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PANORAMA

April 2016

Barometer of sector risks in the world

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists



For the first time, Coface updates its global quarterly sector risk assessments for 12 sectors, in 6 regions worldwide (compared to 3 regions previously). In the current context of flagging global growth, the balance between downgrades and upgrades has unsurprisingly shifted towards downgrades, by nine against two.

The two pieces of good news are due to Western Europe. After the catching-up that began in 2013, car sales in this region are now gathering momentum. Coface even expects investments in this sector in 2016, in order to meet strengthened demand from Europe. Furthermore, the ageing European population is underpinning the pharmaceuticals sector, whose companies are no longer affected by the fiscal austerity measures in Europe. This sector has therefore been reclassified as medium risk.

In the wake of the recovery in Western European countries, Central Europe still

posts a lower risk level than other regions, even though the chemicals sector is suffering from the Chinese slowdown and the contraction in activity in Russia.

In North America, the number of insolvencies linked to shale oil extraction is on the rise. With oil prices close to \$40, investments in this area are not profitable. The risks linked to the energy sector are therefore very high. Risks are also increasing in the automotive sector, even though demand remains vigorous in the United States. Risky consumer loans (subprime) are currently growing sharply.

In emerging countries, and Latin America in particular, energy and metals are, unsurprisingly, negatively affected by the low commodity prices. Pharmaceuticals, one of the sectors least affected by the economic downturn, is suffering from the drastic government spending cuts in many countries in the region.

In Turkey and the Middle East, the sectoral risks remain under pressure. Construction

is negatively affected by the Turkish central bank's monetary tightening, in its bid to fight the depreciation of the lira against the dollar (-28% year-on-year, at end-February 2016). Residential housing sales increased by 11% in 2015. The number of residential housing units built fell by 11% in 2015. The metals sector, already affected by a sharp fall in prices linked to Chinese overcapacity (see studies), is suffering from this contraction in residential investments and has been reclassified to very high risk.

Finally, in emerging Asia, the electronics sector should be watched closely, as companies in this sector are recording a large number of late payments. The retail and information and communication technologies (ICT) sectors have been downgraded, given the weight of electronics.

This overview of sectoral risks is also an opportunity to carry out a more detailed analysis of ICT, energy, the automotive sector and retail.

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FOR SAFER TRADE

APRIL 2016

SECTORAL OUTLOOK

1ST QUARTER 2016



Khalid AIT YAHIA
Economist



Guillaume BAQUE
Economist



Paul CHOLLET
Head of sectors
and insolvencies



Guillaume RIPPE-LASCOUT
Economist

SECTOR RISK ASSESSMENT

Sectors	Western Europe	Emerging Asia	North America	Latin America	Central Europe	Middle East + Turkey
Agrofood	Medium risk	Medium risk	Medium risk	High risk	Medium risk	Medium risk
Automotive	High risk (improved)	Medium risk	Low risk (deteriorated)	High risk	Medium risk	Medium risk
Chemical	Medium risk	High risk	Low risk	High risk	Low risk (deteriorated)	High risk
Construction	High risk	High risk	Medium risk	Very high risk	Medium risk	High risk
Energy	High risk	High risk	High risk (deteriorated)	Very high risk	High risk	High risk
ICT*	Medium risk	Medium risk (deteriorated)	Medium risk	Medium risk	Low risk	Medium risk
Metals	Very high risk	Very high risk	High risk	High risk (deteriorated)	High risk	High risk (deteriorated)
Paper-wood	High risk	Medium risk	Medium risk	High risk	Medium risk	Medium risk
Pharmaceuticals	High risk (improved)	Low risk	Medium risk	Low risk (deteriorated)	Medium risk	Low risk
Retail	Medium risk	Low risk (deteriorated)	Medium risk	High risk	Medium risk	Medium risk
Textile-clothing	Medium risk (deteriorated)	High risk	Low risk	High risk	Medium risk	Medium risk
Transportation	Medium risk	Medium risk	Low risk	High risk	High risk	Medium risk

Source: Coface

* Information and communications technologies

	Low risk		Medium risk
	High risk		Very high risk
	The risk has improved		
	The risk has deteriorated		

Sectoral risk assessment methodology

Coface's assessments are based on the financial data published by listed companies in six major geographic regions: Emerging Asia, North America, Latin America, Western Europe, Central Europe and Middle East + Turkey.

Our statistical credit risk indicator simultaneously summarises changes in four financial indicators: turnover, profitability, net indebtedness, and cash flow, completed by the claims recorded through our network.

Global activity suffered from the high volatility in financial markets and in oil prices in the first quarter. This flagging global growth is having an impact on the soundness of the sectors analysed by Coface (see Table 2, page 2).

Sectors related to household consumption are the least affected, as this is the main driving force for activity, both in the advanced economies (United States, eurozone) and in emerging economies (in particular China). Conversely, sectors depending on corporate investment are more at risk. The sluggish growth in global trade is another source of vulnerability (only +1.8% year-on-year in volume terms at end-January 2016). The growth rate in trade has fallen very sharply since August 2015 (3%). This trend is primarily affecting carriers, as maritime traffic (which carries 80% of global trade) is decreasing. The Baltic dry index ⁽¹⁾ is at a historically low level. The transport sector is, nevertheless, not in a situation of very high credit risk, as the fall in oil prices has enabled carriers to maintain their margins.

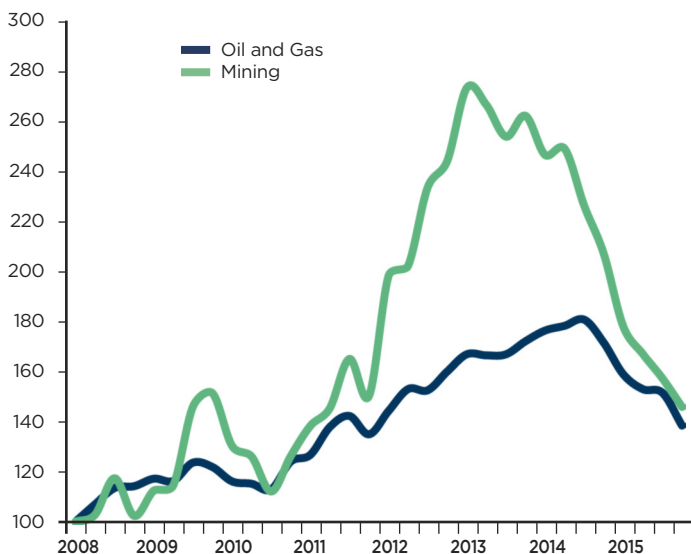
With the backdrop of low energy prices, companies in the sector are, unsurprisingly, particularly vulnerable in all regions (see analysis, p 5 & 6). Credit risk is peaking in Latin America and North America, where investments are contracting. In the United States, the number of shale oil drilling wells decreased by 63% in 2015, causing a decline in production for the first time since 2006. This streamlining of the sector is leading to insolvencies, as the actors are, on average, highly leveraged. Household consumption nevertheless remains vigorous in the United States.

The good performance of the labour market, low levels of unemployment (4.9% of the labour force, at end-February 2016) and dynamic job creation (+242,000 in February) suggest that consumption will continue to underpin US growth (+2% this year according to Coface). The related sectors such as retail, textiles-clothing and pharmaceuticals will remain positive in 2016. While the automotive sector is still experiencing positive momentum in the United States, the financing of car sales is worrying (see analysis, p 7 & 8). The Office of the Comptroller of the Currency, in charge of banking supervision, has shown its alarm concerning this situation, since November 2015.

Contrary to North America, where the energy sector does not represent a systemic risk, South-American oil companies play a key role in the functioning of their economies. Petrobras in Brazil and Ecopetrol in Ecuador have reduced their investments in 2016 by 40%, in order to consolidate their financial situations (see chart). The poor results of these companies are leading to shortfalls in revenues for governments, forcing them to cut public spending, which is dampening activity and especially consumption. This is having significant repercussions on the confidence of households, and they are reducing their spending. As a result, all sectors in Latin America are posting a sharp increase in their credit risks. The metals sector, which was already high risk, has been downgraded again as the prices of the main metals collapsed in 2015 (iron ore by 38%, nickel by 42%, copper and zinc by 25%).

Latin America's agri-food sector is affected by the fall in agricultural commodity prices and remains high-risk. After rebounding by 2.1% between August (second lowest of the year) and October 2015, the FAO commodity price index once again fell in the last two months of the year and hit its lowest levels since February 2007. As a result of the rise in inflation, linked to the depreciation of South-American currencies, economic policy in the region has tightened owing to a hike in key interest rates by several central banks in the region. Since then, the sector has been exposed to an increase in the cost of credit and a currency depreciation that has led to a rise in certain input prices, such as fertilisers.

Investments in the energy and metals sectors are contracting.
Capital expenditure (Capex), 100 = 2008



Sources: Reuters, Coface

(1) Price index for maritime transport of dry bulk (mainly ores, coal and cereals)

While the change in the structure of activity in China - which from now on will be dominated by the service sectors - is not really worrying in the medium term, it is currently creating significant overcapacity. The metal industry (*see Coface overview for April 2016: «Steel sector: Produce at all costs?»*) is the most concerned since China, which is flooding the world with its production, is pushing down prices and weakening all steel manufacturers and smelters in the sector. Furthermore, the growth of the middle classes has been a consequence of the increase in Chinese workers' standards of living. Despite a moderate weight in GDP (37%), the vigour of Chinese consumption is enabling some sectors to perform well. The automotive sector presents medium risks, as new-car registrations picked up again in the fourth quarter of 2015, after support measures for purchases of smaller-engine cars were introduced in September. In 2015, consumption of agri-food products in China grew and the FAO also expects consumption of agricultural commodities in emerging Asia to rise in 2016. The associated risks remain medium. Nevertheless, some sectors are losing in terms of cost competitiveness, for example textiles. This sector has a high credit risk is high and is therefore losing competitiveness against South-East Asian countries such as Bangladesh and Cambodia.

As in France, activity in Europe as a whole is benefiting from a relatively positive economic environment (expansionary monetary policy, weak euro, fiscal easing, cheap oil) and, according to Coface, could grow 1.6% in 2016. The vigour of European household consumption (57% of European Union GDP) is the main explanation for this slight acceleration. It is particularly due to solid growth in sales of new vehicles (+10.1% at end-February 2016, year-on-year). The outlook remains positive for the automotive sector (*see analysis p 7 & 8*), as the number of vehicles sold (12.9 million year-on-year at end-February 2016) is still far lower than the average prior to the 2008 financial crisis (14.4 million). Furthermore, the ageing of the European vehicle fleet (9.65 years in 2014, versus 8.4 in 2006) points to a forthcoming renewal. The automotive sector has accordingly been reclassified to medium risk. Retail sales due to robust consumption, are helping to keep retail in medium risk. Residential investment - even though it varies from one country to the next - also seems to be picking up in Western Europe. In the eurozone as a whole, the number of building permits increased by 1% in November 2015, year-on-year, for the first time since 2010.

Central Europe (+3% in 2016) is benefiting from its proximity and its integration with the eurozone to build up its industrial activity. Furthermore, the development of its business services and personal services sectors - in particular in the area of client relationship - have enabled countries such as Poland to be at the forefront in new technological equipment. The information and communication technologies (ICT) sector has a low credit risk, benefiting from local workers' skills and cheap labour.

While the ICT sector (*see analysis p 9 & 10*) is growing strongly throughout the world, it nonetheless remains risky, as technology rapidly becomes obsolete in this sector. This is particularly the case with PCs as well as tablets, the sales of which continue to contract to the benefit of smartphones with increasing capacity. While this is very evident in developed countries, it is also the case in emerging countries. For example, the rapid development of the Chinese market slowed down in 2015, when smartphone sales grew by only 2.5% (versus 20% growth in 2014) and PC sales fell by 7.7% (IDC). This slowdown has triggered numerous insolvencies in Asia's electronics retailing sector (*see analysis p 11 & 12*) and ultimately a downgrading of ICT to high risk in emerging Asia, although the potential for growth in this sector is high in this area.

Conversely, pharmaceuticals is the best-positioned sector in terms of growth and credit risk in the short term. Despite the increasing determination of agencies in charge of health care provision to keep deficits linked to healthcare spending under control (particularly the reimbursement of drug costs), the development of the middle classes in emerging countries and, in parallel, the ageing of the global population, seem to be a guarantee of solidity for this sector.



coface
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SECTOR RISKS ANALYSIS - APRIL 2016

ENERGY

ASSESSMENTS BY COFACE

NORTH AMERICA



VERY HIGH

LATIN AMERICA



VERY HIGH

EMERGING ASIA



HIGH

CENTRAL EUROPE



HIGH

WESTERN EUROPE



HIGH

M. EAST + TURKEY



HIGH

RISKS ASSESSMENTS

HIGHLIGHTS

Given that the price of Brent was USD 33.9 per barrel in mid-February 2016, versus more than USD 110 in June 2014, **the outlook for the sector has become gloomy**. Cash generation has declined given that prices are a major determinant, which means that the oil majors are continuing to reconsider their investment projects. **The reduction in spending on exploration-production (E&P) has affected contractors**. A large number of fields are no longer profitable enough and are generating operating losses.

Even though **demand** increased by 1.4% in 2015, **this is not sufficient to absorb the excess supply currently available on the markets**. The gradual return of Iran and the end of the ban on US crude exports (voted at the very end of 2015) will translate into increased supply of crude oil, destabilizing prices even more.

Some shale oil actors have succeeded in adapting to these low prices by drastically lowering their breakeven prices, by roughly 20%. By rationalising their production processes, they have thereby limited the impact of the fall in prices on their margins, while maintaining their production levels. **However, a breaking point seems to have been reached in 2015**, as shale oil production started to fall during the year. This phenomenon has not been seen since 2008, when the development of this technology took off. **High debts and cash burning have heavily impacted the sector**.

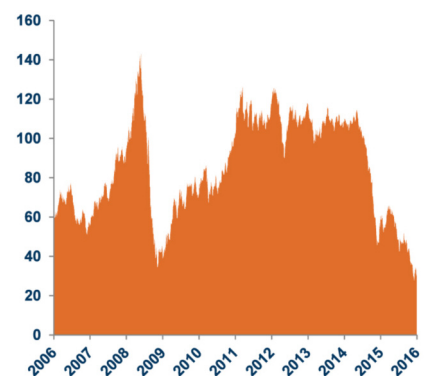
Strengths

- Resilience of the majors in the sector
- Expected growth in demand in 2016
- Oil companies' efforts to rationalise their production

Weaknesses

- High debt levels among shale oil companies
- Excess oil production
- High volatility in crude oil prices
- Overcapacity among certain oil & gas service companies

Oil price (Brent) in \$



Source: Reuters

ENERGY

DEMAND

Global demand for oil should stabilise at around 95 million barrels/day in 2016, according to the EIA, i.e. a 1.3% rise compared with 2015.

Demand in Europe is expected to stagnate in 2016, reaching around 13.9 million barrels/day (as in 2015), according to the IEA. One of the main sectors, in terms of consumption of oil products, is refining. Refineries in Western Europe (NWE Rotterdam) have been able to take advantage of the sharp fall in prices since June 2014 to improve their margins, which were around USD 3/bbl when the Brent price was close to USD 110/barrel, versus USD 4.37/bbl on average in December 2015. Nevertheless, margins were higher in June 2015, at USD 9.34/barrel on average. One of the main causes is the stagnation in demand (caused in particular by a mild winter), and the low level of refinery maintenance which has led to excess supply.

In the United States, the production capacity utilisation rate, as at end-November 2015, was 91%, while in Canada it was 92%, according to the IEA. This rate has been high since the start of 2015 in the United States. Margins are in free fall, from USD 17.08/bbl in August 2015, to USD 14.08/barrel at end-December 2015 for USGC. However, the outlook is positive as crude oil prices are weak while demand is increasing and, according to the EIA, should be 19.5 million barrels/day in 2016.

In Asia, refining margins (Dubai hydrocracking) reached USD 8.6/bbl on average during December 2015. Nevertheless, margins are high when compared with the average levels in 2015, when they were around USD 7.7/barrel. Chinese demand is expected to grow very slightly in 2016, to 11.5 million barrels/day, from 11.2 million in 2015. Growth in demand in the other countries in the region is likely to be lacklustre, with an increase of 0.3 million barrels/day, to 12.5 million barrels/day.

The drop in oil prices allows Middle Eastern Governments to cut oil subsidies, but will affect household' purchasing power and thus demand.

SUPPLY

According to the IEA, supply of oil is expected to increase by 0.4% in 2016, to 96.07 million barrels/day, following an increase of 1.4% in 2015. Investment spending on E&P should fall by a further 30% in 2016, after dropping by 37% in 2015, according to AlixPartners.

The reduction in investment spending, which is going hand-in-hand with the drop in crude oil prices, is intended to preserve cash for companies specialised in exploration-production. This measure is tangible amongst shale oil companies, as their financial strength is weaker than that of the majors and they are more dependent on North American basins. More generally speaking, all operators in the sector are struggling. According to S&P, the number of active wells fell by more than 63% in 2015, compared with 2014, and close to 67 companies became insolvent in 2015 according to Platts. This trend is likely to continue in 2016 and we can expect supply to continue to decline, especially in shale oil, the production of which has been falling since June 2015.

In Western Europe, the net incomes of the main E&P companies dropped. As an example, Total reported a net income of USD 2 billion in 2015 (versus 3.8 in 2014), but nevertheless did better than analysts' expectations. The best-performing companies are those that combine refining and chemical activities with the traditional E&P business. Nevertheless, the risk is higher in oil & gas services activities, as they are directly affected by the fall in investments. The reduction in active wells, especially in North America, as well as the lower activity in exploration, particularly in an era when fields are increasingly difficult to develop, are leading to significant asset impairments, followed by disposals.

In emerging Asia, the extended fall in prices is leading to an enduring fall in cash flows, particularly for public companies. We believe the credit risk is lower for this segment, as they have public support and are also helped by their vertical integration (presence in refining and distribution of oil products).

Latin America is faced with the same problems. Petrobras and Ecopetrol will reduce their investments by respectively 24.5% in the period 2015-2019 and 40% in 2016. Oil & gas service companies such as Vallourec are adjusting their production and are producing together with Mitsubishi, in order to cut costs in the falling market.

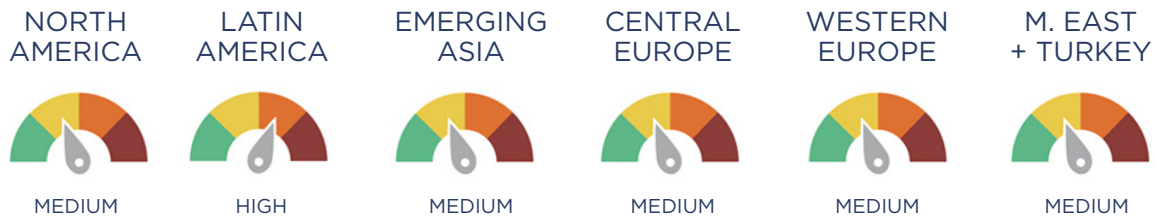
By stressing that American nonconventional oil producers are the new « swing producers », the Saudi oil minister Al Naimi ruled out all cuts in output. Although prices are low, extracting oil in the Gulf is by far more profitable than in North America. Nevertheless, cash-flow generation is impacted, and some predict the privatisation of Saudi Aramco.



SECTOR RISK ANALYSIS - APRIL 2016

AUTOMOTIVE

ASSESSMENTS BY COFACE



RISK ASSESSMENT

HIGHLIGHTS

The global automotive market is showing a mixed picture, with a contrast between the North-American and Asian markets. The former remains vigorous, while the latter is in a slowdown phase. Europe is also catching-up rapidly.

Growth in car sales is slowing in China: 4.7% in 2015 versus 13.9% in 2013 and 6.9% in 2014. Consumption in China is entering a "new normality", where sales growth is likely to stabilise at a level of below 10%. Earnings should also follow this trend, as a result of more intense competition between manufacturers. In the long term, this market remains attractive, as China is lagging behind in the number of cars per capita in comparison with the global average (52 vehicles/1,000 inhab. versus 150 for the world).

In the United States, vehicle sales remained buoyant in 2015: According to end-December 2015 data, they grew by 5.7 %, since the same period one year ago. Car sales are supported by the excessive ability for households with bad credit scores, or no score at all, to borrow. Premium brands also sold well and increased between 1.8% to 12%, (+11.1% for Audi, according to its figures). The very good performance of Tesla should be noted. Sales of its top model, the Tesla S, increased by 43%. This highlights the resilience of Tesla in the context of low fuel prices.

As for Western Europe, new-car registrations have increased over the last 30 months. At end-February 2016, new-car registrations increased by 10.1% compared with 2015. All the main European markets were represented in this resurgence. Italy topped the ranking (+27.3%), followed by France (+13%), and Spain (12.6%).

Strengths

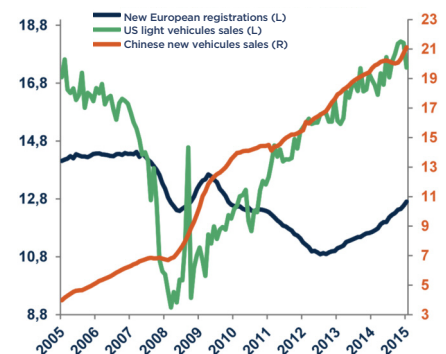
- Ageing of car fleet
- Robustness of US demand
- Car manufacturers are among the largest investors in R&D worldwide

Weaknesses

- Slowdown in emerging countries
- Overcapacity in China
- Increasingly restrictive anti-pollution standards, requiring heavy investments
- Worsened credit risk quality in the US

Sales of new vehicles

(Year-on-year)



Sources : ACEA, Autodata, NBS

AUTOMOTIVE

DEMAND

Global demand shows a mixed picture, with a slowdown in the world's largest market, while the outlook is positive in North America and Europe.

In China, stocks of unsold vehicles are piling up, putting pressure on prices. According to November 2015 data from the CADA (China Automobile Dealers Association), 83% of distributors and dealers are increasing their stocks. Moreover, restrictions on car purchases in certain polluted cities, as well as traffic problems in heavily congested big cities, have contributed to the slowdown in sales. The MNI indicator of car purchasing intentions for January 2016 was below the long-term average (87.2 versus 83.2 in December 2015), indicating that sales growth may be slower in the first quarter of 2016.

In the United States, growth in demand is likely to be positive, although not comparable to 2015. Nevertheless, the risks associated with subprime and deep subprime consumers are increasing, in a sector largely driven by massive access to cheap credit. 9 out of 10 new vehicles are acquired via financing schemes, and credit quality is hit by lengthening maturities (72 months). This also excludes these borrowers from re-entering the market, decreasing the residual values of these vehicles, putting them at financial risk. The Office of the Comptroller of the Currency has already warned about (in November 2015) the excess of securitisation linked to subprime loans.

In Western Europe, the unemployment rate had, according to Eurostat, decreased by 0.5 percentage points at end-December 2015 since the beginning of the year, to reach 10.5%. Although it remains high in Southern Europe (20.8% in Spain, for example), new-car registrations are buoyant in this area, driven by car renters and companies renewing their fleets in order to operate models with lower maintenance costs. Demand is likely to be sustained in 2016. The low interest rates should be positive for car loans. Moreover, the desire to replace old vehicles is helping to boost sales, particularly in southern European countries which have still not returned to their pre-crisis levels. We should nevertheless remain cautious about European household confidence for 2016, which are pointing to negative perceptions: an overall negative sentiment concerning personal finances, while intentions to buy vehicles (new or second-hand) are not improving.

SUPPLY

The restructuring efforts have paid off in Europe and North America. Sales seem solid, although China shows negative signals, in particular with excess capacity.

The slowdown in sales in China is a source of concern for the major global groups, as competition between manufacturers is strong in China, driving down prices. **Coface therefore expects an increase in vehicle sales in mainland China of 6% in 2016, versus 7.3% in 2015.** Over the first 11 months of 2015, car manufacturers' earnings in China decreased by 1.8% compared with 2014. China will probably face overcapacity in the near future. According to JCS Automotive Consulting and Deloitte Consulting, the automotive sector will be the next to suffer from the over capacity phenomenon (estimated at close to 11.4 million vehicles) in 2017, when there will be 140 factories in China, versus 123 in 2014.

In the United States, Coface expects 2% growth in annual sales of vehicles for 2016, which constitute a slowdown in regards of the 2015 increase (+5.7%). Earnings increased in 2015 compared to 2014: doubled for GM's EBITDA, +25% for Ford net profit. But this veils financial incentives granted by carmakers to buyers (an average of \$6432) in order to decrease their inventories, which are early 90 days for two the biggest domestic carmakers. Moreover, the market vigor depends on car rental companies, which is less profitable. This is due to the feeble share of youngest generations to own a car, caused by their preference toward public transportation, but also to their will to use car-sharing schemes.

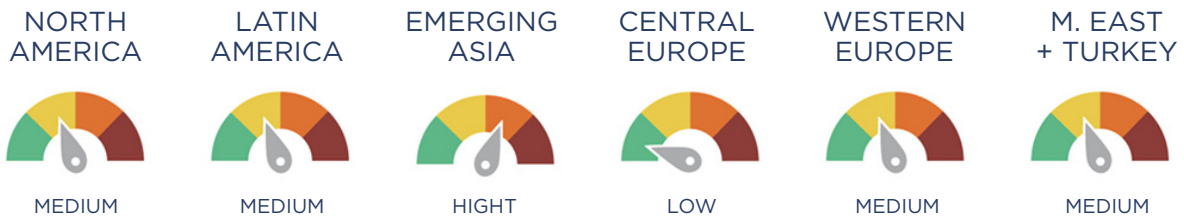
New-car registrations in Western Europe will continue to grow at a rate of between 3 and 5% in 2016. Manufacturers are enjoying increased earnings, particularly Renault SA and Fiat Chrysler Automobiles: +48.1% for Renault, while the latter once again posted positive figures with an adjusted operating income of USD 200 million. The main causes put forward are the upturn in the European market, better price discipline and cost-cutting programmes. Nevertheless, **the slowdown in car sales in China calls for caution, as the impact is significant for European manufacturers.** According to IHS data, brands such as VW, PSA and BMW are highly exposed in China, as they sell a significant part of their production there (respectively 40%, 28% and 24%). Lastly, **the scandals over particle emissions are tarnishing** the image of certain car manufacturers. In addition to the financial consequences in the short term, turning away from diesel-related technologies will require massive investments that will have an impact on their profitability.



SECTOR RISK ANALYSIS - APRIL 2016

ICT

ASSESSMENTS BY COFACE



RISKS ASSESSMENTS

HIGHLIGHTS

The global outlook for the information and communication technologies sector remains buoyant. Growth in internet traffic has been particularly boosted by the democratisation of internet access (due to lower prices of terminals and improved infrastructures) and greater use (replacement of voice communications, HD video, mobile payments). The volume of data exchanged is expected to triple by 2019, when 50 percent of individuals will be internet users (Cisco).

However, the increase in penetration rates is leading to the saturation of some hardware markets. This is particularly the case with PCs, as well as tablets - the sales of which are continuing to fall, to the benefit of increased-capacity smartphones. Although this trend is striking in developed countries, it is also occurring in emerging countries. The rapid development of the Chinese market slowed down in 2015, when smartphone sales grew +2.5% (versus +20% growth in 2014) and PC sales fell by -7.7% (IDC). Nevertheless, the deployment of 4G is bolstering spending on replacement devices. In India, the market share of 4G smartphone sales is now higher than for 3G. The largest growth drivers are the internet of services and applications for the automotive and industrial sectors.

This context is accentuating the competitive pressures between telecom operators and manufacturers (smartphones, computers, semiconductors) and encouraging consolidations and restructuring. In December 2015, Freescale and NXP officially merged, to create a semiconductor group with a turnover of EUR 10 billion. Toshiba has confirmed that it will no longer produce PCs. In October 2015, Western Digital announced the acquisition of SanDisk, which will create one of the leaders in flash memory devices and hard disks.

Strengths

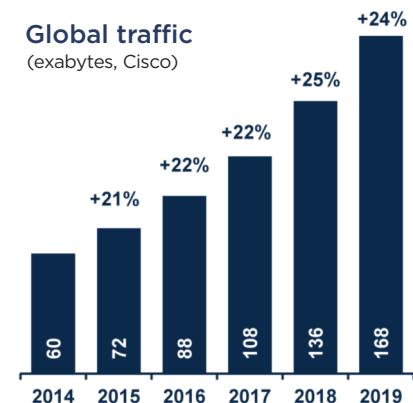
- Democratisation of internet access
- Cost reduction of electronic equipment
- Dynamic deployment of 4G
- Sharp growth in the African market

Weaknesses

- Saturation of some hardware markets in developed countries (tablets, smartphones, PCs)
- Temporary price increases in the eurozone, linked to the appreciation of the dollar
- Increasing competitive pressures for telecoms operators and manufacturers

Global traffic

(exabytes, Cisco)



ICT

DEMAND

Given the saturation of developed markets, **the most dynamic regions are concentrated in emerging Asia (excluding China), Africa and the Middle East.** Iran could become the largest market in the Middle East, in terms of the number of 3G and 4G subscriptions, in 2019 (BMI).

Between 2010 and 2014, the internet access rate in Sub-Saharan Africa doubled to 19% of the population (UIT). This democratisation is mainly via wireless internet networks, which is in turn underpinning the demand for mobile services. In Kenya for example, 30% of financial flows transit via mobile phones. On a worldwide scale, half of all mobile payments are made in Africa (Deloitte). Thanks to investments in 3G and 4G infrastructures, smartphone sales could double by 2017 (Deloitte). The fall in connection costs is continuing in developed countries, within a context of market concentration. Embedded payment systems are also boosting the use of mobile phones. As in the EU, Gulf countries are expected to gradually adopt the end of roaming, from April 2016 until April 2019, which will encourage local demand.

The Chinese market has been driving global sales in all segments for several years, but is currently showing signs of saturation. For smartphones, its world market share fell from 33% in 2014, to 30% in 2015. This share is likely to continue to decrease, particularly to the benefit of India. **While smartphone sales will continue to falter in the medium term, other growth drivers will appear.** This is particularly the case with car equipment, due to the rapid expansion of connected devices embedded in mass-produced vehicles.

Video consumption accounts for a significant share of the increase in internet traffic. The growth of US-company Netflix is an illustration of the new consumption patterns for on-demand audio-visual content, bolstered by the rapid expansion of connected TV. Moreover, the outlook for the development of online storage services remains buoyant. **Lastly, we are seeing fixed/mobile convergence and increasing consumption of data, voice over IP and SMS.** These developments are driving the consumption of cloud services, for which the growth outlook remains very positive. In the EU, these services were used by one-third of households, but only by 19% of companies in 2014 (Eurostat).

PC demand will remain sluggish in 2016, following a worldwide fall of 10.4% in 2015 (IDC). While tablets are gaining market share from PCs, their sales also contracted by 10.1% in 2015. This indicates signs of market saturation on a global scale. **Consumer demand is more favorable for smartphones (where sales, although slowing, grew by +10.1% in the same period) and for detachable tablets.** In some emerging markets, such as India, detachable tablets are now preferred over personal computers. **Consumers will continue to show a preference for these terminals in 2016.**

SUPPLY

While sales growth is decelerating on a worldwide scale, the competitive pressures are increasing. In China, the increase in the number of smartphone manufacturers squeezed the sector's margins in 2015, pointing to a move towards consolidation.

Overall, manufacturers have been affected by the fall in PC sales and the slowdown in smartphone sales. Turnover of the South Korean giant, Samsung, fell by 2.7% in 2015. Nevertheless, Samsung, confirmed its leading position on the smartphone market in 2015, with a 23% market share (IDC). **Prices will continue to fall in 2016 due to increasing competition,** even though the appreciation of the dollar in 2015 temporarily increased selling prices, especially in Europe. Apple reported a record quarter in Q4 2015, with a turnover of USD 75.9 billion (+1.7% compared with Q4 2014). However, iPhone sales showed the first signs of a slowdown, with only +0.4% growth compared with Q4 2014, i.e. 75 million units. The company announced a fall in the sales of its flagship product for Q1 2016, for the first time since its launch in 2007.

Chinese manufacturer Xiaomi confirmed its top ranking in China in 2015, even though the 65 million units sold were far from its 100 million target. The growth drivers for the group are found in India, Brazil and sub-Saharan Africa, where commercial activities were commenced in November 2015. **The number of Chinese companies involved in the smartphone sector has increased significantly, with cost-cutting strategies and innovative distribution channels.** It is unlikely that all will survive as the sector consolidates.

The semiconductor sector remains dynamic, but very competitive. The leader, Qualcomm, reported a -19% decline in its Q4 2015 turnover, while Samsung chips are gaining ground. However the outlook for 2016 is hampered by weakening sales growth. Actors are merging to optimise their cost structures. Avago acquired Broadcom for USD 37 billion and Intel, after a -1% decrease in its turnover in 2015, bought Altera for USD 17 billion. Moreover, the Chinese government is planning to increase its position on this market, after announcing a development plan totalling USD 100 to 150 billion. The country actually imported semi-conductors to a value of USD 128 billion in 2014.

The telecoms market also has to face new competition from internet service companies such as Google and Facebook, who are seeking to increase their internet coverage rate. This scenario will probably give rise to increased competitive pressures on telecom operators, who are already under attack in their traditional core businesses of voice and messaging communications.



SECTOR RISKS ANALYSIS - APRIL 2016

RETAIL

ASSESSMENTS BY COFACE

NORTH AMERICA



MEDIUM

LATIN AMERICA



HIGH

EMERGING ASIA



MEDIUM

CENTRAL EUROPE



MEDIUM

WESTERN EUROPE



MEDIUM

M. EAST + TURKEY



MEDIUM

RISKS ASSESSMENTS

HIGHLIGHTS

The driving force of retailing, household consumption, differs from one region to another. It is contracting in Brazil, it is shrinking but its growth remains positive in Asia as well as in the United States, while it is picking up in Europe.

Since the fall in retail sales at a worldwide level during the 2009 financial crisis (see chart), they have been growing by more than 2% per year since 2010 and close to 3% in 2015. But some sectors do not benefit from this improvement, including that of electronics in Asia.

E-commerce sales of consumer goods represent a major challenge for retailers. They are growing strongly (+28% in 2014) throughout the world, and should reach USD 1,700 billion in 2015 (50% of which in the United States, China and the United Kingdom). In 2015, 11% of the French funds raised for the CapHorn Invest fund (specialised in retailing) relate to digital transformation. According to emarketer, the number of online buyers in the world is estimated to increase by 7.6% year-on-year in 2016, which is promising for the e-commerce giants (Amazon, Alibaba and Ebay), which already had around 800 million clients in 2015. In France for example, online purchases are expected to grow by 10% in 2016 according to Fevad (after a 14% increase in 2015). Although the market potential is great, the retailers' battle to acquire market share has become even tougher.

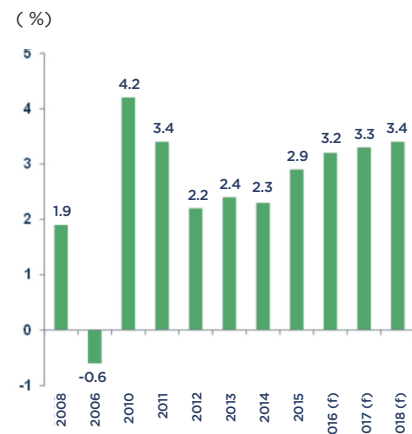
Strengths

- Sustained retail sales growth since 2010.
- Growth in the Chinese middle class.
- Significant urbanisation in Asia and Africa, driving the sector

Weaknesses

- Slowdown in emerging economies
- Fierce competition in the sector

Growth in global retail sales 2008-2018



Sources : PwC; Economist Intelligence Unit

RETAIL

DEMAND

Eurozone growth should come in at +1.7% in 2016 according to Coface (versus 1.5% in 2015) and is likely to be boosted by household consumption, which bodes well for the sector. Indeed household purchasing power grew already in 2015, particularly due to the low level of inflation. The drop in the rate of unemployment, which affected 10.3% of the eurozone labour force in January 2016 (11.3% in January 2015), also explains part of this development. Likewise, retail sales growth remains satisfactory in the euro zone (2.4% in January 2016 year-on-year); it is now higher than in the United States (2.1% in January 2016 year-on-year).

In North America, retailing could be affected by the slight slowdown in growth in the United States (+2% in 2016 according to Coface, versus 2.4% in 2015). If growth is stimulated by household consumption (+3.1% year-on-year in Q4 2015), wages and the continuous fall in unemployment over the past two years (4.8% in the fourth quarter of 2015), then signs of faltering are perceptible for 2015, when the growth rate in retail sales was halved (year-on-year) between February 2015 (4.1%) and February 2016 (2.2%). Given the rise in interest rates and in short-term interest rates linked to consumer loans, the impact should be negative for US consumers who consume on credit. The trend is the same in Canada, where retail sales grew at almost half the rate in January 2016 (+2.6%) as in January 2015 (+4.3%). In spite of a recession in the second quarter of 2015, with a slowdown in household consumption (2.4% year-on-year in the second quarter of 2015, versus 2.8% in the fourth quarter of 2014), consumption is nevertheless likely to pick up slightly in 2016 (GDP growth of +1.5% according to Coface, versus 0.9% in 2015).

Demand should have a negative impact on the retailing sector in Latin America in 2016. The 3% contraction in Brazilian GDP is a sign that consumption will continue to suffer. Retail sales growth in Brazil is negative year-on-year (-5% in January 2016). This economy must deal with rising unemployment, high inflation (+10.7% in 2015), and an erosion of real wages.

The slowdown in the Chinese economy (+6.9% in 2015 and +6.2% in 2016 according to Coface) should continue to drag down demand in 2016. Households' confidence has been eroding since the summer of 2015, and growth in their available income has been slowing down markedly (+8.2% year-on-year in Q4 2015 versus +9.3% in Q4 2014). While retail sales growth still exceeds 10% (10.6% in February 2016), it fell by 31% year-on-year in 2015.

SUPPLY

Revenues of companies in this sector are increasing moderately in Europe, as shown by the resilience of Carrefour, the European leader in food retailing, whose turnover grew by 3% in 2015 to €86.3 billion. Likewise for Leclerc, whose turnover grew by 3.4% on 2015 and which expects it to grow by 3% in 2016. This vigour is seen in France (+3.4% in 2015 versus +1.8% in 2014). In the United Kingdom, revenues from retail sales of beverages and food products recorded 7% growth between 2014 and 2015, and are estimated to grow by 9% between 2015 and 2016 according to Eurostat. Lastly, discounters like Lidl continue to gain market share in France (+0.2 percentage points to 4.9% market share in December for Lidl), while in the United Kingdom, the low-cost airline EasyJet had a very promising start to 2016.

In the United States, while the turnover of the world's largest retailer, Walmart, increased by 2% year-on-year in 2015, it is expected to stagnate in 2016 (according to the group). The strong dollar is having a negative impact on the revenues of the retailers, which generate one-third of their turnover outside the United States. Concerning Walmart, the changes in its wage policy, which will increase the wages of 1.2 million of its employees (USD 10 per hour from USD 9 previously) from January 2016, is expected lead to a 9.8% decline in the operating margin in 2016. Concerning e-commerce, in July 2015, Walmart launched its programme of free and unlimited deliveries on US soil for USD 50 a year (versus USD 90 for Amazon's "prime" programme). Some retailers suffered in 2015 and were placed under safeguard proceedings, such as the groups Quick Silver, taken over by Oaktree capital Management end-2015 and American Apparel (textile), taken over in early 2016. In Canada, the closure of all the stores of the Canadian subsidiary of Target (the fifth largest US retailer) in early 2015 (133 stores and 17,600 jobs affected) confirms this trend.

In Latin America, companies in the sector are suffering from the economic slowdown. In Brazil, the contraction in activity has led the US retailer WalMart, the world's largest retailer, to close 60 stores in 2016. In contrast, Carrefour, which has been present in Brazil for 40 years, was an exception as it managed to obtain 7.9% sales growth in 2015.

Companies in the retailing sector are likely to suffer from the economic slowdown in China in 2016. That is already the case with Carrefour, which posted a 15.7% decline in its organic sales in the fourth quarter of 2015 in this region. The financial situation of certain Chinese food distribution suppliers could therefore tighten, like that of Electronics companies in China and Taiwan, whose credit risk increases. Also, while Alibaba (second largest e-commerce site in the world) posted 38.9% year-on-year growth in its e-commerce turnover in 2015, it did not increase as fast as in 2014 (+54.7%) or in 2013 (+86.5%).

RESERVATION

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COFACE SA

1, place Costes et Bellonte
92270 Bois-Colombes
France
www.coface.com

