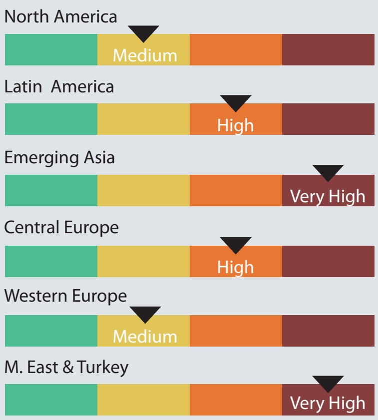
CONSTRUCTION

COFACE REGIONAL SECTOR RISK ASSESSMENT



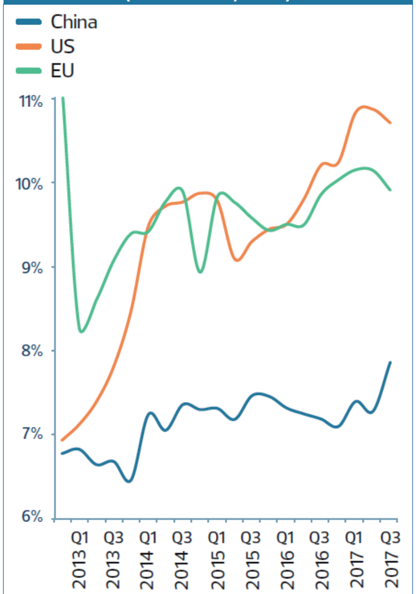
+ STRENGTHS

- Global population growth and urbanisation are driving housing demand
- Low interest rates in most major economies are facilitating borrowing

- WEAKNESSES

- Real estate prices remain overvalued in several OECD countries
- High household debt
- Overcapacity in China and high debt in real estate

SECTOR PROFITABILITY (EBITDA/TO, in %)



Source: Datastream, Worldscope

RISK ASSESSMENT

In 2017, the real estate market in advanced countries benefited from rising household incomes helped by relatively low inflation. Low interest rates played a catalytic role with outstanding real estate loans rising sharply.

In Europe, companies appear solid as shown by the decline in insolvency. This trend is expected to continue in 2018 with the exception of the United Kingdom which is expected to continue to suffer from uncertainties related to ongoing Brexit negotiations. The major decline in confidence of UK households, foreign investors, and the depreciation of the pound over most of 2017 has effectively increased the cost of imports which the sector depends on.

The ongoing tightening of the US monetary policy, with a further rate increase announced by the FED in December (+25 basis points) and uncertainties related to construction costs (timber, land prices), has had little effect on this sector in the United States so far.

The risks are higher in emerging countries. The sector is in difficulty in China. The authorities are trying to address the current real estate bubble and household debt is beginning to increase (47% of GDP in 2017). In Latin America, activity has been penalised by unemployment and inflation which is tending to improve, particularly in Brazil. In the Middle East, income losses related to low oil prices and security risks are penalising the sector.

DEMAND

The situation of households seems resilient and prices will rise again in developed countries in 2017. However, this recovery comes at a time when real estate price over-valuations continue (New Zealand, United Kingdom, France, Canada, Sweden, and Belgium) and households remain highly indebted (United States, United Kingdom). Regarding emerging countries, Asian demand for housing remains strong as falling commodity prices have destabilised South American and Middle Eastern household incomes. By the end of 2018, average selling prices could return to their pre-financial crisis level in 2008.

In 2018, inflation will increase significantly in advanced countries (1.7%). As a result, key interest rates of some major central banks could continue to rise, particularly in the United Kingdom and the United States. The US economy is growing with historically low levels of unemployment which is likely to maintain demand for the sector. Infrastructure work could be supported by public works if President Donald Trump manages to find common ground on this subject with his majority and the Democrats in Congress. During his electoral campaign, one of President Trump's priorities was the modernisation of the country's ageing infrastructure, including transport.

In Europe, the sector is generally doing well despite a contrasting situation. In France, the sector recorded a clear recovery as a result of the demand for housing construction supported by public aid, the recovery in household confidence, and interest rates that remain low in the Euro zone. In Germany, the sector is also supported by demand for private housing and public orders which have been issued since 2015 to house the 1.2 million refugees. The Iberian Peninsula has also been rebuilding rapidly with a 24% increase in permits in Spain and 13% in Portugal in 2017. In addition, activity in Southern Europe (expected GDP growth of 2.2% in Spain, 1.3% in Italy, and 1.8% in France) will also boost the sector.

We expect growth in the Chinese real estate sector to slow in coming years after a period of rapid development as the sector is in overcapacity. This should also be explained by the authorities efforts to address the real-estate bubble. A wider adjustment of the sector also seems increasingly likely. Coface's study on payment terms in China (March 2017) shows a very large number of late payments in the sector.

SUPPLY

In Europe, construction companies will benefit from well-directed demand to consolidate their cash position in 2018 after a long period of sluggish growth. In addition, the presence of multinationals in emerging countries will be less disabling than in 2018 because growth is expected to rebound (+5.9% in 2018).

As such, the LarfargeHolcim Group, a world leader in sales of building materials, recorded a turnover lower than that of the first three quarters of 2016 (-4,7%) at the end of the third quarter of 2017. Although the Group recorded a drop in its turnover in all regions, Latin America was the most resilient (+6%). It highlights the robustness of Mexico, Ecuador, and Argentina. However, the Group points out the stagnation of its business in Europe (-0.5%) related to the difficulties of the construction sector in the United Kingdom in particular. The latter is suffering from high household debt and a drop in real incomes. France is more resilient with growth in cement sales after years of difficulties in the sector.

In the United States, production costs will need to be closely monitored in 2018, excluding cement and aggregates, which could slow the sector's activity in the medium-term. Lumber prices have effectively trended upward this year, which could be exacerbated by the imposition of tariffs on Canadian lumber. In addition, the shortage of skilled labour in construction is putting upward pressure on wages and, therefore, on prices. Nevertheless, the National Association of Home Builders (NAHB), seems optimistic about the sector's development in 2018. Buoyant building permit levels (+4%) in late October 2017 bode well for these professionals.

In China, the costs of materials increased significantly in 2017 (+7.4% at the end of November 2017 according to the Chinese National Statistical Office) but should slow in 2018, in particular, due to the Chinese government's policy to contain real estate prices in major cities. In addition, debts accumulated by real estate companies (of which 38 billion will mature in 2018) will weigh on construction activity if insolvencies occur.