JANUARY 2017

PANORAMA
Coface Brazil corporate payment survey

COFACE ECONOMIC PUBLICATIONS

By Coface Group economists

Coface conducts payment studies for a number of different economies, including China, Morocco and Germany. This survey marks the first such edition for Brazil, with the objectives being to better understand the country's corporate payment habits and the health of its economy.

Brazilian companies are currently faced with a challenging environment. GDP underwent an accumulated contraction of 7.4% during the two years of 2015-2016. Credit conditions deteriorated, against a backdrop of more restrictive credit supply and a tighter monetary cycle (which finally started to marginally ease in October 2016).

Moreover the car-wash operation – the biggest and longest corruption investigation ever carried out by the Federal Police of Brazil - has played an important role in the economic situation. It has not only influenced the performance of major conglomerates involved in the scandals, but also impacted the activities of companies that rely on sales to the groups under investigation. 2017 has just begun, but the year's GDP forecast is already lackluster. Although activity is expected to leave recession, growth is forecast to achieve a meager 0.4%.

The bleak economic environment has overshadowed payment behaviour. Our payment study revealed that, in 2015, 75% of the interviewed companies received requests for payment extensions from their clients. In addition, the majority (58%) observed an increase in their delinquency rates in 2015, compared with 2014. The outcome for 2016 was more divided. The survey found that payment experiences in 2016 had deteriorated in comparison to the previous year for 46% of companies. The same percentage reported that the situation had remained stable in 2016, while a minority of 8% have seen improvements.

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Brazil: Payment experience affected by the bleak economic scenario

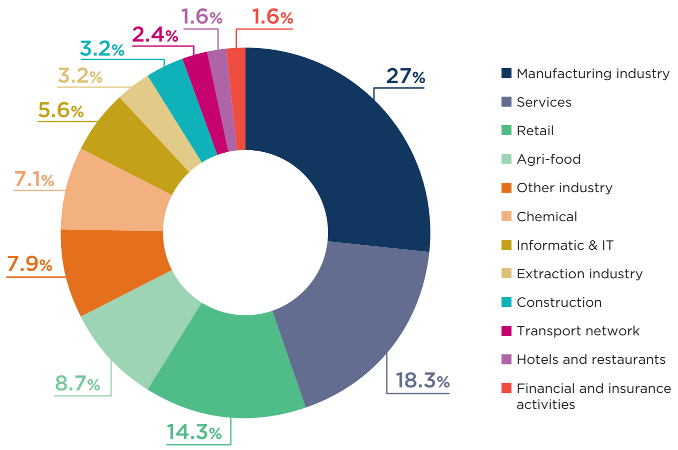
1 THE RESPONDENTS

The Payment Survey, which comprised 22 questions, was conducted throughout 2016, with a sample of 126 companies. Among the respondents *(graph n°1)*, 27% were from the manufacturing segment, 18.3% from the services sector, 14.3% from retail, 8.7% from agro-food and 7.1% from the chemicals sector. Together, these five sectors accounted for 75.4% of the sample.

As regards the size of the companies questioned *(graph n°2)*, the largest representation in the survey was from those with an annual turnover in excess of 175 million Reals (approximately 52.5 million USD). Enterprises with turnovers in the range of between 100 to 175 million Reals accounted for 17% of companies, as did companies of less than 3 million Reals. In terms of number of employees *(graph n°3)*, the proportion of companies in the ranges of up to 20 staff, between 21 and 100 and between 101 and 500 were quite similar, at 26%, 22% and 26% respectively.

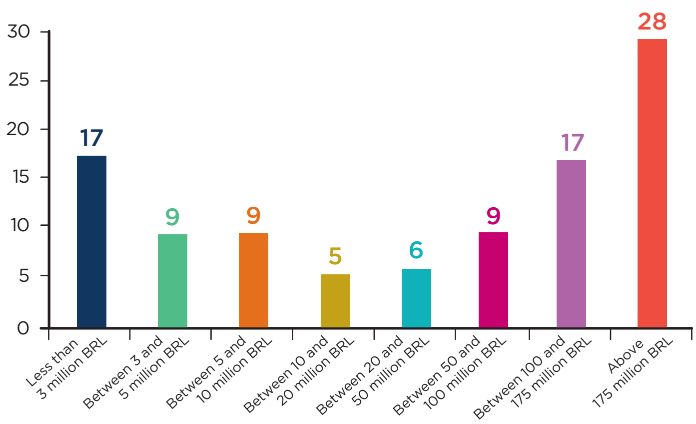
Finally, as concerns markets, only 13% of the sample companies are mainly focused on sales to other countries. This is in line with the nature of Brazil's very closed economy, with limited trade agreements and total exports accounting for just 12.8% of GDP.

Graph n° 1
Company major sector of activity



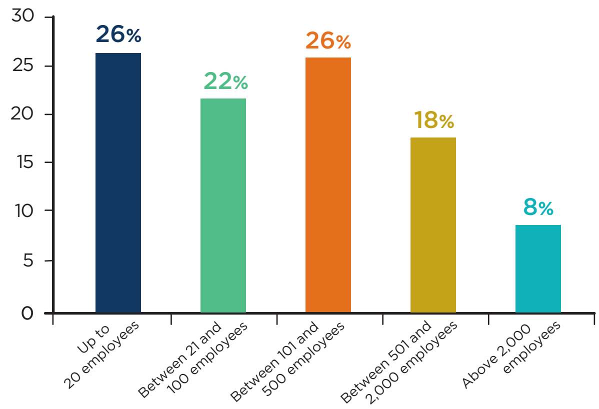
Source: Coface

Graph n° 2
Sales in revenues *(year of 2015)*



Source: Coface

Graph n° 3
Number of employees *(year of 2015)*



Source: Coface

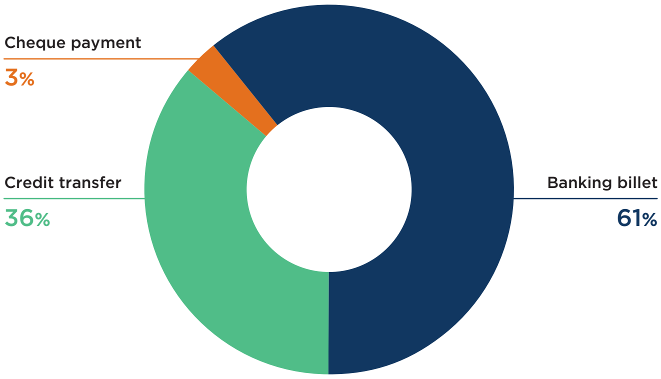
2 PAYMENT PRACTICES AND BEHAVIOUR

The granting of terms of sale is a very commonplace practice in Brazil. Nearly all the companies in the sample (97%) offer this possibility to their clients. The main reason given *(graph n°4)* for this (56%) was very high market competitiveness. Client requirements (26%), tight customer liquidity (13%) and convenience (10%) were also mentioned. However, there were a surprisingly low number of companies that cited customer liquidity issues. This is due to the weak macroeconomic environment. The economy has undergone a strong recession (GDP is anticipated to have decreased by 7.4% in two years until 2016) and tight credit conditions (bank average spread for corporate non-earmarked bank loans reached 16.9% a year in December 2016 – or a hike of 1.9p.p. in 12 months).

The most frequently used method for account payments *(graph n°5)* is the banking billet (61%), followed by credit transfer (36%) and finally cheque payments (3%) – which have lost popularity over the years. Moreover, for 87% of respondents *(graph n°6)*, average credit sales stand at less than 90 days, with the largest share being in the range of between 30 and 60 days (43%).

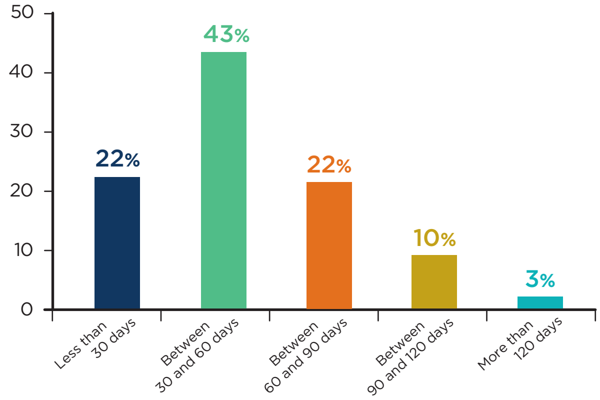
Companies are, of course, not immune to the crisis. As an example, 75% of our sample mentioned that they have been asked for extensions of payment dates over the last year. In addition, the majority (58%) observed an increase in their delinquency rates in 2015, compared with 2014. The outcome for 2016 was more divided. Payment experiences were observed to be deteriorating, compared to the previous year, by 46% of companies. The same percentage argued that the indicator had remained stable in 2016, while only a minority of 8% have seen improvements.

Graph n° 5
Payment methods



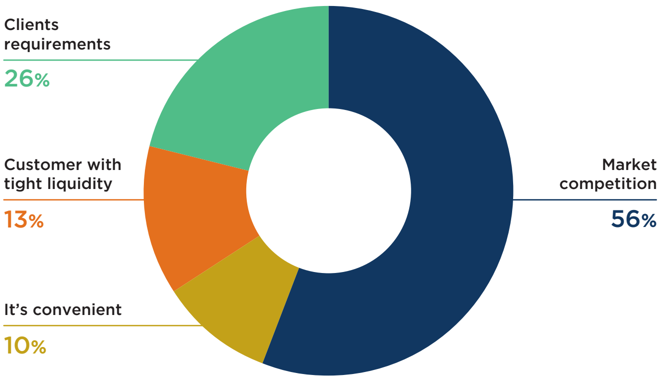
Source: Coface

Graph n° 6
Average credit sales



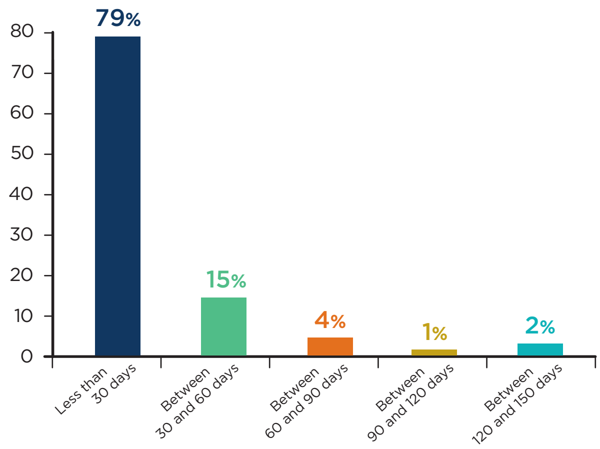
Source: Coface

Graph n° 4
Main reason for offering credit sales



Source: Coface

Graph n° 7
Average overdue days



Source: Coface

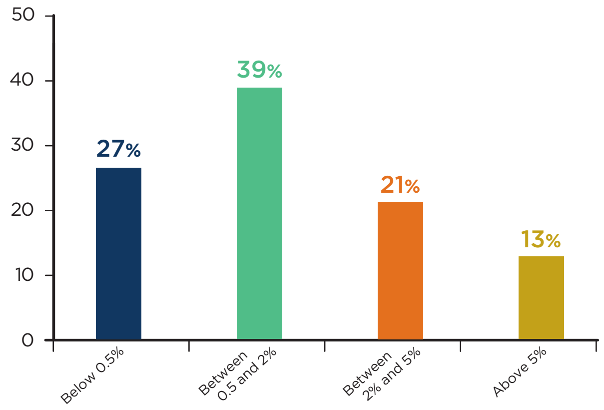
It is also worthy of note *(graph n°7)* that the vast majority (79%) claimed that, on average, overdues did not exceed 30 days *(graph n°8)*. Payment delays of over 60 days accounted for only 7% in the total sample. Finally, the ratio of total sales in overdues as a percentage of total turnover gives a good indication of companies' exposure to risk. Only 13% of enterprises reported a ratio of over 5%. The largest share (39%) replied that overdues account for between 0.5% and 2% of their total turnover.

The main reason (57%) given by clients *(graph n°9)* when asking for payment extensions was that they were experiencing financial difficulties. High delinquency rates in their own client portfolios was the second biggest reason, followed by customer management problems.

We also questioned respondents on the main fundamentals (economic or political) which were impacting their clients' performances. The six possible answers *(graph n°10)* were: the economic recession, political instability, external markets, high interest rates, high unemployment and others. Of these, the recession was cited by 81% of the sample, followed by troubled political scenario (6%) and "others" (also at 6%).

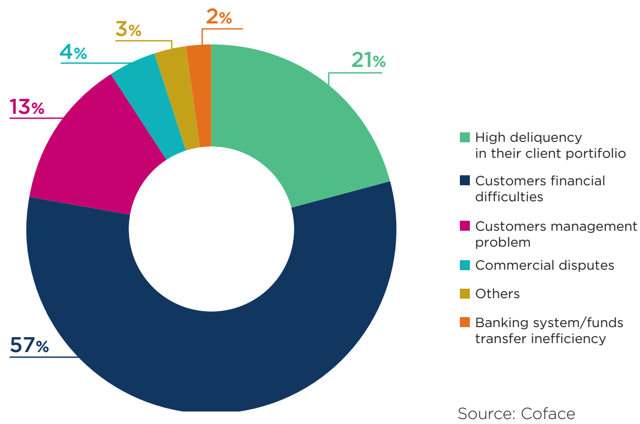
GDP has contracted for seven quarters in a row, accumulating a drop of 4.4% in the four quarters until 3Q2016. Moreover, preliminary figures suggest that the last quarter of 2016 was marked by a further contraction. Coface only forecasts a slight rebound in GDP for 2017, of 0.4%.

Graph n° 8
Overdue in terms of total turnover



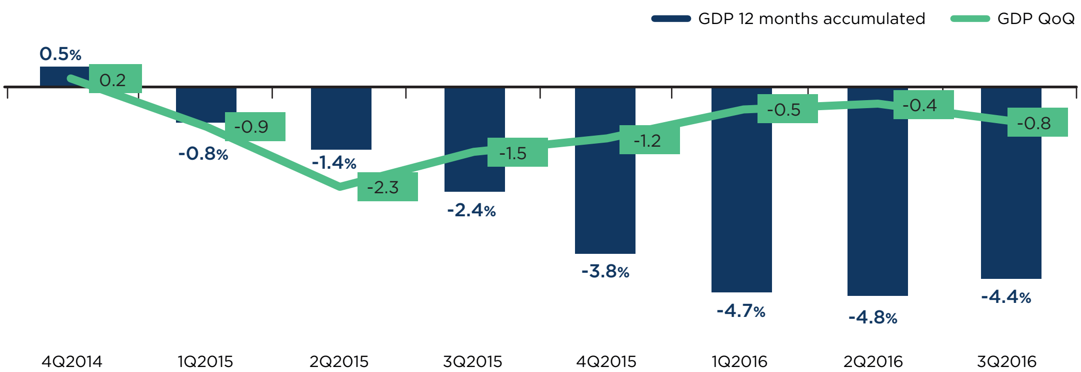
Source: Coface

Graph n° 9
Main reason for overdue account



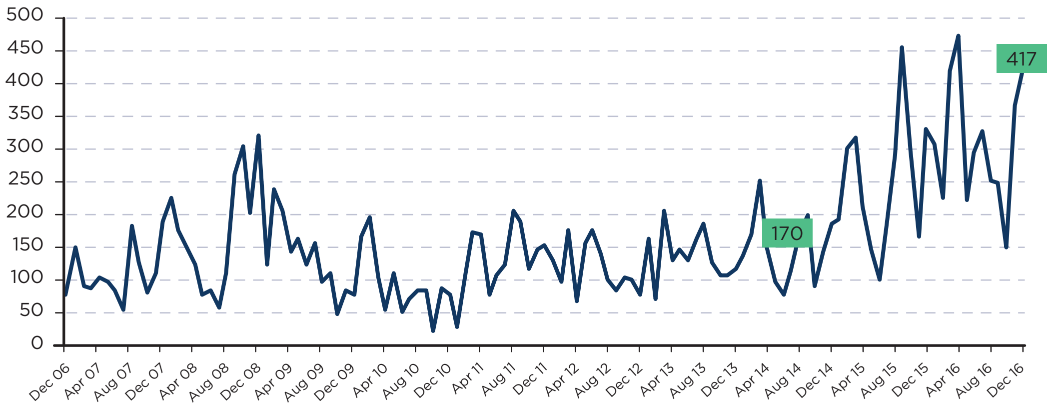
Source: Coface

Graph n° 10
Brazil – GDP growth



Source: IBGE

Graph n° 11
Brazil - EPU political uncertainty index



Source: Economic Policy Uncertainty

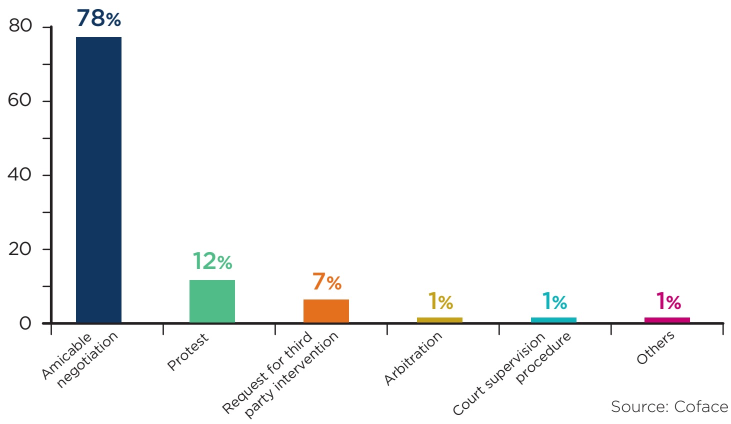
Political instability *(graph n°11)* is high - and is unlikely to calm down in the short term. The car wash operation, which has been undergoing investigation since March 2014, is at the heart of this instability. The Federal Police of Brazil are investigating bribe scandals involving the state-owned oil giant Petrobras, large economic conglomerates and several politicians. Even though it was not the official cause of ex-president Dilma Rousseff's impeachment in August 2016 (she was ousted for breaking fiscal responsibility laws), the revelation that politicians in her party (left-wing Labour party) were under investigation played a decisive role. Vice president Michel Temer (from the centrist PMDB party) then took office, but the political atmosphere failed to improve. This was not only associated with Dilma´s remaining supporters, but also because members of his party is also implicated in the car wash operation. Mr. Temer has seen the already high level of resentment against him swelling since the beginning of December 2016, when a major economic group signed a plea bargain agreement with Brazilian prosecutors. In end January 2017, the bargain was approved by the president of Brazil's Supreme Court, Carmen Lucia Rocha. Despite her decision to keep the testimony sealed, it has been leaked to the press that Michel Temer´s name was cited 43 times. Brazil's political instability has clearly halted its economic recovery.

The EPU political uncertainty index[1] corroborates this perception (see chart below - the higher, the worse). In the period since car wash began, up until December 2016, the index climbed by around 247 points.

As regards actions taken in cases of non-payment *(graph n° 12)*, the vast majority (78%) believe amicable negation to be the most effective tool, with 12% having recourse to protest (12%) and 7% to third party intervention (7%).

In the World Bank 2017 Doing Business Index, Brazil is ranked in 37th place out of 190 economies, in terms of the ease of enforcing contracts. These take, on average, 731 days and cost 20.7% of the value of a claim. As a comparison, the average for the Latin America region is 749 days, at a cost of 31.3%.

Graph n° 12
Most effective action in case of non-payment



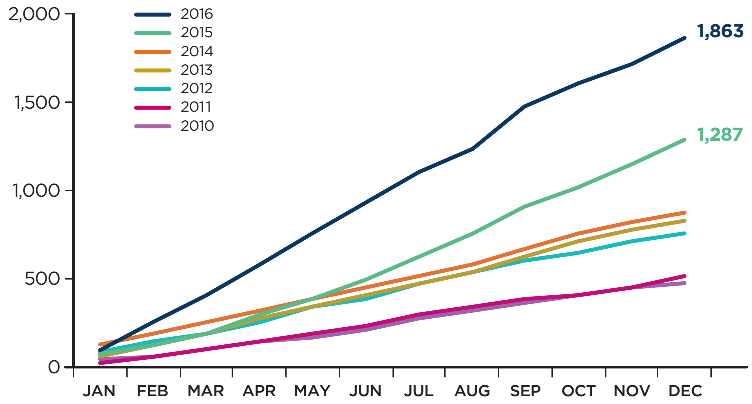
Source: Coface

1/ The EPU index (Economic Policy Uncertainty) was developed by Baker, Bloom and Davis. It is built on the basis of the number of key-words, which define uncertainty, found in the press of the country studied. It relates to three different fields, the economy, politics and uncertainty, that are subdivided into different categories, such as public spending, financial regulations and interior security.

As regards insolvencies, the majority of surveyed companies (58%) saw the number of clients that filed for Chapter XI[2] soar last year. This percentage is supported by the strikingly negative figures for insolvencies in Brazil overall. According to Serasa *(graph n° 13)*, the number of companies requesting protection has been increasing since 2015, when a hike of 55% was reported compared to 2014. A further increase of 45% YoY (see chart) was observed in 2016.

Of those companies that reported an increase in Chapter XI cases, 53% did not evidence changes in the client´s behaviour prior to the request. Over recent years, Chapter XI has become more and more common in Brazil and is affecting companies of varying sizes and sectors.

Graph n° 13
Number of Chapter XI requests *(number of requests accumulated during the year)*



Source: Serasa

In theory, Chapter XI closes when a company meets all the requirements laid down its recovery plan - but in practice, few have been able to return to health. Brazil's legislation is very benevolent and many companies have been under Chapter XI protection for over eight years. Grace periods can be two years, with endless payment installments and high discounts. According to the Doing Business Index, the resolution of insolvencies in Brazil takes an average of 4 years and costs 12% of the debtor´s estate, with recovery rates averaging 15.8cents per dollar. The process is inefficient, even when compared with Brazil's emerging country neighbours. The Latin America average stands at 2.4 years and costs 4.5%, with a recovery rate of 31cents per dollar.

2/ Chapter XI was established in Brazil in 2005, under the new Law of Bankruptcies. It was designed as a measure to try to avoid Chapter VII (bankruptcy) and is applied when a company loses its ability to pay its debts.

3 PAYMENT EXPERIENCE BY SECTOR

The bleak context of the Brazilian economy has clearly taken a serious toll on various sectors of activity. Coface's sector risk assessment does not currently classify any of the country's segments at low risk. The paper-wood and pharmaceuticals segments (both at medium risk) have shown higher resilience than others. In contrast, metals, energy, construction, automotive and agro-food are all classified at very high risk.

This section of the report examines the survey data by individual sectors. As there are limited answers from certain sectors, the four segments with smaller representativeness (transport network, hotels and restaurants and financial and insurance activities and extraction industry) are considered as "other industries" within this analysis.

SECTOR RISK ASSESSMENT

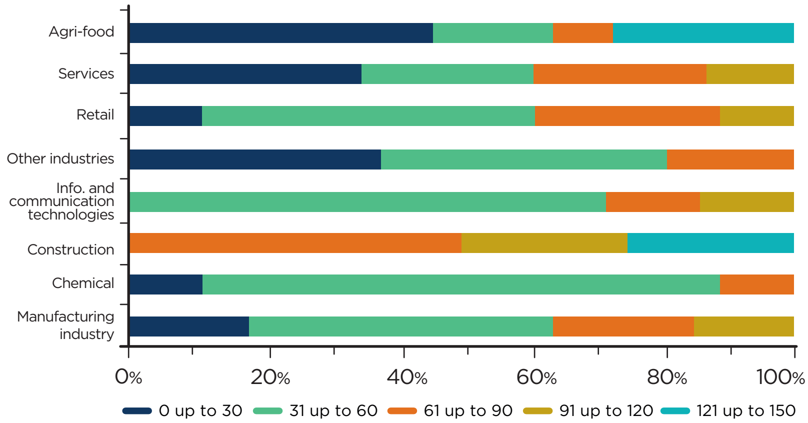
Sectors	Latin America	Brazil	Mexico
Agro-food	High risk	High risk ↘ Very high risk	High risk
Automotive	High risk	Very high risk	Low risk ↘ Medium risk
Chemical	High risk	High risk	High risk
Construction	Very high risk	Very high risk	High risk
Energy	Very high risk	Very high risk	Very high risk
ICT*	Medium risk	High risk	Low risk
Metals	Very high risk	Very high risk	High risk
Paper-wood	Medium risk	Medium risk	Medium risk
Pharmaceuticals	Medium risk	Medium risk	Low risk
Retail	High risk	High risk	Low risk ↘ Medium risk
Textile-clothing	High risk	High risk	High risk
Transportation	High risk	High risk	Medium risk

**Information and communications technologies*

Low risk · Medium risk · High risk · Very high risk · ↘ The risk has improved · ↘ The risk has deteriorated

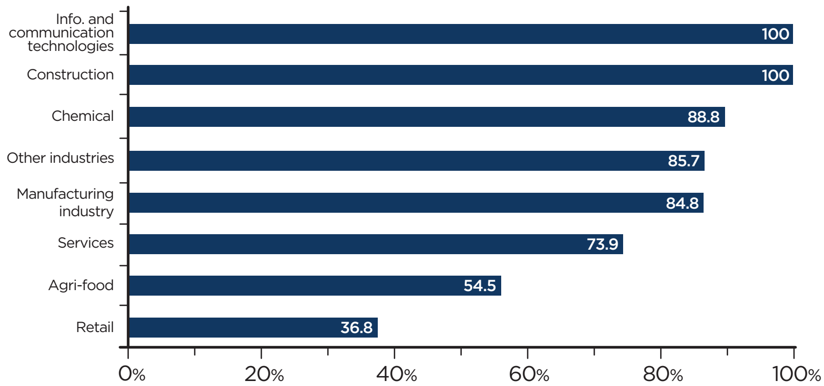
Source: Coface

Graph n° 14
Average credit sales by sector



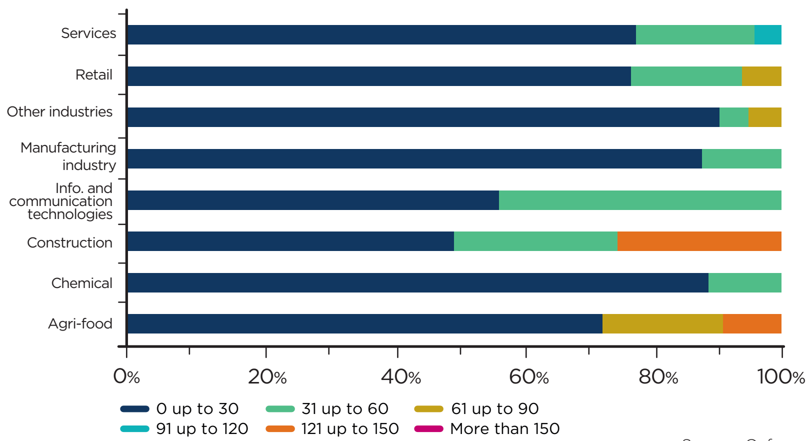
Source: Coface

Graph n° 15
Share of companies experiencing



Source: Coface

Graph n° 16
Distribution of average overdue days per sector (%)



Source: Coface

Average credit sale periods *(graph n°14)* are divergent among the sectors - although in most segments, they do not exceed 60 days. Only the construction and agri-food sectors granted credit periods of over 120 days. Interestingly, construction is the only industry which did not report sales periods of below 60 days.

In terms of payment behavior by segment *(graph n°15)* delays appear to be high in almost all industries. Information & communication technologies and construction are the most affected, as all of these companies (100%) report payment issues. Surprisingly, the least affected is retail, with 36.8%. This is a somewhat unexpected outcome, due to the recent poor performance of retail (-6.5% in the year of 2016) which is strongly influenced by the weak income fundamentals (the unemployment rate stood at 11.5% in 2016 – a rise of + 3.1 b.p. in one year). However, it should be noted that our limited database may have influenced this result.

Average overdue days per sector *(graph n°16)* are, for the most part, up to 30 days. The only segments which reported delays of over 121 days were construction and agri-food. Both of these sectors work with relatively longer terms of payment, as seen in a previous chart. Finally, it is also of interest to note that none of the cases in our sample exceeded 150 days.

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