Business Insolvency Worldwide

Economic Outlook **no. 1235-1236**

Summer 2017

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High Stakes Game

Payment Behavior, **Cash Piles** and Major **Insolvencies**

Economic Research

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EDITORIAL


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Poker face

LUDOVIC SUBRAN

I was once told that there are only two options for a report with unpleasant messages to be read: you have to spice it up with either sex or gambling. We went for the latter since the economic outlook is still considered PG-rated.

News are not great: the economic acceleration does come with disagreeable surprises. Turnovers are growing but so are input costs and the jaw effect on companies can be important. Credit is still cheap but time has come to wean the private sector off abundant liquidity. And of course, when it comes to political risk, all bets are off.

From payment behavior to cash piles to major insolvencies, companies will have to gamble a little if they want to break the bank this year yet you should never roll the dice when it comes to payment risk.

First, payment behaviors continue to be tense: 1 out of 4 companies worldwide are paid after 88 days. In China, for example, days sales outstanding (DSO) has climbed to a nine-year high of 89 days in 2016. Upstream industrial sectors (Aeronautic, Machinery, Chemicals, Construction or Information and Communication Technology) are faced with the recovery curse: they tend to go for broke when growth looms ahead as they jeopardize the financing of their working capital to have a seat at the recovery table.

Second, non-financial corporations are sitting on a staggering 7 trillion USD of cash on their balance sheets, up 34% compared to 2010 and now representing 10% of global GDP, that is to say twice as much as before the crisis. This precautionary saving pile is either good news (because there is so much to invest) or bad news: there is not much to invest in to get returns. The biggest cash pile now is with Asian companies and the tech industry is now ahead of oil and gas and automotive when it comes to compulsive hoarding. Nobody wants to let the chips fall where they may when it comes to investing shareholders' money.

Last, while the overall number of insolvencies is expected to stabilize over the next two years, major insolvencies (companies exceeding 50 million euros of turnover) went up by 68% and the cost by 34% to 19 billion euros of cumulative turnover disappearing into thin air. The United States is the most affected with 8 of the top 20 failures in the first quarter; and sector wise, services and retail are suffering the most as digitalization had them make bets in a burning house.

Not all companies have an ace up their sleeve so they all have to hedge their bets to make the best out of the renewed momentum, especially in Europe. While they put their cards on the table, company leaders will have to keep a poker face. Nobody wants to know they are playing Russian roulette.

DAYS SALES OUTSTANDING

Who's Playing the **Invisible Bank?**

MARC LIVINEC, JULIEN AYME-DOLLA

- Euler Hermes expects global Days Sales Outstanding (DSO) to level off at a worldwide average of 64 days in 2017.
- In 2016, 1 out of 4 companies worldwide were paid after 88 days on average – this is a modest improvement and 2 days faster than in 2015.
- The situation in China should be monitored after DSO have climbed to a nine-year high of 89 days in 2016.
- In Western Europe, the average waiting period has continued to increase albeit at a slow pace (+1 day). DSO has improved in Mediterranean countries where it has been above the regional average. Thus, the gap between worst and best performers is shrinking.
- Globally, upstream industrial sectors such as Machinery, Chemicals, Construction or Information and Communication Technology, face DSO levels above the global average. The Metal sector, however, recorded a DSO level of 56 days.
- Companies operating in sectors with retail outlets such as Food, Transportation or Household goods are typically paid faster than the worldwide average of 64 days.
- The Aeronautic sector's frenetic level of activity has pushed up DSO and Working Capital Requirements (WCR) since 2012 (by +8 and +16 days respectively).

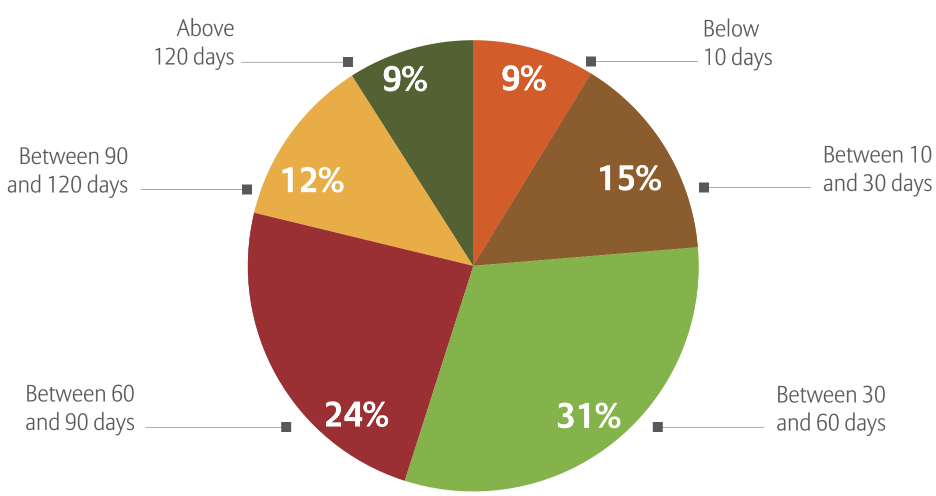
64 days

The worldwide average of Days Sales Outstanding

1 out of 4 companies worldwide has to wait at least 88 days before being paid

Based on our Bloomberg panel of 27,000 listed companies worldwide, the global average Days Sales Outstanding (DSO) has fluctuated a little around 64 days since 2010. In 2016, 25% of companies in our panel had to wait for 88 days or more to get paid by their clients while 25% were paid within 31 days. Half of companies were paid between 1 and 3 months. A positive aspect is that the upper range of the DSO improved by 2 days from 90 to 88 days during 2016. Nevertheless, the time required to collect trade receivables is still very uneven across countries and sectors. DSO levels vary to a large extent depending on the country. While the global average was 64 days at the end of 2016, four groups of countries can be broadly distinguished:

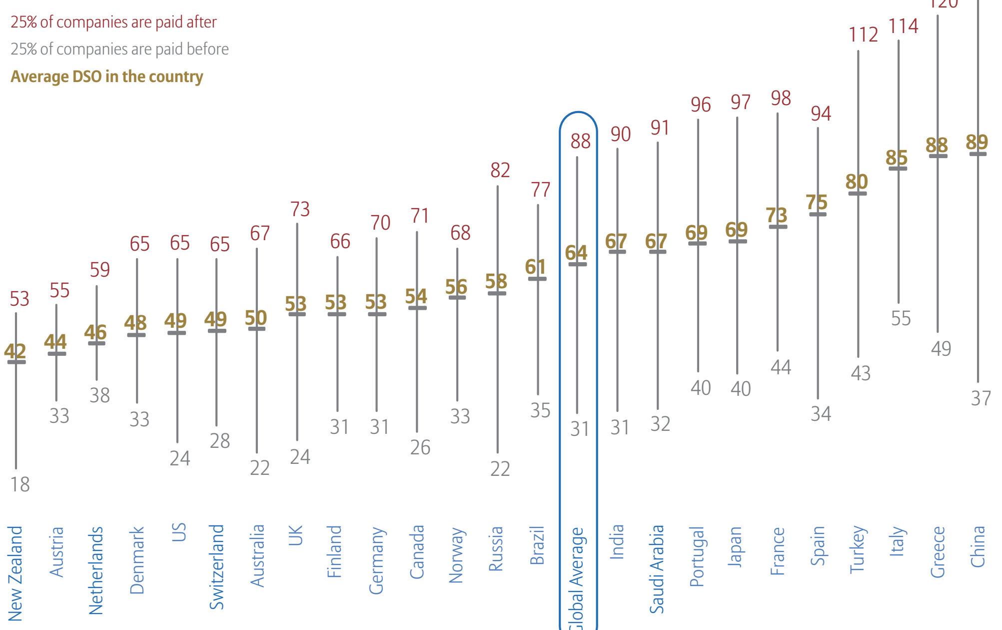
Chart 1 How long did companies wait to get paid in 2016?



Sources: Euler Hermes, Bloomberg

- The four countries where it takes the longest for companies to get paid are Turkey, Italy Greece and China (80, 85, 88 and 89 days respectively in 2016).
- The six countries with a DSO well above the global average include India and Saudi Arabia (67 days), followed by Portugal and Japan (69 days), France (73 days) and Spain (75 days).
- The six countries where DSO remains within a 10-day range below the global average are the UK (53 days), Germany (53 days), Canada (54 days), Norway (56 days), Russia (58 days) and Brazil (61 days).
- The seven best performers where DSO levels are the shortest, in ascending order, are New Zealand (42 days), Austria (44 days), Netherlands (46 days), Denmark (48 days), the U.S. as well as Switzerland (49 days) and last, but not least, Australia (50 days).

Chart 2 DSO distribution by country in 2016
(number of days)



Sources: Euler Hermes, Bloomberg

88 days

The electronic sector has the highest average DSO worldwide

Customer payment terms depend on the end business and whether it is focused on structurally opposing B2B and B2C activities, particularly within the Metals sector. Electronics, Capital goods (Machinery) and Construction are the three sectors where companies have to wait the longest to be paid: respectively 88, 87 and 82 days on average in 2016. They all suffer from upstream positioning which means they accumulate all payment delays within their industrial supply chain. The diverse and highly fragmented nature of the Construction sector explains the significant gap of 73 days between the 25% least fortunate companies being paid after 113 days and the most fortunate 25% being paid within 40 days. Despite its apparent close connection with end consumers, the Pharmaceutical sector's average DSO level is 80 days with an even higher WCR level of 104 days. Rather than the patients themselves, drug makers are contending with public health insurance systems that are strapped for cash. Still, the pharmaceutical sector's key players have significant cash reserves which enable them to withstand the resultant (very) long payment delays.

At the opposite end of the spectrum, sectors oriented towards final consumers enjoy an average DSO below 60 days. With an average DSO of 46 days in 2016, the (agri) food industry cashes in on short payment terms as a result of expiration date compliance across fresh product ranges. And DSO levels in the Household goods sector also benefits from the strong support of household consumption.

With its low DSO level of 56 days in 2016, Metals could have been an exception as it is not centered on B2C activities. With a relatively high WCR level of 91 days, the Metal sector maintains its DSO at a sound level. This is at the expense of the heavy burden of financing inventories it holds on behalf of customers. The Metals sector has the second longest Days Inventories Outstanding after Aeronautics, respectively topping 80 and 106 days last year.

Western Europe: A clear improvement in payment behavior in Mediterranean countries

2016 saw the average DSO in Western Europe go up +1 day so European companies have had to wait for 61 days on average to collect their trade receivables, from 60 days in 2015. This slight rise may signal a real return to economic growth across European industries. This should not overshadow interesting developments within Mediterranean countries which have succeeded in chtting DSO levels: -25pp for Italy and Greece and -15 pp for Spain and Portugal on average since 2015.

A DSO-level analysis shows that three existing groups of Western European countries have stood the test of time: at the favourable end is Scandinavia (Denmark, Norway, UK, Sweden) and the German-speaking countries (Austria, Germany, Switzerland). All are well below the

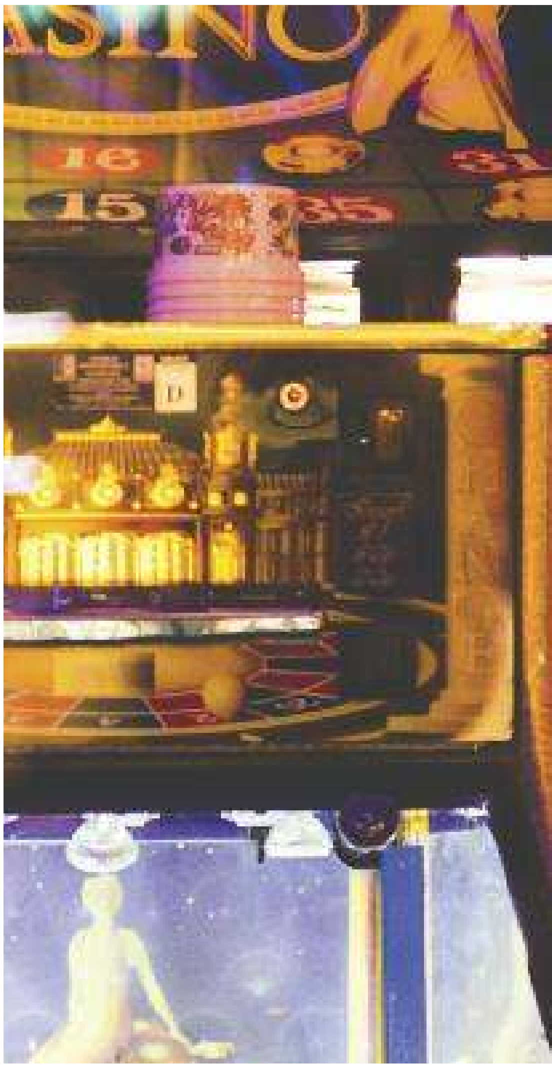
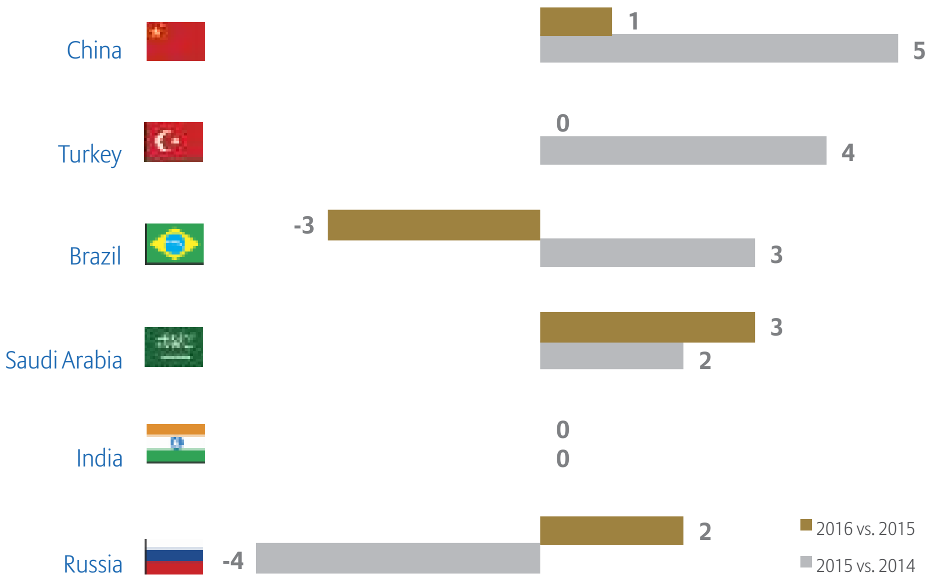


Chart 3 DSO change over the last two years in major emerging markets



Sources: Euler Hermes, Bloomberg

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global DSO average of 64 days. Yet, Norway and Sweden have suffered a little more than expected with their respective DSO levels rising by 5 and 4 days over 2016 vs. 2015. Tumbling investment in the energy sector has taken a toll on Scandinavian companies, especially those in Norway.

The second group of countries - Portugal, Belgium, France and Spain – have held their DSO back within a ten-day limit above the global average of 64 days. Spain arouses some concerns, however, as its average DSO soared by 7 days over 2016 as did its WCR (by +11 days). This longer DSO might be a double-edged sword: either the rise reflects real higher economic growth across Spain or a premature loosening of domestic payment discipline.

The last two countries, Italy and Greece, have seen little change in their DSO above 85 days in 2016. However, the DSO in Greece has tumbled by 16 days since 2012 to an average of 87 days in 2016. Austerity measures and privatization have forced Greek companies to tighten the management of their trade receivables.

Overall, it is very encouraging that the significant gap between the three groups of European countries' DSO levels exceeding 90 days has been curtailed over the past two years.

China, Turkey, Saudi Arabia: Continued deterioration

Payment terms appear to be somewhat gloomy across key emerging countries. None saw their average DSO shorten in 2016 (see chart 4), except for Brazil.

This demonstrates that a great deal more work is required for companies in emerging countries to control the quality of their payment terms. One positive aspect, however, is that this has not had a negative impact on their WCR (yet). Either companies are able to pass DSO increases on to their suppliers or they are better managing the level of their inventories.

The Middle East region is set apart from a Cash Conversion Cycle (CCC) point of view in light of Saudi Arabia's problems: DSO in Saudi Arabia has climbed by 3 days to 67 while its DI (Days Inventory) has increased by 5 days to 71 over 2016. Because its DPO went down by 2 days over the period, Saudi Arabia saw its WCR level soar by 6 days in 2016. The problem is that the rise in WCR does not come from oil price fluctuations as they did not bounce back during the period. Thus, DSO and WCR variations across the Middle East are likely to result from management and economic issues.

Despite its DSO increasing by 1 additional day in 2016, China has kept its WCR at the same high level of 96 days because it succeeded in reducing its inventories by 2 days. From a CCC perspective, however, the fragile position of Chinese companies has not yet improved. The payment terms of Chinese companies' customers exceeding 120 days have not been cut over the last two years. One Chinese company out of three is still paid beyond 4 months by its customers. Five years ago, this was the case for less than one company out of four. The fact that the Chinese economy remains uneven makes it uncomfortable with either the DSO or WCR being rapidly cut. It would be advisable to monitor certain Chinese companies as there is a high risk of a domino effect emanating from State-owned companies.

In contrast to China, India manages its CCC rather well. Its DSO, like its WCR, has been leveling off for two years at a sound level of 67 days and 71 days respectively. No matter how difficult it may be to comply with payment terms in India, Indian companies ultimately appear to take advantage of Modinomics.

Russia stands out having seen its DSO go up 2 days in 2016. It appears Russian companies have been more predisposed to grant longer time limits to their clients as the business environment has improved. Indeed, the Russian WCR has gone up by 2 days to 83 days following the ramp-up of recent industrial activity.

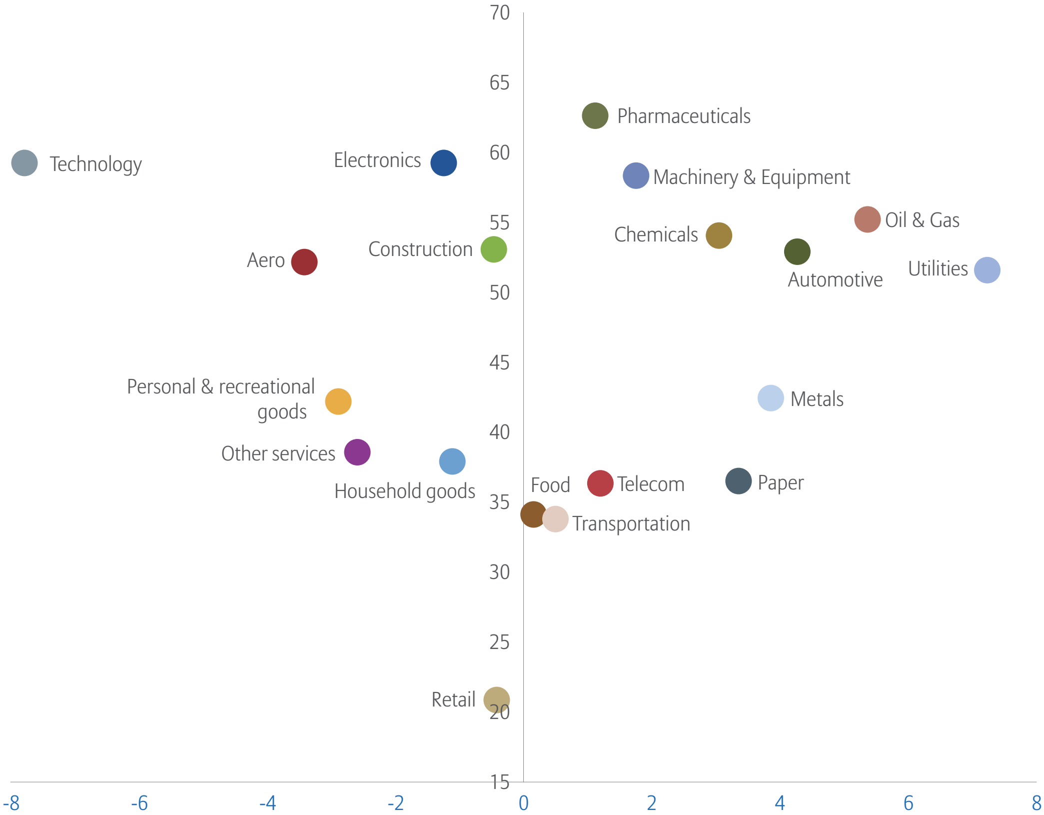
Overall stability in the US with pockets of risk

The average DSO of US listed companies has been remarkably stable at around 50 days over the past three years. It is the same story for Days Paid Outstanding (DPO) which has remained at around 34 days on average over the last ten years. As a result, Working Capital Requirement (WCR) figures do not show any risk of real degeneration in the U.S. However, this stability is masking some discrepancies and divergences across sectors (see chart 6).

The right-hand side of the chart shows US sectors considered at low(er) risk as their DSO levels have increased following a greater flexibility in payment terms. US Chemicals (Pharma included) has been taking advantage of growing investment in upstream industry and of the good performance of its main outlets such as Construction and Automotive. The US Metal and Energy sectors are particularly notable as their DSO level had fallen by 4 days in 2015 but has regained between 4 and 6 days respectively in 2016. They have come through hard times and their improved outlook has increased their confidence in offering their customers greater payment term flexibility.

The left-hand side of the chart illustrates US sectors where DSO levels have reduced. This means either their customers have been better managed or their outlets have faced economic difficulties. The Technology, Electronics, and Telecom sectors are a case in point. DSO levels in these industries decreased by around -8 days in 2016. Listed US companies seem to have tightened their payment terms in order to accommodate downward pressures on profitability. However, the backdrop may not be lackluster going forward as these sectors' worldwide WCR dropped by 3 days on average between 2015 and 2016. While maintaining strong cash reserves, US companies may loosen their purse's strings in the year ahead.

Chart 4 DSO by sector **in the US** in 2016
(x-axis is change versus 2015; y-axis is the level)



Sources: Euler Hermes, Bloomberg

64 days

In the US, Pharma faced the highest DSO level in 2016

Aeronautics under pressure

Globally speaking, six sectors have seen their WCR rise by +4 days since 2012. Looking at the panel of listed companies, global WCR has reached 91 days for Chemicals (+7 days between 2012 and 2016), 104 days for Pharmaceuticals (+6 days), 82 days in the Auto sector (+4 days), 100 days for Household equipment (+4 days), 84 days for Construction (+4 days) and 136 days for Aeronautics (+16 days).

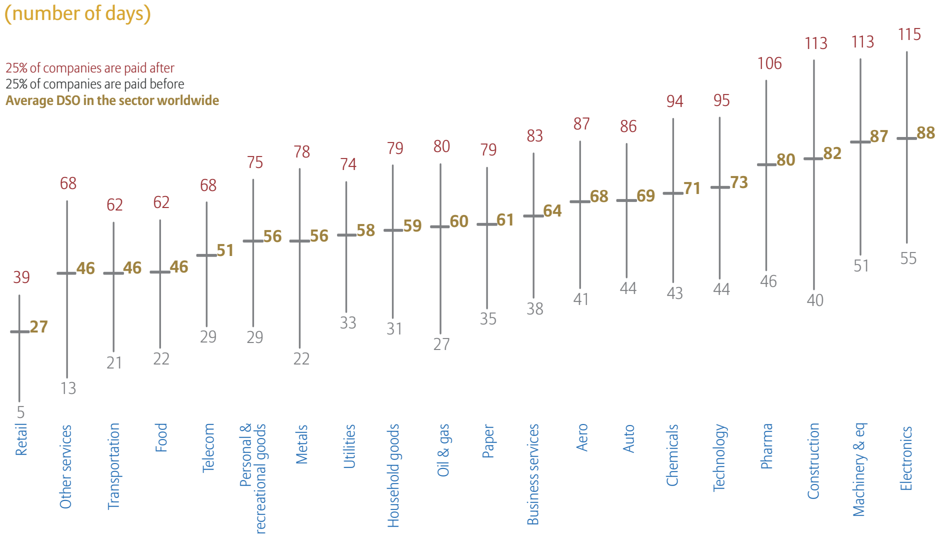
As US drug makers are allowed to set prices, the pharma industry's profitability is on the rise. This trend is buoyed by a high degree of innovation with new drugs introduced to the market. While this pushes up WCR, it is manageable as long as drug makers maintain healthy turnovers and profits.

The Chemicals sector worldwide has seen a marked rise in activity and profitability since the beginning of the decade, which might explain rising WCR. Overconfidence should be avoided and, as activity levels off, companies would be wise to tighten their financing before they are forced to.

Automotive has enjoyed buoyant sales. Yet it is a market in flux, as more and more innovative components are integrated into vehicles. As research and development costs mount in an effort to gain customers' loyalty, DSO and WCR levels are on the rise.

The Aeronautics sector requires special attention. The Aeronautics sector's frenetic level of activity has pushed up DSO and Working Capital Requirements (WCR) since 2012 by +8 and +16 days respectively. Aeronautics bears the brunt of disorganization within the supply chain. As the outlook for air travel reaches unprecedented heights, suppliers' activity levels follow. The challenge will be to sustain the elevated pace of product delivery. ■

Chart 5 DSO distribution by sector in 2016
(number of days)



Sources: Euler Hermes, Bloomberg

CASH ON BALANCE SHEETS

Place **Your Bets**

LAURA MESBAHI, MAXIME LEMERLE

- Cash hoarding reached a new record in 2016. Non-financial Corporations (NFCs) held a staggering 7USDtn in cash on their balance sheets at the end of 2016, posting a +2.9% increase compared to 2015 and +34% compared to 2010. Since the financial crisis of 2008, the world's cash pile has doubled to reach 10% of global GDP.
- While US companies hold 30% of the global total on the back of ongoing fiscal optimization, Chinese companies have doubled their cash piles since 2010. In regional terms, the cash hoard held by Asian Pacific companies is now the world's biggest. Accumulation remains limited and uneven in Western Europe.
- The tech industry remains the strongest cash machine, outpacing Oil & Gas and Automotive. This pile is concentrated in US firms (71%), particularly a dozen multinational giants such as Apple, Microsoft, and Alphabet.
- Two sectors faced a strong decline in 2016: Machinery & Equipment (- USD278bn) and Household Equipment (- USD104bn). These developments warrant close monitoring.
- Global economic growth supports cash generation. Yet it is coupled with various uncertainties and risks which prompt saving behavior. Thus, companies will continue to be pushed to hoard. However, the recovery in global investment and Mergers and Acquisitions activity should soften the pace of cash accumulation.
- A US government's repatriation plan might be a game changer as companies could be incentivized to ship large amounts of cash back to America. While de-offshorization might lead to investment in job creation and research and development in the US, yield-starved businesses could opt to continue hoarding.

10%

of global GDP is held as cash on companies balance sheets

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The amount of cash on balance sheets has reached a new record of USD7tn

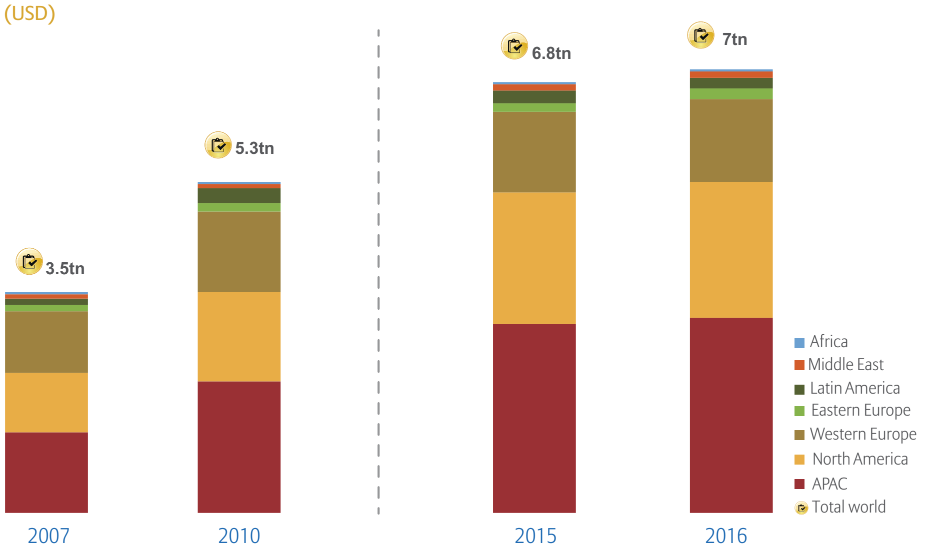
Based on a panel of 30,500 listed companies in 94 stock markets, the global cash pile grew by +2.9% in 2016 compared to 2015 when taking into account the cash and cash equivalents published on the balance sheets of non-financial companies. Cash accumulation has doubled from USD3.5tn in 2007 to USD7tn in 2016 while the global economy expanded by +29% in nominal terms. It now accounts for 9.5% of global GDP, compared to 6.1% in 2007.

Cash accumulation surged particularly in the aftermath of the crisis, with a +49% increase between 2007 and 2010 (i.e. a +14.3% CAGR). The main objective was to meet precautionary needs in times of high uncertainty but the halt on investment also played a key role by holding back the use of cash. In this context, emerging markets, hit by the crisis, recorded a solid expansion of their listed companies' cash pile: +12% CAGR for East European companies, +15% for African companies, +18% for Asian Pacific companies and +24% for Latin American companies. The pace was lower for advanced economies: +9% in Western Europe and +15% in North America.

The upward trend in global cash accumulation has not ceased since 2010 yet it registered a softening pace at +5.0% CAGR between 2010 and 2016. It also proved not to be as broad-based. The uneven macroeconomic and financial dynamics and risks have led to different cash behavior among regions. For instance, the severe recession in Brazil pushed down cash accumulation in Latin America as the fall in profits outpaced the drop in investment. In contrast, cash piles continued to grow for Asian Pacific and North American companies, and to a lesser extent Middle-Eastern and East European companies. This was thanks to (i) the positive trend in activity and profits, and (ii) the remaining fear of risks - supporting the need for reserves/buffers - and high level of uncertainties which softened the willingness to invest.

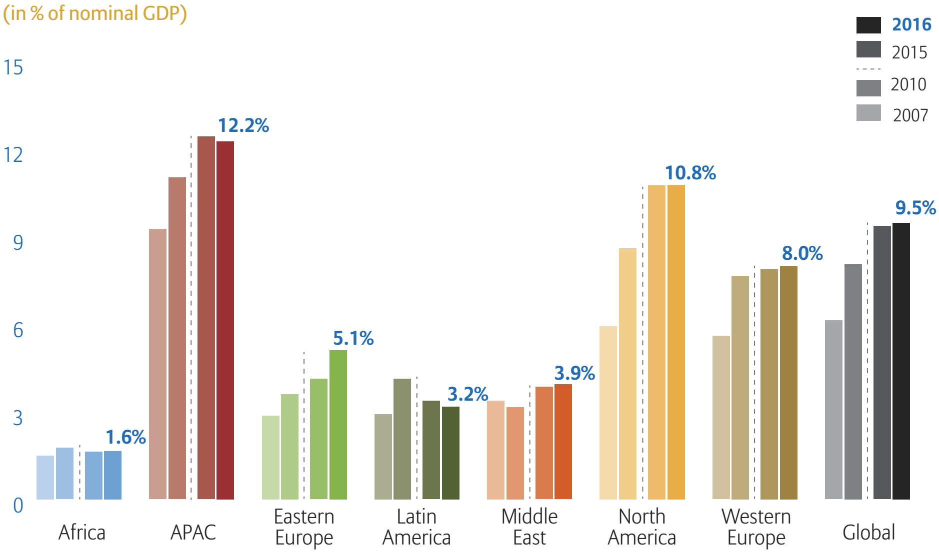
Cash accumulation proved to be more dynamic in regions with the strongest economic growth. This explains why the total world cash shares of the Asia Pacific and North America regions have kept growing while the European share has de- ▶

Chart 1 Global cash pile of listed firms by region
(USD)



Sources: Bloomberg, Euler Hermes

Chart 2 Global cash pile of listed firms by region
(in % of nominal GDP)



Sources: Bloomberg, Euler Hermes

creased over time. The most remarkable rise is for Asian-Pacific countries, from 35.9% of global cash holding in 2007, they now account for 43.8%, compared to less than 50% for Western Europe and North America combined. The proportion has also expanded in the latter region, but to a lesser extent, from 26.7% in 2007 to 30.7% in 2016. As for Western Europe, corporates hold a far smaller share of global cash than before - though in volume terms the amount of cash grew by +31.2% from 2007 to 2010 before stabilizing.

30% of global cash is held by US companies

US non-financial corporates' cash increased by +2.8% in 2016 compared to 2015. It is up +55.1% compared to 2010 - more than twice the rise in nominal GDP over the same period. Out of a total of USD2.1tn held by US businesses, USD916bn (44%) are held by the Tech sector, notably the Top 5 Tech giants - Apple, Microsoft, Alphabet (Google's parent company), Cisco and Oracle. They collectively amassed USD565mn of cash by the end of 2016 - more than the combined cash pile of German and British non-financial companies. US companies benefit from their large domestic market, but also from their large overseas sales volumes.

US multinationals keep a large proportion of their earnings abroad to elude American tax laws which charge overseas income at up to 35% on repatriation. This overseas cash is estimated at USD1.2tn or 60% of US total cash. This record amount has given rise to a debate on possible tax changes by Donald Trump's administration aimed at encouraging firms to bring overseas cash back to the US for investment and job creation.

In China, the cash pile has doubled since 2010

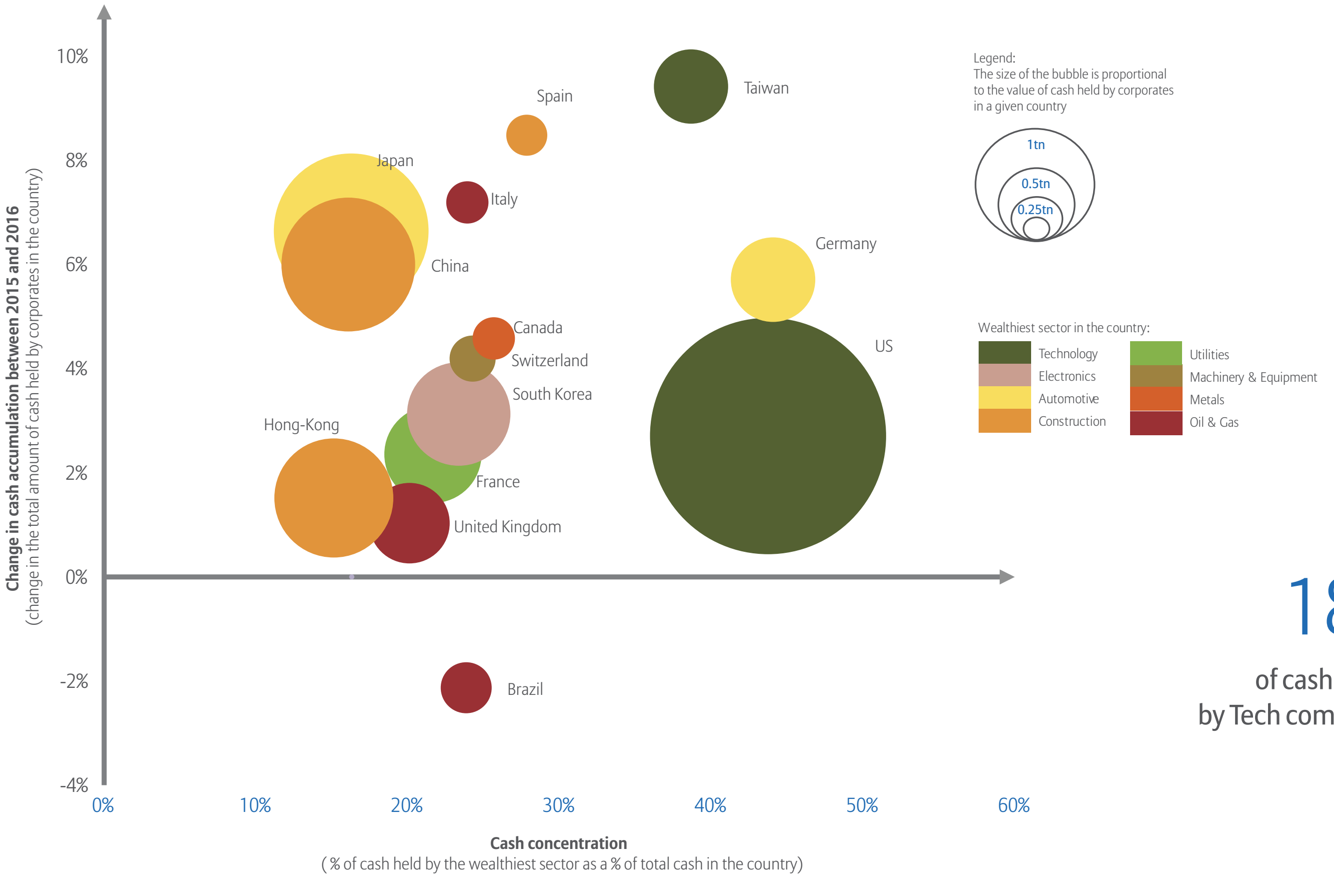
Since 2010, one of the fastest increases in cash accumulation took place in mainland China with a +95% rise that appears in line with economic expansion. Chinese non-financial corporates are now holding USD671bn, which represents 9.5% of global cash (up from 6.6% in 2010). 16% of this total belongs to the Construction sector where the level of cash has accelerated recently (+19% since 2015) – and should continue to do so on the back of the 'One Belt One Road' long-term state infrastructure project. The next top cash holders remain the Electronics sector (9.2%), Machinery and Equipment (8.1%) and Automotive (7.2%). Adding the cash pile from Hong-Kong firms would push up the total to USD1.2tn (17.1% of global cash) and the Tech industry to 7.3% of the total, after Construction (15.7%). Yet, the fastest increase occurred in South Korea, with an impressive +168.2% since 2010, which supported the expanding global cash share of Asia Pacific

Cash hoarding is up by +2.4% in Western Europe

Western Europe corporates have registered a moderate rebound in cash in 2016 (+2.4% over 2015) to USD1.3tn. While relatively stable since 2010, this means that the European cash pile is declining in relative terms and accounts for 18.5% of world total cash. This global picture masks uneven dynamics between countries. On the one hand, Greek, Swiss and Nordic non-financial firms decreased their cash pile in USD terms in 2016. In contrast, German (+5.7%), Italian (+7.2%), Spanish (+8.5%), Belgium (+11.8%) and Dutch (+15.6%) firms posted a huge increase in their cash piles relative to their national GDP growth, suggesting that investments have been postponed during the year. In France and in the UK, companies' wealth stabilized at +2.3% and +1% respectively.

From a sectoral point of view, the European cash pile looks relatively widespread. Utilities (EUR168bn), which combine all public services including electricity, and the Automotive

Chart 3 Cash level in 2016, change and sector concentration by country
(USDtn, in %)



Sources: Bloomberg, Euler Hermes

18%

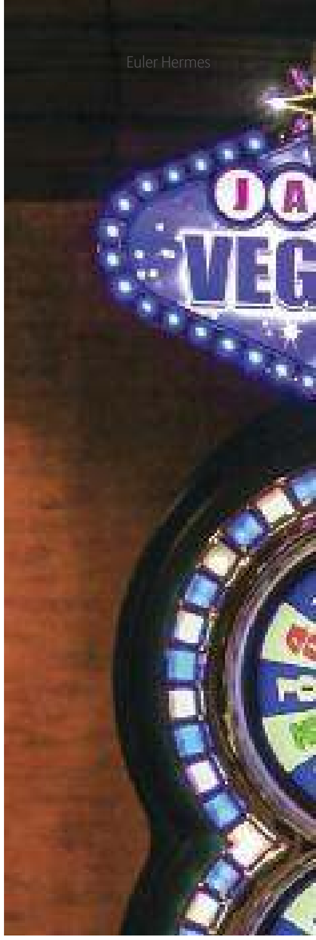
of cash is held by Tech companies

(EUR161bn) sectors were the richest in cash terms at the end of 2016, followed by Oil & Gas, which reduced its cash pile by USD25mn to USD145bn. For some sectors, cash accumulation has become noticeably concentrated in a handful of firms within individual countries: French firms hold 40% of the Retail cash pile, 46% of the Utilities' and 76% of Aeronautics; UK firms have amassed 43% of the cash pile of Business Services and 73% of the Metal sector's; while Germany has the major part of the cash pile of Chemicals (61%) and Automotive (73%).

The tech industry: On top of the pile

By far, Tech industry continues to stand out with almost USD1.3tn in cash. This represents 18% of the global cash pile, thanks to another strong increase in 2016 (+7.3% after +13.9% in 2015). This sector is also where cash is most concentrated with 71.1% found in the US, out of which 75% is from the top 10 American corporates, while Asian Pacific firms hold (almost) all the remainder. This record amount reflects not only the disincentives of US tax rules but also the challenges the whole industry is facing, between (i) the tough competition and need for permanent innovation and, thus, huge investment in R&D, (ii) the shareholders' pressure for more dividends and share buybacks, and (iii) finding profitable investment opportunities and new strategies (from integration to diversification). The second cash-heavy sector remains Oil & Gas, with USD593bn. This is slightly less than half of the cash pile held by the Tech industry. Oil & Gas companies grew the cash on their balance sheets by +11.2% in 2016, mostly due to cuts in operating costs and capital spending. The objective was to build up new reserves to prevent a further decline in operating cash flows that would follow a further potential fall in oil prices.

It is also worth noting that the majority of sectors that suffered a declining cash pile in 2015 posted a bounce-back in 2016, with 4 exceptions: Transportation (-4.0% to USD261mn), Telecom (-0.8% to USD302mn) and more importantly, when considering the magnitude of the cash pile fall, Household Equipment (-42.8% to USD113mn) and Machinery & Equipment (-52.7% to USD250mn). For the latter, cash piles plummeted due to depleted order backlogs as the sector's outlets (companies in Energy, Metal, and Agrifood) have themselves coped with falling EBITDA over the last two years. ■



INSOLVENCIES

The House Sometimes **Loses**

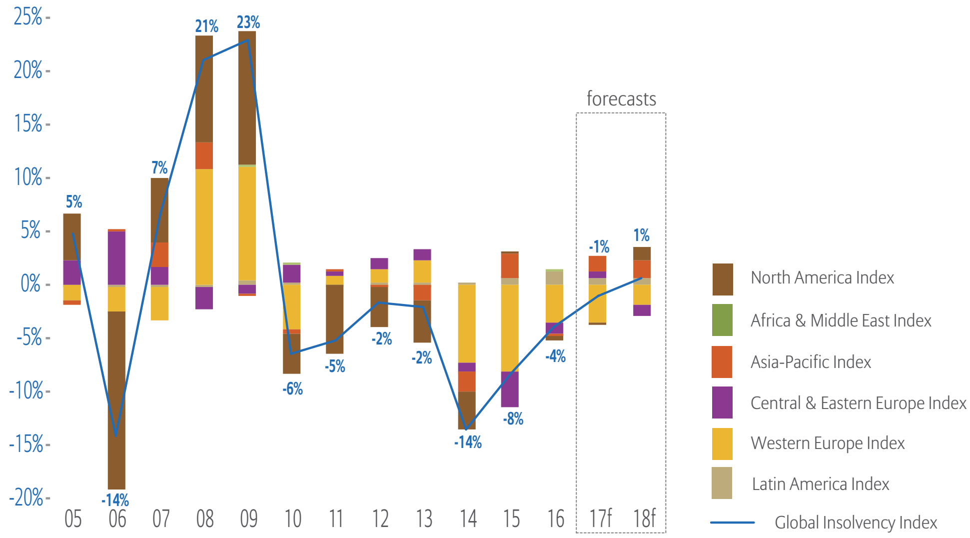
LAURA MESBAHI, JULIEN AYME-DOLLA, MAXIME LEMERLE

- Insolvencies are expected to decline by -1% this year and to rise by +1% in 2018. At the same time, there is a sharp rise in bankruptcies of large companies (turnover of more than EUR50mn). Major insolvencies have been on an increasing trend in Q1 2017, as 74 companies went bust, 30 more than in Q1 2016. The cumulative turnover of insolvent companies jumped by +34% reaching EUR19.1bn*.
- Europe accounts for the largest increase in the number of large bankruptcies while North America accounts for the largest rise in the cost of major insolvencies in Q1 2017.
- Services, with seven more major insolvencies, compared to Q1 2016, and Retail (+9) were the two most affected sectors.
- Pharmaceuticals and Computer/Telecom recorded only one major failure over the last 4 quarters.
- Companies should beware of a domino effect, as the overall severity of failures is worsening. The spike in the number of too-big-that-failed could have serious knock-on effects on providers along the supply chain. Retail bankruptcies in the US and UK, for example, might impact Textiles, Electronics, and Manufacturing worldwide.

-1%
in 2017

+1%
in 2018
insolvencies worldwide

Chart 1 Euler Hermes Global Insolvency Index and regional indices
Yearly changes in % and contribution to the Global Index



Sources: National statistics, Euler Hermes forecasts

Insolvencies to increase by +1% in 2018

At a global level, the insolvency outlook across the 43 markets monitored is quite balanced for 2017 and 2018: Euler Hermes' Index in 2017 has registered its weakest decrease (-1%) since 2009 and is expected to rise moderately in 2018 (+1%). However, this global picture is driven by uneven regional trends.

After three years of substantial declines (-13.6% in 2014, -8.4% in 2015 and -4% in 2016), Euler Hermes expects worldwide insolvencies to continue its softening tempo and to increase moderately by +1% in 2018 after a -1% decline in 2017. This swing will be driven by uneven regional trends:

▶ First, a persistent and broad-based rise in insolvencies in Latin America (+8% and +11% respectively in 2017 and 2018), Africa (+10% and +6%) and Asia-Pacific (+3% both years), since Latin American countries are barely making their way out of recession and the whole Asia-Pacific region still has to adapt to the growth normalization occurring in China.

▶ Second, a plateau in North-America in 2017 (0%), before a pick-up in 2018 (+5%), after seven-years of steady fall to a (almost) historical low, on the back of rising interest rates, renewed tensions in working capital requirements (3 out of 4 industries registered an increase in WCR in 2016) and business demography dynamic.

▶ Third, a slower pace of decline in bankruptcies in Western Europe (resp. -5% and -2% (compared to -16% in 2014, -12% in 2015 and -7% in 2016)), while in Central and Eastern Europe (+1% and -6%) the on-going difficulties in major countries (Russia, Poland, Turkey) will continue in 2017 offsetting the improvement in smaller countries. However in the region, the level of ▶

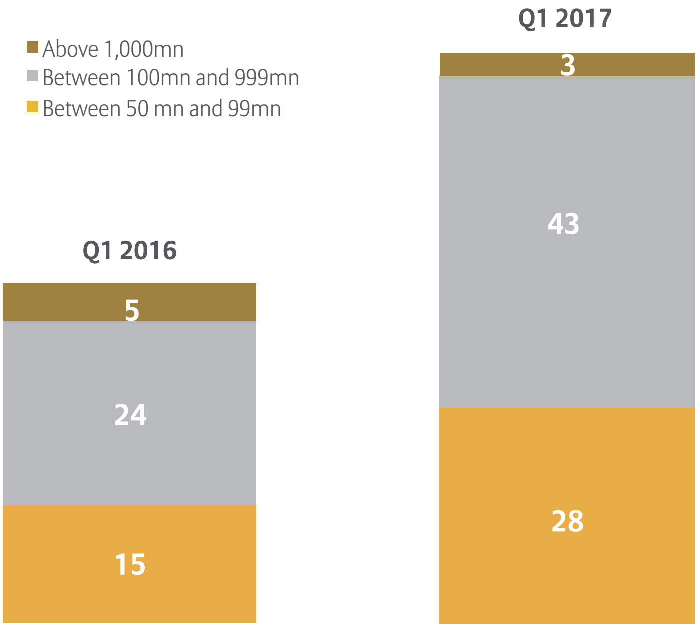
Chart 2 Euler Hermes Insolvency Heat Map 2017

(Level and change in 2017)

	Very low level (more than 10% **below** the 2003-2007 level)	**Low level** (between 0% and 10% **below** the 2003-2007 level)	**High level** (between 1% and 10% **above** the 2003-2007 level)	**Very high level** (more than 10% **above** the 2003-2007 level)
Strongly deteriorating strictly more than +5%	Taiwan (+15%) Hong-Kong (+8%) Poland (+8%) Russia (+8%)	China (+10%)	Brazil (+13%)	Lithuania (+21%) Chile (+12%) Morocco (+12%) Singapore (+12%)
Deteriorating +1% to +5%	UK (+5%) South Korea (+3%) Austria (+1%)		Switzerland (+1%)	Turkey (+4%)
Stable or improving -5% to 0%	Germany (0%) Japan (0%) Sweden (0%) US (0%) Canada (-1%) Estonia (-3%) Greece (-3%) Slovakia (-5%) South Africa (-5%)	**GLOBAL (-1%)** New Zealand (-4%)		Luxembourg (0%) Norway (0%) Belgium (-2%) Spain (-5%) Colombia (-5%)
Strongly improving strictly more than -5%	Latvia (-10%) Romania (-11%) Netherlands (-15%) Finland (-19%)	Bulgaria (-10%)		Italy (-6%) Czech Rep. (-6%) France (-7%) Australia (-8%) Ireland (-8%) Denmark (-13%) Portugal (-16%) Hungary (-25%)

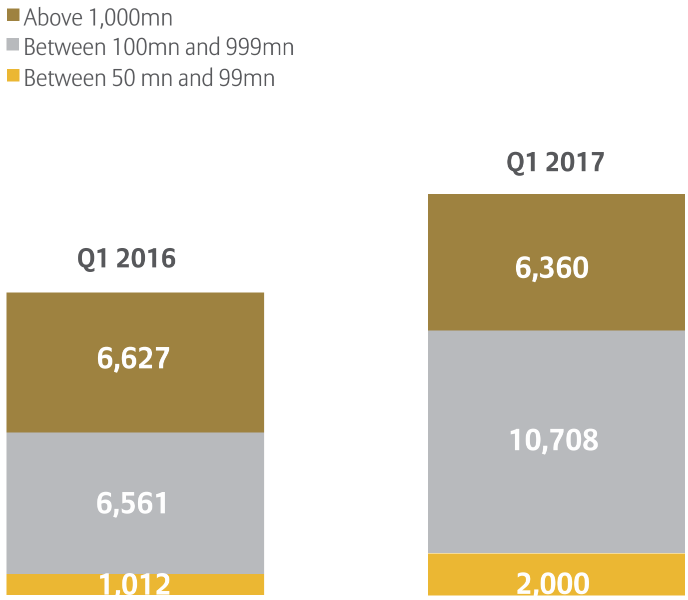
Sources: National statistics, Euler Hermes forecasts

Chart 3 Number of insolvencies by turnover group



Source: Euler Hermes

Chart 4 Cumulative turnover of insolvencies by turnover group (EUR mn)



Source: Euler Hermes

bankruptcies will remain high with 10 out of the 17 countries monitored still reporting more insolvencies in 2017 than registered, on average, before the crisis (over the 2003-2007 period). Overall, four main factors explain this balanced outlook for credit risk: (i) global growth and trade, despite the improving trend, still results from out of sync growth engines which struggle to break the volume ceiling (at respectively +3% for GDP growth and +4% for trade growth); (ii) recovering prices support turnovers but also squeeze margins in countries and sectors where input prices are increasing more rapidly than selling prices; (iii) renewed tensions in working capital requirements (for half of the industries); and (iv) the current rebound in large bankruptcies i.e. bigger companies going bankrupt cause a domino effect on fragile suppliers.

1 out of 3

countries are forecast to record more insolvencies in 2017 than pre-crisis average

Major insolvencies increased by +68% in Q1 2017

Q1 2017 data points to a sharp increase in major insolvencies, specifically affecting companies with a turnover exceeding 50mn Euro. While this follows the trend seen throughout 2016, the pace of deterioration is on the rise.

The number of global major failures recorded in Q1 2017 jumped by +68% to 74 companies, up from 44 in Q1 2016. These failed businesses' cumulative turnover soared by 34% to EUR19.1bn.

The striking hike in failures of companies with turnovers from EUR101mn to EUR1bn played a preeminent role in this deterioration. 19 more companies in this category collapsed in Q1 2017 compared to Q1 2016. Their cumulative turnovers accounted for more than half of the global amount (EUR10.7bn). This is particularly worrying as, despite an overall favorable economic outlook, failures tend to be increasingly concerning major firms. Big companies still struggle to stay in the safe zone, and upon breakdown, release a negative spillover that spreads across supplies chains, sectors and economies: smaller companies are then impacted, creating a top-down domino effect.

When comparing the last 4 quarters to previous periods a similar trend emerges, albeit to a

lesser extent. The number of major insolvencies went up by +43% in the last four quarters, reaching 294, up from 206 recorded in Q2-3-4 2015 and Q1 2016. Cumulative turnovers were down by 7% over the last 4 quarters, still reaching a substantial EUR98.9bn.

The divergence across major insolvencies is impressive. While the top 20 largest failures account for 70% (EUR13.4bn) of the global cumulative turnover recorded in Q1 2017, of these, 8 cases are in the US, 5 in Central & Eastern Europe (2 in Russia, 2 in Poland), 5 in Western Europe (2 in Germany) and 2 in Asia Pacific (China).

+68%

large companies becoming insolvent in Q1 2017

Major insolvencies to cost EUR8.7bn in the US and EUR 3.8bn in Europe

Europe accounts for the largest increase in the number of large bankruptcies while North America (and particularly the US) accounts for the largest rise in the cost of major insolvencies in Q1 2017.

49 European companies closed their doors during Q1 2017, more than double the figure in Q1 2016 (24). In Central & Eastern Europe, cumulative turnovers related to big insolvent companies recorded a sharp +112% increase, with 24 firms going bankrupt (up from 9 in Q1 2016). Failures were concentrated in Russia (10) and Poland (10). In Western Europe, 25 major insolvencies (+66% compared to Q1 2016) were registered but no one location stands out, implying a more even spread of bankruptcies across countries in this region.

In the Asia-Pacific region and North America, major insolvencies in Q1 2017 affected 13 (+30%) and 12 (+20%) companies respectively. Cumulative turnovers of failed North American companies add up to double those recorded in any other region. In fact, they account for almost half of the global total (46%) to the tune of EUR8.7bn, though the pace of growth was 8% (+EUR665mn). Out of the 12 registered collapses in this region, 10 are located in the US.

As for the Asia Pacific Region, the overall severity of insolvencies escalated in the first quarter of 2017, as the related cumulative turnovers went up by 45% (reaching EUR2.5bn) on the back of 6 major Chinese firms going out of business in the Metals sector. To a lesser but still substantial extent, 4 major insolvencies in Japan darkened the picture. Moreover, adding both of these countries' cumulated turnovers accounts for 89% of the region's total.

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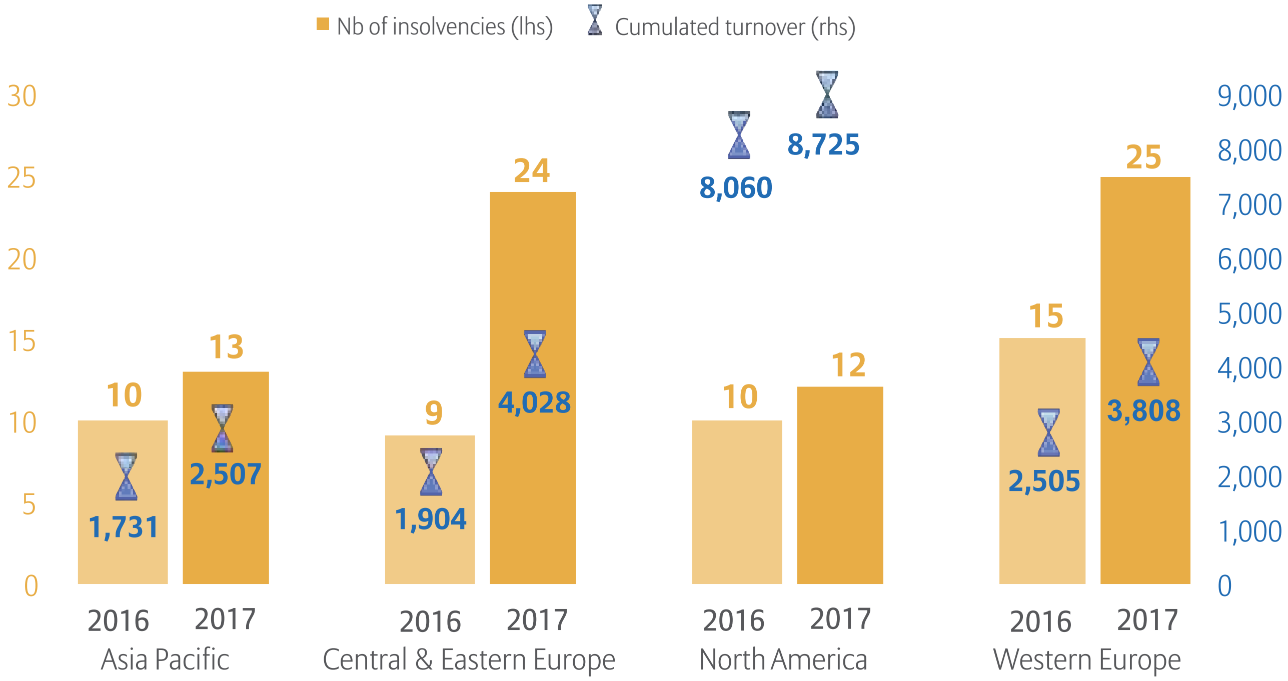
Chart 5 Number of major insolvencies and their cumulative turnover by region in Q1
(EUR mn)



Source: Euler Hermes

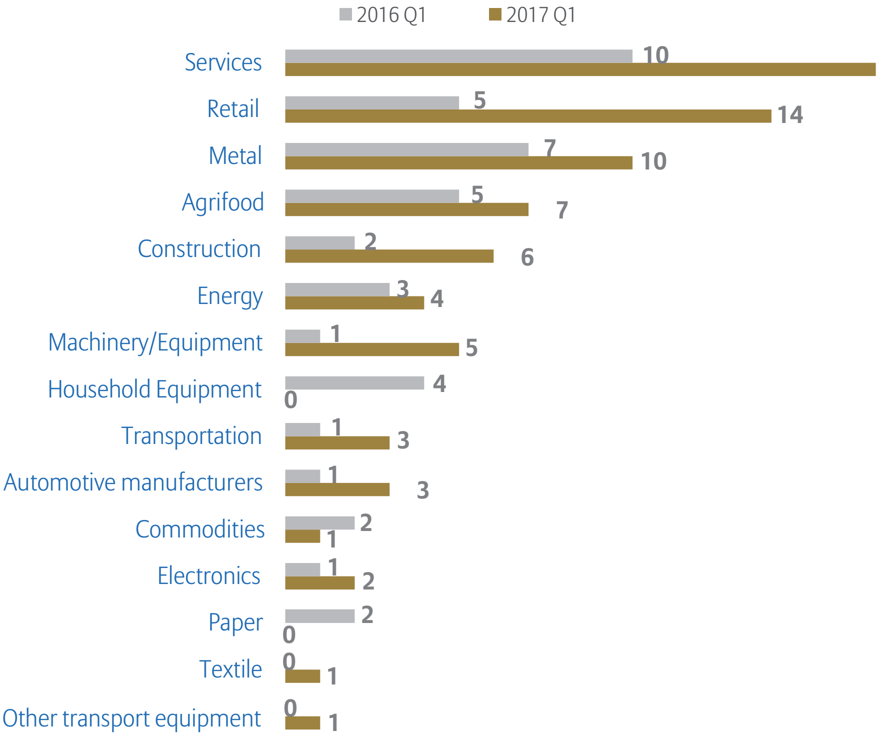
Latin America's situation keeps on improving. No major insolvencies were recorded in Q1 2017, compared to 10 in Q1 2016. The number of major insolvencies over the last 4 quarters decreased by -21% compared to the same period a year earlier. The Middle East & Africa haven't recorded any major failures, as with Q1 2016.

Services and Retail: Warning Signs

The Services and Retail sectors were the main culprits behind the sharp rise in major insolvencies in Q1 2017. These sectors recorded the highest number of large failures: 17 (+70% from Q1 2016) and 14 (+180%), respectively. This continues the trend of the last 4 quarters when Services and Retail consistently occupied the first and second positions at the top of the insolvency rankings.

Cumulative turnovers of failed companies in these sectors significantly increased from Q1 2016 to Q1 2017, reaching EUR6.2bn for services (+579%) and EUR5.2bn for retail (+477%). It is not much surprise that the three largest failures occurred in these sectors, all in the US: for Services, Avaya Holdings (EUR3.3bn) and for Retail, Hhgregg (EUR1.8bn) and Gander Mountain (EUR1.26bn). For more details on the state of digital disruption in the retail sector and a focus on the US, see our special report "Retail, disrupted – Pressure and Potential in the Age of the Digital".

Chart 6 Number of major insolvencies by sector



Source: Euler Hermes

Retail, Services, Metal

are the three sectors with the highest nmber of major insolvencies

To a lesser degree, Metal and Agrifood sustained large losses in the first quarter of the year. The former registered 10 major failures (up from 7 a year earlier) and EUR2.2bn in cumulative turnovers. This was mainly due to bankruptcies by 4 large Chinese companies (our Sector risk grade for the Metal sector in China is 3 out of 4). For the latter, the failed German firm Euromar Commodities and Chinese firm Liaoning Huishan Dairy contributed a hefty amount to the cumulative turnover of bankrupt companies in the sector which reached EUR2bn, a +55% rise on Q1 2016.

For other sectors, numbers of insolvencies edged up but remained at low levels, so did cumulative turnovers. In Transportation, although the number of major insolvencies went up from 1 to 3, smaller companies went bankrupt, implying a -56% reduction in their cumulative turnover (from EUR1.1bn to EUR528mn in Q1 2017). Companies in Computer & Telecom and Pharmaceuticals stayed sound and safe, with only 1 major failure recorded over the last 4 quarters, and none in Q1 2017. ■

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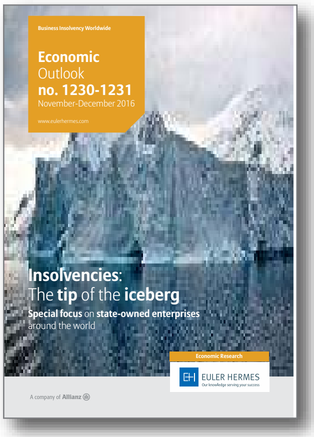

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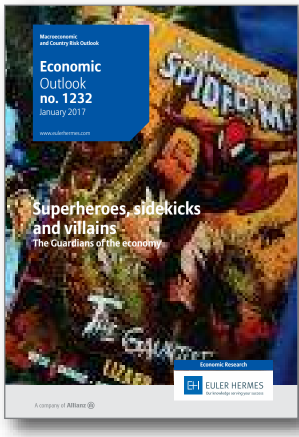

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