer durables underwriting team had foreseen the potential difficulties that this sector was going to experience in 2011. We were visiting more buyers to identify the risks, which provided us and our customers with more risk-related information in 2011. This will continue in 2012.

As already mentioned, the typical characteristics of a business in difficulty continue to be easily identifiable but, because of the speed with which we saw businesses deteriorate in 2011, we are paying particular attention to the underlying trends that could point to potential future difficulties: such as high leverage, adverse performance against budget and erosion of profit margins.

We have therefore put in place action plans to ensure that our underwriting decisions are based on the most up-to-date available information, through both management accounts and face-to-face meetings. In the knowledge that Christmas is a key trading time for this sector, we have recently sought updated financial information from those businesses that we believe to be at risk of deterioration in performance.

British consumer durables retail sector

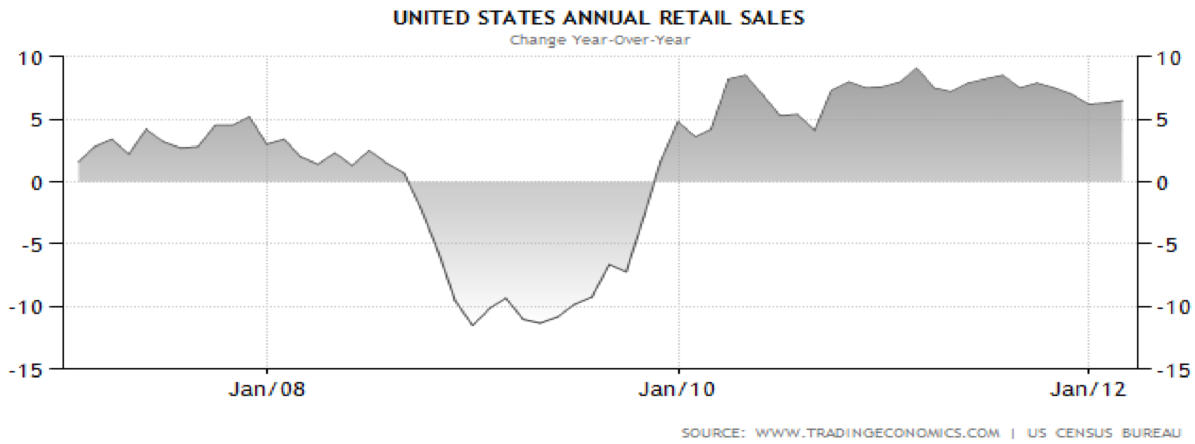
STRENGTHS	WEAKNESSES
2nd phase of capacity fall-out from the industry is a welcome boon to ongoing trade by remaining companies	Customers increasingly expect discounts as part of shopping experience
Public still sees shopping as a leisure activity	Continued low footfall levels
Increasing consumer confidence should have a direct impact on retail	Availability of lending from traditional channels such as banks is still restricted
Significant interest from private equity in investment in growth or turnaround strategies	Store based retailers have high fixed overheads and therefore suffer major impact when revenue falls

Back to contents page

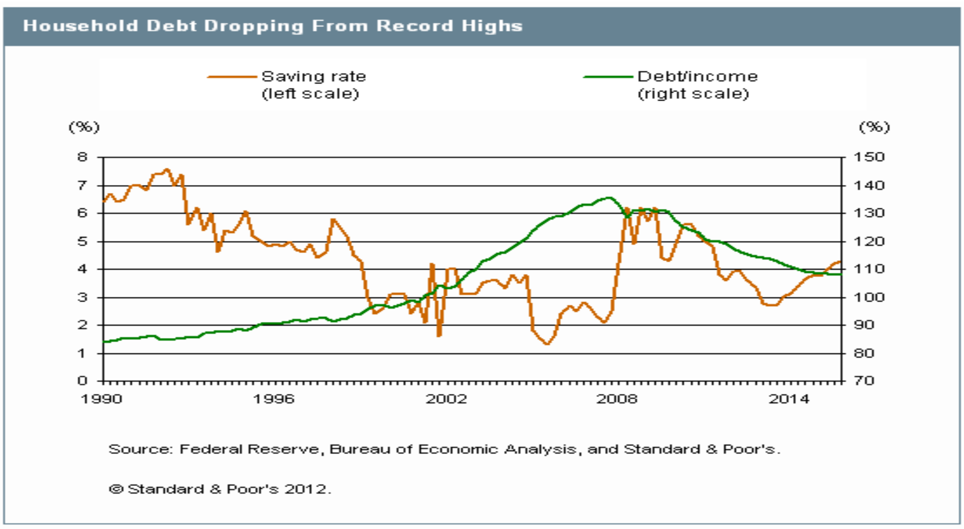
United States

Private consumption slightly lower in 2012

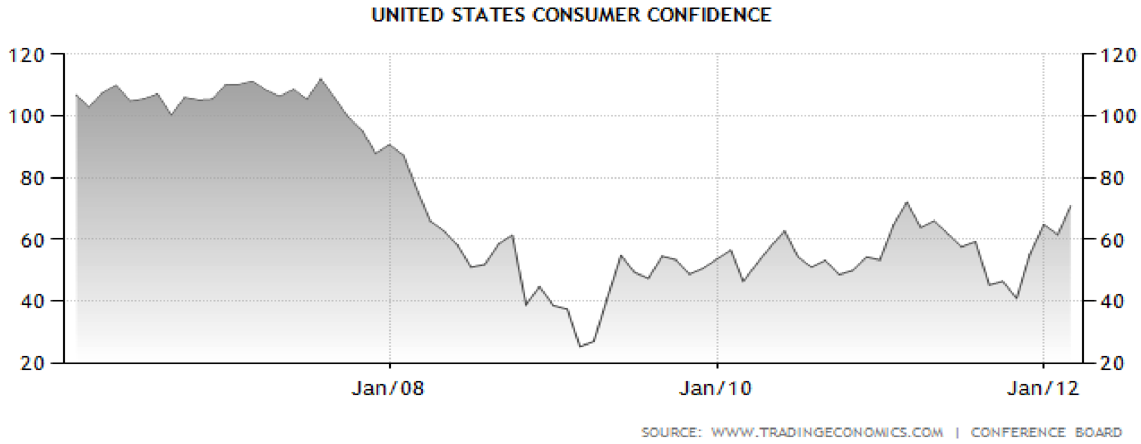
According to the Securities Industry and Financial Markets Association's Economic Advisory Roundtable, the US economy grew by around 1.8% in 2011. The committee expects GDP to increase 2.2% in 2012: down from the mid-year 2011 prediction of 3.1%. The primary drivers of the revised forecast include the European sovereign debt crisis, US fiscal policy, domestic politics, oil prices, and regulatory uncertainties. Unemployment stood at 8.3% in February 2012, and despite the decreasing trend since October 2011 it will probably continue at an elevated level throughout 2012. Inflation stood at 3% for the fiscal year 2011.



Consumer spending accounts for approximately 70% of GDP in the United States. US private consumption grew by 2.2% in 2011 and is expected to drop to 2.0% this year. As unemployment remains high and wage increases fail to keep pace with inflation, increased pressure on consumer spending is likely to persist. From late 2009 until June 2011, the personal saving rate hovered around 5%, as consumers sought to restore wealth lost in the financial crisis and the real estate crash. This rate has steadily declined since then, reaching a low of 3.5% in November 2011, as consumers cut their savings in order to purchase cars and other goods and services (see chart below).



US consumer confidence has recently shown a rising trend and stood at 70.8 in February 2012 (see chart below).



While consumer durables retailers reported record sales over Thanksgiving weekend, overall spending was modest, despite the significant discounts and promotions offered to consumers. The major subsectors within the industry include household appliances, furniture, and consumer electronics.

Household appliances sales set to grow in 2012

According to Hoovers, the US household appliances manufacturing industry consists of about 300 companies with combined annual revenue of more than US$ 20 billion. The major manufacturers include GE, Whirlpool (owner of the Maytag brand, among others), and the US-based operations of Electrolux. The major retailers within the household appliances market include the big players like Best Buy and Wal-Mart, online retailers such as Amazon, regional retailers including H.H. Greg and Fry's, wholesale clubs, and small local dealers.

The US appliances market continues to show modest growth, as US retail sales of electronics and appliances grew 0.9% year-on-year in the period from January to November 2011. The household appliances industry is significantly affected by developments in the housing industry. According to the US Department of Housing and Urban Development, an estimated 302,000 new homes were sold in 2011: a 6.2% year on-year decline. Despite this decrease in new home sales, used home sales are on the rise and the Remodeling Futures Program at the Joint Center for Housing Studies of Harvard University recently released positive 2012 figures for the Leading Indicator of Remodeling Activity (LIRA). According to the National Association of Realtors existing home sales increased 4.3% in January 2012, marking three gains in the past four months. This and the resulting increase in homeowner improvement spending should have a positive impact on the US household appliances market this year.

Furniture: Growth and fiercer competition

The US furniture retailing industry includes about 20,000 companies, with combined annual revenue of US$ 50 billion. The sector is highly fragmented, with the 50 largest companies generating about 35% of revenue. Household furniture and mattresses account for about 70% of the market. During the 2008/2009 economic crisis several furniture and bedding retailers filed for bankruptcy or were liquidated, and consolidation has been a feature of the industry in recent years, especially among mattress retailers. This wave of store closings hurt manufacturers, saddling them with bad debt expenses and fewer retail outlets for their products. However, the sector has largely worked through this disruption, and furniture and bedding retailers are now stronger than they were in 2008. According to the U.S. Census Bureau furniture sales increased 8.3% year-on-year in February 2012 and 9.2% in the December 2011-February 2012 period, also driven by the rebound of existing home sales.

Furniture stores have long competed on price, but most high-end furniture stores shifted to focusing on 'lifestyle' rather than just selling furniture. Many mid-ranged brands are also shifting strategy from product and price to style. As design trends change and furnishings reflect style and function, stores can better anticipate demand for items for media, bonus and multipurpose rooms, and other specialty spaces that need furnishing. However, the home furniture industry continues to face a significant threat from foreign competition, e.g. from China. Discount retailers are increasingly offering quality products from foreign manufacturers: particularly wood furniture.

Consumer electronics: high tablet sales saving the sector's record

Although subject to many of the same hurdles that most industries face (such as market saturation and economic downturns), the consumer electronics industry has fared better than most in times of flux. However, if not for tablets and mobile phones, 2011 would have been a miserable year for the US consumer electronics industry: with total US sales in 2011 worth US$ 144 billion - down 1% from 2010 - according to NDP Group. Sales of PCs, TVs and video game hardware were all down, and sales of mobile phones were flat. Only tablets experienced robust growth: accounting for 10.7% of US consumer electronic sales, up from 5.1% in 2010. Nearly all those tablets were iPads - and many of the mobile phones sold were iPhones.

Although consumers have been cautious in their buying patterns, analyst research has found that individuals view consumer electronics products as necessities rather than luxury items, reinforcing the strength of the consumer electronics industry even in times of economic troubles. According to the Consumer Electronics Association (CEA), in 2012 the consumer electronics industry will exceed US$ 200 billion in overall revenues in the US for the first time. The sector is expected to grow by 3.7 percent in 2012, after reaching an estimated US$195.2 billion in revenues in 2011. But the increasingly competitive landscape of the consumer electronics sector continues to drive prices downward, diminishing margins. Throughout the 2011 Christmas period, aggressive price promotions and rebates encouraged consumers to purchase new products and technologies including flat screen televisions, tablet computers, and e-book readers.

No substantial insolvency increase expected…

On average, payments in the consumer durables retail industry take between 30 and 60 days, but there are exceptions: furniture businesses have been known to offer consumers terms as long as 360 days interest free as an incentive to buy. We have not seen any change in payment behaviour over the last six months in the domestic appliances, furniture or consumer electronics subsectors. Notifications of non-payment relating to the consumer durables retail sector have been stable for the last six months with no increasing trend. However, we cannot rule out a slight increase in the coming months, as consumers use their extra cash to pay for higher gas and food prices.

Our credit insurance claims experience over the last six months has shown no negative developing trends. Compared to other industries, the consumer durables retail sector's default rate is average with no large bankruptcy filings to date. We do not anticipate an increase in claims as many of the struggling small businesses were already squeezed out of business by the larger retailers during the recession.

…but caution should prevail

However, there is always the possibility of a major insolvency in this sector and, although we do not anticipate an increase in insolvencies for the time being, many potential risk factors remain. A persistent high level of unemployment, flat wages continue to put significant pressure on discretionary consumer spending. Further climbing energy price may dissuade consumers from discretionary spending.

At the same time, the Eurozone debt crisis is far from being resolved, and there is uncertainty about what will follow November's presidential election. Unemployment and fiscal policy are two of the major issues facing the presidential candidates, and job creation and tax relief will both be very important indicators of future consumer confidence. While small businesses and citizens alike are looking for tax relief, the rising US government deficit is likely to continue to put increased pressure on tax reform. The outcome of the presidential election will therefore have a major impact on consumer confidence and the US economy. Meanwhile, the competitive landscape continues to be challenging for consumer durables retailers, with increased pressure on prices expected this year. In light of all these factors, our underwriting approach remains cautious, and we continue to carefully evaluate businesses in this sector, closely observing their liquidity situation.

US consumer durables retail sector

STRENGTHS	WEAKNESSES
Short-term stabilization of unemployment and economy	Weaker consumer discretionary spending
High demand for new technology creating higher margin products	Intense brick and mortar as well as online competition
Diversified distribution channels	Uncertain future economy

Back to contents page

Snapshots

Market performance at a glance

Ireland

No relief in 2012

The Irish retail market for consumer durable goods is still suffering from the deterioration of the Irish economy, with consumer confidence at low ebb and households digging into their savings to reduce personal debt. But, despite their efforts, households' debts are now double their income. Average weekly earnings have continued to fall (by 1.5% year-on-year in Q4 of 2011), while the cost of living is still rising: overall prices have risen by over 2% in the past year. Unemployment remains high - at 14.2% in February 2012 - and the government's austerity measures are limiting disposable incomes and putting pressure on retailers and consumers alike. The recent 2% hike in VAT has only compounded the pressures on retailers, who are finding it difficult to align their cost base with decreasing revenues; hampered as they are by 'upward only' rent reviews, and high commercial rates and labour costs. The average transaction value rate of consumer purchases is falling: down 4.9%, from EUR 41.67 in Q4 of 2010 to EUR 39 in Q4 of 2011. In January 2012, the volume of retail sales (excluding the motor trade) decreased 1.6% on the previous month and 2.7% year-on-year. Among the main contributors to this monthly decrease are department stores (-18.4%), electrical goods (-12.0%) and clothing, footwear & textiles (-5.7%).

The consumer durables retail sector is extremely competitive and, with price as the priority, consumer loyalty is non-existent. Sales or 'special offers' are an almost permanent feature of the clothing, electrical and furniture subsectors. Increasingly, cash-strapped households are moving away from buying name brands.

Retail continues to have a high insolvency rate – third by volume behind construction and services. It is worrying that the initial figures for January and February 2012 show another year-on-year increase. Unfortunately, the short-term outlook for the consumer durables retail sector is not positive, and the difficult economic environment shows no sign of stabilising in the foreseeable future. Additional 'stealth' taxes in the form of carbon, water and property levies are to be introduced in 2012 and this will further deter consumer spending.

We continue to view the sector as high risk, as retailers struggle with reducing revenues, high costs and stifled access to credit due to the pressures on domestic banks to get their own affairs in order. Therefore, our underwriting approach is cautious. Sight of the most recent financial information (normally the latest audited accounts plus quarterly management accounts) is a minimum requirement. When reviewing financial information, we focus on cost control, working capital management, cash generation, debt maturity and security, and the ability to service debt. A positive approach is taken where possible, but we must be confident that the decisions we are making are fully supported by the information that is available to us. Membership of a stronger group or additional security will be taken into consideration.

Back to contents page

Italy

Private consumption and retail forecasts revised downwards

Italy's uncertain economic and financial landscape is discouraging demand and private consumption. Italy again entered recession in Q4 of 2011, with GDP shrinking 0.7% on the previous quarter (-0.2%). Consensus Economics have revised their January and February 2012 forecast downwards, and in March forecast that both GDP and private consumption will shrink in 2012: by 1.6% and 1.7% respectively. Consumer sentiment will be hit by the recent introduction of emergency austerity measures, rising unemployment and restrictions on the availability of credit.

This has - and will - hit non-food retail/consumer durables even more than expected a couple of months ago. According to the Italian Statistics Institute ISTAT, in Q4 of 2011 non-food retail sales decreased 1.4% on the previous quarter, and 1.8% year-on-year. IHS Global Insight predicts retail trade (food and non-food) to contract further after a 3.5% decline in 2011: by 2.7% in 2012.

There is wide diversity in average payment terms between subsectors: from below 60 days for the telephone market to above 120 days for furniture. We expect payment behaviour in the non-food segment to deteriorate further. Consortia in particular have been most exposed to changes in the economy, showing a higher rate of financial distress. In general, there have been problems with the quality of assets (credit, stocks, and fixed assets), poor capitalisation, a conflict of interest with associates and a culture of slow payment.

Our experience of credit insurance claims relating to this sector shows a clearly worsening trend over recent months, and we expect insolvencies to increase further in 2012 as retailers continue to suffer from the deteriorating economic environment and structural weaknesses such as high fragmentation, poor profits, low earnings retention and a modest equity base. We expect Italian business insolvencies to increase 10% in 2012 to about 13,000 cases, after a 17% increase in 2011.

Therefore, we continue to be more restrictive when underwriting non-food retail. Our main focus for the consumer durables retail sector is on financial assessment and market information. Taking gearing as an accurate indicator of financial structure, we see that the situation is worsening for many businesses. This can be explained by the decrease in consumption and the consequent increase in net working capital, as high stocks levels have to be financed through short term financial debt.

We also take into account shareholder skills like the management of key risks (credit, financial, governance). The age of a company is no longer a meaningful indicator of its competitive capacity. Defaults by many established businesses in 2011 proved that even years of experience in business and the wealth of family-owners may not be sufficient to see firms through this tough economic period.

Back to contents page

Spain

All subsectors show a downward trend

Private consumption in Spain was weak last year, and this year's outlook of economic stagnation - or even contraction - will probably mean a worsening labour market. Consequently, a further drop in real household income and lower household consumption can be expected.

In 2011, retail trade sales decreased 5.8% year-on-year, with non-food subsector sales decreasing 7.5%, according to the Spanish Statistics Office. This continued in January 2012, with a 4.8% year-on-year retail decline. Sales of non-food products decreased 7.0%.

During the first nine months of 2011, turnover in the furniture sector decreased 5.2% year-on-year: slightly worse than the year-on-year 4.0% decrease reported for January to September 2010. In that same period, retail sales of IT equipment and consumer electronics fell 3.8% and 5.6% respectively.

Restructuring is prevalent in the major appliances and brown goods subsector. The prolonged period of contraction in demand and the subsector's fragmentation have forced businesses to adjust their cost structures. A vertical integration process is underway and companies will seek synergies and focus on internationalisation.

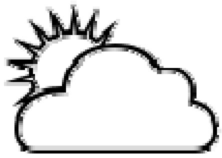
The ongoing adjustment in the real estate sector has also had a negative impact on demand for household appliances. In 2011, turnover fell 16.8% year-on-year due to a 14.6% decline in units sold and a 2.6% decrease in prices.

In addition to high unemployment and falling household disposable income, further austerity measures taken by the new Spanish government to reduce the public deficit, coupled with a continuing reluctance by banks to grant loans, are putting even more pressure on households' consumption of durable goods. Foreign demand from other EU members for durable goods will also lag behind 2011.

We have seen a slight increase in insolvencies in the retail sector in the last six months. While retailers focusing on basic goods, such as food, are facing fewer troubles, the consumer durables subsector may not be as fortunate. But, irrespective of the subsector, businesses´ liquidity, financing needs and access to external financing are key issues. When underwriting the retail industry, we take into account that many businesses in this sector are very small/mid-sized independent companies, and we factor in their subsector and product lines, tailoring our risk assessment accordingly. However, in the current economic situation, our analysis of solvency and payment record is essential for Spanish businesses of all kinds, as is our scrutiny of their dependence on external financing and level of indebtedness.

Back to contents page

Brazil
Continued growth in 2012



Brazilian consumer durables retail subsectors - such as furniture and electronic home appliances; computer and communication material equipment; and textiles, clothing and footwear - all registered robust growth at the end of 2011, and this trend is expected to continue in 2012, provided that Brazil's good economic performance continues and potential risks, such as a global economic downturn, do not materialise. Consumer durables retail is currently supported by robust private consumption, which increased 4.1% year-on-year in 2011, triggered mainly by a higher average income (+2.9% year-on-year in 2011 and forecast to increase 2.5% in 2012, partly because of an increase in the minimum wage) and a very low unemployment rate (5.5% in January 2012). Higher consumer price inflation (6.5% in 2011) has not had a great impact on the sales of durable goods, as in Brazil these products are generally sold in several instalments - in the case of electronics, up to 24 instalments. Prices for white goods fell at the end of 2011, due to a reduction in IPI (a tax on industrialized products) that will run until the end of March 2011.

High domestic demand is also proving a boost for imports thanks to a stronger Brazilian Real which, together with low cost Asian products, makes it possible to meet domestic demand without exerting major inflationary pressures. However, this surge in imports has had negative effects on domestic producers of consumer durables, whose prices are less competitive. Retail companies are using financial services as a tool to retain customers. They increasingly offer credit cards, insurance, bonds and facilitate the payment of utility bills in store, especially to assist those consumers who do not have access to the banking network. However, infrastructure deficiencies are hampering distribution logistics, particularly for small rural retailers, and limiting the range of products available.

Competition in the electronics home appliances segment is fierce, and there has been a consolidation process in recent years. As a result, the three biggest players (Pao de Acuçar, Ricardo Eletro and Magazine Luiza) are constantly vying for market share. Because of consolidation, the results of the big players in consumer durables retail are improving as a consequence of scale gains. Besides that, mergers in the retail sector allow for greater investment and business expansion, especially in the northeast and in the cities of Rio and Sao Paulo.

With our relatively high exposure in this sector, constant monitoring and a selective underwriting approach are essential. We regularly review companies' financial situation, looking at indexes such as solvability, indebtedness level, and profitability. As publication of financial statements is not mandatory in Brazil for all companies, it's very important to try to get updated financial information (e.g. through our underwriters' direct approach or through our insured customers).

Back to contents page

Mexico
Uncertainties affect consumer sentiment

According to the Mexican retail association ANTAD, in 2011 department store sales increased 8.3% year-on-year (3.9% growth in same-store-sales). Specialist stores' turnover increased by 9.9% (3.4% increase in same-store-sales) and the profit margins of big department stores are high. Most of the sector's revenue increase has been from the opening of new stores. In contrast, regional retailers are less profitable, because of competition from large players who are expanding in the market. Not surprisingly, while the big retailers have adequate equity and liquidity, the regional players rarely do. For 2012, growth is expected to be the same as in 2011 and still driven by the opening of new stores.

The domestic appliances subsector is restricted by the low demand for new houses, but we feel confident that the sales of white goods will be sustained by the growth of the retail stores. The furniture subsector's profit margins are generally still negative or only slightly positive as the industry model is based on economies of scale that are not being achieved. With low sales expectations, some manufacturing companies will have to lay off employees or even close down. However, companies that do not depend on exports to the US and are more active in the domestic market can be more optimistic, as department and retail stores are successfully selling their goods.

In February 2012, the Mexican Consumer Confidence Index (CCI) showed a slight setback compared to January, but is still at one of the highest levels for the last two and a half years (see chart below). Mexican consumers are currently confident that their financial situation will improve in the next 12 months but, with uncertainties about the outcome of the Mexican and U.S. presidential elections in 2012, and the impact of the Eurozone crisis still unclear, their willingness to purchase consumer durable products has decreased compared to earlier months, although sales are still higher than a year ago. The banking sector remains healthy but, since some of the major banks in Mexico are subsidiaries of European banks, the availability of consumer credit could be lower in 2012.

On average, payments in the consumer durables industry take 60 days, and we do not expect payment delays to increase in 2012. The outlook for the retail sector is stable for big players but with a slightly negative trend for small and medium sized players.

Back to contents page

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