

Coface Sector Forecasts for 2007

In determining its sector-based forecasts for 2007, Coface has downgraded the world and regional ratings for the following sectors:

- **Construction:** From A- to B+, with a downgraded rating in North America and Western Europe
- **Pharmaceuticals:** From A to A-, with a downgraded rating in North America
- **IT:** From B to B-, with a downgraded rating in every region throughout the world
- **Telecom manufacturers (mobile telephones):** From A- to B+, with a downgraded rating in Western Europe and the emerging Asian economies.

The regional ratings for three sectors have also been adjusted:

- **Mass distribution:** Downgraded from A to A- in North America, and upgraded from B+ to A- in Western Europe and Japan
- **Automotive:** Downgraded from B to B- in Western Europe
- **Electronics:** Downgraded from A+ to A in emerging Asia.

The world rating for the air transport sector has been upgraded from C+ to B-, with an upgrade from C to C+ in North America.

Coface's sector @ratings evaluate the average payment default risk for companies worldwide in a given sector (see appendix 2). It is based on an analysis of the sector's economic environment, the companies' financial solidity and above all Coface's knowledge of past payment behavior (taken from Coface's database of 50 million companies). This rating consequently represents an advanced indicator of company health in a given sector.

Forecast Overview

In 2007, the economic environment for the different sectors will be characterized by a moderate global slowdown, essentially due to a turnaround in trends in the United States and, to a lesser extent, Europe. Growth should remain sustained overall.

On the other hand, this change should cause oil prices to stabilize, provided there are no major geopolitical incidents. Similarly, the prices of other raw materials are likely to show slower growth, or may even fall in certain cases. This turnaround will limit production cost increases and should boost company margins in the sectors that use these products intensively (iron and steel, mechanical, automotive, etc...). It will only partially offset the negative impact generated by a less sustained demand.

Moreover, the economies in the emerging countries, notably in Asia, will continue to deliver strong performances despite the moderate pace expected in 2007. Dynamic internal demand and substantial comparative benefits will have a particularly favorable impact on local companies' financial situations and solvency levels. This dynamic environment is also the reason for the continuing relocation trend towards these regions, where companies benefit from buoyant markets and low production costs. The ratings for most sectors in these regions are now higher than those in the industrialized countries, even if this favorable environment does not exclude intense price competition and over-capacity in certain sectors (notably in China).

In this context, the world ratings for several sectors have been downgraded, while only one has been upgraded (see appendix 1).

After years of exuberance, **demand in certain sectors has seen a slowdown**, and this trend is likely to continue in 2007. This is notably the case in the **construction** sector, where the ratings have been downgraded both worldwide (world rating downgraded from A- to B+) and regionally (United States downgraded from A- to B and Europe from A- to B+). Likewise, the **automotive sector** rating, having already been downgraded in the United States (C), has now also been downgraded in Europe (from B to B-). In view of the household consumption slowdown expected in the United States, Coface has also downgraded the **mass distribution** sector rating from A to A-, despite the less cyclical nature of this sector. Conversely, this sector's rating has been upgraded in Europe and Japan (from B+ to A-).

The fierce **competition** observed in numerous sectors could be intensified, given the drop in demand. Pressures on company margins are now likely to remain particularly strong, which is why the following ratings have been downgraded: the **electronics sectors in Asia** (from A+ to A), **IT** (from B to B-) and **telecommunications equipment manufacturers** (from A- to B+). Similarly, the **pharmaceutical** sector has also been downgraded from A to A-, in view of restrictions on public health spending and the competition generated by generic drugs.

Conversely, the **air transport** sector (worldwide rating upgraded from C+ to B-) is enjoying a sustained increase in traffic, which, combined with the impact of numerous restructuring operations, is ensuring a better aircraft load factor. The competition generated by the low cost airlines remains fierce, but the recent recovery has enabled several airlines to move out from behind Chapter 11 bankruptcy protection in the United States (rating upgraded from C to C+). Moreover, a stabilization of oil prices in 2007 should enable these airlines to strengthen their financial situation.

Construction

Building public works	World	North America	Japan	Western Europe	Central Europe	Emerging Asian economies	Latin America	Middle East	CIS
2007 Forecasts	B+	B	B-	B+	A-	A-	B	A	A-

The ratings for the construction sector have been downgraded from A- to B in North America and from A- to B+ in Western Europe, in view of the gloomier residential property prospects, which could affect the solvency levels of the most vulnerable companies in the sector.

In the United States, investment in **residential** construction declined by 6% **in 2006**, as a result of an imbalance between a surplus offering in the marketplace and declining demand, generated by a 100% price increase over a period of 10 years (with significant household debt). This trend has had a negative impact on the sector's professionals, and notably suppliers of wooden components (structures, frameworks, panels etc), building contractors and even property developers, who have had to offer reductions or sales incentives. This trend is likely to continue, or even intensify, in 2007.

In Western Europe, the entire sector enjoyed an acceleration **in 2006**, with the slump in the German market coming to an end. However, this is unlikely to continue in **2007**, since it is improbable that the German recovery will be able to offset the slowdown expected in

numerous other countries. House prices have seen a significant increase over the last 10 years (+300% in Ireland, +200% in the UK, +150% in Spain and approximately 100% in most other countries). The level of household debt has increased and, in view of the deterioration in household solvency ratios, the possibility of a sharp decline in the residential market cannot be excluded. These new prospects will impact on the financial situation of the most vulnerable companies in the sector.

Automotive

Automotive	World	North America	Japan	West. Europe	Central Europe	Emerging Asian economies	Latin America	Middle East	CIS
2007 forecasts	B-	C	A	B-	B+	B+	B+	A	B

The automotive sector rating has been downgraded from B to B- in Western Europe.

Demand has suffered a slow-down, essentially due to a lack of innovation, consumers being more aware of fuel prices, a rise in interest rates and a cyclical decline after several years of exuberance. Sales of new vehicles have stagnated and are unlikely to see any real growth in 2007. Most car makers are suffering heavy pressure on their margins, due to intense competition and high input costs. They are consequently relocating, notably to Central Europe, in order to benefit from lower labor costs. They are also setting up common platforms for the production of their models, in order to generate economies of scale. Equipment and parts manufacturers, notably second-tier ones, are enduring the backlash of the poor performances achieved by their contractors. While some have been able to expand internationally and follow their clients, others are facing serious financial difficulties.

Mass Distribution

Super/hyper markets	World	North America	Japan	Western Europe	Central Europe	Emerging Asian economies	Latin America	Middle East	CIS
2007 forecasts	A-	A-	A-	A-	B+	A	A	A	A

The world rating for the sector remains stable. The regional rating for North America, however, has been downgraded from A to A-, while the regional ratings for Western Europe and Japan have been upgraded to A-.

In the United States, the sustained consumption seen in 2006 should be replaced by a slowdown in 2007. This environment will be less favorable to the sector as a whole, and the performances delivered by the sector's principal player, Wal-Mart, were disappointing in 2006. Stores specializing in household construction and fittings are likely to be affected by the slowdown in the property sector.

Conversely, in Japan and Europe, distributors are seeing renewed growth thanks to the rise in household consumption. In Japan, the financial situation of the sector's principal players has improved. One can observe, however, that profitability still remains low for too many brands. In Europe, competition remains fierce and the specific national characteristics are still significant. Distributors are benefiting from healthier consumption, notably in France, Holland, the UK and, to a lesser extent, Germany. In Spain, the sector is still enjoying

sustained sales. The profitability levels posted by the sector's principal players, moreover, are benefiting from the current trend to refocus on the most profitable activities.

Electronic Components

Electronic components	World	North America	Japan	West. Europe	Emerging Asian economies
2007 forecasts	A	A	B+	B	A

The sector's rating has been downgraded from A+ to A in Asia

The components industry is coming to the end of its third year of strong growth and seems to be heading for a fourth one. The rise in volumes has offset the fall in prices seen in 2006, and demand should remain sustained in 2007. The volume effect, however, linked to the implementation of new capacities, will reinforce the downward price trend. The pressure on margins generated by this fall is what has caused the sector rating to be downgraded in Asia.

IT

IT	World	North America	Japan	West. Europe	Central Europe	Emerging Asian economies	Latin America
2007 forecasts	B-	B-	B-	B-	B+	B+	B+

The sector ratings have been downgraded as a result of intense price competition, which is weakening the financial situation of certain equipment manufacturers.

Manufacturers (contractors and sub-contractors) and distributors of computer equipment are facing a downward price trend, which the increase in volumes is struggling to offset. Competition is also fierce in terms of delivery deadlines and after-sales service. The increasingly large role played by the emerging markets and the household segment (in comparison to the business segment) in the mature markets represents a whole new challenge for the operators in the sector. Restructuring operations are still ongoing, but are still not resolving all the financial difficulties.

Telecommunication Equipment Manufacturing

Telecom equipment manufacturers	World	North America	Japan	West. Europe	Emerging Asian economies
2007 forecasts	B+	B+	B+	B+	B+

The rating for telecom equipment manufacturers has been downgraded to B+, as a result of the strong pressure on terminal manufacturers' margins.

Nine-hundred sixty million mobile telephones should be sold by the end of 2006 (+25%), and nearly a billion in 2007. Sales have exploded in China, India, Brazil and Russia. In view of

the increasing sophistication of these appliances (sold to a well-off clientele), the drop in the average price has been limited. But mobile phone manufacturers are having to deal with very specific requirements from the emerging markets (in terms of low-price products) and are facing the same problems with the operators. These constraints are making it difficult, if not impossible, for manufacturers to survive, as labor costs are too high and volumes too low for them to impose their products in the marketplace, or take up new technological challenges. The recent bankruptcies of BenQ in Germany or the Korean company VK are clear examples of this.

Pharmaceuticals

Pharmaceuticals	World	North America	Japan	West. Europe	Emerging Asian economies
2007 forecasts	A-	A-	B+	A-	A

The sector rating has been downgraded from A to A- as a result of the deteriorating prospects in North America, the principal market.

The growth of the world pharmaceutical market remains sustained (5% expected in 2007) but is no longer enjoying the two-digit growth seen in the past. Restricted health-spending and competition from generic drugs are hampering sales in the industrialized countries. In North America (the sector's principal market), laboratories are now likely, following the Democrat victory in the November 2006 mid-term elections, to re-negotiate their prices downward as part of the Medicare program, while patent losses continue to accelerate. The laboratories now, therefore, have to adapt to a more competitive environment by developing research, and finding new markets and products. Faced with the inexorable rise in generic drugs, their strategies are still embracing innovation, but do not exclude new partnerships or even buyouts of some of these generic manufacturers. Consolidation and asset disposal trends are likely to remain prevalent. Given this environment, margins in this sector will be tightly controlled, and the solvency levels of the most vulnerable companies could be at risk.

Air transport

Air transport	World	North America	Japan	West. Europe	Emerging Asian economies
2007 forecasts	B-	C+	B-	B	B-

The sector rating has been upgraded from C+ to B-, as a result of an improvement in the financial situation of North American airlines and still-favourable prospects for 2007.

Airlines are benefiting from an increase in air traffic (6.5% in 2006 and 5.8% in 2007), which is generating a better aircraft load factor. They are also pursuing their strategy to drastically cut and control costs and capacities. In global terms, operating margins have risen in 2006, and losses have been revised downwards. Prospects for 2007 are generally favorable, and the world context is one of sustained growth. Oil prices should stabilize, provided there are no further major geopolitical conflicts. The competition generated by "low cost" airlines remains fierce. Attracted by the renewed profitability of long-haul flights, some of these are tempted

to make a foray into this segment. Restructuring operations will continue, and this will have a negative impact on the most vulnerable operators. Thanks to the improvement in results in North America, several airlines have been able to free themselves from Chapter 11 bankruptcy protection. In Europe, airlines have reinforced their positions by multiplying the number of partnerships and mergers. Certain players, however, remain particularly vulnerable. In Asia, sales are showing growth but certain airlines have been heavily exposed to the rise in oil prices, while competitive pressures have intensified.

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All Coface's press releases and publications, together with any financial information concerning Coface, are available on the Internet at: <http://www.coface.com>

Founded in 1946, Coface, rated AA+ by Fitch Ratings, AA by S&P and Aa3 by Moody's, is a subsidiary of Natixis whose share capital (Tier 1) was 9.9 billion euros end 2005 (pro forma data). Coface's mission is to facilitate global business-to-business trade by offering its clients four product lines to fully or partly outsource trade relationship management and to finance and protect their receivables: credit insurance, company information and ratings, receivables management and factoring. Coface also offers three other business lines: guarantee insurance, receivables management training, and, in France, management of government export guarantees. Coface operates a quality local service for its 85,000 clients thanks to its 4,850 staff in 60 countries where Coface has a direct presence. This local service also covers in 93 countries via partners in the CreditAlliance worldwide network, organised around an integrated credit risk management tool, the Common Risk System.

APPENDIX 1

Sector ratings: WORLD

	2003	2004	2005	2006	2007 forecasts
Steel	B	A	A	A	A
Automotive	B	B+	B↘	B-	B-
Mechanical	B	A-	A-	A-	A-
Construction	A	A	A	A-	B+
Chemicals	A	A	B+	A-	A-
Pharmaceuticals	A+	A+	A	A	A-
Paper	B	A-	A-	A↗	A↗
Electronics	B-	A+	A	A	A
IT	C+	B-	B-	B	B-
Telecommunication ^(manufac..)	B-	B+	A-	A-	B+
Textiles	C+	C+	C	C	C
Clothing	C-	C	C-	C-	C-
Mass distribution	B+	A-	A-	A-	A-
Air transport	C+	B-	C-	C+	B-

APPENDIX 2

Sector @rating methodology

Coface sector analysis is available and regularly updated on www.coface-usa.com, under “Products & Services, Country Risk.”

Sector @ratings measures the average level of non-payment risk associated with companies in each economic sector. A rating reflects the influence of the economic outlook and average company financial situation on payment behavior in short-term commercial transactions in a particular sector.

In determining Sector @ratings, Coface assesses three critical parameters:

- Economic trend and outlook in the sector, as reflected by market prospects, price levels, inventories, order books and production costs.
- Corporate financial situation in the sector reflecting the capability of companies to cope with economic downturns or prosper on upturns.
- Payment experience on short-term transactions as reflected by Coface databases.

Coface establishes Sector @ratings on ten levels — ranging from A+ for the lowest risk to D for the highest — based on the following definitions:

A+ A A-	In a favorable sector economic environment coupled with a generally robust company financial situation, payment experience is satisfactory with low average default probability.
B+ B B-	In an essentially favorable economic environment nonetheless not safe from short-term deterioration with negative repercussions on the company financial situation, payment behavior is generally correct and default probability acceptable.
C+ C C-	In a very uncertain sector environment combined with a very vulnerable company financial situation, payment behavior is poor with disturbing default probability.
D	In a very unfavorable economic environment, a deteriorated company financial situation is responsible for generally deplorable payment behavior with high default probability.