Managing risk, enabling trade

September 2016

# market monitor

## Focus on steel and metals performance and outlook

## Disclaimer

# 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 facing difficulties

Until recently, China was the driver of growth in the steel and metals industry since accounts for half of the world's demand. However, since 2014 steel and metals demand from China has deteriorated, largely due to weak demand from the Chinese property sector. At the same time, China's steel exports have continued to increase (up 22% in 2015). As Chinese steel surpluses have found their way to international markets, its lower steel price is putting pressure on prices worldwide. This has led to a decline of roughly 40% in metals prices and increased overcapacity over the past two years.

The World Steel Association (WSA) forecasts that worldwide apparent steel use is expected to decrease further, by 0.8% in 2016, after a decrease of 3% in 2015. The global steel and metals sector continues to suffer from overcapacity and under demand, against a backdrop of sustained price pressure and high fixed production costs, resulting in elevated credit risk for many businesses in the industry.

Businesses in upstream industries have been the ones mostly affected due to high fixed production costs, high capital and operating expenditure needs and leverage. Many companies´ ratings have been downgraded, resulting in higher financing costs, as interest rates are generally linked to rating triggers. These companies suffer from reduced cash flows due to revenue decreases and higher debt service costs. At the same time, the steel and metals trading segment has been affected; especially businesses with low margins, substantial stock that they have owned for longer periods of time and high debt levels.

# China

- So far, consolidation efforts have been limited
- High business leverage remains an issue
- Insolvencies expected to increase further in 2016

## Overview

| Credit risk assessment | significantly improving | improving | stable | deteriorating | significantly deteriorating |
|---|---|---|---|---|---|
| Trend in non-payments over the last 6 months | | | | ✔ | |
| Development of non-payments over the coming 6 months | | | | ✔ | |
| Trend in insolvencies over the last 6 months | | | | | ✔ |
| Development of insolvencies over the coming 6 months | | | | | ✔ |
| **Financing conditions** | **very high** | **high** | **average** | **low** | **very low** |
| Dependence on bank finance | ✔ | | | | |
| Overall indebtedness of the sector | ✔ | | | | |
| Willingness of banks to provide credit to this sector | | | | | ✔ |
| **Business conditions** | **significantly improving** | **improving** | **stable** | **deteriorating** | **significantly deteriorating** |
| Profit margins: general trend over the last 12 months | | | | | ✔ |
| General demand situation (sales) | | | | | ✔ |

Source: Atradius

In 2015, Chinese steel output decreased 2.3% - the first year of decline since 1981. According to the China Iron and Steel Association (CISA), total revenues of its members decreased 19% in 2015, to about CNY 2.89 trillion (EUR 392 billion), while the overall net loss amounted to CNY 64.5 billion (EUR 8.7 billion). In Q1 of 2016 Chinese steel demand and businesses' profits picked up due to some government stimulus measures. However, the rebound has been short-lived, with profits decreasing again in June 2016 and steel demand expected to decline 4% in 2016 and 3% in 2017. The adverse market conditions will probably deteriorate in 2016 and 2017. Steel prices continuously declined over the last four years.

Overcapacity remains the main challenge, as the rebalancing of the Chinese economy from investment and export-oriented driven growth towards private consumption continues. China's GDP growth is expected to slow down to 6.5% in 2016 and 6.3% in 2017, after 6.9% in 2015.

In 2015, Chinese steel exports increased 20.3% year-on-year, to 111.2 million tonnes. This growth slowed down to 11.5% year-on-year in Q1 of 2016, and it is expected that steel exports will bottom out in 2016 and decrease thereafter, as more countries impose duties on Chinese steel imports. In March 2016, the US imposed import duties of 266% on certain Chinese steel products. In January 2016, the EU announced the imposition of new tariffs which focus on the construction-use steel bars and these were raised from 9.2% to 13%.

China's government has repeatedly said that it will reduce steel overproduction and consolidate the industry, e.g. the goal is to concentrate 60% of the country's total steel capacity in the hands of its top 10 steel producers. However, success has been limited so far as regional governments have a strong incentive to support local production where possible to maintain employment and prestige. While a comprehensive consolidation of the sector still has a long way to go, in 2016 consolidation efforts have fi-

### China: Metals sector

| | 2015 | 2016f | 2017f |
|---|---|---|---|
| GDP growth (%) | 6.9 | 6.6 | 6.3 |
| Sector value added growth (%) | 7.2 | 4.8 | 4.3 |

| | |
|---|---|
| Sector share in the national economy (%) | 5.0 |
| Average sector growth over the past 3 years (%) | 8.8 |
| Average sector growth over the past 5 years (%) | 9.6 |
| Degree of export orientation | high |
| Degree of competition | very high |

Sources: IHS, Atradius

nally been reinforced. Accusations of Chinese steel dumping will also pressure the government to scale back domestic steel production and exports over the coming years.

According to the World Steel Association China's steel output is expected to contract by an average of 1.4% annually from 2016 to 2020, compared to an average growth of 4.9% from 2011 to 2015.

For both steel manufacturers and steel traders, bank financing is the major source of funding. High leverage has been an outstanding issue over the last couple of years, together with shadow banking, while many steel companies have repeatedly pledged the same collateral for loans from several different banks, thus multiplying the risk. At the same time, loans - especially to steel traders - are being used for purposes other than investment in steel: i.e. to invest in more profitable businesses. The intertwined nature of loan guarantees in China's steel sector implies that credit default by a single company could trigger a chain reaction across a string of other firms which are often guarantors of debts for their bankrupt competitors. For all those reasons, there is a high potential systemic risk for banks, forcing them to cut loans. In 2014, many banks suddenly revoked credit lines all of a sudden, which forced many players to leave the market immediately.

Payments in the Chinese steel and metals industry take between 60 and 120 days, on average. Payment behaviour has been very bad over the past two years, and a further increase in payment delays is expected in the coming months. Insolvencies have increased substantially in 2015 and H1 of 2016, and are expected to increase further due to the combination of the slowdown in construction activity, and the low margins, net losses and high gearing of many steel businesses. While leading state-owned steel makers still show some resilience, many private owned steel and metals producers face serious trouble. Many Chinese steel and metals traders do not have many fixed assets, and suffer from slim margins and very limited bank facilities.

Given the currently poor performance, our underwriting stance is very restrictive on the steel and metals sector.

### Chinese steel/metals sector

| | |
|---|---|
| Strengths | Government support for state-owned enterprises will prevent drastic production cuts in the short term |
| | Growth in the automotive sector may provide a silver lining for steel producers |
| | Consolidation is likely to lead to the elimination of surplus capacity in the long term |
| Weaknesses | Low margins and heavy losses |
| | Steel and metals consumption growth will see a marked slowdown over the coming years |
| | Restrictive bank policies will force more producers to go out of business |

Source: Atradius

# Germany

- Better results expected in 2016
- Payments take between 30 and 45 days
- Increasing payment delays in some segments

## Overview

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

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

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

Source: Atradius

The German steel and metals sector (with its main subsectors metals manufacturing, wholesale of metals and ores, iron and steel) is heavily dependent on the overall development of the German economy, especially on the performance of construction and export-oriented sectors such as mechanical engineering and automotive manufacturing.

According to the German Association of Steel and Metal Processing, production increased just 0.5% year-on-year in 2015, and in 2016 production growth of 1%-2% is expected, while the market environment is expected to remain difficult. In 2015, overcapacity and lower prices led to strong competition with decreasing sales and margins and depreciation of inventory. Therefore, the balance sheets of many steel and metals businesses show losses, especially due to the fact that prices deteriorated sharply last year. However, prices rebounded in early 2016, which means that businesses can expect better results in 2016, with improved profit margins.

While profit margins are shrinking, the general equity and liquidity of steel businesses in Germany are better than the manufacturing industry average, except for small wholesalers without pre-fabrication and/or steel service activities. Banks are generally willing to provide loans to the steel and metals sector.

It is expected that structural challenges (global overcapacities, cheaper imports from China and other foreign competitors, price volatility, geopolitical uncertainties, high energy costs in Germany) will continue to be downside risks for the time being. That said, the German steel and metals sector remains resilient with a competitive edge, due to its high technology products. Market participants remain rather optimistic about the further development of the main steel consuming sectors like automotive, construction and mechanical engineering. But without market adjustment, the economic slowdown in China and the unsatisfactory price development may have further negative impacts on export activities. Additionally, the final outcome of the Volkswa-

### Germany: Metals sector

| | 2015 | 2016f | 2017f |
|---|---|---|---|
| GDP growth (%) | 1.7 | 1.6 | 1.2 |
| Sector value added growth (%) | -0.2 | 0.6 | 0.5 |

| | |
|---|---|
| Sector share in the national economy (%) | 0.8 |
| Average sector growth over the past 3 years (%) | 0.9 |
| Average sector growth over the past 5 years (%) | -0.6 |
| Degree of export orientation | high |
| Degree of competition | very high |

Sources: IHS, Atradius

gen scandal has to be closely monitored, as automotive suppliers could be affected by lower demand and cancelled orders.

We have seen no change in the payment behaviour of companies in the steel and metals sector over the past couple of months, with payments taking, on average, between 30 and 45 days. However an increase in payment delays in some more troubled segments cannot be excluded: the tubes and pipe segment suffered from decreased orders and postponed projects in the oil and gas industry. Those businesses are now more dependent on their credit lines in order to finance their working capital/high inventories and potential losses. Another difficult subsector is scrap recycling where businesses suffer from low steel prices and decreased margins. Additionally, smaller steel traders without additional business like prefabrication and weak equity ratios are facing strong competition and low margins.

While we are more cautious when underwriting the aforementioned segments, in general our underwriting stance for German steel and metals businesses is basically positive. Insolvencies in this industry are not expected to increase in the coming six months. We pay particular attention to recent financial information (balance sheets, interim figures, bank status, payment terms, duration of contract, order volume, payment behaviour).

### German steel/metals sector

| | |
|---|---|
| Strengths | Broad range of customer industries and export destinations |
| | High quality/niche products |
| | High technology level compared to other competitors |
| Weaknesses | High energy costs |
| | High competition, increased by imports from China |
| | High dependency on raw materials |
| | Increasing overcapacity with pressure on margins |

Source: Atradius

# India

- Robust growth drives domestic steel consumption
- Government measures to stem steel imports
- Payments take between 60 and 90 days on average

## Overview

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

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

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

Source: Atradius

According to the Joint Plant Committee (a unit set up by the Indian Ministry of Steel), in the 2015-2016 fiscal year (in India the financial year runs from 1 April to 31 March) India's steel production decreased 1.9% year-on-year, to 90 million tonnes. That said, steel consumption increased 4.5%, to 80 million tonnes, driven by demand from the automotive and (road) construction sectors as well as increased public sector spending. Steel imports increased 25.7%, while exports decreased 27.1%. Imports of total finished steel products accounted for 15% of domestic steel consumption, in contrast to the average 10% rate in the previous five years. As in 2014, India was a net importer of finished steel.

In order to stem rising imports and to protect domestic steel producers, the Indian government has implemented certain measures in 2015 and early 2016, such as increasing the steel import duty from 5% to 12.5%, fixing a Minimum Import Price (MIP) for steel ranging from USD 341 to USD 752 per tonne with effect from February 2016, and putting steel imports under Mandatory Bureau of Indian Standards (BIS) certification scheme. This resulted in a decrease of steel imports by 29% year-on-year in April-May 2016.

The measures to stem cheap steel imports have been welcomed by the Indian steel industry, which has seen two years of sliding net sales, dropping profits and, in some cases, rising net losses and an erosion of net worth. Due to decreasing imports and rebounding sales prices, domestic steel producers are expected to increase sales volumes again.

Domestic steel demand is expected to increase 6.3%-6.5% in the fiscal year 2016-2017, due to increased consumption by key end-user industries such as construction, capital goods and consumer durables. The government's focus on infrastructure growth through initiatives such as Housing for All, the develop-

**India: Metals sector**

| | 2015 | 2016f | 2017f |
|---|---|---|---|
| GDP growth (%) | 7.6 | 7.5 | 7.6 |
| Sector value added growth (%) | 1.1 | 4.7 | 6.2 |

| | |
|---|---|
| Sector share in the national economy (%) | 1.6 |
| Average sector growth over the past 3 years (%) | 4.9 |
| Average sector growth over the past 5 years (%) | 5.4 |
| Degree of export orientation | medium |
| Degree of competition | high |

Sources: IHS, Atradius

ment of 100 smart cities (Smart Cities Mission), and the launch of a National Infrastructure Investment Fund is expected to spur demand in the construction sector. A benign inflationary environment along with lower interest rates is expected to support demand for capital goods and consumer durables.

However, it is expected that the benefits from domestic demand growth will be offset by limits to raise sales prices due to the global steel overcapacity and cheap imports. At the same time, the share of stalled projects in the steel and metals industry has risen steadily since June 2015, to more than 12% at the end of March 2016. This was mainly due to the private sector where more than 20% of investments are stagnant. As a result, outstanding loans in the steel industry have increased, making the sector one of the largest contributors to non-performing assets (NPA) in India. Due to the high NPA level, banks remain reluctant to provide loans to the industry. External financing at competitive conditions remains a challenge for many steel businesses.

On average, payment periods in the Indian steel and metals industry have remained unchanged since last year, taking between 60 and 90 days. However, we also have monitored cases where payment terms have been extended, going up to 180 days.

We have received just a few credit insurance claims in the last three years and, based on our experience to date, we do not plan any imminent major change in our underwriting approach as we do not expect any major increase in payment delays or insolvencies. Nevertheless, we remain prudent in underwriting this sector.

We are maintaining a particularly cautious approach on steel traders and wholesalers. To accurately assess credit limit applications we always require up-to-date financial information and, more importantly, details of up-to-date trading experience with buyers in order to assess actual requirements and monitor any changes in payment behaviour. We also assess the strength of the customer/buyer relationship.

As securities (in the form of guarantees to trade suppliers) are fairly unusual in India, we would tend to agree to partial decisions rather than require a security, which is hard or even impossible for the customer to obtain. If we are restrictive in our decisions, we always explain our areas of concern and what information we would need to reassess. We would generally not encourage customers to lengthen their normal terms of payment.

**Indian steel/metals sector**

| | |
|---|---|
| Strengths | Increased infrastructure spending |
| | Increased pace of urbanization and industrialization |
| | Relatively low capital and labour costs |
| | Protectionist measures in order to curb imports |
| Weaknesses | Cheaper imports from China and other countries |
| | Regulatory hurdles hamper iron ore mining |
| | Increased number of stalled projects due to stagnant investment in the private sector |
| | Infrastructure constraints |

Source: Atradius

# Italy

- Still no major rebound in 2016
- Mergers and integrations to help the sector
- Payments take 90 days on average

## Overview

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

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

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

Source: Atradius

For the Italian economy the metals, and in particular, the steel industry are of major importance, accounting for about 2% of GDP. The steel sector suffered from massive production and consumption decreases in 2009 and again in 2011-2013, due to weak demand, overcapacity and flat prices, with all the players along the value chain suffering from deteriorating margins. Since then the industry's performance has bottomed out, thanks to increased demand from the automotive sector. Demand from construction, however, which accounts for about 50% of steel consumption, remains flat. All businesses along the value chain, from steel mills to service centres and wholesalers, are impacted by the still subdued domestic demand for steel.

Italian steel production decreased by more than 7% in 2015, to 22 billion tonnes, and continued to decline in Q1 of 2016. In addition to the subdued demand, producers suffered from low cost Chinese steel imports, especially in the flat steel products segment (prices of flat products imported from China are on average 15% cheaper than domestic products). The Chinese competition has also taken advantage of the fact that the Ilva steel mill still operates well below full capacity.

The stainless steel segment is less impacted by Chinese dumping policies, while the margins of foundry businesses have rebounded due to lower energy prices. The Italian steel distributor and service centre segments has a large number of relatively small companies. While we are seeing mergers and consolidation among the top players, smaller players are experiencing a greater impact from weak demand, pressure on margins and are highly leveraged. In this segment, businesses linked to the construction sector and to the oil and gas industry (tubes) continue to face difficulties, while businesses dependent on automotive

### Italy: Metals sector

| | 2015 | 2016f | 2017f |
|---|---|---|---|
| GDP growth (%) | 0.8 | 0.8 | 0.8 |
| Sector value added growth (%) | -2.8 | 0.1 | 0.5 |

| | |
|---|---|
| Sector share in the national economy (%) | 0.6 |
| Average sector growth over the past 3 years (%) | -1.8 |
| Average sector growth over the past 5 years (%) | -1.1 |
| Degree of export orientation | medium |
| Degree of competition | high |

Sources: IHS, Atradius

have benefitted from the upswing in the car industry. Wholesalers of scrap have been negatively affected by persistently low prices, leading to an uptick credit insurance claims.

The outlook for the Italian steel and metals industry in H2 of 2016 and early 2017 remains mixed, as exports benefit from a weaker euro exchange rate. However, the Algerian market as one of the main export destinations (together with Germany) is expected to mature within the next 4-5 years and has recently imposed limits on steel imports. While steel and metals prices are expected to rebound somewhat in the coming months, helping to stabilise businesses´ margins, excess production capacity will remain an issue for the industry.

Despite the on-going challenges, payment delays are not expected to increase for the time being after increasing in 2015. However, businesses operating in the domestic market are still affected by slow payments from their customers. Insolvencies are not expected to show a major increase in 2016, however, caution is advised due to the still fragile nature of the sector.

Our underwriting stance remains generally neutral to cautious, depending on the performance of the subsectors and their main buyer industries.

### Italian steel/metals sector

| | |
|---|---|
| Strengths | Flexible production |
| | Export oriented |
| | Consolidation in certain sectors |
| Weaknesses | Weak domestic demand |
| | Market remains quite fragmented |
| | High dependence on construction |

Source: Atradius

# United Kingdom

- **The market situation remains difficult**
- **Payments take 60 days on average**
- **No major insolvency increase expected in 2016**

## Overview

| Credit risk assessment | significantly improving | improving | stable | deteriorating | significantly deteriorating |
|---|---|---|---|---|---|
| Trend in non-payments over the last 6 months | | | ✔ | | |
| Development of non-payments over the coming 6 months | | | ✔ | | |
| Trend in insolvencies over the last 6 months | | | ✔ | | |
| Development of insolvencies over the coming 6 months | | | ✔ | | |
| **Financing conditions** | **very high** | **high** | **average** | **low** | **very low** |
| Dependence on bank finance | ✔ | | | | |
| Overall indebtedness of the sector | ✔ | | | | |
| Willingness of banks to provide credit to this sector | | | ✔ | | |
| **Business conditions** | **significantly improving** | **improving** | **stable** | **deteriorating** | **significantly deteriorating** |
| Profit margins: general trend over the last 12 months | | | ✔ | | |
| General demand situation (sales) | | | | ✔ | |

Source: Atradius

The market situation of the British steel and metals industry remains difficult, as overcapacity, fierce competition, exchange rate volatility, high energy costs, on-going austerity measures and increased uncertainty due to the Brexit decision continue to weigh on the performance and financial strength of many businesses.

Like their European peers, British steel producers suffer from the increased levels of steel shipments originating from Russia and China, while steel prices remain depressed, largely as a result of low commodity prices and in particular iron ore. Both countries, in particular Russia, have always been near the bottom end of the cost curve providing them with a competitive advantage.

Additionally British steel and metals businesses were affected by on-going difficulties in the construction sector, which is a main consumer of steel. While the residential building sector has reported growth, this segment requires very little steel and metal. It is expected that the UK construction sector will be negatively affected by the recent Brexit decision, as the subsequent economic uncertainty has started to trigger the postponement of investment decisions.

The more adverse market conditions have continued to impair revenues, margins, profits and cash flow for many businesses. Consequently, in a bid to mitigate liquidity risks, cost cutting programmes and vigilant cost management strategies have been implemented, inventories are being unwound and non-core assets disposed of. However, while cost containment measures have been the industry´s main response to overcapacity so far, this could turn out to be just a short-term remedy. Maintaining margins through cost reduction and focusing on high-end products should not be seen as an ultimate solution to structural problems.

**United Kingdom: Metals sector**

| | 2015 | 2016f | 2017f |
|---|---|---|---|
| GDP growth (%) | 2.2 | 1.6 | 0.6 |
| Sector value added growth (%) | -5.5 | -0.2 | 0.1 |

| | |
|---|---|
| Sector share in the national economy (%) | 0.2 |
| Average sector growth over the past 3 years (%) | -0.7 |
| Average sector growth over the past 5 years (%) | -0.3 |
| Degree of export orientation | low |
| Degree of competition | high |

Sources: IHS, Atradius

That said, many businesses have already invested in new technologies, such as laser cutting and detailed integrity scanners in order to gain competitive advantages. In the steel and metals industry the ability of businesses to process products efficiently is a major asset. Although low margin businesses, UK steel stockholders are mainly long established and profitable. They are heavily reliant on bank finance (mainly invoice discounting) in order to have stock available as and when it is required. Usually they have low overheads, which makes them resilient to economic changes, as they are able to unwind inventories in order to free up cash. Low steel prices also provide them with opportunities to purchase products cheaply.

The average payment duration in the UK steel and metals industry is 60 days. Despite the current challenges, payment delays are not expected to increase for the time being. Insolvencies are not expected to show a major increase in 2016, however, caution is advised due to the still fragile nature of the sector, which can lead to unexpected failures.

Our underwriting approach remains selective, as market conditions are unstable and the potential volatility of a rebound should not be underestimated. However, we continue to underwrite positively on acceptable risks. While our underwriting strategy is largely on a case-by-case basis, over the last few years, we have adopted a comprehensive understanding of the sector and the prevailing issues. We are mindful that this is a low margin sector, with fierce competition and high dependency on banking lines, where highly leveraged balance sheets can cause issues during a downturn.

**British steel/metals sector**

| | |
|---|---|
| Strengths | Investment in new technologies |
| | Abundant access to external financing |
| Weaknesses | Decreasing profit margins |
| | High dependence on construction |

Source: Atradius

# Market performance snapshots

## Thailand

- **Demand is driven by public construction projects**
- **Slim margins and strong competition**
- **Our underwriting stance is cautious**

Thailand is a net importer of steel due to low domestic production. The country is ranked 8th in the world as a net importer with net imports of 14.6 million tonnes in 2015. Thailand´s steel demand is expected to increase in 2016 due to new and on-going public construction projects, such as new public transportation systems (underground trains) and new private residential projects in response to the government public housing programme for low-income earners. Demand from the Thai construction sector alone is expected to increase by about 3% in 2016, to 8.4-8.6 million tonnes, following a2% increase in 2015.

We expect Thai steel producers´ margins will increase slightly due to rising demand. Margins should remain stable for steel traders and minor processors, who account for the large majority of Thai steel players. Competition in this downstream segment of the steel sector is very high, leading to very thin margins of just 0.5%-1.5% on average.

The gearing of steel businesses is high due to long trade cycles and slim and volatile margins. As a result, the gap between cash generated and cash required is usually financed by external parties such as banks. However, Thai banks are less willing to provide loans to the steel sector, given the high default rate and the recent debt impairment from one of the big local steel manufacturers at the end of 2015. Usually debts in the steel industry are on secured terms with high interest rates.

Payments in the industry take between 60 days and 120 days. In most cases payments are on time, as any payment delay from a particular buyer will cause the local suppliers to terminate and boycott the business relationship. The payment delay news spread very fast in Thailand as the relationship among the players in the steel industry is strong. That said, due to higher risk and increased volatility in the steel sector, the level of protracted payments is higher than in other industries.

Despite the rather benign growth outlook for the coming 12 months our underwriting stance remains cautious for the steel sector, due to the structurally weak market conditions in this sector and the on-going volatility in the global steel market. Local steel producers are not running cost-effective businesses due to outdated production technology, high labour and energy costs and volatile import raw material prices. Steel/metals traders and wholesalers are mainly  weaker buyers due to strong competition and slim margins.

# United States

- Increasing imports affect profit margins of US businesses
- Payment delays expected to increase further
- More insolvencies expected in the tubular goods segment

The US steel and metals sector´s revenue performance remains negatively affected by the lower cost of imported steel and decreasing demand from the oil/gas industry, which suffers from the oil price decline. The latter particularly affects the oil country tubular goods (OCTG) sector. Increased demand from construction and automotive sectors will not help US production facilities in the near term, as many manufacturers are buying their metal and steel products offshore. It is expected that the US steel/metals market will continue to see below-average demand, weaker pricing and strong import competition in H2 of 2016.

Profit margins of steel and metals businesses have substantially deteriorated over the last 12 months due to the negative impact that lower import prices has had on the sector, and this negative trend is expected to continue through the end of 2016. The inventory of some businesses is currently stocked at higher prices than they can sell to the market. Competition is increasing, as companies try to expand their regional reach (local to regional, regional to national) in order to find new business and increase revenues and profits.

Financing requirements and gearing are generally high in this industry, and banks have become increasingly reluctant to provide loans to businesses. Steel/metals companies must be financially very viable in order to obtain preferred lending terms and interest rates. Banks with tighter controls will pressure companies to reduce unused credit lines if history shows they are not using the maximum borrowing capacity, this is particularly the case for revolving credit lines.

The average payment duration is 30-45 days domestically and 60-90 days for businesses abroad. Payment delays and defaults have increased and are expected to rise further, as the cash flow of end-buyers has been impacted by lower growth, especially in the OCTG sector. Insolvencies have increased in the OCTG-related segment and are expected to increase further in 2016. Therefore, our underwriting stance remains restrictive for the time being.

We expect to see financial statements of many steel and metals businesses with lower revenues and operating profits and net income at the break-even or loss level. Cash flow is expected to weaken, but many of the larger public-listed companies, having experienced the 2008/2009 downturn, have hoarded cash over the last three years and should be able to survive the current downturn.

# Market performance at a glance

## Brazil

- The steel and metals sector remains severely impacted by the economic downturn (Brazil's GDP is expected to contract 3.4% in 2016 after shrinking 3.8% in 2015). The Brazilian business environment has deteriorated while interest rates, inflation and exchange rate volatility remain high.
- In the domestic market steel and metals mainly suffer from a massive decrease in public and private investment, especially in the major buyer industries construction and oil/gas. At the same time, exports are hampered by steel oversupply in the global market and the low competitiveness of many Brazilian businesses, even with a depreciated currency.
- Steel and metals is a sector highly dependent on bank financing, with many businesses highly indebted. Serving those debts has become increasingly difficult, mainly due to higher interest rates and the fact that banks are unwilling to provide new credit.
- Next to demand, profit margins have deteriorated over the last 12 months and are expected to further decline in the coming six months. Many businesses have to accept lower margins in order to preserve sales volumes.
- Payment behaviour in the steel and metals sector is bad, as non-payments have increased in 2015 and H1 of 2016. Due to the credit crunch generated by high interest rates many businesses are stretching their payment terms. Insolvencies of steel and metal businesses have sharply increased, and a further rise in business failures is expected in the coming months.
- Due to increasing credit insurance claims, the deteriorated business performance and increased credit risk, our underwriting stance is currently restrictive for all steel and metals subsectors.

## France

- The French steel and metals sector benefits from increased demand from automotive and from what appears to be the bottoming out of the slump in the construction sector. The French steel and metals trading segment is highly concentrated, with about two thirds of market share owned by trading subsidiaries of steel majors (Arcelor, Riva) or independent large groups.
- The high level of competition (domestic and foreign), overcapacity and persistent low prices continue to affect revenues and margins, especially of smaller steel/metals traders, wholesalers and processors. However, many smaller businesses are able to provide added value or are operating in niche segments that provide higher margins.
- Steel businesses are generally highly dependent on bank finance, either due to high capital expenditure when operating upstream and/or the need for short-term facilities to finance working capital requirements and inventories. Currently, the willingness of banks to provide credit to the sector can be described as neutral.
- Payment delays are not expected to increase in H2 of 2016, and the level of steel/metals insolvencies is not overly high. This is mainly because many steel and metals traders and wholesalers are able to adapt with a flexible cost structure. That said, the foundry segment and steel and metals businesses that are dependent on the oil and gas industry as their end-market currently face difficulties.
- Our underwriting approach remains neutral for the time being. However, conditions can change quickly in this industry, especially if decreasing revenues and margins are not bolstered on time by prudent cost management. Our underwriting strategy therefore takes into account the sector trends as well as the intrinsic financial situation of each buyer and potential support from lenders. We pay specific attention to receivables, inventories, and structural flexibility (supply network rationalization, diversification efforts, adaptation of business models from pure trading towards processing activity order to increase added value and therefore margins).

## Mexico

- In 2015 Mexico´s domestic steel production decreased 3.7%, to 18.2 million tonnes, the lowest amount in six years. Domestic production capacity decreased from 65.7% to 62.5% due to the suspension of activity in certain steel plants, as low-priced Chinese steel imports increased. Total steel imports rose by more than 10%, accounting for 47% of apparent national steel consumption. Mexico´s apparent steel consumption increased 6.6% in 2015.
- On average, payments in the Mexican steel and metals industry take 90 to 120 days. Payment delays have increased over the last 12 months due to steel price volatility and slower economic growth. That said insolvencies have remained stable, and no increase is expected in the coming months. The level of protracted payments, however, is expected to remain high.
- External risk factors for the Mexican steel industry remain the volatility of the currency exchange rate as well as international metals prices, together with uncertainty concerning China's economic performance and oil price developments. International competitiveness of the Mexican steel industry is hampered by the subdued quality of infrastructure, informality that prevails in the recycling industry and energy costs.
- As in previous years our underwriting stance remains cautious, especially due to potential exchange rate and steel price volatility. In order to accurately assess a credit limit application in this sector, we currently ask for audited financial statements for the year 2015 and management accounts for 2016. If audited financials are not yet available, we could consider year-end 2015 and 2016 management accounts signed by a company director, together with the most current interim financial information. Some underwriting cases can be supported by trading experience and/or guarantees or promissory notes (pagarés).

## The Netherlands

- The Dutch steel and metals sector consists mainly of steel traders and wholesalers, and is highly dependent on domestic economic development, especially construction sector performance. Therefore, the industry has benefitted from the recent rebound in the building sector. At the same time, demand from the oil and gas industry has decreased.
- Competition remains high in this industry, especially in the trade and wholesalers segment. Profit margins are generally low in the steel and metals industry, but are expected to remain stable in 2016, in line with the steel price development.
- Dutch steel traders and wholesalers are higly dependent on banks in order to finance their stocks. Banks have become more willing to lend than in previous years due to the economic rebound, however any major steel price decrease makes it harder to obtain additonal credit facilities.
- Payments in the Dutch steel and metals sector take 45 days on average. Payment behaviour is quite stable, and it is expected that non-payment notifications will not increase in the coming six months.
- Insolvencies have decreased in 2015 and are expected to level off in 2018. The insolvency level in this segment is quite low.
- Our underwriting stance will remain generally neutral for steel and metals traders who benefit from the construction rebound, and restrictive for steel and metals businesses that are negatively affected by lower orders from the oil and gas sector. Given the deterioration in this segment our general outlook for the industry remains “Poor” for the time being. Close monitoring of all steel and metals buyers is still necessary due to the very competitive business environment, which could lead to decreasing margins or even to the loss of contracts/orders for some steel/metals businesses.

## Singapore

- In Singapore construction accounts for 80% of steel consumption. Steel demand increased 5% year-on-year in 2015, to around 4 million tonnes. In early 2016, demand increased further due to the fact that in Q1 of 2016 construction was the best-performing GDP component, as building activity expanded 6.2%, thanks to increased public and private sector construction activities.
- Singapore is a net importer of steel due to the lack of upstream players. Almost all steel businesses in Singapore are traders and wholesalers, who either import steel and sell it locally or re-export from/to other countries.
- While the current upswing benefits domestic steel traders and wholesalers, the market situation in the segment remains difficult due to a fiercely competitive environment, which puts persistent pressure on (already thin) margins. Given the long trade cycle, external funding demand is very high for businesses in order to stay liquid. However, given the elavated risk situation in this sector due to very thin margins and price volatility, banks are generally unwilling to provide loans.
- Payments in the industry take between 60 days and 120 days. The level of protracted payments is high due to fiercecompetition and risky trading conditions. While steel insolvencies are expected to decrease in H2 of 2016 by 2%-3% due to the currently higher demand for steel in Singapore, our underwriting stance remains cautious because of the structurally weak market conditions in this sector and the on-going volatility in the global steel market. That said, our underwriting stance for the metal producers segment is more open, given the positive performance outlook and the fact that there are just a few long established players with a good reputation in the market.

# Industries performance forecast per country

September 2016

| | Agriculture | Automotive/ Transport | Chemicals/ Pharma | Construction Const.Mtrls | Consumer Durables | Electronics/ ICT | Financial Services |
|---|---|---|---|---|---|---|---|
| Austria | ⛅ | 🌧 | ☀ | ☁ | ⛅ | ☁ | ⛅ |
| Belgium | ☁ | ⛅ | ☀ | 🌧 | ☁ | ⛅ | ⛅ |
| Czech Rep. | ⛅ | ☀ | ⛅ | 🌧 | ☁ | ☁ | ⛅ |
| Denmark | ⛈ | ☁ | ☀ | ☁ | 🌧 | ☁ | ☁ |
| France | 🌧 | ☁ | ☀ | 🌧 | ☁ | ☁ | ⛅ |
| Germany | ☁ | ☁ | ⛅ | ⛅ | ☁ | ☁ | ⛅ |
| Hungary | ☁ | ☁ | ⛅ | ☁ | ☁ | ☁ | ☁ |
| Ireland | ☁ | ☁ | ⛅ | ☁ | ☁ | ☁ | ☁ |
| Italy | ☁ | ☁ | ⛅ | ⛈ | ⛅ | ⛅ | ⛅ |
| The Netherlands | ⛅ | ☁ | ☀ | ☁ | 🌧 | ☁ | ⛅ |
| Poland | ⛅ | 🌧 | ☁ | 🌧 | 🌧 | ☁ | ⛅ |
| Portugal | ☁ | ☁ | 🌧 | 🌧 | ☁ | 🌧 | 🌧 |
| Russia | 🌧 | ⛈ | ☁ | 🌧 | 🌧 | 🌧 | 🌧 |
| Slovakia | 🌧 | ⛅ | ⛅ | ⛈ | ☁ | ☁ | ⛅ |
| Spain | ☁ | ⛅ | ⛅ | 🌧 | ☁ | ☁ | ☁ |
| Sweden | ⛅ | ☁ | ⛅ | ☁ | ⛅ | ⛅ | ⛅ |
| Switzerland | ⛅ | ☁ | ⛅ | ☁ | ⛅ | ☁ | ☀ |
| Turkey | ⛅ | ⛅ | ☁ | 🌧 | ☁ | 🌧 | ⛅ |
| UK | ⛅ | ☁ | ⛅ | 🌧 | ☁ | ☁ | ☁ |
| Brazil | ☁ | 🌧 | ☁ | 🌧 | ⛈ | ⛈ | ⛅ |
| Canada | ☀ | ☁ | ☁ | ☁ | ☁ | ☁ | ☀ |
| Mexico | ☁ | ⛅ | ☁ | 🌧 | ☁ | ☁ | ⛅ |
| USA | ☁ | ⛅ | ⛅ | ☁ | ☁ | ⛅ | ⛅ |
| Australia | ⛅ | 🌧 | ☁ | 🌧 | ☁ | ⛅ | ⛅ |
| China | ☀ | ☁ | ☁ | 🌧 | ☁ | ☁ | ☀ |
| Hong Kong | N/A | ☁ | ☁ | ☁ | ⛅ | ⛅ | ⛅ |
| India | ☁ | ☁ | ⛅ | 🌧 | ☁ | ☁ | ☁ |
| Indonesia | ☁ | 🌧 | ☁ | ☁ | ☁ | ☁ | ☁ |
| Japan | ⛅ | ☁ | ☁ | ☁ | ☁ | ⛅ | ⛅ |
| New Zealand | ⛅ | 🌧 | ⛅ | ⛅ | 🌧 | ⛅ | ⛅ |
| Singapore | ⛅ | 🌧 | ☁ | 🌧 | ☁ | ☁ | ⛅ |
| Taiwan | N/A | 🌧 | ☁ | ☁ | ⛅ | ⛅ | ☁ |
| Thailand | ☁ | ☁ | ☁ | ☁ | 🌧 | ☁ | ☁ |
| United Arab Emirates | ⛅ | ☁ | ☁ | 🌧 | 🌧 | 🌧 | ☁ |

| Food | Machines/ Engineering | Metals | Paper | Services | Steel | Textiles |
|---|---|---|---|---|---|---|
| Good | Good | Fair | Fair | Good | Poor | Poor |
| Good | Fair | Fair | Poor | Poor | Fair | Poor |
| Fair | Fair | Fair | Fair | Fair | Poor | Poor |
| Good | Fair | Fair | Bleak | Fair | Poor | Poor |
| Good | Fair | Fair | Poor | Fair | Fair | Poor |
| Fair | Good | Fair | Poor | Good | Fair | Poor |
| Fair | Good | Poor | Fair | Good | Poor | Poor |
| Good | Fair | Fair | Bleak | Poor | Fair | Poor |
| Good | Fair | Poor | Poor | Good | Poor | Poor |
| Good | Fair | Poor | Fair | Good | Poor | Poor |
| Fair | Fair | Fair | Fair | Good | Fair | Fair |
| Fair | Fair | Poor | Fair | Good | Poor | Fair |
| Poor | Poor | Poor | Fair | Poor | Poor | Poor |
| Fair | Good | Fair | Fair | Fair | Poor | Poor |
| Good | Fair | Poor | Poor | Fair | Poor | Poor |
| Good | Good | Poor | Fair | Fair | Poor | Poor |
| Good | Good | Fair | Bleak | Good | Poor | Fair |
| Good | Fair | Bleak | Poor | Poor | Fair | Poor |
| Fair | Fair | Poor | Poor | Fair | Poor | Poor |
| Good | Poor | Poor | Poor | Fair | Poor | Poor |
| Good | Fair | Fair | Poor | Good | Fair | Bleak |
| Good | Fair | Poor | Good | Good | Poor | Poor |
| Good | Fair | Poor | Poor | Good | Poor | Fair |
| Good | Fair | Poor | Poor | Fair | Poor | Poor |
| Fair | Fair | Bleak | Poor | Good | Bleak | Poor |
| Excellent | Fair | Poor | Fair | Good | Poor | Fair |
| Good | Fair | Poor | Good | Good | Poor | Fair |
| Good | Fair | Poor | Fair | Fair | Poor | Fair |
| Good | Fair | Fair | Fair | Fair | Fair | Poor |
| Fair | Fair | Fair | Poor | Poor | Poor | Poor |
| Good | Fair | Fair | Fair | Good | Poor | Fair |
| Excellent | Fair | Poor | Fair | Good | Poor | Fair |
| Good | Fair | Fair | Fair | Fair | Poor | Bleak |
| Poor | Fair | Poor | Fair | Good | Poor | Poor |

Excellent

Good

Fair

Poor

Bleak

# Industry performance

## Changes since August 2016

## Europe

### United Kingdom

**Metals**

Up from Bleak to Poor

**Steel**

Up from Bleak to Poor

See article on page 13. While the general situation for UK steel and metals businesses remains difficult, payment delays are not expected to increase for the time being, and insolvencies are not forecast to show a major surge in numbers in 2016.

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