

Company Insolvencies



SOMMAIRE

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by Jennifer Forest
and Julien Marcilly

In this Panorama, you will find the Coface barometer, which analyzes the evolution of French insolvent companies between November 2012 and October 2013. With a 4.3 % increase during this period, the number of insolvencies (62 431) is now close to the historical peak on the top of the 2009 crisis. However, their financial cost (outstanding amounts of insolvent companies) fell by 7.4%. Now France presents, for «business risk», a more traditional situation with Intermediary size companies less affected (-29%), after having been particularly penalized in the first part of the year, to the detriment of most affected SME / micro-enterprises. We then publish a study on insolvencies in the French construction sector, overrepresented in insolvencies compared to its weight in the economy. Where does this fragility come from ? First the structure (composed mainly of very small companies) and the financial situation (with profitability decreasing alarmingly and more strongly than the average of French companies) of the construction companies are playing a role. The property market is not so favourable, as shows the evolution of housing permits and the prices. A statistical analysis underlines that lower prices are associated with higher insolvencies. Hence the slight expected increase in GDP in France in 2014 not benefits the construction. An expected correction of prices though slight, will cause a further increase in insolvencies in the construction sector in 2014.

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Insolvency Monitor / Autumn 2013

Khalid Ait Yahia, Jennifer Forest and Emmanuelle Hirsch
Economic research department, Coface

The number of insolvencies is showing a significant increase: 62,431 in total, representing a 4.3% rise year-on-year (+ 4.2% since January 2013), which is evidence of the continued fragility of the business companies in France. Coface notes that SMEs are the hardest hit. In fact our size-indicators show that MSBs are less affected, with the cost of insolvencies down 7.4% year-on-year. Indeed, the number of insolvencies amongst MSBs is falling (-29%). Thus, Coface is seeing a return to a less atypical situation for French insolvencies.

	January - October 2013	November 2012 - October 2013			
	Number	Number	Cost (€ bn)	Cost/GDP	Jobs threatened
Insolvencies	52,222	62,431	4.25	0.21%	196,564
Change*	+4.2%	+4.3%	-7.4%	-8.6%	-3.3%

* Versus the same period 12 months earlier

Sources: Scores & Décisions, Coface

In the first ten months of the year, there were 52,222 insolvencies. This is a high number, which is rising sharply (+4.2%) and approaching the level seen over the same period in 2009 (52,589). The same is true for the last twelve months with the number of insolvencies rising by 4.3%.

This strong rise is due to the explosion of insolvencies in commercial companies: 46,751 cases over the year (+6.7%). This type of company is even worse hit than in 2009 (44,455 insolvencies). Figure 2 also highlights that the development in the level of insolvencies in 2013 is comparable with 2009, with a similar third quarter. Insolvencies for the 2013 year are likely to be at a historically high level.

Beyond the rise in the number of insolvencies, our cost of insolvency indicators are showing a return to a more classical situation. The financial cost, namely the outstanding amounts of insolvent companies, has fallen in the last twelve months by 7.4%. It has now reached €4.25 billion and continues to represent a high proportion of GDP (0.21%). Despite everything, the last four months of 2013 still saw a number of insolvencies in companies with significant debt, but there were less of them. For example, there was the court-ordered receiverships of "SA sportive professionnelle Le Mans FC" in August 2013, of "Européenne Food" in September 2013 (central purchasing entity in the food sector) and the liquidation of the insurance broker "Assor France" in July. In addition, the ten largest insolvencies in terms of outstanding amounts represent 3.8% of the total debt.

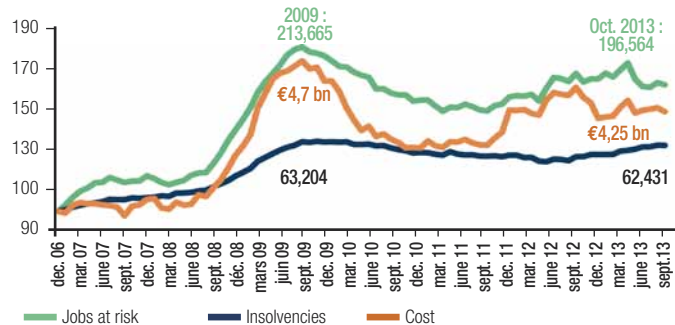
Jobs at risk due to insolvencies decrease slightly (-3.3%) and remain below the 200,000 threshold.

Whilst the average workforce of insolvent companies is 3.15, September and October still saw the court-ordered receivership of companies with high employment levels, such as "LH2" (specialized in market research), "CALL Expert" (business call-center) and "GUICHARD et associés" (moving out services).

The 4.3% rise in the overall number of insolvencies hides the differing situations by company type. SMEs were the hardest hit with a 8% increase in insolvencies in the autumn. Insolvencies of VSEs also jumped by 5.7%, with a smaller 4.2% rise in insolvency for micro-enterprises.

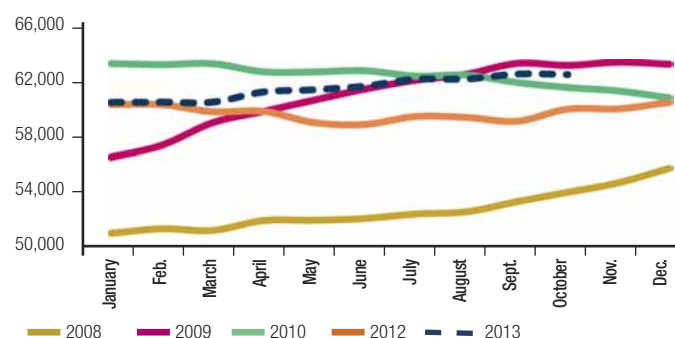
In contrast, there was a sharp drop in insolvencies in the MSB sector (-29%), which explains the fall in the cost of insolvencies. MSBs are suffering less in the current economic environment.

FIGURE 1:
Change in number and cost of insolvencies (base 100: December 2006)



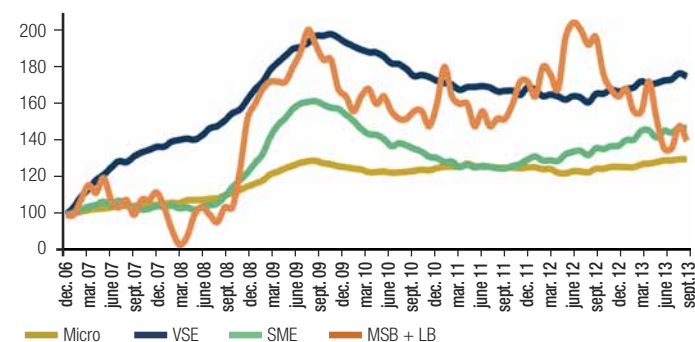
Sources: Scores & Décisions, Coface

FIGURE 2:
Rolling 12 month development in insolvencies in France



Sources: Scores & Décisions, Coface

FIGURE 3:
Change in number of insolvencies by company type (base 100: December 2006)



Sources: Scores & Décisions, Coface

Sector Analysis

Despite the 4.3% increase in insolvencies at the end of October, risk is improving in some sectors such as paper-wood and chemicals. Other sectors such as retail, textiles-clothing and construction continue to show significant deterioration.

Sectors	Number**	Change**	Share***	Change in cost**	Cost share
Construction	20,541	5.1%	33%	9.6%	29.3%
Services to individuals	10,887	7.8%	17%	-9.2%	4.2%
Other services*	9,025	-0.3%	14%	-4.3%	10.2%
Retail	5,870	8.1%	9%	47.3%	10.2%
Automotive and transport	4,119	2.8%	7%	-20.8%	8.5%
Food industry	4,396	2.2%	7%	-12.3%	9.8%
Textiles and clothing	2,239	4.8%	4%	67.3%	5.5%
Electronics and IT-telecoms	1,904	8.6%	3%	-26.0%	7.0%
Paper-wood	1,767	-0.6%	3%	-27.2%	6.0%
Metals	1,074	-0.2%	2%	14.2%	7.0%
Chemicals	609	-5.3%	1%	-76.6%	2.3%
Total	62 431	4.3%	100%	-7.4%	100%

* Services for companies and local authorities

** 12 months from November 2012 to October 2013

*** Share: number of insolvencies in the sector/total number of insolvencies

Sources: Scores & Décisions, Coface

Sectors with deteriorating risk

● Retail

This sector remains sensitive to the economy. The number of insolvencies has risen by 8.1% with a 47.3% increase in the cost of insolvency, which is still dominated by the Virgin liquidation in January 2013. Specialist stores (sports, furniture, florists, etc.) are hardest hit by shrinking household budgets. The Milonga chain (musical instrument retailer) went into court-appointed liquidation in October 2013.

● Textiles-clothing

The general rise in insolvencies in this sector (+4.8% year-on-year) is mainly attributable to clothes and shoe retailers, which alone accounted for 70% of insolvencies. This sector has suffered from apathetic consumer spending and concentration within the sector.

The insolvency of large players in the clothing sector such as Marèse (known under the Ooxoo brand), L.T.J. Diffusion (Arthur licence), and in weaving and manufacturing (Roland Vlaemyck Tisseur, H ET C), contributed to the rise in costs.

● Construction

With over 20,000 insolvencies, construction continues to deteriorate, (+5.1%), and a similar 9.6% increase in the associated costs. This rise is linked in particular to the strong drop in construction permits (-16% year-on-year at the end of September).

Sectors where the risk outlook is improving

● Chemicals

Although there are different trends, we are seeing a general decline in the number of insolvencies in this sector (-5.3% year-on-year). This change is due to the downturn in the number of insolvencies in the trade in chemicals (-3% year-on-year), whilst the plastics industry is still suffering from weakness in the automotive sector. Costs meanwhile fell by 76.6% year-on-year. The refineries sector has not seen any major insolvency since Petroplus was put into receivership by the courts.

● Paper-wood

The sector has seen a decline in insolvencies (-0.6% year-on-year), particularly in the publishing sub-sector (-4.4%). The paper packaging segment has also improved. The cost has also fallen sharply (-27.2%), there have been no major insolvencies of the size of Comareg in November 2011 (€259 million of turnover).

Sharp increase of Indebtedness

Total debt (outstanding amounts and financial debt) of insolvent companies is close to €7 billion. This represents a 6.8% fall over the last twelve months, but an increase of 57.5% in 6 years.

60% of this debt relates to outstanding amounts and 40% to bank debt. Despite its lower weighting, bank debt has more than doubled in 6 years rising from €1.3 billion in 2007 to €2.8 billion today. Bank debt has fallen by 5.9% in the last twelve months, as many as the 7.4% fall in outstanding amounts.

This provides support for our findings concerning the size effect.

Change in total debt of insolvent companies (in € bn.)



Sources: Scores & Décisions, Coface

GLOSSARY:

- **Insolvency:** legal insolvency i.e. court-ordered receiver ship or liquidation
- **Micro-entreprises:** companies with fewer than 10 employees
- **VSE:** very small entities with 10-19 employees
- **MSB:** medium-sized businesses with between 250 and 4,999 employees
- **Cost of insolvency:** total outstanding amounts of each insolvent companies

Insolvencies in the construction sector in France: breaking all dangers

Jennifer Forest et Julien Marcilly,
Economic research department, Coface

Construction lies at the heart of the French economy. As regards households, 62% of the population claimed to be property owners in 2013, making them vulnerable to changes in real estate prices. Non-property owners are also susceptible to changes in housing prices: the median French household devotes 18.5% of its budget to housing. On the corporate side, the construction sector includes more than a sixth of French companies.

Today this sector is faced with a paradoxical situation: the real estate market in France has certainly not suffered a marked correction following the 2008-2009 economic crisis, in contrast to most other European countries. Yet despite this resilience, the sector accounts for more than 30% of total insolvencies in France. So how can we explain this overrepresentation of the sector as regards insolvencies, even when the economic outlook is favourable? This question is all the more crucial as the sector is currently slowing, faced with apathetic growth and high unemployment. To find a response, we will first present recent trends in insolvencies in the construction sector in France, and then analyse its distinctive financial fragility. We will then detail the outlook for real estate prices in 2014, and their influence on insolvencies in the construction sector.

INSOLVENCIES INDICATE DETERIORATION IN THE CONSTRUCTION SECTOR

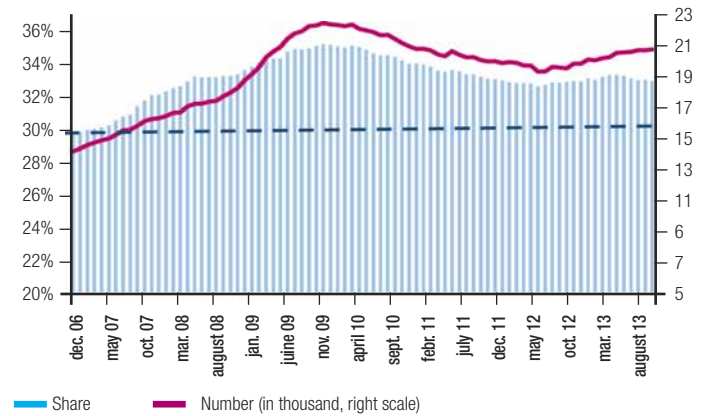
The slump in the construction sector is reflected in the number of insolvencies: more than one over three insolvencies in France relates to a construction company and this number together with the associated costs have been on a rising trend over the last year.

A structurally high level of insolvencies...

The construction sector has seen the highest level of insolvencies in France during the last seven years. At the end of October 2013, the construction sector accounted for 32.9% of insolvencies. At the top of the economic crisis in June 2009, this figure was as high as 36%. By way of comparisons, investment in construction represents "only" 10% of GDP, the sector employs 10% of the labour force and includes 18.4% of French companies⁽¹⁾ (2012). Figure 1 highlights that the sector accounts for a minimum of 30% of total insolvencies, irrespective of changes in growth levels. With comparable turnover, the food industry (turnover of €160.9 billion in 2012⁽²⁾ versus €170 billion in construction⁽³⁾, the equivalent of New Zealand's GDP) accounts for just 7% of total insolvencies.

This overrepresentation of the construction sector in France is also striking when compared to its share of insolvencies in other European countries. In Germany⁽⁴⁾ only 19.4% of total insolvencies were in the construction sector in 2012, and in Spain, where there is a chronic real estate crisis, this figure was 27% for the first nine months of 2013⁽⁵⁾.

FIGURE 1:
Share of the construction sector in total insolvencies



Sources: Scores & Décisions, Coface

Definition of the construction sector

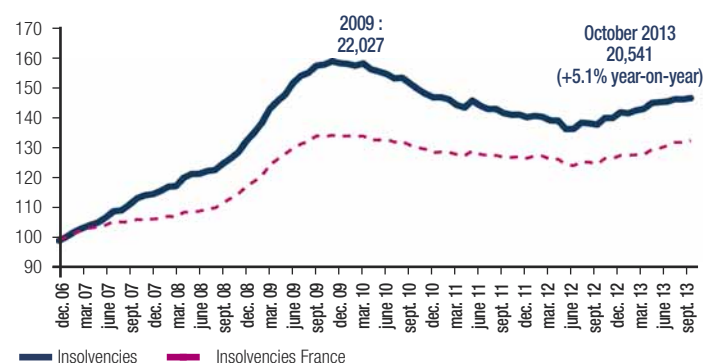
The construction sector in this study overlaps with the INSEE definition, i.e. "the construction, extension, demolition, restructuring, maintenance and renovation of buildings for residential or non-residential use" together with real estate business.

When analysing insolvencies in this sector, we have also included producers of commodities used in the construction sector and distributors of products linked to this business. It should be noted that for the financial and solvency analysis the study uses Banque de France datas, which defines the construction sector in the strict sense and the real estate sector.

... and still on a rising trend

When comparing insolvency levels (Figure 2), we can see that insolvencies in the construction sector have risen more quickly than insolvencies for all companies since 2007, with particularly sharp divergence between the two in 2009. In the next two years insolvencies amongst construction companies declined slightly, before a fresh upsurge in 2012. At the end of October 2013, the number of insolvent companies in the construction sector was up 5.1% year-on-year. This is now above the 20,000 threshold whereas it was close to 14,000 at the end of 2006.

FIGURE 2:
Number of insolvencies in the construction sector
(base 100= 2006; year-on-year)



Sources: Scores & Décisions, Coface

(1) INSEE scope
(2) ANIA, press release 16 April 2013
(3) FIEC, European Construction Industry Federation
(4) Source: Destatis
(5) Source: INE (Instituto Nacional de Estadística)

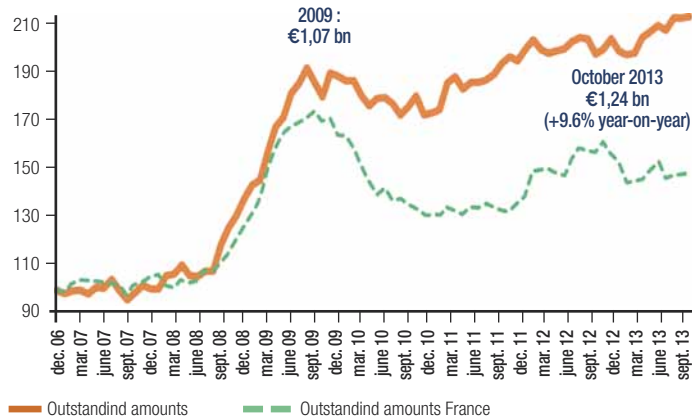
Workforce figures linked to these insolvencies are following the same trend. In October 2013, 58,619 jobs were at risk as a result of insolvencies in the previous twelve months. This remains an extremely high figure, with an average of 2.9 jobs at risk by insolvency.

In 6 years, the workforce affected by insolvencies in the construction sector has risen by 68%, faster than the 29.4% increase in the number of insolvencies over the same period.

In addition, the financial cost of these insolvencies, i.e. total outstanding amounts of each insolvent company, has been constantly rising. At the end of October 2013, this twelve month rolling financial cost was €1.24 billion (Figure 3), representing a 9.6% increase versus a year earlier. As this represents 29.3% of the total cost of insolvencies in France, the construction sector is therefore the most “expensive”, way ahead of the food industry (9.8% of the total) and retail (10.2%).

2012 was moreover a record year (as 2013 will most certainly be) for the cost of insolvencies in the construction sector, 16% higher than the previous peak in 2009.

FIGURE 3:
Cost of insolvencies (base 100: 2006; year-on-year)



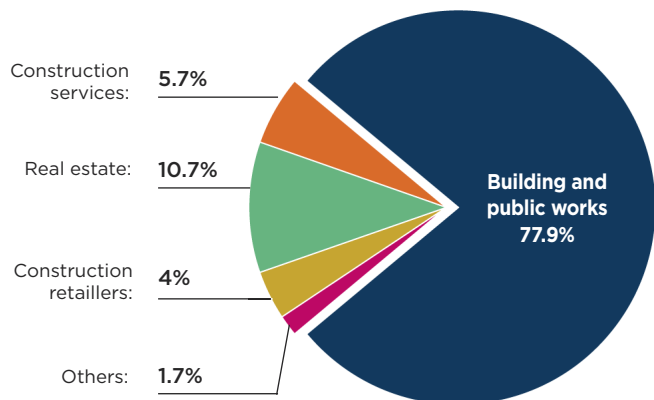
Sources: Scores & Décisions, Coface

Differences by sub-sector

Although the entire sector (building and public works, real estate, services and trade linked to construction) are experiencing difficulties, there are different developments by type of activity.

Building and public works (which accounts for 77.9% of insolvencies, including a large number of masonry, joinery and plastering companies) recorded a rise of 1.5% in the number of insolvent companies in 2012.

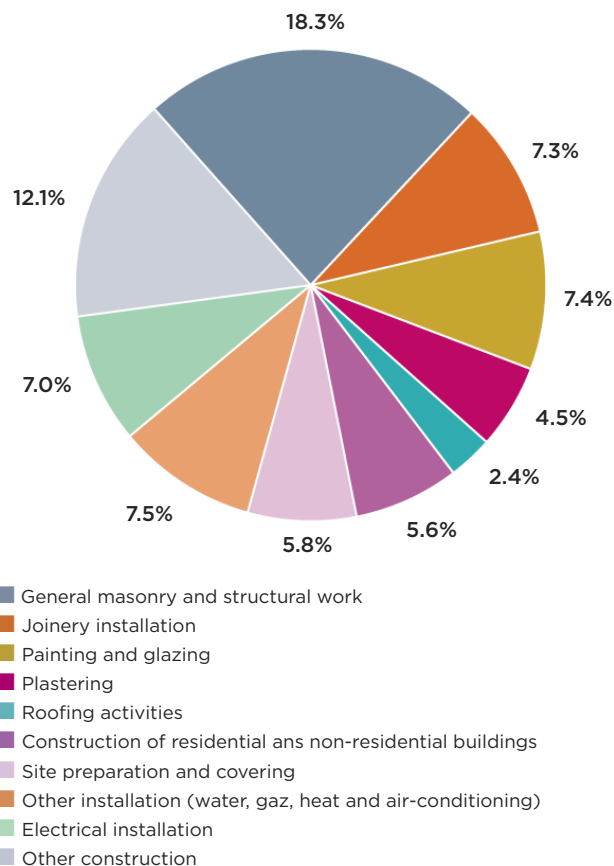
FIGURE 4:
Split of insolvencies by sub-sector in 2012



Sources: Coface Services, Coface

The number of insolvencies in the real estate sector (10% of insolvencies in the sector) is showing a more marked deterioration (+3.5% year-on-year and +67.6% between 2006 and 2012). Finally, service providers to the construction sector, in particular companies of architects and engineers, are hardest hit with a 9.2% increase in insolvencies.

FIGURE 4 (part 2):
Zoom of insolvencies for building and public works



The ranking of the largest insolvencies over the last twelve months (Table 1) also highlights these differences: in particular, it features the court-ordered receiverships of joinery companies and manufacturers of components for the building and public works sector.

Table 1:
Top 5 insolvencies from November 2012 to October 2013 ranked by workforce

Company name	Workforce	Business
HUIS CLOS	1,083	Timber and pvc joinery
CLESTRA	583	Joinery
MULTITEC	400	On-site electrical installation work
OXXO	400	Manufacture of plastic components for the construction sector
AREA FRANCERAM SA	264	Manufacture of builders' ware of plastic

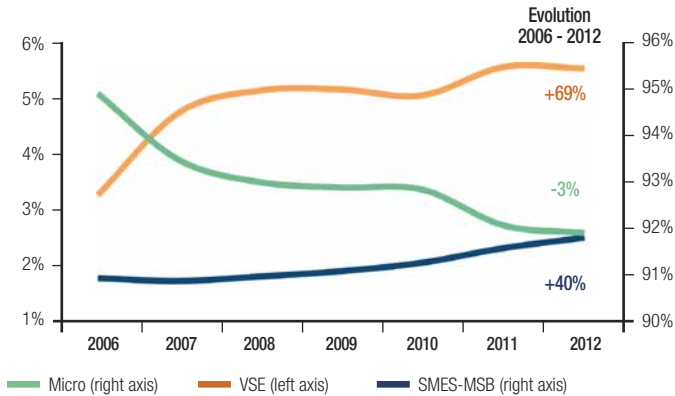
Sources: Scores & Décisions, Coface

This rise in the number and cost of insolvencies is linked to the characteristics of the companies affected, such as their size and age.

Insolvencies increasingly affecting large, longer-established companies

The profile of insolvent companies has changed significantly over the last six years. Traditionally insolvencies have been in the micro-enterprise segment (92% of the total), very fragile and “incompressible” in size. Thus in 2006, the sector was characterized by insolvencies amongst very small companies (Figure 5) that had been in existence for between three and five years (Figure 6). Six years later and the number of VSE and SME-MSB has risen sharply (+69% and +40% respectively). Insolvencies are now therefore affecting larger companies, which explain the increase in associated costs.

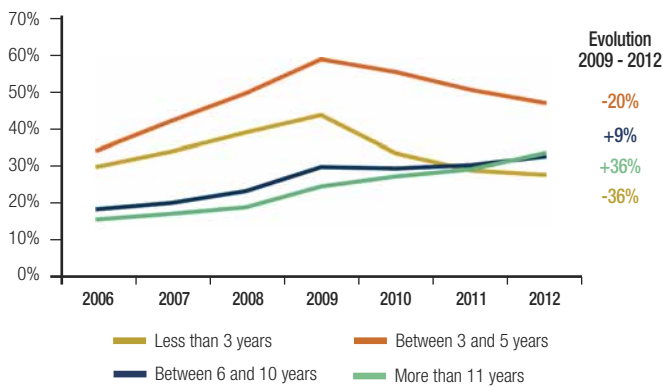
FIGURE 5: Insolvencies by company size



Sources: Coface Services, Coface

Similarly, the age of companies entering insolvency has changed significantly. Since 2009, it is increasingly older companies being hit, and less young start-ups. The number of insolvencies amongst companies in existence for less than three years, and between three and five years have declined by 36% and 20%, respectively. In contrast, insolvencies amongst companies in existence for between six and ten years or over eleven years have risen by 9% and 36%, respectively.

FIGURE 6: Insolvencies by company age



Sources: Coface Services, Coface

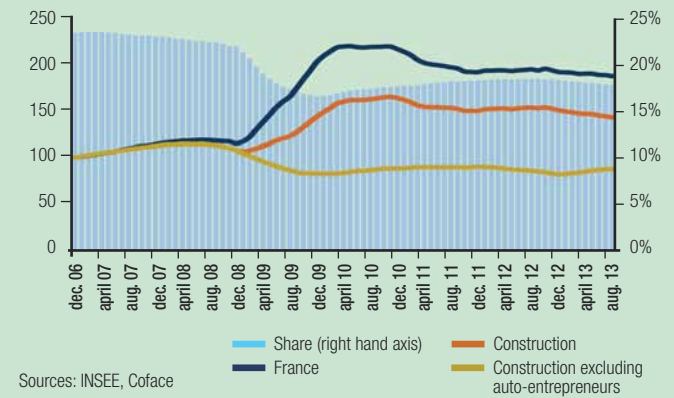
There is no link between the rise in insolvencies and the number of new companies

The rise in the number of new companies could explain the increase in the number of insolvencies in the sector. The number of new companies has risen very significantly since 2009 (see Figure below), with the launch of the auto-entrepreneur status in France. However, as this status is not currently subject to court-ordered insolvency or liquidation, it cannot be the cause of the rise in the number of corporate insolvencies.

Excluding this type of company the number of new start-ups fell by 7.7% between May 2009 and May 2013 on a 12 months rolling basis.

Also, the share of all French companies in the construction sector has been falling and today stands at just 18% versus 23.5% in 2009.

New companies in the construction sector and in France



Continuous rises in insolvencies and the associated costs is a worrying trend, due mainly to the increasing financial fragility of players in the sector.

STRUCTURALLY FRAGILE COMPANIES

The sector comprises mainly small structures

Although insolvencies amongst large companies have been rising since 2009, the sector is still dominated by micro-enterprises (95% of the sector) and their number is constantly rising, in contrast to small companies (4.5% of the sector) and SME/MSB/large companies (less than 0.5% of the sector). This dominant group of small structures are by nature more financially fragile as they have relatively little equity. In fact, there are not really any minimum requirements for share capital levels for micro-enterprises (especially for individuals and sole proprietors; a SARL-French private limited liability company-can be set up with minimum obligatory capital of € 1). This makes them more vulnerable to business fluctuations, as highlighted by the economic crisis in 2008-2009, which provoked insolvencies amongst the smallest and most fragile companies.

However the demographic characteristics of companies in the construction sector do not explain the recent trend of difficulties amongst larger-sized companies with higher associated costs. This is attributable rather to the persistent economic crisis: its length and severity is causing difficulties for larger and larger companies.

FIGURE 7: Construction sector breakdown by company size



Sources: INSEE, Coface

Three questions to Paul Baillot d'Estivaux

Construction arbitrator, Arbitration department, Coface

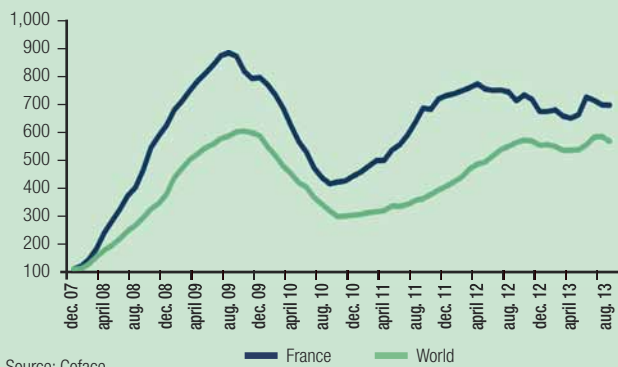
How is the current situation in the construction sector?

There was a flicker of activity in the second quarter of 2013 with a rise in the number of construction starts. However, activity in the construction sector is still clearly in a downturn over the last twelve months and the environment remains difficult. New housing construction is suffering, as is housing renovation (which is rarer), reaching a level comparable to that of 2010.

Credit risk, characterized as the arrears we are recording, has been on a rising trend since the second quarter of 2013. The risk level remains very high, close to that seen at the beginning of 2009 or indeed at the end of 2011.

The 2009 economic crisis hit the smallest and most fragile companies in the sector. However, given the length and extent of the crisis, larger companies are increasingly being affected.

Coface arrears in the construction sector in France (base 100=2007)



Source: Coface

Which factors are penalizing companies in the sector in 2013?

Current economic difficulties are affecting the entire sector. The rise in unemployment and taxation and the fall in purchasing power is obliging households to adopt a "wait and see" approach, paying particular attention to spending on the acquisition and renovation of property.

The deterioration in corporate liquidity has accelerated since the beginning of the year and has today reached a level comparable with that at the beginning of the economic crisis.

In the public works sector, despite an improvement in the second quarter of 2013 (pre-election year), the local and regional authorities' budgets are still as restricted as ever.

What is the outlook like for this sector in France?

Construction permits issued today represent tomorrow's construction starts. Therefore, given the long cycle of the construction sector, the sharp fall in construction permits in the last year (-14%), which worsened in the second quarter of 2013, means that no real and durable upturn in activity can be envisaged for the sector before the second quarter of 2014.

Order books continue to deteriorate and only account for 82 days for small companies.

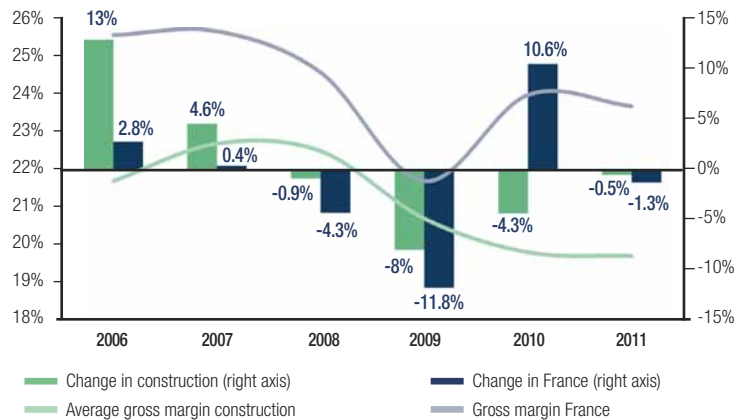
Finally, the new stimulus packages put in place in September 2013, some of them quite vague, will not have the expected effect for several months.

We must therefore remain vigilant.

Corporate margins falling

Beyond this size effect, the high number of insolvencies reflects the more general financial vulnerability of companies in the construction sector. Gross margin developments confirm this: profitability has deteriorated sharply since 2009 (Figure 8). The average gross margin has gone from 22.7% in 2007 to 19.7% in 2011, a 13.2% decline. Similarly in real estate, although the gross margin is around 60%, 2011 saw deterioration of 3.4% in results.

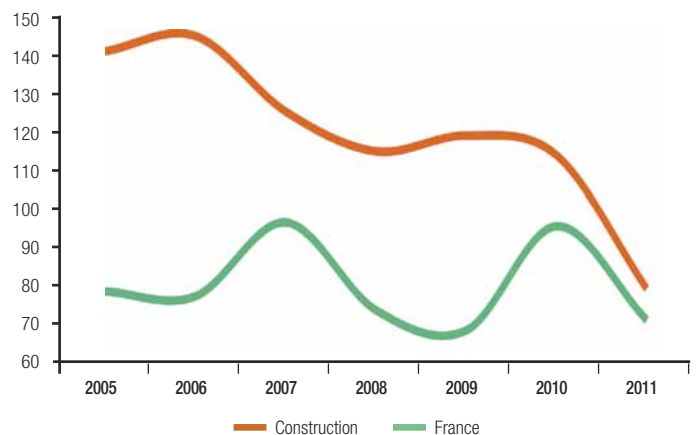
FIGURE 8: Gross margin of companies in the construction sector and all companies in France



Sources: Banque de France, Coface

The deterioration in the average self-financing rate also highlights the increasing financial vulnerability of the sector. In 2005, the self-financing rate in the construction sector was double that of the average seen in France (Figure 9). It has collapsed by 44% in six years, to reach 79.5% in 2011. Whilst the self-financing rate of the construction sector was almost twice that of the average for French companies in 2005, self-financing rates are now very close. Real estate has also seen its rate decline by 27% over the same period going from 34% to 24%.

FIGURE 9: Self-financing rate (average)



Sources: Banque de France, Coface

INTERVIEWS

Arnaud Brocard,
Chairman, SODIMAT*

«2014 WILL BE WORSE THAN 2013»

In your opinion, what are the difficulties facing the construction sector at the moment?

At the end of last year, there was a slight bubble in the sector in order to avoid changes in energy regulations. Difficulties in the sector are now mainly concentrated in the new building market. Our clients, namely VSEs and tradespeople have seen things come to an abrupt standstill since the beginning of the year.

The renovation market will be more or less flat with last year.

Subcontractors and others dependent on the large construction companies with less work are experiencing serious financial difficulties. In addition, there is a real problem with payments, and extreme tension surrounding payment terms.

Who is hardest hit by this situation?

In past years, it was rather the VSEs and tradespeople who were hit by insolvencies. Now companies with 5 to 50 employees are increasingly struggling, and they have higher payables.

2013 is seeing a second wave: the 2009 economic crisis hit the smallest companies first, particularly micro-enterprises; it is now weakening the SMEs, which are increasingly eating into their equity.

What is your feeling for 2014?

2014 will be worse than 2013. In my opinion we have not yet hit the bottom in the new building market. Simply because a lot of projects were sold at the end of 2012 and are being realized currently. After that, things are likely to get more complicated in 2014.

I believe we will see a trend towards stabilization in the renovation market. However troubles are not over for the new building sector.

In my area, namely the north of France, activity may be saved by the industry majors, which still have some decent projects.

Nicolas Macarez,
President, GEDIMAT - BRUHY-VACHERAND SAS*

«PAYMENT TERMS ARE LONGER THAN IN 2009»

How would you characterize the construction sector in 2013?

The sector is characterized by the clear absence of new project starts and equally by significant tensions surrounding payment. Payment terms are being extended and are even longer than in 2009.

We are seeing a lot of delayed payments by some clients. Subsequently our company is increasingly taking on the role of a bank, with limited capacity.

Who is hardest hit by this situation?

Our two client groups are being stretched at the moment. All companies, whatever their size, are experiencing difficulties. Well-established companies that have been around for 20 or 30 years are closing, which was unthinkable previously. We therefore have to be careful with all types of company.

Also private individuals, who make up 35% of our client portfolio, have reined in expenditure in the construction sector, with less impulse buying and more careful spending.

Do you think the situation will improve in 2014?

In my opinion, 2014 will be similar to 2013. We should not expect an improvement or any real upturn. It's a difficult situation, liquidity is tight everywhere. This has been the situation since 2011, with continued falls in turnover. A return to normal will therefore be difficult.

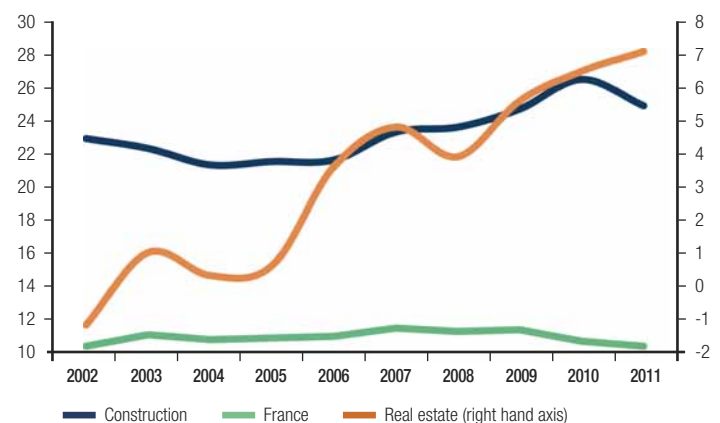
* Brokered by AU®

Corporate trade credit unsustainable

The construction sector is also cash-strapped, lacking liquidity, and in an eroded financial situation, making undercapitalized companies fragile. The extension of payment terms is one very significant example of this. This corporate trade credit⁽⁷⁾ often represents an important factor in the viability of many SMEs. At the end of 2011 it was estimated at over €600 billion in France, 30% of GDP⁽⁸⁾.

Whilst average payment terms in France are 10 days, this figure is much higher in the construction sector. In 5 years it has risen by 15.3% to reach around 25 days of turnover, which is double the national average. In real estate where intercompany lending was traditionally very low or even negative, payment terms have risen from 97% starting in 2006.

FIGURE 10:
Corporate trade credit, average of individual ratios



Sources: Banque de France, Coface

(6) www.au-group.com

(7) Intercompany loans are "Loans granted implicitly between companies via the payment terms accorded by a company to its clients. It is one of the components of the working capital requirement". Source: Vernimmen

(8) IGF, report no.2012-M-070-04 "Intercompany loans and coverage of trade receivables"

These payment terms in the construction sector have become much longer for SMEs, but have remained more or less stable for MSBs and large companies. However the French law to modernise the economy (*Loi de la Modernisation de l'Economie: LME*⁽⁹⁾) should have led to an €8.7 billion liquidity gain for companies in the sector in 2011 as highlighted by the French payments period Observatory (*l'Observatoire des délais de paiements*⁽¹⁰⁾). However, according to this body, the sector is actually seeing payment terms increasing, particularly as a result of unconventional practices. The report indicates that despite application of the *LME* and the French law on construction and housing (*Code de la construction et de l'habitation*), the sector saw a rise in payment terms in 2012 due in particular to «hidden delays»: contested invoices, invoices outsourced abroad, purchases made directly abroad rather than in France in order to evade regulated payment terms.

However, whilst insolvencies among companies in the construction sector are mainly explained by their heightened financial fragility, this is in turn due to deterioration in the macroeconomic environment.

ECONOMIC DETERIORATION AFFECTING COMPANIES IN THE SECTOR

The slight fall in real estate prices has depressed activity since the end of 2011

Real estate prices⁽¹¹⁾ have risen sharply since the middle of the 1990s: +155% between 1996 and the peak in the third quarter of 2008 for existing housing. Inflation rose by only 23% over the same period, so real estate prices more than doubled in real terms. The 2008-2009 economic crisis then caused a first correction: -9% year-on-year in the second quarter of 2012. After a very slight bounce, prices started falling again (-4.2% since the third quarter of 2011).

FIGURE 11: France: real estate prices and construction permits



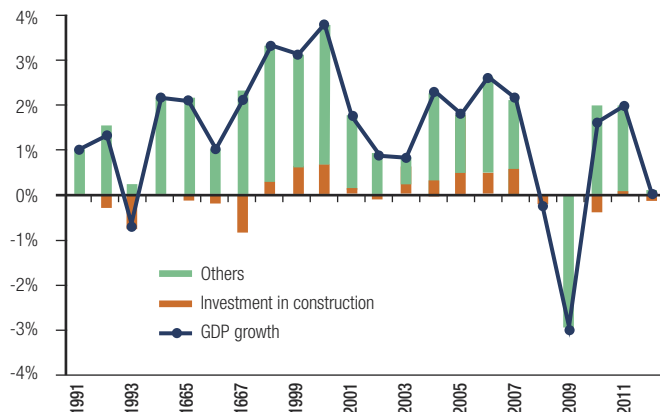
Source: Banque de France

The leading indicators for the construction sector suggest that this bearish trend is likely to continue in coming quarters: the number of construction permits awarded in August 2013 declined by 34% year-on-year, which is the biggest drop since March 2009. The confidence index for professionals in the sector is also close to the lows reached in 2009-2010.

This downturn in real estate prices has an impact on activity. The most obvious is the positive correlation between housing prices and investment in construction: a rise in prices encourages invest-

ment as it tends to make this investment more profitable. Investment in real estate represents a significant proportion of GDP in France, around 10%. And whilst the average contribution of the sector to growth during the last 20 years has been zero, investment in the construction sector is a good leading indicator for activity: in 1993 and then in 2008, recessions in France were preceded by a fall in investment in residential construction.

FIGURE 12: France: GDP growth



Source: INSEE

Besides investment, real estate prices also have an impact on activity via household consumer spending: an increase in real estate prices equates to an increase in the assets of households. This is likely to lead to rising optimism and therefore higher household consumer spending. Chauvin and Damette (2010)⁽¹²⁾ confirm the existence of these wealth effects in France: an increase (or decrease) in the value of real estate assets of 10% led to a rise (or fall) in household consumer spending of 0.6% between 1987 and 2008.

Prices remain overvalued by around 30%

The slight downturn in real estate prices seen since the economic crisis of 2008-2009 in France is modest in comparison to those seen in other developed economies. Combined with the sharp rise in real estate prices between the middle of the 1990s and 2008, this relative resilience partly explains why the French real estate market currently looks overvalued. In fact, whilst prices for existing housing have risen by 70% since 2003, disposable household income has risen by only 33% over the same period.

Persistent divergence between growth in income and the rise in house prices means the latter is not sustainable over the long term and a correction in prices is therefore likely. This approach suggests that the real estate market is overvalued by around 30%⁽¹³⁾. Taking account of this long-term average for real estate prices and incomes, the OECD comes to the same conclusion, considering the French real estate market the most overvalued amongst OECD countries after Belgium (see Figure 13).

Amongst the major developed economies, real estate prices also appear overvalued in the United Kingdom (by around 20%) and to a lesser extent in Spain (between 10 and 15%), even if the sharp price correction of the last four years has absorbed a large part of the imbalance⁽¹⁴⁾. Conversely, corrections to housing prices following the economic crisis of 2008-2009 in the US, Ireland and Greece explain why prices are no longer overvalued in these countries.

(9) The LME was implemented in August 2008, and in particular promotes the reduction of payment terms

(10) 2012 Annual report of *L'Observatoire des délais de paiement*

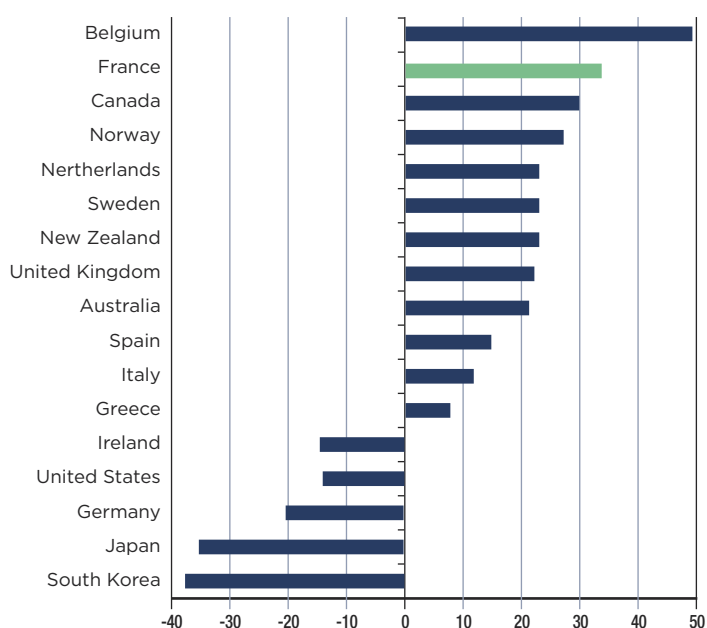
(11) Measured here by the price of existing housing. Source: INSEE.

(12) Chauvin V. and Damette O. (2010): Effets de richesse : le cas français, INSEE, Economie et statistiques N° 438-440.

(13) Calculation made using INSEE data on real estate prices and household income since 2003.

(14) Based on this indicator, prices were overvalued in Spain and the UK by 50% and 45%, respectively, in 2007.

FIGURE 13:
Ratio of real estate prices to income (2012; long-term average = 0)



Source : OECD

In addition to valuation issues in the French market, prices could fall for economic reasons. Developments in interest rates is one such reason: for the first time since March 2012, the average interest rate on bank loans granted to households rose in August 2013⁽¹⁵⁾. This trend is likely to continue in coming months, in particular as a result of the improved growth outlook and lower concerns over the future of the eurozone. This likely rise in rates on loans will dampen the demand for housing.

Finally, the aggregate effect on the sector of all measures taken by the government is difficult to assess at this stage (see inset). On the one hand, the measures to regulate rents, alleviate tax on capital gains realized on the sale of second homes and the rise in notaries' fees should have a negative effect on demand for housing and therefore contribute to the downturn in real estate prices. However on the other hand, measures such as the reduction in VAT on renovation work will support the sector.

Recent government measures in relation to the construction sector

Several measures linked to the construction sector have recently been announced by the government. They are included in the French «Alur» law and the draft Budget Act for 2014.

The «Alur» law (access to housing and urban renewal) aims to reduce housing costs. In order to achieve this it provides for regulated rent levels (based on a median rent which has yet to be defined) in order to stamp out any marked increases. It also provides incentives for a broader range of housing by changing the capital gains tax on the resale of a real estate asset (lower tax or tax exoneration depending on the number of years the asset was held). This law also proposes a universal rental guarantee (garantie universelle des loyers-GUL) allowing owners to limit the level of potential arrears even if this represents an additional tax initially. The law was passed by the French National Assembly on 18 September 2013 and adopted by the Senate on 26 October. GUL financing was rejected in 2016.

However, the complexity of this law and difficulties in implementation (notably in compiling the data to enable calculation of the median rent level) are unlikely to incite owners to sell or let their properties, particularly in stretched areas like the Ile-de-France.

As part of the Budget Act 2014, a second series of measures affecting the construction sector has been proposed. It should be approved in December 2013. These measures include, in particular, a reduction in VAT on thermic renovation work, increased emphasis on environmental aid, an increase in notary fees, a freeze on housing subsidies, and an increase in taxes linked to the sale of buildable land.

If these elements to improve the real estate market and the economy aim to predict coming price trends, they cannot predict the speed with which these increases/falls will occur. In light of recent experiences in the eurozone economies, there are two potential scenarios: 1) A swift and marked correction in prices as occurred in Spain, Ireland and Greece (declines of 30% to 50% in total since 2008); 2) A more restricted downturn as in Italy or the Netherlands (between 15% and 20% since 2008, which is less than 5% per year).

We believe that this second scenario is the most appropriate for France for several reasons. Firstly, loans to households have only grown at a slow rate during recent years: +2.1% year-on-year only in the second quarter of 2013 and +4.4% per annum on average since the beginning of 2009. These figures indicate that the banks have remained relatively cautious in their lending, choosing only the most creditworthy households. Doubtful debts confirm this assumption, as they have remained at a low level: non-performing loans to households represent just 1.7% of the total in the second quarter of 2013, a rise of just 0.5 of a percentage point since the end of 2008⁽¹⁶⁾. A swift and brutal limitation on lending terms by banks aimed at improving their balance sheet structure therefore seems unlikely.

Secondly, household incomes are another factor supporting the real estate market. Despite the economy contracting and unemployment rising, disposable household income has risen by more than 7% since the beginning of 2009. This growth remains very slightly positive on an inflation-adjusted basis. In other words, purchasing power has not fallen in France. In contrast, in Italy and Spain household purchasing power dropped by 10% and 7%, respectively, over the same period. More resilient economic growth, relatively high social transfers and low interest rates on the debt burden may explain this difference.

Finally, household indebtedness remains at a moderate level. It represents 82%⁽¹⁷⁾ of disposable income and has risen only very slightly during recent years (+4 percentage points since 2008). It is at a much lower level than the eurozone average (99%). Spanish households (125%), British households (138%) and even those in Germany (86%) are more indebted. This moderate level of indebtedness constitutes a further favourable factor for the creditworthiness of households.

Given this environment, it is unlikely that real estate prices will see a correction of the magnitude seen in Spain, Ireland and Greece since 2009. However, overvaluation means that a moderate decline in prices in 2014 is likely, which we estimate at around 5%.

This expected fall in prices should translate into an increase in the number of insolvencies in the construction sector in 2014.

(15) Source: Banque de France.

(16) Source: Banque de France.

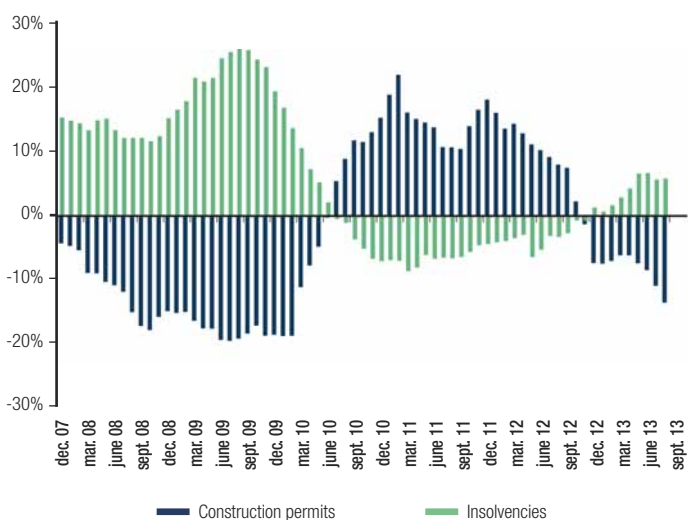
(17) Source: Eurostat, data for 2011.

NEW RISE IN INSOLVENCIES IN THE CONSTRUCTION SECTOR IN 2014

French insolvencies influenced by housing permits and real estate prices

Insolvencies in the construction sector are linked to changes in activity and therefore in economic indicators. The correlation between the change in the number of housing permits and insolvencies in the sector confirms this (Figure 14).

FIGURE 14:
Housing permits and insolvencies, change t/t-1



Sources: Ministry of Ecology, Sustainable Development and Energy; Scores & décisions, Coface

This intuition is backed up by the existence of a statistical correlation. Using quarterly data since 2006, we can measure the past correlation between the change in the number of insolvencies and the change in the number of housing permits. The independent variable, construction permits (*Permis*) represents the change in the number of permits year-on-year. The dependent variable (*Def*) corresponds to insolvencies. This gives the following statistical model:

$$\Delta Def_t = Const + \alpha \Delta Permis_t + \varepsilon_t$$

Table 2:
Statistical model, based on the number of construction permits

Variables	Estimate	P Value *
Constant	4.347	p<0.0001
Housing permits	-0.7658	p<0.0001

* Enables verification of the significance of the variables. The p-value is the smallest value of α for which the decision would be to reject the null hypothesis. α is the probability of wrongly rejecting the null hypothesis; α is also called the p-value or test level. In addition, the adjusted R^2 is 0.85.

This model shows that construction permits have a significant effect on insolvencies. Thus a 5% fall in the number of construction permits is linked to an 8% rise in the number of insolvencies in the construction sector, all other things remaining equal.

In addition, the correlation between real estate prices and the number of insolvencies is equally significant. In fact, using quarterly data since 1996 (and up until the second quarter of 2013), we have measured the statistical correlation between

the change in real estate prices (independent variable $Px^{(18)}$) and the change in insolvencies (dependent variable *Def*):

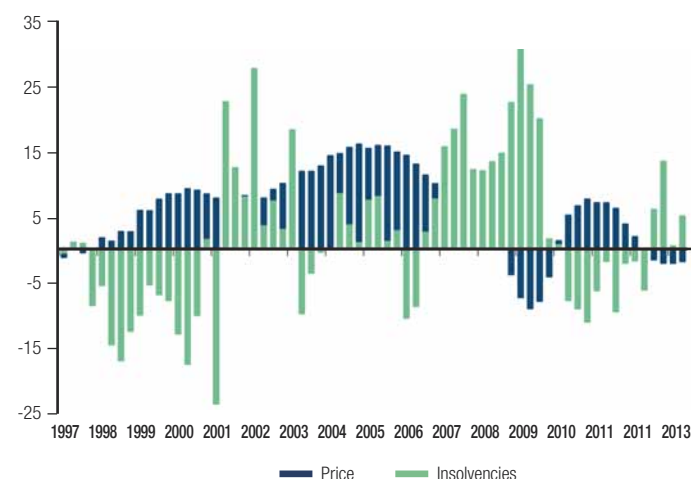
$$\Delta Def_t = Const + \alpha \Delta Px_t + \varepsilon_t$$

Table 3:
Statistical model based on real estate prices

Variables	Estimate	P Value *
Constant	4.8354	0.0188
Price	-0.4545	0.0571

This model indicates that a 5% fall in real estate prices (i.e. our basic hypothesis for 2014) would lead to a 7% increase in the number of insolvencies. Were the fall in prices to be stronger than anticipated (in the order of 10%), insolvencies would rise by close to 10% in 2014. In contrast, if prices were to remain stable, insolvencies would rise by just under 5%.

FIGURE 15:
Change in prices for existing housing (seasonally adjusted) and insolvencies, change t/t-1, in %



Sources: INSEE, Banque de France, Coface

CONCLUSION

Historically, the construction sector has been overrepresented in corporate insolvencies. The 2008-2009 economic crisis and the apathetic growth of 2012 and 2013 have only aggravated this imbalance. This study highlights the fact that the construction sector is being squeezed on two sides, explaining why this is the case. As regards the companies themselves, they are suffering financial difficulties, particularly as a result of their small size or due to lengthening payment terms. On the market side, companies are hampered by lacklustre demand as shown by the recent slight downturn in real estate prices. We also anticipate that this decline in real estate prices will continue next year. In conjunction with the expectation of weak growth in France (+0.6%, according to Coface), this seems to indicate that companies in the construction sector will continue to suffer in 2014 with close to 22,000 insolvencies

(18) Price index for existing housing, seasonally adjusted.