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Corporates

EMEA
Special Report

EMEA Industrial: 2010 Outlook

Encouraging Signs but Risks Remain

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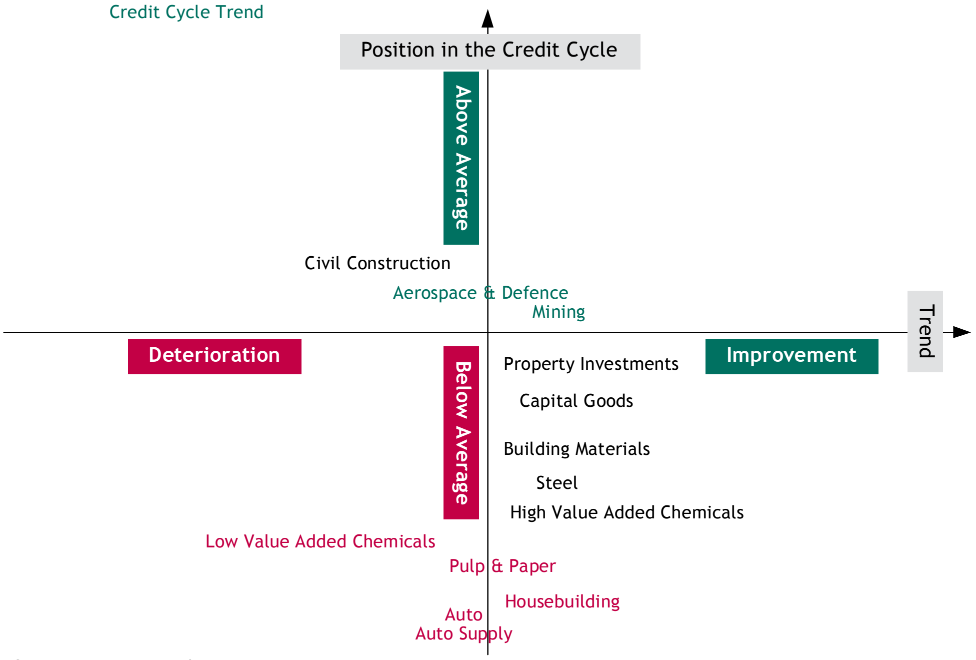
Executive Summary

Credit Cycle Trend



Source: Transaction documents

- Anaemic growth in 2010 after 2009 low point.
- Fitch Ratings forecasts Industrials as the slowest corporate sector to recover — with revenues in 2011 still 11% below their earlier peak.
- Ratings: 48% still on negative outlook or watch as of end-December 2009.
- Stabilisation of outlooks to gain pace, but with some delay compared with other sectors; potentially at a lower rating level than pre-credit crisis.
- All sectors except Automotive, Civil Construction and commodity-grade (or Low-Value-Added) Chemicals to undergo positive revenue development in 2010 — and with only modest further declines in both Autos and Chemicals, although with significant differences by company.
- Recovery in metrics coming more from cost-cutting and cash preservation than from improving end-user demand which remains fragile.
- The more defensive Aerospace & Defence and Property Investment sectors have been relatively less affected by the crisis.
- Among the more cyclical segment, Mining has been the first to stabilise.
- Building Materials, High-Value-Added Chemicals, Steel, and Capital Goods are likely to follow in 2010.
- The Automotive and UK Homebuilder sectors may take longer, due to continued uncertainty on sustainable demand trends and have a higher risk of stabilising at a lower rating level than currently.

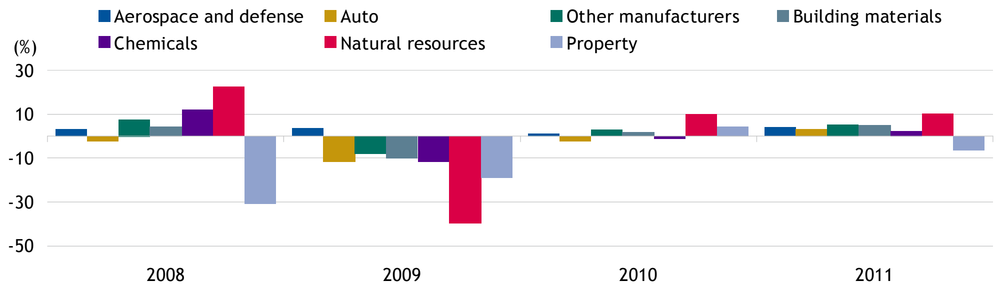
- EBITDA likely to remain below 2007’s level until 2011.
- Impact of the downturn on Civil Construction to bite with a lag, due to weakening order-books and project cancellation at the height of the crisis.
- Liquidity no longer an immediate concern — thanks to refinancing in 2009’s exuberant bond market, banks rolling existing exposure (albeit at a higher cost), and companies pro-actively conserving cash.

How Badly have Industrial Companies been Affected?

Industrials include the worst-hit sub-sectors in the corporate universe; such as automotive (2009 EBITDA down 28% from 2007), building materials (down 13%), chemicals (down 12%), and natural resources (principally metals and mining, down 11%). As a result, whereas median credit ratings fell in almost all corporate sub-sectors between December 2007 and December 2009, in only three cases were these average falls in excess of one notch: autos (2.3 notches), building materials (1.7 notches) and natural resources (1.2 notches).

Constant Currency Revenue Change

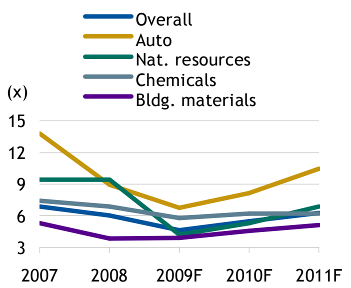
Selected industrial sectors



Source: Fitch

Median FFO Interest Cover

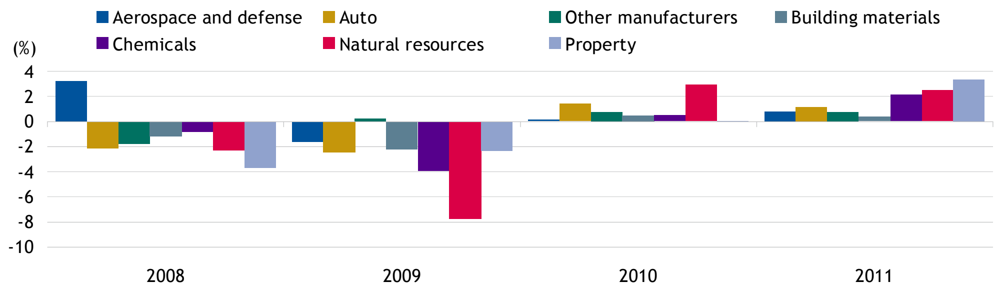
Selected industrial sectors



Source: Fitch

EBITDA Margin Change

(Percentage points)



Source: Fitch

After a fall of about one third in absolute terms in 2009 — as per Fitch’s expectations — EBITDA should improve across the board in 2010 and 2011, due to a combination of improved end-customer demand and cost-cutting. However, the industrial sector as a whole is expected to end 2011 with EBITDA 9% lower than in 2007. Only in aerospace & defence, and “other manufacturing”, should EBITDA return to 2007 levels by 2011. All other sectors will take longer to recover.

Cash Generation

Cash flow from operations (CFO) should remain broadly stable in 2010, as the modest improvement in EBITDA will be absorbed by working capital outflows. However, free cash flow (FCF) is likely to return to mildly positive territory thanks to companies’ steps to preserve cash, in particular by curtailing capex and dividends — which Fitch expects will remain subdued until 2011.

The drop in capex is concentrated in basic materials; with natural resources (including metals & mining) falling by one-third in 2009, but manufacturing dropping less steeply on average. However, cuts in manufacturing will continue into 2010. Fitch expects that dividend growth from 2010 will mirror weak improvements in performance; therefore remaining at the depressed 2009 level (over 50% cut), although with a significant variation between sectors and individual companies. Natural resources (83% cut), autos (69%) and building materials (50%) lead the pack in terms of expected or announced dividend cuts in 2009. Perhaps more surprising is the resilience of chemicals — with only modest cuts, despite a 20% revenue decline in 2009.

Industrials — Aggregate Cash Flow Statement

	2007	2008	2009F	2010F	2011F
Revenue	1,882	1,922	1,627	1,654	1,729
Operating EBITDA	268	251	162	184	214
EBITDA (%)	14.2	13.0	10.0	11.1	12.3
Cash interest	-15	-14	-27	-25	-23
Cash tax	-43	-42	-16	-20	-28
Non-controlling interest	6	6	1	1	1
Other items before FFO	1	2	2	3	3
Funds flow from operations	**217**	**203**	**121**	**144**	**167**
Change in working capital	-10	-43	22	-3	-2
Cash flow from operations	**207**	**159**	**143**	**141**	**165**
Total non-operating/non-recurring cash flow	6	2	-7	-2	-0
Capital expenditures	-121	-136	-111	-105	-110
Common dividends	-37	-44	-21	-22	-27
Free cash flow	**55**	**-18**	**3**	**13**	**28**
Net acquisitions and divestitures	-63	-48	8	6	-7
Net equity proceeds	-12	-28	28	-5	-2

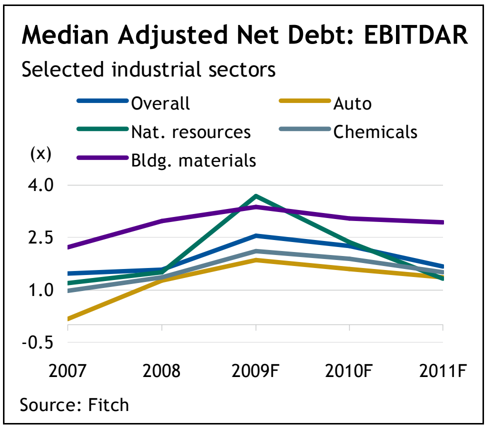
Source: Fitch

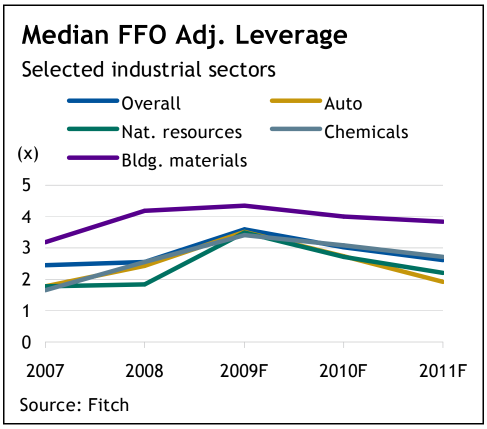
Further improvements in FCF are forecast for 2010 and 2011, as companies conserve cash to repair stretched balance sheets. This movement is driven by the automotive sector, in which FCF will move from a negative USD37bn in 2008 to an outflow of only USD4bn in 2009 — through a combination of working capital swings, capex savings, and dividend cuts. Despite further improvements from 2009, Fitch is not forecasting positive FCF for the sector until after 2011.

As elsewhere, cash-based acquisitions are forecast to be almost non-existent for the foreseeable future. The widespread share buybacks of 2007-2008 were replaced in 2009 by equity issuance in sectors such as natural resources, building materials and property. These have been necessary both to strengthen balance sheets and to support previous M&A activity — Rio Tinto Plc's ('A-'/Stable) USD14.9bn equity-raising accounts for more than half of this. The mild upturn in the economy, and the assumption of a continuation of open debt capital markets in 2010, means that no repeat of these exercises is anticipated — but neither is a return to large share buybacks for the immediate future.

Credit Metrics

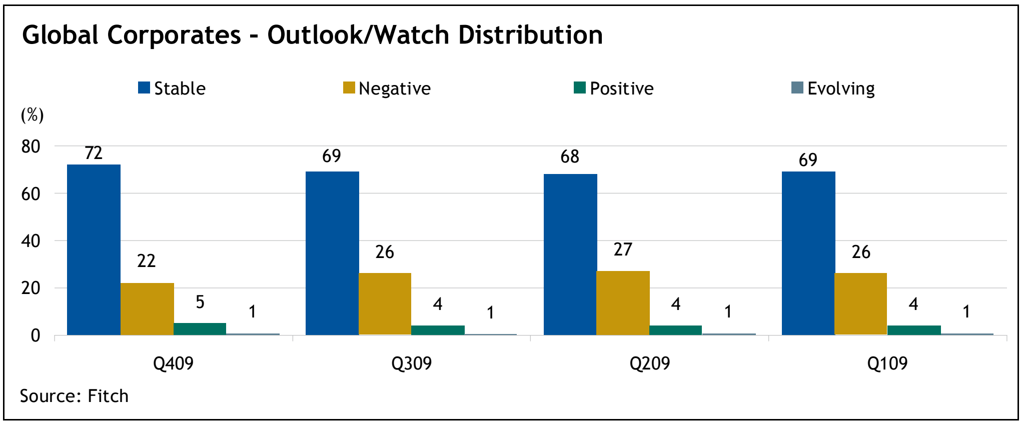
Median credit metrics primarily reflect the sector's EBITDA performance, with 2009 expected to represent a low point for credit protection measures. On the whole, the sector will peak at approximately 1x (i.e. one turn) higher leverage in 2009 than in 2007, with interest cover dipping in 2009 to 4.5x from 7x. All metrics are, on an aggregate basis, expected to revert to near 2007 levels by 2011.





Despite this, there is significant variation in the individual sub-sectors, and median credit metrics charts for selected industrial sectors illustrate this. In line with the agency's forecast performance in 2009, the sharpest peak in leverage and drop in interest cover is in natural resources. There is also a very significant decline in interest cover and rise in leverage in automotive. Building materials, as a result of widespread capital increases, features a relatively moderate peak in leverage, with interest cover actually forecast to have improved in 2009 compared with 2008.

Rating Actions



The credit positioning of the EMEA industrials sphere remains below the average of the overall global corporate group. At end-2009, 48% of ratings were either on negative outlook or watch, 26 percentage points more than for the global rated universe. Only 38% of ratings were on stable outlook, down from 56% in February 2009. Whereas the number of negative outlooks started to significantly decrease in Q409 for the overall corporate universe, the ratio of negative outlooks/watches to positive equivalents continued to deteriorate to reach 16:1 in December 2009, compared with 6.6:1 in February 2009 and 1.8:1 in January 2008.

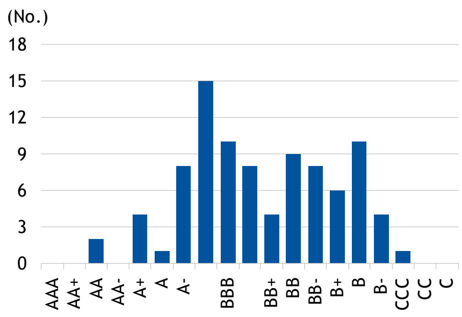
The greater portion of negative outlooks reflects the high level of uncertainty over the depth of the recovery for many industrial sectors. Fitch remains concerned that a significant portion of recent performance may be due to re-stocking rather than a long-term trend of improving end-demand. Moreover, the rate of improvement in the speed of industrial activity can mask the fact that absolute levels are still low and overcapacity remains a looming problem.

Although it is likely that the pace of outlook stabilisation will accelerate in 2010, potentially at a lower rating level than pre-crisis — to reflect permanently weakened credit profiles — the stabilisation is expected to be somewhat delayed for industrials issuers compared with other corporates.

Potential downside risks to the stabilisation trend do exist, however, most notably if economic conditions disappoint. Although not Fitch's central assumption, economic conditions could worsen further during 2010 — especially given the high levels of government debt, the unknown impact of a withdrawal of fiscal stimulus, a still-fragile banking system, and concerns over future deflation/inflation. Similarly, if shareholder-friendly actions re-emerge — such as large dividends, share buybacks or debt-funded M&A — negative rating action could occur.

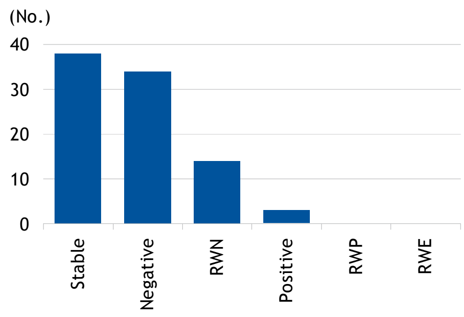
Rating and Outlook/Watch Distribution of EMEA Industrials
(as of December 2009)

By Rating



Source: Fitch

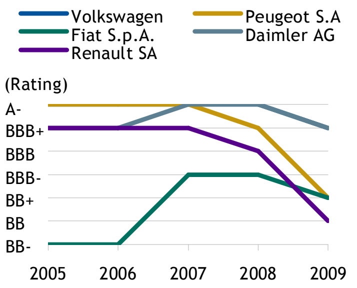
By Outlook/Rating Watch



Source: Fitch

Manufacturing
Automotive

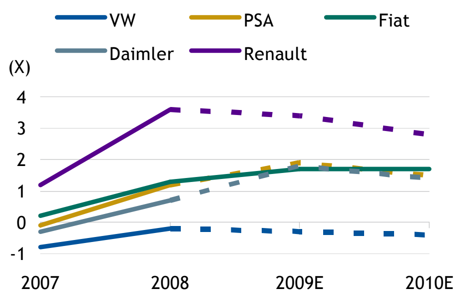
Rating Movement
Autos 05 to 09



Source: Fitch

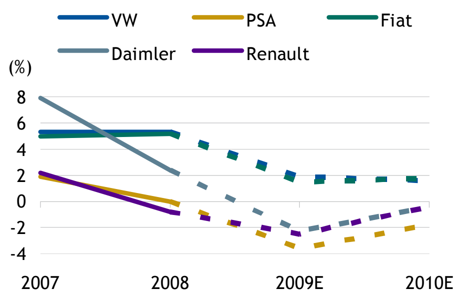
Position in the Cycle: Negative
Trend: Stabilising

Total Adj. Debt/EBITDAR
(Industrial operations)



Source: Fitch

Operating Profit Margin
(Industrial operations)



Source: Fitch

Fitch expects a slow and gradual recovery in operating performance trends from H210, factoring in the results from cost-cutting measures and growth in emerging markets — which should mitigate the impact of falling sales in Europe, as a result of most incentive schemes being phased out in several European markets. There is, however, still a high degree of uncertainty about the extent of sales that were brought forward into 2009 from 2010, and of the deterioration in product mix resulting from these schemes — as well as how sustainable the economic recovery proves, and the improvement in consumer and corporate confidence.

If the trend confirms the agency's base forecasts, H110 could be the point for the stabilisation of outlooks on some ratings. However, the likelihood and timing of outlook stabilisation differs between the Fitch-rated issuers. By decreasing order of probability, this gives the following picture:

- Volkswagen Group's ('BBB+'Stable/'F2') ratings are already on Stable Outlook thanks to the company's above-average business profile and the increased

Key Points
- Underlying demand for new cars distorted by scrapping incentives
- Unabated price pressure and deteriorating product mix
- Low growth prospects in mature markets compensated for by better growth potential in emerging regions
- Overcapacity still a critical issue, and a continuous burden on profitability
- Rebounding revenue combined with severe cost-cutting is supporting a recovery in operating margins
- Liquidity risk receding

Recent Research
- *Global Automotive Industry Outlook 2010 (February 2010)*
- *Fitch Ratings: U.S. & European Automotive Seminar (December 2009)*
- *Liquidity Focus: European Auto Manufacturers (July 2009)*
- *European Auto Manufacturers: Slower, Lower, Weaker (June 2009)*

headroom in the current ratings, although its financial profile has deteriorated in the wake of the Porsche acquisition.

- Fiat S.p.A (Fiat, 'BB+'/Negative/'B') and Daimler AG (Daimler, 'BBB+'/Negative/'F2'):
  - Fiat, which like Daimler is exposed to the heavy truck sector, faces the uncertainties and weak growth prospects of the truck, agricultural and construction equipment industries in 2010. However, Fiat benefits from its positioning in the growing segment of small and fuel-efficient cars, and its relative resilience in the current recession
  - Daimler was relatively less affected by scrapping incentives due to the group's positioning in the premium segment, and should therefore rebound more quickly — although the product mix may be at risk should customers trade down to smaller models. Leverage remains low, and financial flexibility is solid despite recent erosion.
- Peugeot S.A. (PSA, 'BB+'/Negative/'B') and Renault SA (Renault, 'BB'/Negative): both manufacturers are relatively heavily exposed to the still-difficult European market, which would constrain the improvement in financial metrics. In addition, Renault entered this recession with substantial financial debt, and deleveraging should be a slow process in the absence of specific actions such as capital increases or asset sales.

Fitch remains concerned about a further sales decline in many regions, particularly western Europe, as the scrapping schemes are phased out. The agency forecasts auto sales in western Europe to decline by 8%-10% in 2010, following a slight increase of 0.5% in 2009 — versus an initial forecast of a decline of 12%-15% at the beginning of 2009. Although the negative impact from the end of these incentive schemes — notably in Germany, Europe's largest market, where approximately one million vehicles were sold under this plan — should not be overestimated, the uncertainty around how sales will develop in 2010 remains significant. It is unclear how incentives have distorted the used-car or new-car markets, and whether improving consumer confidence, greater credit availability, and a timid increase in new car purchase intentions, will mitigate the payback effect from expiring incentive schemes and potentially rising unemployment.

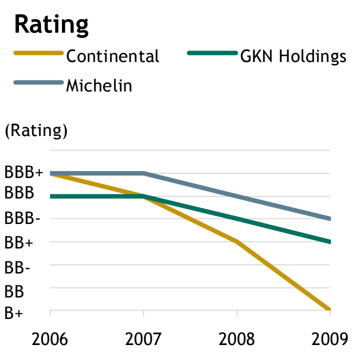
Like all high fixed-cost sectors, the auto industry's profitability is particularly driven by revenue growth/decline. A collapse in sales in H208 and H109 led to falling operating margins and substantial cash outflows from rising inventories and working capital swings, as production could not be cut back as swiftly. Although the recent unwinding of working capital swings has boosted cash generation, further benefits of this magnitude would not be repeated in 2010. Furthermore, consumers have become accustomed to price discounts and are likely to expect more of the same, which is likely to compound demand for smaller, less profitable cars, and weigh further on the product mix.

Although global sales are likely to have bottomed out, they have stabilised at a low level, which could require further adjustments to the cost base. Fitch notes that this recession did not lead to the substantial cut in assembly capacity and the industry consolidation that was anticipated at the start of the crisis, notably because of social and political issues. The decision in January 2010 of the French authorities to intervene in Renault's decision to allocate production of the next-generation *Clio* between France and Turkey, as well as the appointment of a government representative on Renault's Strategic Board, illustrates the political pressure on auto manufacturers and potential interference in their strategy — which could hinder the necessary restructuring of the sector.

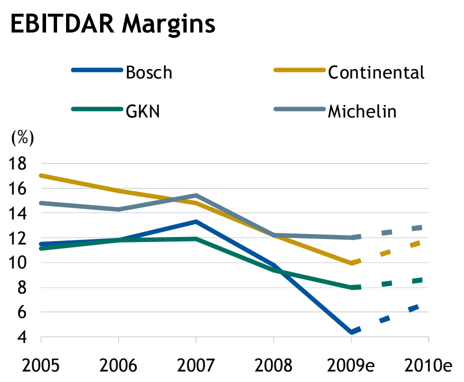
Overcapacity remains a critical issue for car manufacturers, and puts considerable pressure on profitability. However, from a creditor perspective, this negative impact may be mitigated if it strengthens the commitment of the state to continuously support the industry financially in time of need (eg the EUR3bn emergency loan granted to each of Renault and PSA at the peak of the crisis). The agency expects the previous trend of selective alliances and agreements to continue in 2010, as well as discreet and gradual reductions in capacity and workforce — which are necessary to support a leaner cost structure more in line with reduced sales expectations.

The major liquidity concerns facing the industry in late-2008/early-2009 have faded as credit markets reopened. All auto manufacturers accessed the capital markets in 2009, and strengthened their liquidity positions. Increased availability of funding has also supported financial services (FS) subsidiaries, although borrowing is now more expensive than before the start of the economic recession and auto industry crisis. A gradual stabilisation of auto manufacturers' credit profiles — leading to declining borrowing costs, the modest improvement of the environment expected in 2010, and a confirmation of the recent recovery in used-car residual values — should further support manufacturers' FS operations.

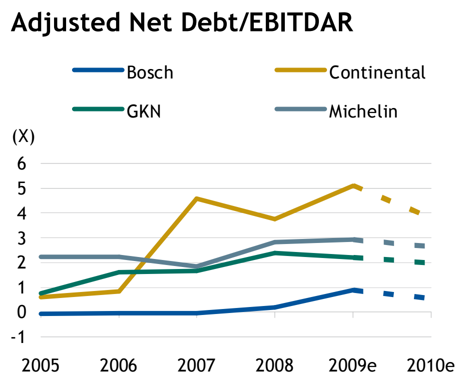
Automotive Supply



Source: Fitch



Source: Fitch



Source: Fitch

Position in the Cycle: Negative Trend:
Decline Slowing Down

Key Points

- Ongoing depressed vehicle production volumes in Europe
- Global players to benefit from growth regions (particularly Asia), and expected moderate recovery of US markets
- Structural overcapacities and trend towards smaller cars pressurise profitability
- Environmentally-friendly technology on the rise

Recent Research

- *European Auto Suppliers to Remain Challenged in 2010 (November 2009)*
- *Moderate Recovery Expected for U.S. Automotive Suppliers in 2010 (November 2009)*
- *Liquidity Focus: European Auto Suppliers (April 2009)*

As described in the previous section, vehicle production volumes remain depressed and volatile as state incentives for new cars are phased out. This will challenge any marked recovery of the auto supply industry's weak profitability — despite ongoing restructuring and cost-savings measures. Moreover, suppliers' liquidity will be tested once production activity ramps up and requires the financing of more working capital. However, the scrapping of incentives mainly affects European markets; and diversified suppliers with a strong global footprint should benefit from growth regions, particularly in Asia, which will help reduce the risk of further rating downside.

Although new car registrations in some countries in 2009 were above the level of the previous year — fuelled by state incentives — actual production figures fell significantly short of 2008. At end-2009, Fitch expects light vehicle production in Europe to have come in at approximately 20% below that of 2008, whilst sales were broadly flat. However, this production/sales mismatch, due to the destocking efforts of car manufacturers, should decline over time. Suppliers will benefit from any market recovery only after a time lag. The trend towards smaller cars is another challenge for technology-oriented western European suppliers, as profit margins are usually higher in the larger and premium car segments.

The slump in global automotive production has had a persistent negative impact on the credit quality of auto suppliers, which has translated into several negative rating actions since H208. However, the extent of the degradation of credit profiles has seen a considerable difference between the well-positioned global players (to which category belong the issuers rated by Fitch) and the weaker, more local, tier-2/tier-3 suppliers for which Fitch also expects the higher level of bankruptcies in 2009 to continue into 2010. This, combined with structural overcapacities, will likely lead to further sector consolidation. This divergence, as well as company-specific factors (such as equity issuance), explains why the rating outlook on Fitch-rated issuers is now stable — whereas the credit outlook for the sector remains negative.

Fitch remains concerned about the weak credit quality of leveraged automotive credits. This sector, including auto-parts suppliers and auto-related service providers, has seen the highest number of negative rating actions among Fitch's shadow rating universe over the last 18 months. As of December 2009, 88% of credits in the European leveraged auto sector were shadow-rated 'B-*' and below, compared with 69% as of July 2009 and 55% at June 2008. Approximately half of the performing companies continue to have a negative outlook.

While the liquidity profiles of many European suppliers have suffered in the downturn, the agency expects liquidity for most of Fitch's European publicly-rated universe to remain adequate, supported by longer-term financings and the extension of debt maturity profiles as several issuers have accessed the buoyant corporate bond market. However, refinancing risk remains high — particularly for smaller companies with limited access to capital markets, and because of banks' increased risk awareness. Fitch is particularly concerned that a pick-up in production levels, which would require the financing of higher inventories and receivables, could overburden vulnerable suppliers with already-stretched liquidity.

Of the Fitch-rated issuers, the agency downgraded Robert Bosch GmbH's (Bosch) Short-Term IDR to 'F1' from 'F1+' in July 2009, on the expectation that the group's profitability and financial profile will not recover to pre-crisis levels in the foreseeable future.

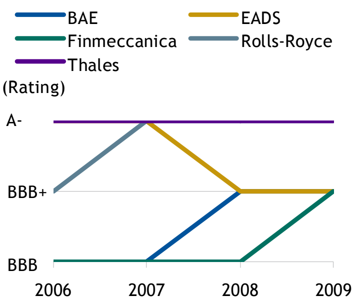
Continental AG's (Continental, 'B+'/Stable) ratings have been downgraded several times on increasing concerns about its credit profile, exacerbated by M&A issues in addition to the economic crisis. The Outlook on Continental's 'B+' IDR has been put back to Stable following the recent implementation of a EUR1.1bn capital increase and a EUR2.5bn forward-start facility. Similarly, GKN Holding PLC's (GKN, 'BB+'/'B') Outlook was revised to Stable from Negative in June 2009, due to a rights issue which strengthened GKN's balance sheet and financial flexibility — reducing the downside risk to the Long-Term IDR.

Moreover, in November 2009, the Outlook on Compagnie Generale des Etablissements Michelin (Michelin, 'BBB-'/'F3') was revised to Stable from Negative, due to its relatively resilient performance amid the sharp downturn of the global vehicle and tyre markets.

Aerospace & Defence

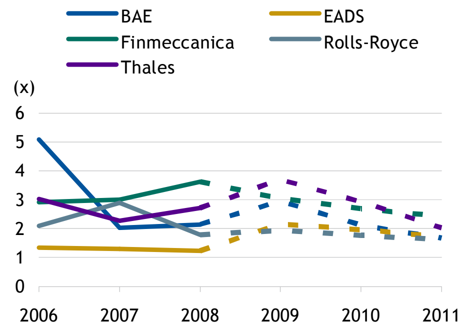
The 2010 credit outlook for Fitch-rated EMEA aerospace & defence (A&D) companies is stable, as negative factors such as continually weak commercial end-markets and pressure on defence budgets in developed countries will be offset by companies' relatively strong financial profiles, chiefly exemplified by their healthy liquidity positions. Possible rating actions in 2010 are likely to be event-driven (eg acquisitions) or by company-specific factors such as issues relating to key programmes.

Rating



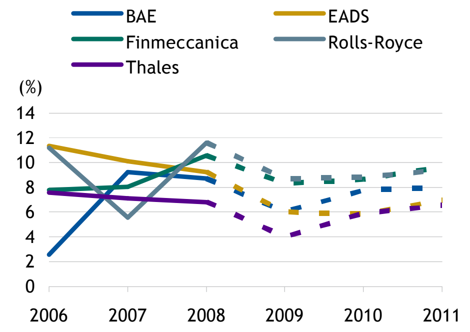
Source: Fitch

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Position in the Cycle: Average
Trend: Stable

Key Points

- Commercial aerospace industry affected by poor business environment for airlines
- Defence industry benefits from long lead-times on defence programmes despite pressure on defence budgets
- Re-emergence of M&A activity likely in 2010
- Credit metrics and liquidity typically strong, supporting stable credit outlooks

Recent Research

- *Fitch: 2010 EMEA Aerospace & Defence Outlook Remains Stable (December 2009)*
- *Fitch: U.S. Aerospace & Defense Outlook Steadying But Downside Risks Remain (December 2009)*
- *Liquidity Focus: EMEA Aerospace and Defence (October 2009)*
- *Fitch: EMEA A&D Results Reflect Challenging Operating Environment*

Companies exposed to the commercial aerospace sector will continue to suffer from the effects of the global recession and weak airline profitability. However, Fitch believes that deterioration in credit profiles in 2010 will be relatively minor — given the offsetting low cyclicality of the defence segments, and the strength of the five large A&D companies in Fitch's rating universe.

Most of the large A&D companies rated by Fitch have strong liquidity positions and financial flexibility, both of which will help the industry withstand the expected weak global economy in 2010. At end-H109, the top five EMEA A&D companies rated by Fitch had cash and equivalents totalling approximately EUR18.1bn. Short-term debt and debt maturities for these companies totalled approximately EUR5.7bn, and total debt outstanding was about EUR18.6bn. All of the companies have committed, long-term credit lines, with no credit lines expiring in the next 18 months. Fitch expects EMEA A&D companies to follow conservative cash deployment strategies in 2010 to maintain liquidity.

Nevertheless, Fitch expects earnings margins and cash generation capability to be pressured by weak commercial markets as well as tighter defence spending in core markets. While the sector has historically been able to generate relatively strong levels of FCF, Fitch believes that cash generation will be substantially lower in 2010.

Fitch's near-term outlook for the commercial aerospace industry is weak because of the vulnerable economic environment and concerns about financing. While the backlogs at major commercial aircraft manufacturers Airbus (100%-owned by European Aeronautic Defence and Space Company NV (EADS, 'BBB+'/Stable/'F2')) and The Boeing Company ('A+'/Negative/'F1') are large by historical standards, poor airline profitability and weak passenger growth may lead to a rise in deferrals and cancellations — and thus exert pressure on production rates in H210.

Key risks for the sector include the global economy, aircraft finance, exogenous shocks (terrorism, disease pandemics), and execution of new programmes. A general risk is that production rates have not been significantly revised downward despite the weakening economy, and several segments are at or near historical delivery peaks.

The defence industry is expected to remain stable in 2010. While defence budgets in EMEA companies' home markets will show little growth, the long lead-time on defence programmes, a greater focus on export sales, higher-margin segments like defence electronics, and the less-cyclical after-sales and maintenance markets, mean that revenue and margins are likely to be maintained.

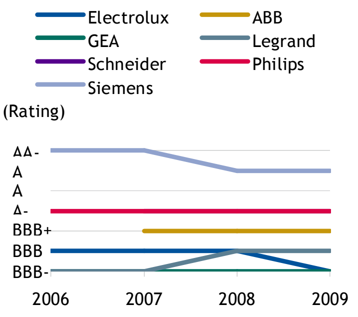
While there were no significant acquisitions made by the large rated EMEA A&D companies in 2009, Fitch believes that significant M&A activity involving these companies is likely in 2010. Despite the challenging pricing environment, most of the large companies have appetites for growth via acquisition. Political challenges to large cross-border mergers will continue to affect M&A activity, which may lead to companies forging JV or partnership alliances; however, the likelihood remains high of some of the smaller players being acquired by the large tier 1 companies.

As most companies have achieved their rating targets, Fitch expects little deliberate change to financial profiles throughout 2010, with no significant alteration to either the dividend or share buyback policies.

Other Fitch-rated EMEA A&D companies are BAE Systems plc ('BBB+'/Stable); Finmeccanica SpA ('BBB+'/Stable); Rolls-Royce Group plc ('A-'/Stable); JSC Sukhoi Civil Aircraft ('BB'/Stable); and Thales SA ('A-'/Negative).

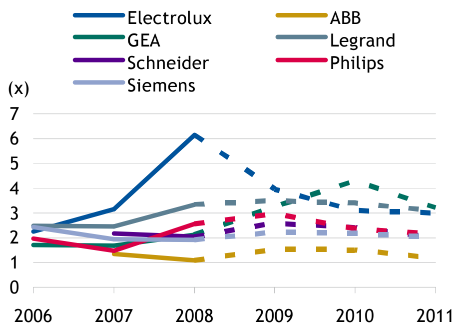
Capital Goods/Diversified Manufacturing

Rating



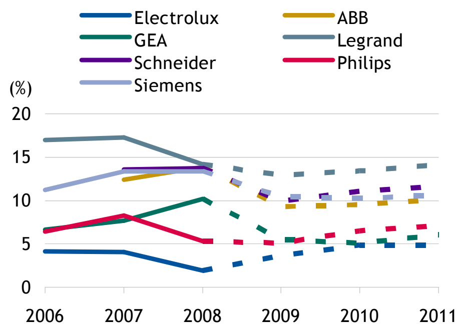
Source: Fitch

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Position in the Cycle:
Negative
Trend:
Slowly Improving

Key Points

- End-market conditions improving slowly from low levels
- Speed of recovery will vary according to end-market exposure
- Modest improvement in credit metrics expected in 2010
- Corporate liquidity remains strong
- M&A appetite may return

Recent Research

- *U.S. Diversified Manufacturing: 2010 Outlook (January 2010)*
- *Fitch: EMEA Capital Goods Outlook Remains Stable for 2010 (December 2009)*
- *EMEA Corporate Capital Expenditure - Cut-backs Support Free Cash Flow Recovery (October 2009)*

The credit outlook for the EMEA capital goods (CG) sector remains stable — despite weakened demand in many CG end-markets, and ongoing economic fragility as the credit profiles of Fitch's rated CG companies continue to be supported by strong business profiles, good cash generation, conservative credit metrics, and solid liquidity profiles.

Although the global economic downturn undoubtedly affected EMEA CG companies during 2009, it has also demonstrated the resilience of most of their business models, with some companies reporting substantial yoy increases in FCF. Although 2010 will likely continue to pose challenges, especially if an economic recovery is slow to materialise, Fitch believes that the CG sector should retain enough financial flexibility to prevent a significant decline in credit quality.

The agency expects demand within most CG end-markets to remain depressed, following significant falls in 2009. Although signs of stabilisation in many end-markets emerged during H209, any recovery during 2010 is likely to be slow and tepid, reflecting the agency's view that global economic growth will be anaemic at 2%. In turn, this will likely continue to restrict industrial production, consumer confidence and corporate capex (which may fall by a further 3% in Europe in 2010, based on Fitch research), all of which are key drivers of CG end-demand.

Fitch is therefore currently forecasting (February 2010) organic sales growth of between -3% to +4% for most of its rated CG companies in 2010 — with any growth notably from a low base, and with sales unlikely to return to their peak 2008 levels until 2012 or later. Profitability may also remain under modest pressure, although recent cost-cutting, decent pricing power, and an expectation of limited input cost inflation should provide support to EBITDAR margins. Credit metrics across the sector are expected to improve moderately in 2010.

However, companies exposed to late-cycle end-markets (such as GEA Group Aktiengesellschaft (GEA, 'BBB-'/Stable)), weak residential construction markets (such as Legrand SA, 'BBB'/Stable) or those dealing with shrunken order books (such as Siemens), may experience a slower recovery in financial performance. Nevertheless, the credit profiles and financial metrics of these companies remain robust, in most cases, and should underpin existing rating levels — albeit with certain company-specific exceptions, such as AB Electrolux ('BBB-'/Negative), which is on Negative Outlook due to an ongoing secular decline in earnings; and ABB Ltd ('BBB+'/Positive), which is on Positive Outlook due to its exposure to long-term growth markets and financial resilience despite the market slowdown.

Fitch notes that CG companies have maintained — and even enhanced — FCF generation in 2009 through cost-cutting measures and the unwinding of working capital (mainly though inventory destocking). However, FCF generation in 2010 may noticeably fall from 2009 levels, even if market conditions recover quicker than expected, because (1) not all recent cost-savings will be structural, (2) pricing will remain under pressure in many sub-sectors, (3) positive working capital trends will begin reversing as inventory levels are re-built, and (4) capex and dividends may creep upwards. Nevertheless, positive FCF generation is expected across most of the sector in 2010.

Furthermore, the liquidity profiles of most CG companies remain strong, with limited short-term debt maturities more than covered by substantial cash balances and committed undrawn credit facilities. The sector also retains good access to the capital markets should external financing be needed.

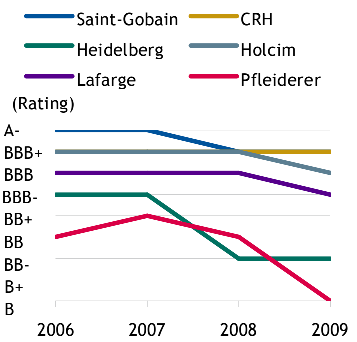
Fitch believes that acquisition appetite in the CG sector may moderately increase in 2010, as market conditions stabilise and companies look to deploy large cash balances built up over the last two to four years; as evident from Schneider Electric SA's ('A-'/Rating Watch Negative (RWN)) announcement in December 2009 that it intends to buy Areva's electrical distribution unit during H110.

Other companies, such as Legrand, GEA, Electrolux and Royal Philips Electronics ('A-'/Stable) have indicated at recent Q309/Q409 results calls that they may soon resume modest acquisition activity. However, significant debt-funded M&A is considered unlikely during the next 12 months — given that management teams remain in a relatively cautious mode — and Fitch will therefore continue to treat such transactions as event risk. Other Fitch-rated EMEA CG companies are Arcelik ('BB-'/Positive) and Vestel Elekronik Sanayi Ve Ticaret A.S. (Vestel, 'B'/Stable).

Basic Materials

Building Materials

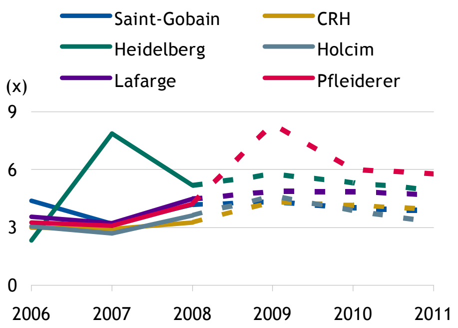
Rating



Source: Fitch

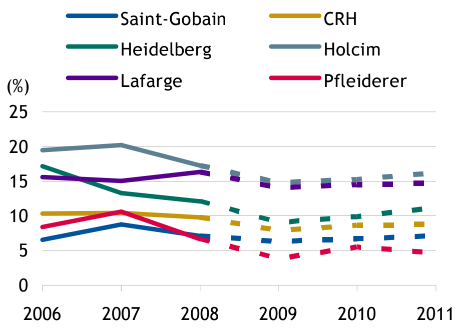
Position in Credit Cycle: Negative
Trend: Slowly Improving

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Although most of the Fitch-rated European building materials (EBM) issuers have negative outlooks, the expectation of a gradual improvement in credit metrics during the next 24 months — due to cash flow preservation measures rather than an

Key Points

- Improving metrics — due to cash flow preservation measures despite weak market fundamentals — could support outlook stabilisation
- Divestments to reduce debt may remain challenging
- Liquidity remains satisfactory
- Leveraged credits likely to experience slower stabilisation

Recent Research

- *India Cement Outlook 2010 - Capacity Growth Way Ahead of Demand (January 2010)*
- *U.S. Homebuilding/Construction: The Chalk Line -- Quarterly Update: Winter 2009/2010 (January 2010)*
- *Latin America Homebuilders 2010 Outlook: Fundamentals Will Begin to Recover (December 2009)*
- *U.S. Building Materials - 2010 Outlook, (December 2009)*

improvement in market fundamentals — could lead to a stabilisation of rating outlooks. Cash flow preservation measures have included aggressive fixed-cost reductions and working capital optimisation. The energy cost decline from Q408 has supported cost reductions, although this has shown some reversal since H209.

Fitch expects the absolute amounts of CFO in 2010 to continue to be lower than 2007-2008 peaks by about 30%. However, capex containment — which for EBM-rated entities in 2009 was about 35% on average lower than in 2008 — and lower dividends expected in 2010, should result in the average 2010 FCF margin being higher than the five-year historical average.

However, Fitch notes the continuing risk of a slower-than-anticipated improvement in credit profiles, should the recovery in general economic activity prove to be more anaemic than expected by the agency. Fitch expects mature markets to continue to be weak while emerging markets will continue to grow, although regional differences are notable in all markets.

The Fitch-rated universe of EBM issuers includes CRH Plc ('BBB+'/Negative/'F2'), Compagnie de Saint-Gobain ('BBB+'/Negative /'F2'), HeidelbergCement AG ('BB-'/Positive/'B'), Holcim Ltd. ('BBB'/Stable/'F2') and Lafarge SA ('BBB-'/Negative/'F3'). All these global players have operations in numerous countries, with Holcim and Lafarge deemed by Fitch to have above-average geographical diversification.

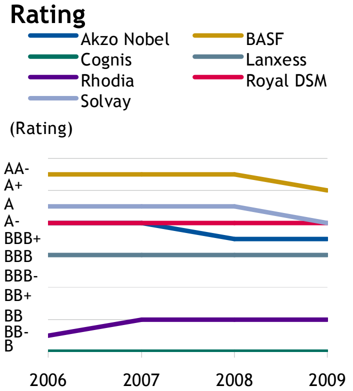
Levels of absolute debt are expected to have notably declined in 2009 compared with 2008, partly due to equity injections carried out by almost all the rated companies. However, in the absence of extraordinary inflows such as disposals, Fitch expects debt reduction to be only modest in 2010. The agency believes that issuers that continue to rely on divestments to reduce their debt, such as HeidelbergCement and Lafarge, might continue to face challenging M&A markets due to the persistently tight credit environment; Fitch notes that Lafarge has achieved to date (February 2010) 75% of its stated disposal target (EUR1bn) for 2009.

Liquidity for rated EBM companies is expected to remain satisfactory, supported by adequate cash balances and sufficient existing credit lines to cover debt maturities until financial year-end 2010 (FYE10). During 2009, EBM issuers actively accessed the debt capital markets to refinance existing debt, partially replacing bank debt, and to extend their average debt maturity.

The total value of bonds issued in the capital markets was in excess of the equivalent of EUR10bn (about EUR3.6bn in 2008). This total issuance included: HeidelbergCement, with EUR2.5bn issued in October, which it used to partially refinance the substantial December 2011 EUR8.7bn Hanson acquisition loan; Lafarge, with an aggregate equivalent of EUR3.1bn; Saint-Gobain, with a total of EUR1.75bn (January and May); Holcim, with over CHF3.2bn; and CRH, with EUR750m (in May).

Fitch notes that, as with publicly-rated entities, the profiles of leveraged credits in the building materials industry have also been under pressure during 2009. However, the agency believes that rating stabilisation is likely to be slower due to the complexity of these credits' debt structures. At 30 November 2009, about 75% of Fitch's shadow-rated building materials credits were on negative outlook or RWN (compared with over 42% at end-December 2008), and 83% were rated 'B-*' and below (63% at end-December 2008).

Rating



Source: Fitch

Position in the Cycle:
Negative
Trend:
Slowly Improving (High-Value-Added Chemicals)
Negative (Low-Value-Added Chemicals)

Key Points

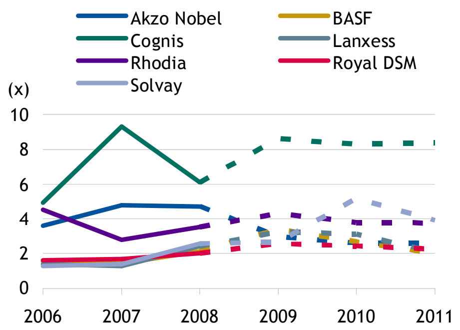
- Fragile and modest recovery in demand, with wide geographical divergence
- Path to recovery uncertain for commodity chemicals; challenged by low-cost competition
- Specialty chemicals better positioned to benefit from economic growth
- Stance on financial policies likely to remain conservative, i.e. with moderate increases (if any) from 2009
- Liquidity profile mixed; with no concerns for European issuers, but refinancing risk for some emerging market players

Recent Research

- *Liquidity and Refinancing Trends for Western European Chemicals (February 2010)*
- *Fitch Expects W. European Chemicals to Face Input Cost Pressure in 2010; Markets Seen Improving (February 2010)*
- *EMEA Chemical Industry: on the Mend? (February 2010)*
- *EMEA Chemicals 2010 Outlook: Negative but Stabilising (December 2009)*
- *North American Chemicals Industry: Outlook 2010 (December 2009)*
- *Crop Protection Market Trends and Credit Implications (November 2009)*

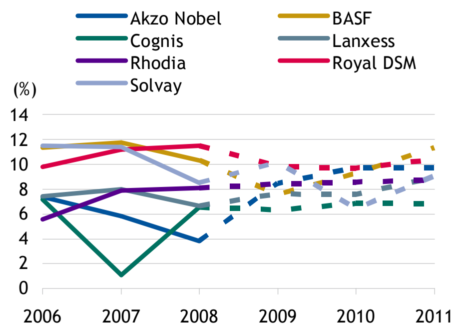
Chemicals

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Fitch expects a modest and fragile recovery in demand for chemicals in 2010, with a continuation of the sequential rebound observed in H209. Regional disparities in growth trends will reflect the varying economic expansion forecasts; with Asia (China and India) and, to a lesser extent, South America (Brazil), driving global demand. Anaemic recovery will constrain prospects in the western European and North American markets, and chemicals production in those regions is not expected to return to pre-crisis levels for another two to three years.

Other factors clouding the near-term sector outlook for European players include renewed inflationary cost pressures, particularly at levels of the value chain where structural overcapacities persist and where producers' pricing power is strongly dictated by the demand/supply balance, as well as the phasing-out of stimulus packages.

The economic downturn has taken its toll on the credit profile of the European chemicals industry. As expected by Fitch, the casualties or near-casualties of the trough were issuers with significant exposure to commodity chemicals — and resulting volatility in operating earnings — and those entering the downturn with a weakened capital structure and a substantial debt burden as a result of aggressive financial strategies during the 2007/early-2008 boom (LyondellBasell, Kazanorgsintez).

Downside pressure remains in Fitch's EMEA rating universe, with seven out of 14 public ratings on Negative Outlook and one on RWN. However, headroom is likely to widen in 2010, particularly for those issuers at the higher end of the rating spectrum where negative outlooks had reflected aggressive financial profiles and policies at the peak of the cycle — BASF SE ('A+'/Negative), Akzo Nobel N.V. ('BBB+'/Stable).

The cash preservation and cost-saving measures implemented at the onset of the downturn, combined with the slow recovery in demand, should support a gradual improvement in operating earnings and cash flows, and alleviate the pressure on credit metrics. Conversely, and barring issuer-specific actions (eg Belgium-based Solvay SA's ('A-'/Negative) announced sale of its pharmaceutical operations), negative rating pressure is likely to signal companies' inability to maintain liquidity and minimise cash burn until a solid improvement in demand and margin expansion materialises.

Chemicals sub-sectors will not be equal in the face of recovery. Petrochemicals will not only continue to be exposed to the cyclicality along major basic chemical and plastic value chains, but will also struggle with new capacity coming on stream in the Middle East. The cost advantage afforded by the substantially cheaper feedstock supply means that the new production facilities can operate profitably at prices where western European and North American capacity becomes uncompetitive. While the permanent shutdown of inefficient high-cost capacity in Europe and North America during the downturn partly offsets the impact of the new supply on the global balance, the net effect is expected to outpace demand growth in the near to medium term. Naphta-based feedstock places European players at a stronger disadvantage than their US peers.

Specialty chemicals products without much differentiation will face stiff competition and become commoditised much faster than before. As a result, specialty companies with product portfolios geared toward commoditised specialty products will change their strategy to purely low-cost manufacturing. In contrast, specialty chemicals with high-value-added, innovative product portfolios will increasingly focus on research and development in order to maintain the cutting-edge nature of their products.

Liquidity remains strong across investment-grade-rated western European chemicals producers which have tapped the debt capital markets or issued private placements (eg German Schuldscheindarlehen) to refinance borrowings, extend average debt maturities, or bolster liquidity.

In emerging markets, the liquidity situation is more challenging. The Negative Outlook and RWN assigned to Russian issuers JSC Acron (Acron, 'B+'/Negative) and OAO Nizhnekamskneftekhim (NKNK, 'B'/RWN), respectively, reflect varying degrees of refinancing risk due to potential financial covenant breaches, and borrowings skewed towards the short-term — with uncommitted lines vulnerable to non-renewal. Fitch notes here that both Acron and NKNK tapped the domestic bond market in late-2009, thereby easing the near-term liquidity and refinancing risk.

OJSC Kazanorgsintez (KOS, 'RD') faces a complex debt restructuring exercise after the deteriorating market conditions and high debt levels led to successive financial covenant breaches under its bank facilities and Eurobond. With the exception of the latter, liquidity risk is low, and debt maturity schedules remain manageable.

Despite the availability of discounted distressed assets, Fitch expects M&A activity to remain subdued in 2010 due to the combined effect of tight credit markets, challenging valuations, and a cautious approach to spending. Bolt-on acquisitions could increase, but the scope for large transactions remains limited under current credit profiles and, with the exception of Solvay — which has earmarked the proceeds from the disposal of its pharma business for acquisitions in the chemicals sector — issuers are expected to concentrate on integrating recent acquisitions (BASF, Akzo), or on the disposals of identified non-core assets (BASF's Styrenics business)

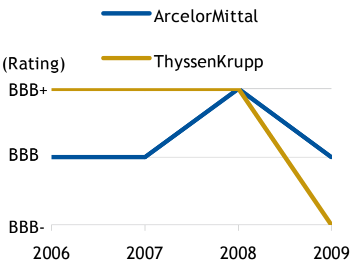
Fitch's rating actions on shadow-rated leveraged chemical companies were largely affirmations in 2009. As of January 2010, 50% of the ratings were on 'B-' or below, and the same percentage had a negative outlook or RWN — reflecting the increased vulnerability of chemical players operating under financially-leveraged, mostly private equity-owned structures.

Steel

Fitch expects demand for steel to recover from the lows at a modest pace over the next 12–18 months, but not to return to peak levels in the medium term. Pricing is likely to be constrained by excess capacity, however increases in raw material costs could provide some "cost push" to prices. Excess or below-cost production should be limited.

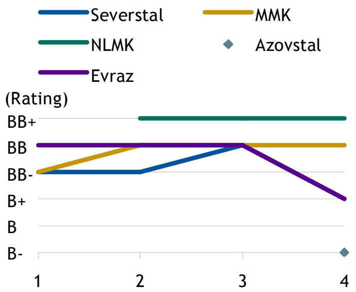
Regional differences in steel market dynamics have re-emerged, and will be a major influence on steel producers' profitability and cash flow generation. Worldwide steel trade has fallen by more than global production trends as a result of sharply lower demand in importing nations, coupled with low capacity utilisation and short lead-times at domestic steel mills. Producers relying on exports will be exposed to price competition approaching marginal cost, intensifying trade barriers, and potentially the most significant factor — currency fluctuation.

Rating



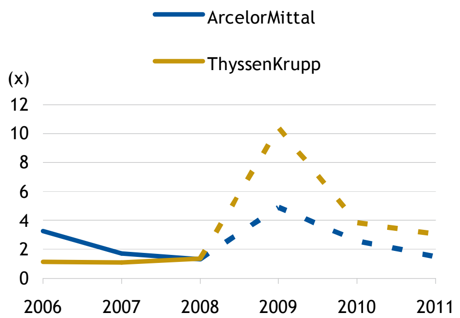
Source: Fitch

Rating



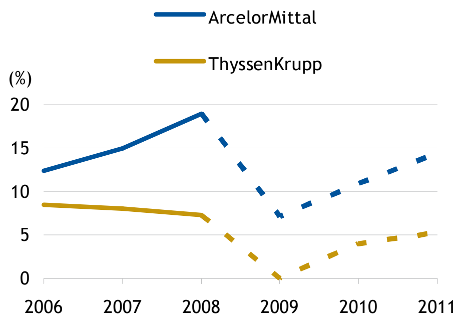
Source: Fitch

FFO Leverage



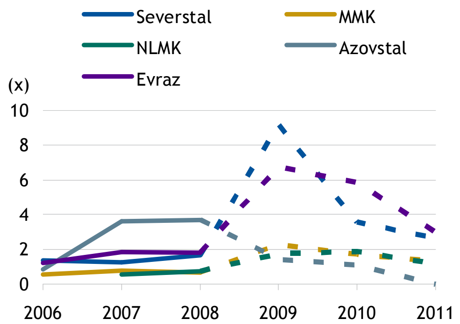
Source: Fitch

FFO Profitability



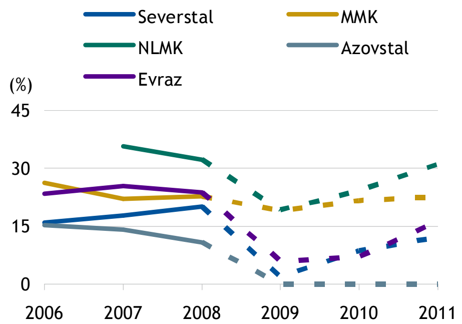
Source: Fitch

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Position in Cycle: Negative
Trend: Slowly Improving

Key Points

- Weak — but progressive — recovery in real demand
- Steel price outpaced by increases in raw material prices — pressuring margins of non-integrated producers
- Revenue growth in 2010 of CIS steel producers is constrained by high capacity utilisation (90%) achieved in Q309-Q409.
- Outlook remains challenged due to the low profitability of producers' overseas operations; substantial leverage; and liquidity constraints for some issuers

Recent Research

- *Worldwide Steel Outlook - The Worst is Behind Us, but so May Be the Best (December 2009)*
- *2010 CIS Steel Outlook - Performance to Stabilise; Outlook Remains Challenging (December 2009)*

While demand in China grew in 2009, it was outpaced by production increases. This, coupled with high stocks at traders, resulted in a build-up in domestic stock levels which will need to be worked through — limiting short-term price appreciation. Excess production (i.e. bringing too much capacity on stream ahead of demand improvements) could pressure weak domestic markets in Europe and North America or exports from Russia and Ukraine.

The rebound in production from China is driving up prices for raw materials, albeit from reduced levels. Fitch expects raw material prices to be up by at least 20%–25% overall in 2010.

Outside of consolidation and integration activity between Chinese producers, Fitch expects M&A activity in the sector to be modest.

Results for Q409 should show seasonal weakness, but Fitch expects H110 results to be more indicative of the strength and sustainability of the recovery. Restocking activity in most markets has been modest but progressive, and this is likely to persist.

Steel producer earnings were severely affected over 2009, but most companies rated by Fitch improved their liquidity through cost reductions, working capital management, dividend reductions, spending reductions, capital raisings, and/or credit facility amendments. These measures should serve well over this period of slow recovery, and financial leverage should decline over 2010. Ratings, meanwhile, remain under some pressure.

The only rating action that Fitch took amongst western European steelmakers over H209 was the revision in July of ArcelorMittal S.A.'s ('BBB+'/'F2') Outlook to Negative from Stable.

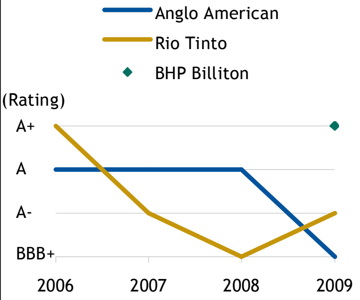
For Russian steel companies, the 2010 industry outlook is stable, due to the stabilisation of steel prices in Q309-Q409 and expected slow recovery in volumes. However, the credit outlook for Russia's Fitch-rated steel manufacturers remains challenged due to the low profitability of producers' overseas operations, substantial leverage, and liquidity constraints for some issuers. For Ukrainian steel producers, the outlook remains negative due to the economic downturn in Ukraine and producers' heavy export orientation, and because the recovery period is expected to be longer than in Russia. The outlook also reflects significant foreign-currency debt, the constrained liquidity of some issuers, and the risks of issuer default due to non-compliance with debt covenants and/or payment defaults.

Fitch believes that the credit outlook for Russian steel producers such as OJSC Novolipetsk Steel (NLMK, 'BB+'/Stable/'B') and OJSC Magnitogorsk Iron and Steel Works (MMK, 'BB'/Stable) are likely to remain Stable. The ratings of Ukrainian producer METINVEST B.V. (METINVEST, 'B-'/Negative/'B') are constrained by the Ukrainian sovereign rating/Country Ceiling. Conversely, the credit profiles of Evraz Group SA (Evraz, 'B+'/RWN/'B'), OAO Severstal (Severstal, 'B+'/Negative/'B') and Interpipe Limited (Interpipe, 'RD'/'D') are likely to remain under pressure in 2010.

The liquidity positions of CIS Fitch-rated metals companies (except Interpipe) are expected to be satisfactory. The agency is concerned about Interpipe's liquidity due to negative FCF and significant capital commitments.

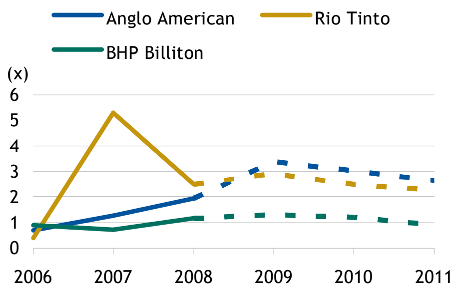
Mining

Rating



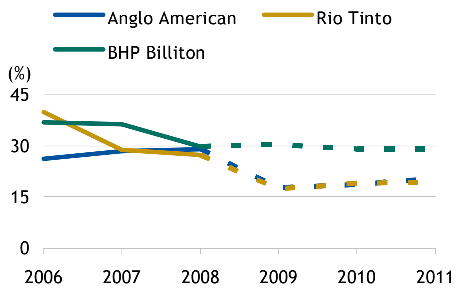
Source: Fitch

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Position in the Cycle: Average
Trend: Stable

Key Points

- Key to demand growth in 2010 switching to MAEs from China
- Strong price outlook for steelmaking raw materials; base metals prices to be higher on average
- Cost pressures to re-emerge
- 2010 EBITDAR margins of CIS mining companies producing raw materials for steelmaking is expected to grow by 20%-30% yoy, due to price appreciation and tight supply

Fitch expects global metals demand will be more dependent on growth in developed economies over 2010. The recent recovery in metals prices was primarily driven by domestic consumption and restocking in China, amplified by the return of speculative demand. The construction, automotive and capital goods sectors, which are key to consumption of base metals, remain weak in most mature advanced economies (MAEs), with only modest increases in real demand.

The general price outlook for the base metals complex is for higher average prices than in 2009, but somewhat weaker than spot levels seen in Q409. Copper exhibits the best fundamentals (due to robust underlying demand), whilst aluminium is likely to have the slowest recovery due to continuing high stock levels.

The outlook for the steelmaking raw materials (iron ore, coal, scrap) is uniformly strong, with anticipated MAE steel production increases coming against the background of already-tight supply. Expect 25%+ price increases in the upcoming benchmark price settlements for iron ore and coal.

While construction should benefit from stimulus spending, the automotive and durable goods sectors depend more on consumers, and high unemployment will impede growth. Cost pressures have returned; driven by strengthening local currencies, increases in energy prices, and wage increases. During 2009, many

Recent Research
- *India Base Metals Outlook 2010 - Capex-Led Growth (January 2010)*
- *Base Metals Outlook: Differentiating by Supply (December 2009)*

mining companies raised capital and/or sold assets to improve their cash positions or to support necessary spending. For most producers, capital-raising and spending decisions were taken when the outlook was most dire, and the rebound in metals prices has proved a significant surprise to the upside.

The precipitous contraction in demand beginning in Q308 resulted in sharp reductions in spending on exploration and expansion projects. This has lowered the future trajectory of supply growth, which will benefit producers as demand continues to recover. Fitch expects producers to remain disciplined on capital and exploration spending in 2010.

Downside risks to Fitch's view include a tightening in monetary or fiscal policy, a re-assertion of financial risk avoidance, or a return to recession. Upsides to the agency's view include supply disruptions or a strong recovery in consumer durables.

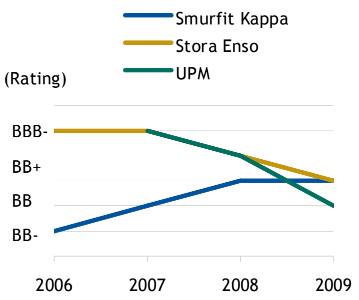
Key rating actions over late-H209/early-2010 included an upgrade of Rio Tinto by one level to 'A-' due to expectations of continued deleveraging; the assignment of initial ratings to BHP Billiton Limited ('A+'/Stable/'F1'); and the revision of OJSC MMC Norilsk Nickel's (Norilsk Nickel, 'BBB-') Outlook to Stable from Negative in November. In August 2009, Anglo American plc ('BBB+'/Stable /'F2') was downgraded by one notch, as a part of Fitch's regular sector peer analysis review reflected weaker recovery expectations for the company.

In the CIS, mining companies producing steelmaking raw materials (iron ore, coking coal) improved capacity utilisation to 80%-90% in Q409, due to an increase in demand from domestic steelmakers and exports to Asian countries. They also enjoyed a significant increase in domestic prices: for coking coal from USD45 per tonne (t) in the beginning of 2009 to USD90/t in Q409; and for iron ore from USD30/t to USD45/t.

Such price growth is attributable to an increase in prices in world markets — due to rising consumption in China, and a shortage of iron ore and coking coal in domestic markets. Fitch expects that these companies will be able to increase revenue in 2010 by 30%-40% yoy, and achieve a boost in EBITDAR margins by 20%-30% yoy. The deficit of iron ore and coking coal in CIS domestic markets will continue in 2010, due to the lack of any new mining assets being developed.

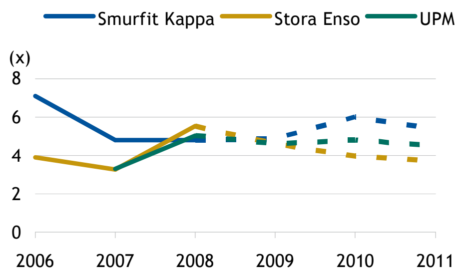
Paper and Forest Products

Rating



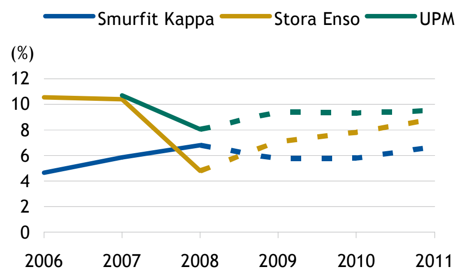
Source: Fitch

FFO Leverage



Source: Fitch

FFO Profitability



Source: Fitch

Position in the Cycle: Negative
Trend: Slowly Improving

Fitch expects that the European paper and forest products (EPFP) industry will remain under pressure in 2010, as subdued demand and structural overcapacities continue to affect issuers' credit metrics.

The pace of the decline in paper consumption appears to be decelerating; with a lower contraction in demand and deliveries in Q309, although this was partly due to seasonal effects. Fitch believes that demand is likely to improve in 2010, but remain weak by historical standards.

Key Points

- Demand contraction is expected to stop, but absolute level will remain weak
- Significant concerns on input costs
- New capacity in containerboard and weak US dollar may create competitive pressure

Recent Research

- *Fitch: European Paper & Forest Products to Remain Under Pressure in 2010 (December 2009)*
- *Latin America Pulp, Paper, and Forest Products 2010 Outlook: Trends Look Favorable (December 2009)*

Of the three EPFP issuers rated by Fitch, one, Stora Enso Oyj (Stora, 'BB'/'B'), has a Negative Outlook, reflecting the agency's expectation that credit metrics will remain weak in the near term.

Paper consumption was unsurprisingly depressed in 2009, in line with the lower consumer, corporate and advertising spend associated with the economic downturn. In the 10 months to November 2009, European deliveries of uncoated woodfree (UWF) and coated wood-free (CWF) paper were down by 22.4% and 14.6%, respectively, yoy. European shipments of coated and uncoated mechanical grades declined by 23.6% and 20.9%, respectively. Shipments of newsprint and super calendared (SC) paper were lower by 11.9% and 14.7%.

The performance of Stora and UPM Kymmene Oyj (UPM, 'BB-'/Stable/'B') also suffered from the downturn's impact on divisions that have historically provided some earnings stability. Fitch downgraded both issuers in 2009, to reflect the agency's view that the cyclical drop in demand compounded the effect of the sector's structural weaknesses — and accelerated the gradual and fundamental deterioration in their credit profiles.

Fitch regards input-cost pressure as a key risk for the sector in 2010. In 2009, lower fibre, wood, chemicals and energy costs partly helped contain margin compression, along with the benefits of the restructuring exercises undertaken across the sector. However, pulp prices have risen by about 23% since January 2009, supported by strong demand from China and by aggressive capacity adjustments by pulp producers. In November 2009, stocks of woodpulp at European ports were 58% below the levels of November 2008. Recovered paper prices are also trending higher due to robust Chinese demand, and energy and chemical costs are rising in line with oil prices.

New containerboard capacity coming on stream in 2009-10 in Europe (Mondi, Prowell, Hamburger) poses the biggest challenge for the packaging sector against the backdrop of weak demand. Further capacity adjustments and mill closures are expected.

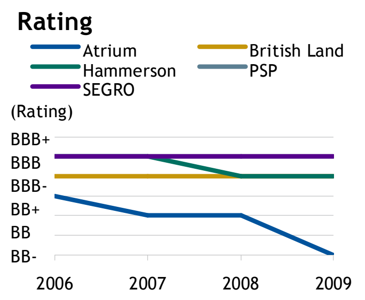
While some recovery in cash flow generation is likely, Fitch believes that EPFP companies are likely to maintain the restrictions adopted in 2009, and to continue limiting capex and dividend spending. For publication paper producers, M&A activity will continue to revolve around JVs and partnerships, resulting in further vertical integration into forest assets in Latin America.

Deleveraging capacity is likely to be modest; and the agency forecasts weak — albeit slightly improving — leverage and coverage ratios for Stora and UPM. Smurfit Kappa Group plc's (SKG, 'BB'/'B') Stable Outlook reflects Fitch's belief that the company's cost leadership, operating profile and financial flexibility put it in a good position to face the expected overcapacity in the containerboard market.

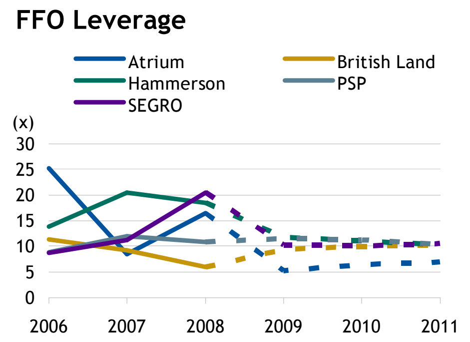
Near-term sector liquidity remains adequate for 2010 maturities, and Stora and SKG both accessed the bond market in 2009 to refinance existing debt. UPM's interest-bearing liabilities amounted to EUR300m at 31 December 2009, against liquidity of EUR2.2bn comprising availability under committed facilities and cash balances of EUR438m. Stora held cash positions of EUR877m at 31 December 2009, and a EUR1.4bn undrawn revolving credit facility (RCF) maturing in 2012 against current maturities of EUR815m. SKG's debt repayments are minimal — less than EUR100m per annum until 2011, and liquidity was supported by cash balances of EUR601m as of 31 December 2009 and around EUR510m available under the group's EUR525m RCFs maturing in 2012 and 2013.

Construction and Property

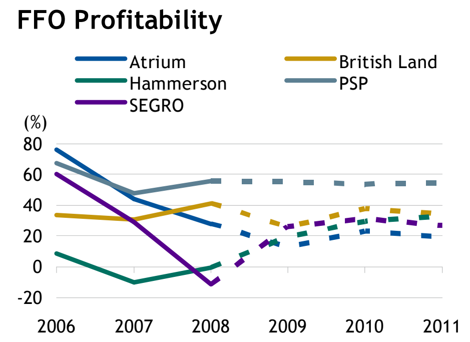
Property Investment



Source: Fitch



Source: Fitch



Source: Fitch

Position in the Cycle: Stable
Trend: Stable

Key Points

- Share issues and asset disposal in 2009 have strengthened balanced sheets
- Long-term nature of rental contract in the UK leads to stable income profile
- Further capital value decline in the UK unlikely to put pressure on covenants
- Swiss market remains relatively strong
- Central & Eastern Europe under more pressure
- Liquidity generally strong

Recent Research

- *Stable Credit Outlook for European Property Companies in 2010 (December 2009)*
- *Liquidity Focus: UK Real Estate Investment Trusts (June 2009)*
- *Raising Equity Increase Options for UK (February 2009)*

Fitch's 2010 credit outlook for European property investment companies (PICs) remains stable, and mainly reflects one-off improvements in UK PIC capital structures — share issues and asset disposals — during H109. All the entities rated by Fitch have stable outlooks compared with Q109 — when almost 60% of the same entities had a negative outlook or were on RWN.

Whilst there is a risk that UK market rents will continue to decline for the next 12 to 18 months, the generally long-term contracted rental income and quality tenants of Fitch-rated issuers means that interest cover will remain within acceptable parameters for the current rating levels. Fitch projects that falls in rental income for its UK-rated issuers will be limited to a maximum of 2% in 2010, and that declines in capital values will be no more than 5% for prime properties — following falls of around 60% since the market peak in 2007. Neither factor is likely to put pressure on covenants or rating headroom within the next 12 months.

Any variance on the agency's prediction of capital value declines may derive from the actions of banks in materially selling property assets related to a portion of the GBP250bn of outstanding UK commercial property loans that could become impaired — and hence become economically unviable to hold on banks' balance sheets. If significant realisations do occur, it is possible that capital values will be negatively affected again — as a large amount of property assets comes on to the investment market, compared with the currently supply-constrained situation.

The Swiss markets in which PSP Swiss Property AG (PSP, 'BBB+'/Stable) operates, i.e. offices in Zurich and Geneva, have held up well compared with the UK; with vacancy rates static in 2009 compared with 2008, and rents increasing on a like-for-like basis. This reflects a shortage of supply in these markets, and Fitch expects nominal growth in both capital values and rents in 2010.

In central and eastern Europe, where Atrium European Real Estate Limited (Atrium, 'BB-'/Stable) operates, conditions were tougher in 2009 than in the UK and Switzerland. This reflects a weak retail environment and a high proportion of rents linked to the euro and the dollar, meaning that PICs have had to reduce rents to prevent tenant defaults — as rental costs become unaffordable to tenants earning revenue in depreciating local currencies.

Discounts of up to 40% on rents have been required in Russia. Whilst the currency impact has somewhat stabilised, continued tough macroeconomic conditions are likely to ensure that rental and capital values remain under considerable pressure during 2010 at least. Atrium nevertheless remains on Stable Outlook due to its low-leveraged financial structure.

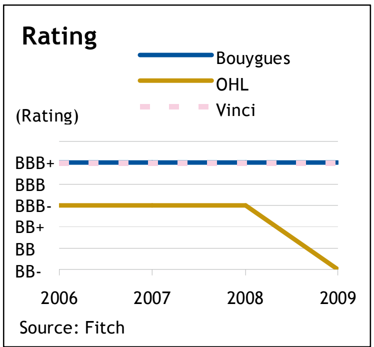
On the financing side, short-term refinancing requirements are relatively modest at around GBP0.7bn — out of total debt approaching GBP12bn equivalent for Fitch-rated issuers. Liquidity is also strong, with total sources of liquidity (balance sheet cash plus committed undrawn debt facilities) approaching GBP6bn equivalent. However, there is a general trend towards bank deleveraging, particularly by reducing commercial real estate exposure, which could create a "funding gap" when more substantial debt maturities fall due from 2011. This will be compounded by the refinancing requirements of the EUR61bn of European CMBS maturing between 2011 and 2012, although the Fitch-rated issuers are not significantly exposed to short-term CMBS refinance risk.

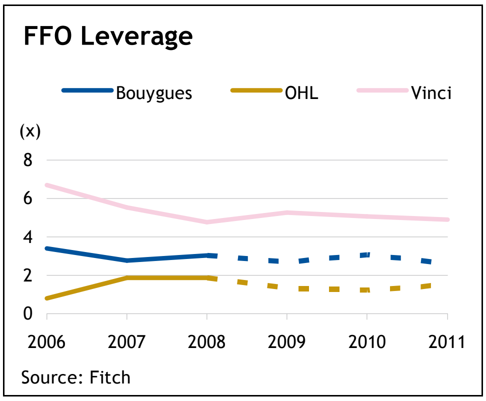
The agency will focus on how PICs deploy their substantial available liquidity in ramping-up development capex amid the market perception, in the UK at least, that capital values are stabilising. In general, increased development activity equates to increased credit risk, as it uses up available liquidity and leaves a PIC exposed to letting risk on new developments.

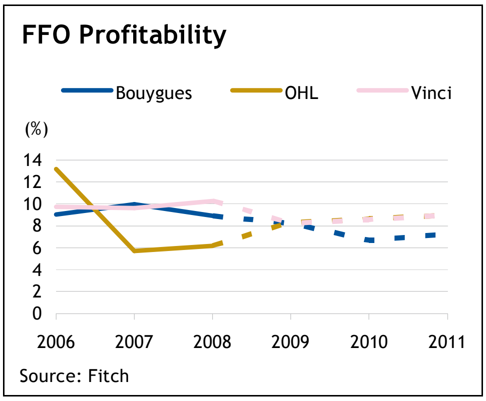
Fitch rates the major UK PIC REITs British Land Company PLC ('BBB'/Stable), Hammerson plc ('BBB'/Stable), SEGRO PLC ('BBB+'/Stable) and Land Securities Capital Markets Plc (secured notes: 'AA'/Stable); and Continental European PICs Atrium and PSP Swiss Property AG.

The agency also rates a number of European real estate companies on a private shadow basis. This portfolio currently has a median rating of 'B-*'; reflecting the generally secondary nature of assets, highly-leveraged capital structures, and widespread covenant pressures. All of Fitch's shadow-rated European real estate companies have negative outlooks or are on RWN.

Western European Construction







Position in the Cycle: Average
Trend: Negative

Key Points

- Weakening order books to pressure cash flow from 2010-2011
- Margins at risk from ultra-competitive bidding processes
- Fiscal stimulus provides some medium-term support
- Refinance risk limited for the majors

Fitch considers that the 2010 credit outlook for European construction companies is negative, as economic conditions remain fragile and access to finance difficult. The combination of weakened order books and margin pressures stemming from increasingly competitive tendering processes, means that the medium-term cash flow outlook looks increasingly challenging.

Construction order-books have generally been declining over the course of 2009 — Obrascon Huarte Lain SA's (OHL, 'BB-'/Negative) short-term order book was down 9.5% yoy in 9M09, while Bouygues SA's ('BBB+'/Negative) fell by 8% over the same period. This decline is likely to manifest itself in weakening operational cash flows from 2010 and into 2011. There is a heightened risk that margins on new orders will erode due to intensified bidding competition as the overall volume of work shrinks, compounding negative cash flow pressure.

Fiscal stimulus packages in western Europe are a short-term positive, but Fitch is conscious that these will need to be reversed over the medium-term as they simply represent an acceleration of a finite amount of infrastructure spending. This risks adding to negative cash flow pressures for European civil-focused construction companies — including Bouygues, OHL and Vinci S.A. ('BBB+'/Stable) — from late 2010.

Recent Research

- *Fitch: Negative Credit Outlook for European Construction in 2010 (December 2009)*
- *Fitch: Liquidity Risks Remain for W. European Constructors & Homebuilders (July 2009)*
- *Fitch Maintains OHL on Rating Watch Negative (July 2009)*
- *Obrascon Huarte Lain SA (OHL) (May 2009)*
- *Fitch: Weakening Order Books to Impact European Construction Companies (April 2009)*

Position in the Cycle: Negative

Trend: Slowly Improving

Key Points

- Insufficient operational cash flow generation to repay outstanding debt
- Strong concentration of debt maturities in 2011/2012
- UK market still uncertain in terms of credit availability for borrowers
- Timing of new investment in land/construction will be critical for working capital management
- Covenant headroom, particularly related to cash flow; could be limited in the next one to three years

Recent Research

- *Fitch: Liquidity Risks Remain for W. European Constructors & Homebuilders (July 2009)*
- *Fitch: False Dawn for UK Housing Market (October 2009)*
- *Fitch Upgrades Taylor Wimpey to 'B'; Off RWP; Outlook Stable (August 2009)*
- *Fitch: Site Openings and Restocking Present New Risks for UK House Builders (July 2009)*
- *Fitch: Weak Conditions to Limit De-leveraging at UK housebuilders (May 2009)*

Based on an expectation of a contined weakening in order-books, Fitch is forecasting an average 5% to 10% annual fall in construction revenues until 2011, and a shift in average construction EBITDAR margins to about 4% in 2010-2011 from 6% in 2008.

Although lending (including bond issuance) to the European construction sector will likely remain tightly rationed during 2010, refinancing risks remain relatively low for the majors given their good access to back-up liquidity, including cash and committed undrawn lines and continuing support from relationship banks. Nevertheless, if the rationing of credit persists into late-2010 — in combination with an expected drop in construction cash generation — this could increase pressure on ratings in the sector.

UK Housebuilders

Fitch's 2010 credit outlook for UK housebuilders also remains negative. Certain companies in the industry may be unable to generate sufficient cash flow to meet large debt repayments due in 2011 and 2012. This is the result of continuing poor market conditions, despite some early signs that the market may be stabilising after the severe downturn of 2008 and H109.

A quick and sustainable improvement in UK housing conditions is unlikely, and this will restrict the potential for rating upgrades. The main economic indicators point towards a period of stagnation at best, or at worst a "double-dip" contraction in house prices.

Fitch expects UK house prices to fall by 25% overall from the October 2007 peak, Prices have currently fallen 13% from the peak(including the impact of the recent pick up in prices). Despite signs of stabilisation in H209, economic indicators such as unemployment, housing affordability and mortgage lending suggest further weakness for the next one-to-three years.

The 56,215 mortgage approvals in the month of September 2009 was 68% higher than in the same month of 2008, but 44% lower than in September 2007 when 100,095 mortgages were approved. A rise in interest rates, combined with rising unemployment, could also threaten a housing recovery. Over 66% of UK mortgage borrowers are now on floating-rate mortgages, compared with 48% in August 2008, and their ability to service existing mortgage debt — as well as their ability to borrow — would be adversely affected by any hike in interest rates.

While UK housebuilders have been de-stocking in 9M09 and repaying debt from FCF generation, this has now slowed as stocks of completed units have run out. Fitch believes UK housebuilders' cash generation will be anaemic in the next two years, reflecting the slowing down of positive working capital movements. The agency estimates average CFO to sales in the sector will decline to less than 7.5% in 2010 compared with an estimated 10.0% in 2009. As such, rating upgrades will remain limited for at least the next two years. This may be the case for Taylor Wimpey plc ('B'/Stable), one of the UK's two largest housebuilders, whose cash flow generation between 2010 to 2012 may not be sufficient to repay outstanding debt (GBP750m at FYE09).

The agency also estimates that the UK housebuilding sector faces a high concentration of debt maturities of up to GBP7.0bn in 2011-2012, even after large share rights issues of GBP1.7bn in aggregate between February and September 2009. A key rating driver for the agency will be the ability of housebuilders to reduce their current over-leverage and repair balance sheets. However, it is unlikely that housebuilders will reduce debt quickly enough to repay 2011-2012 debt maturities from internal resources without a significant improvement in market conditions, substantial asset disposals, and/or additional equity-raising. The sector could also face significant refinancing risks in 2011-2012.

The timing of new investment in active sites, and significant purchases of land, will be a sensitive decision for UK housebuilders in uncertain markets. While housebuilders will have to re-invest in land and development at some stage, it will be important to time the cycle correctly. If the timing is not right, housebuilders could be stuck with increasing (potentially debt-funded) working capital requirements, only to find that market conditions remain weak.

Covenant headroom, although relaxed or amended by many lenders over 2009, may be limited in the next one-to-three years. Although liquidity in the sector has improved as banks have preferred to restructure debt rather than foreclose on loans, liquidity concerns could return if covenant compliance once again becomes problematic.

Fitch remains concerned about the weak credit quality of the leveraged UK housebuilders. Within the agency's shadow rating portfolio, Long-Term IDRs range between 'B+*' and 'CC*'. Some of these shadow-rated companies have had to restructure their debt in 2009, but are still suffering from a severe fall in revenue and profitability. The majority are either on RWN or have a negative outlook.

Appendix A

Industrial Sectors

Sector	Key Trends	Rating Outlook
Manufacturing		
Automotive Manufacturer	• Payback effect from scrapping incentives in several markets partially offsetting brighter growth prospects in several emerging regions • Continuous pressure on price and product mix • Structural overcapacity and difficulty to restructure on the back of social and political pressure • Lower refinancing risk • Limited cuts in R&D and capex to cope with continuously stricter environmental legislation, and maintain long-term product plans	Negative
Auto Suppliers	• Depressed vehicle production volumes likely to continue as state incentives for new cars are phased out; any recovery of the industry's weak profitability levels expected to be slow and modest • Challenging industry conditions will lead to continued elevated level of insolvencies, particularly affecting vulnerable tier-2/tier-3 suppliers with limited financial flexibility • Further sector consolidation expected • Longer-term prospects remain good for suppliers with strong positions in growth areas such as environmental-friendly technologies and electronics	Negative
Aerospace & Defence	• Commercial aircraft OEM market to show low order intake, and remain somewhat vulnerable to cancellations amid weakness in airline industry • European defence budgets remaining flat • Certain sectors — like defence electronics and after-sales maintenance — experiencing faster growth • Pan-European consolidation continuing slowly at tier-2 level, however cross-border collaboration still limited to JVs and partnerships • Access improving to the large and desirable US defence market for some European companies, but pricing environment remains challenging • Liquidity remains strong at most companies	Stable
Capital Goods/ Diversified Manufacturing	• Restructuring measures, cost-control and product/geographical diversification have allowed most companies to weather the economic slowdown in 2009 relatively well • End-market demand will continue to recover, albeit slowly, with improving credit metrics expected • The speed of recovery will vary by sub-sector, with a stronger recovery in 2010 expected for companies exposed to short-cycle markets and/or with a good exposure to growing emerging markets • Even with improving conditions, cash flows could be pressured by weak pricing, a possible reversal of positive working capital trends seen in 2009, and increased capex • Shareholder-friendly action may return, including increased dividends and debt-funded M&A activity • Strong corporate liquidity persists across the sector	Stable
Basic Materials		
Building Materials	• Western European construction markets still under pressure. Stabilisation in US construction also aided by increased impact from positive infrastructure spending. Growth expectations in emerging countries remain positive • Expectation of gradual improvement in credit metrics thanks to cash preservation measures undertaken during 2009. Liquidity expected to remain satisfactory, as access to debt capital markets has been recurrent • Average FCF margin expected to be positive — thanks to capex curbs • Issuers reliant on divestments to reduce debt levels will continue to face challenging M&A markets	Negative
Chemicals	• Modest demand, with diverging regional trends; growth momentum to be driven by emerging economies with anaemic trends in mature markets, in line with economic prospects • Resurgence of inflationary trends and volatility in feedstock costs could put pressure on margins, particularly if not supported by demand • Petrochemicals will remain under pressure, with new low-cost capacity ramping up in the Middle East and Asia in 2010 • Operating rates, earnings and cash flow generation will improve from the record low base of 2009, aided by stronger demand and ongoing restructuring measures • Working capital relief observed across the sector in 2009 will not be repeated • Conservative stance on financial policies to be maintained; M&A activity likely to remain subdued, although bolt-on acquisitions could be on the rise; strategic focus will remain on partnerships in high-growth/low-cost regions	Negative

Industrial Sectors (cont.)

Sector	Key Trends	Rating Outlook
Steel	• Weak recovery in real demand. Apparent consumption to increase roughly in line with real demand • Steel production volumes in western Europe to increase by 15%-20% yoy • Higher raw material input costs creates some "cost-push" pressure to prices, but limited by weak real demand. Risk of higher imports into western Europe will also limit price increases • CIS producers were able to recovery capacity utilisation to 90% in Q3-Q409 due to significant export sales • Revenue growth in 2010 of CIS steel producers is constrained by high capacity utilisation (90%) achieved in Q3-Q409. The credit outlook remains challenged due to the low profitability of producers' overseas operations, substantial leverage, and liquidity constraints for some issuers	Negative
Mining	• Strong Chinese demand growth in 2009: the key to demand in 2010 shifts to a recovery in mature advanced economies (MAEs) • Strong price environment expected in 2010 for steelmaking raw materials. Prices for base metals to average more than in 2009, but some moderation from Q4 2004 spot levels could occur • Diversified mining companies to continue to perform comparatively better than single-commodity producers • Mining cost inflation (eg diesel fuel, explosives) to recommence • 2010 EBITDAR margins of CIS mining companies producing steelmaking raw materials is expected to grow by 20%-30%, due to appreciation of prices and tough supply	Stable
Paper & Forest Products	• Profitability and cash flow generation to moderately improve yoy on the back of a modest rise in demand • Rising input costs could partly offset the benefit of restructuring measures, as structural weaknesses remain • Further capacity rationalisation could be needed to support prices and preserve margins • Downside supply-driven overcapacity risk in the packaging sub-sector • Conservative stance on capex and dividend spending expected to be maintained	Negative
Construction and Property		
Construction	• Negative outlook for western European housebuilders – given higher leverage, falling earnings, and possible covenant breaches • Western European construction majors showing few signs of weakening, but negative pressure mounting • Debt restructuring increasingly likely for some western European house-building LBOs • Stable outlook for GCC construction and property companies – given the state involvement for many Fitch-rated issuers	Negative
UK Housebuilders	• Negative outlook for UK housebuilders due to poor market conditions, insufficient cash flow generation and high leverage • Although the UK market is now improving, unemployment levels and credit availability remain major negative credit factors • High level of debt maturities in 2011 and 2012 point to significant refinancing risk • Tight cash flow covenants leave limited headroom for new build • Timing of investment in new sites and construction will be critical, particularly if "double-dip" recession scenario pertains	Negative
Property	• Overall stable outlook for UK and European REITs and PICs, due to stabilised interest serviceability and leverage • Liquidity in sector remains comfortable, with modest short-term debt maturities in FY10 • There is a general trend towards bank deleveraging by reducing real estate exposure, which could create a funding gap when substantial debt facilities mature in 2011 • In the UK, any fall in rents and values in 2010 will not lead to breaches of covenants or put rating headroom under pressure • Stable outlook for Swiss property companies, with the local market in a balance between supply and demand • Overall negative outlook for central European markets, with a reduction in rents due to discounts for tenants. Weak macroeconomic environment may put further pressure on rents – and hence values – in 2010	Stable

Source: Fitch

Appendix B

Fitch Ratings EMEA Industrial Corporate Ratings
(as of 17 February 2010)

Issuer name	Market Sector	Long-Term IDR	Rating Outlook/Watch
Manufacturing			
Thales SA	Aerospace & defense	A-	Negative
Rolls-Royce Group plc	Aerospace & defense	A-	Stable
EADS	Aerospace & defense	BBB+	Stable
BAE Systems plc	Aerospace & defense	BBB+	Stable
Finmeccanica SpA	Aerospace & defense	BBB+	Stable
Sukhoi Civil Aircraft JSC	Aerospace & defense	BB	Stable
Peugeot S.A	Automotive manufacturer	BB+	Negative
AB Volvo	Automotive manufacturer	BBB-	Negative
Volkswagen Group	Automotive manufacturer	BBB+	Stable
Daimler AG	Automotive manufacturer	BBB+	Negative
Renault SA	Automotive manufacturer	BB	Negative
Fiat S.p.A.	Automotive manufacturer	BB+	Negative
Compagnie Generale des Etablissements Michelin	Auto suppliers	BBB-	Stable
GKN Holdings PLC	Auto suppliers	BB+	Stable
Continental AG	Auto suppliers	B+	Stable
Robert Bosch GmbH	Auto suppliers	n.a.	
Schneider Electric SA	Capital goods	A-	Rating Watch Negative
ABB Ltd	Capital goods	BBB+	Positive
AB Electrolux	Capital goods	BBB-	Negative
Legrand SA	Capital goods	BBB	Stable
GEA Group Aktiengesellschaft	Capital goods	BBB-	Stable
Arcelik	Capital goods	BB-	Positive
Vestel Elektronik Sanayi Ve Ticaret A.S.	Capital goods	B	Stable
Siemens AG	Diversified manufacturing	A+	Stable
Adolf Wurth GmbH & Co KG	Diversified manufacturing	A-	Negative
Royal Philips Electronics	Diversified manufacturing	A-	Stable
ThyssenKrupp AG	Diversified manufacturing	BBB-	Negative
Interpipe Limited	Diversified manufacturing	RD	
Merinos Hali Sanayi ve Ticaret A.S.	Diversified manufacturing	B	Negative
Dogus Holding A.S.	Diversified services	BB-	Negative
Mubadala Development Company PJSC	Diversified services	AA	Stable
Basic materials			
Compagnie de Saint-Gobain	Building materials	BBB+	Negative
CRH Plc	Building materials	BBB+	Negative
Holcim Ltd.	Building materials	BBB	Stable
Lafarge SA	Building materials	BBB-	Negative
HeidelbergCement AG	Building materials	BB-	Positive
Pfleiderer AG	Building materials	B	Rating Watch Negative
BASF SE	Chemicals	A+	Negative
Saudi Basic Industries Corporation (SABIC)	Chemicals	A+	Stable
Solvay SA	Chemicals	A-	Negative
Royal DSM N.V.	Chemicals	A-	Negative
Akzo Nobel N.V.	Chemicals	BBB+	Stable
Lanxess AG	Chemicals	BBB	Stable
JSC SIBUR Holding	Chemicals	BB	Stable
OJSC EuroChem Mineral and Chemical Company	Chemicals	BB	Negative
Petkim Petrokimya Holdings A.S.	Chemicals	BB-	Negative
Rhodia SA	Chemicals	BB-	Negative
OAO Nizhnekamskneftekhim	Chemicals	B	Rating Watch Negative
Cognis GmBH	Chemicals	B	Negative
OJSC Kazanorgsintez	Chemicals	RD	

Fitch Ratings EMEA Industrial Corporate Ratings (cont.)

(as of 17 February 2010)

Issuer name	Market Sector	Long-Term IDR	Rating Outlook/Watch
Rio Tinto Plc	Metals & mining	A-	Stable
Norilsk Nickel	Metals & mining	BBB-	Stable
Harmony Gold Mining Company Limited	Metals & mining	BB	Stable
Anglo American plc	Metals & mining	BBB+	Stable
ArcelorMittal S.A.	Metals & mining	BBB	Negative
OJSC Novolipetsk Steel (NLMK)	Metals & mining	BB+	Stable
OAO Severstal	Metals & mining	B+	Negative
OJSC Magnitogorsk Iron & Steel Works (MMK)	Metals & mining	BB	Stable
Evraz Group SA	Metals & mining	B+	Rating Watch Negative
Habas Sinai ve Tibbi Gazlar Istihsal Endustrisi A.S.	Metals & mining	B+	Stable
OJSC Raspadskaya	Metals & mining	B+	Stable
PJSC Azovstal Iron and Steel Works	Metals & mining	B-	Negative
METINVEST B.V.	Metals & mining	B-	Negative
GAP Guneydogu Tekstil San. Ve Tic. A.S	Other	n.a.	
Calik Holding	Other	B-	Negative
Stora Enso Oyj	Paper & forest products	BB	Negative
UPM-Kymmene Oy	Paper & forest products	BB-	Stable
Smurfit Kappa Group Plc	Paper & forest products	BB	Stable
Construction and property			
Bouygues SA	Construction	BBB+	Negative
Obrascon Huarte Lain SA (OHL)	Construction	BB-	Negative
OJSC LSR Group	Construction	B-	Negative
Taylor Wimpey plc	Construction	B	Stable
Tourism Development & Investment Company (TDIC)	Construction	AA	Stable
Dubai Holding Commercial Operations Group LLC	Property/real estate	B+	Rating Watch Negative
SEGRO PLC	Property/real estate	BBB+	Stable
PSP Swiss Property AG	Property/real estate	BBB+	Stable
Qatar Real Estate Investment Co. Q.S.C.	Property/real estate	BBB+	Rating Watch Positive
Hammerson plc	Property/real estate	BBB	Stable
British Land Company Plc (The)	Property/real estate	BBB	Stable
Atrium European Real Estate Limited	Property/real estate	BB-	Stable

Source: Fitch