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22 June 2011

Business risk downgrades worse than during global crisis

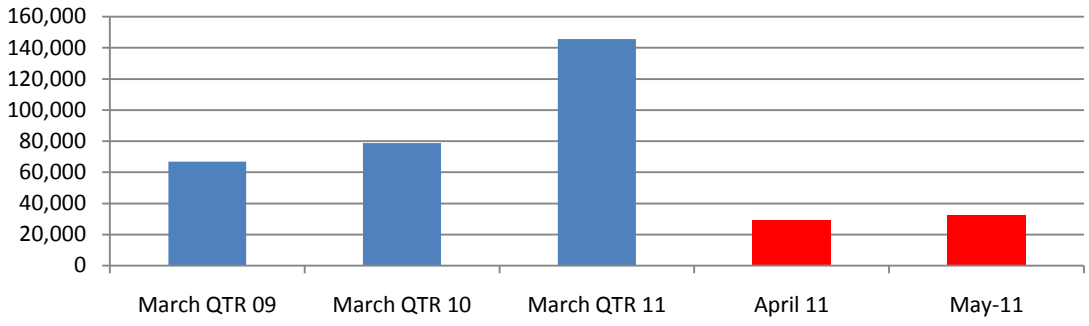
More than 145,000 businesses suffered a risk downgrade in the March quarter 2011 as rising payment terms and a weaker than expected outlook for sales and profits put pressure on cash flow. And in a sign that the risk outlook for many businesses will deteriorate further interim results for the June quarter 2011 reveal more than 62,000 firms were downgraded in April and May.

These are the findings from Dun & Bradstreet's *Corporate Health Watch* that examines the risk profile of Australian firms. Dun & Bradstreet provides risk ratings on more than 195 million companies around the world, including three million credit active entities in Australia.

Dun & Bradstreet's *Dynamic Risk Score* predicts the likelihood of a firm experiencing financial distress over the next twelve months and the latest research examines the number of firms that have experienced deterioration in their score during the March quarter 2011 and interim results for the first two months of the June quarter 2011.

The latest data reveals that the number of downgrades in the March quarter 2011 was 75 percent higher than at the same time last year and nearly 125 percent higher than the number of downgrades that occurred during the Global Financial Crisis (GFC). The March 2011 downgrades coincide with rising business payment terms that have now peaked at three year highs and declining expectations for sales and profits all of which are impacting business cash flow and increasing the risk profile of many firms.

The data also reveals that the forestry and manufacturing industries were hit with the highest number of downgrades and that older firms fared worst than younger firms. The Northern Territory, Victoria and South Australia were the worst performing states.



Deteriorating risk scores by quarter, March 2009 – March 2011
Incl. Interim results April-May

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Sector

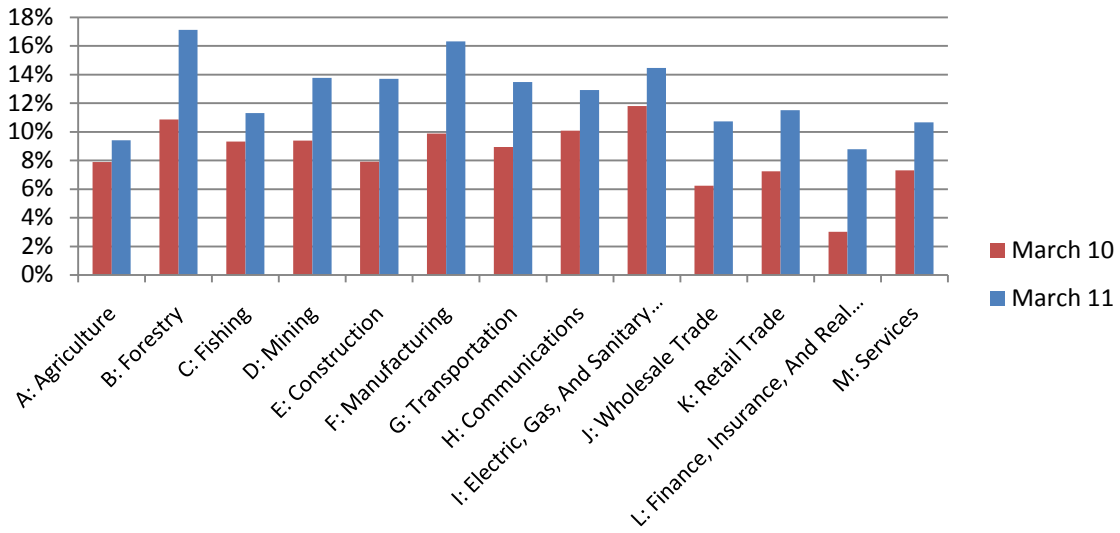
The forestry sector had the largest number of downgrades with 17 percent of firms suffering deterioration in their risk profile. The manufacturing sector was also one of the more volatile industries, with 16 percent of businesses in this sector receiving downgrades during the March quarter.

The construction sector had a 75 percent jump in the number of businesses downgraded during the March quarter 2011, compared with the same period in 2010. The number of firms suffering a downgrade in this sector jumped to 13.7 percent in the March quarter 2011 from just under 8 percent a year ago.

Likewise, a significant percentage of businesses in the transportation and retail industries were at greater risk of financial distress than 12 months ago. Transportation rose to 13 percent from 9 percent in first quarter 2010, while retail downgrades rose to 12 percent from 7 percent in first quarter 2010.

While no individual sector has seen its risk profile improve in the last twelve months, industries such as agriculture and the electric, gas and sanitary services have remained relatively stable since 2010.

The downgrades have continued throughout the first half of the June quarter 2011 with 29,100 firms downgraded in April and 32,656 firms downgraded in May. In recent months it has been the mining sector that has experienced a deteriorating risk outlook, with the number of firms suffering a downgrade in that sector in May jumping to over 11 percent compared with just 3.5 percent in May last year.



Deteriorating risk score by industry first quarter 2010-2011

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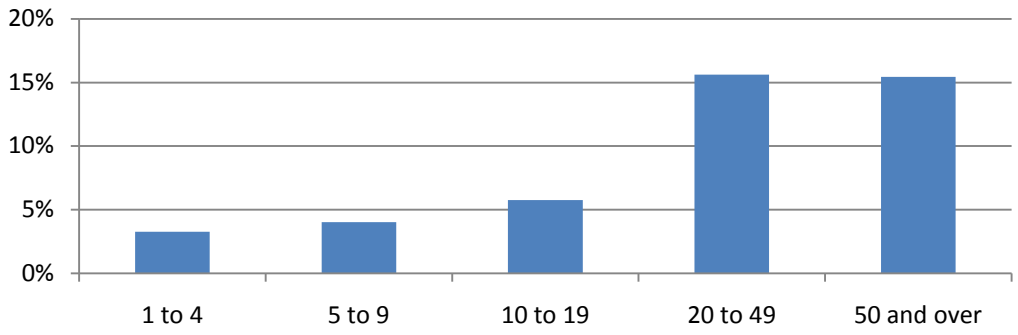
Age

Surprisingly, it was the more established businesses that experienced difficulties during the March quarter, rather than new starters. Sixteen percent of businesses aged between 20 and 49 years saw their risk rating deteriorate while 15 percent of businesses aged 50 years and over were also downgraded.

The number of older businesses downgraded has tripled in the 12 months to the end of March, signalling that seemingly secure businesses, many of which managed to survive economic shocks over the last two decades, are not coping with the multi-speed economy as well as could be expected.



Risk downgrades by age March quarter 2011

Location

Businesses operating in the Northern Territory, Victoria, South Australia and Tasmania recorded the worst deterioration of risk scores over the last 12 months, with the Northern Territory the country's most precarious commercial market during the March quarter 2011.

Downgrades in Western Australian rose only minimally since the first quarter of 2010 reflecting the robust outlook for that state. However, the rising number of downgrades in the mining sector revealed in the April and May 2011 interim results is a reminder of the inherent risk for a state dominated by firms requiring large capital injections years before a return may be realised.

Company type

More public companies were downgraded than private firms with over 15 percent of public companies downgraded during the March quarter. This trend has continued into May with almost 30 percent of public companies downgraded, up from 7 percent the month before and just 4 percent in May 2010.

The risk downgrades coincide with the failure of more than 2,300 firms in the March quarter 2011; a figure that is on pace with 2010 in which there was a 23 percent jump

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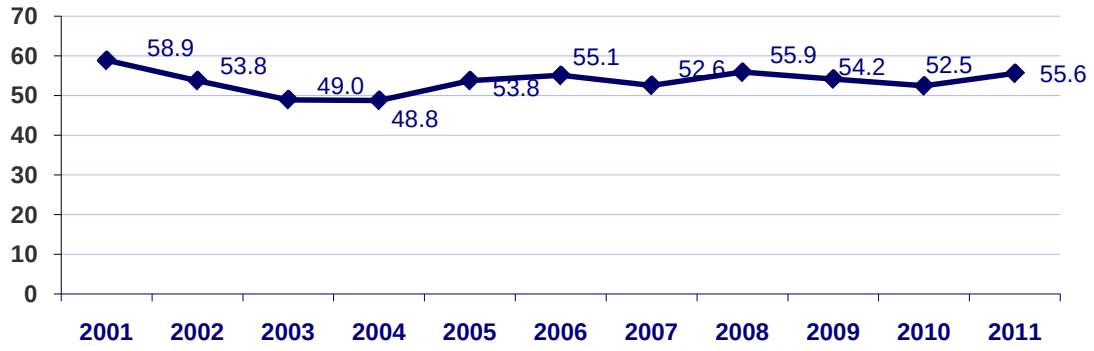
year on year in business failures. During the same period average payment terms rose to 55.6 days; the highest level in three years and the second highest in a decade.



Average payment terms year on year

Dun & Bradstreet CEO Christine Christian argues that the latest risk data is a reminder that firm level risk is closely associated with business management fundamentals rather than simply related to the macroeconomic outlook. Indeed, a strong economic environment can heighten a firm's risk profile as rapid expansion places pressure on cash flow.

"Almost exclusively business failure is a result of poor credit risk and negative cash flow. These factors are the primary cause of insolvency and can occur at any time regardless of the macroeconomic outlook", said Ms Christian.

"It is a reminder of the need for firms to pay attention to the fundamentals particularly at times when rapid growth places pressure on a firm's cash flow."

About D&B

Dun & Bradstreet is the world's leading provider of credit, marketing and purchasing information and receivables management services.

D&B manages the world's most valuable commercial database with information on more than 195 million companies, including 3 million in Australia, and millions of consumers. The database is refreshed more than 1.5 million times daily as part of D&B's commitment to provide accurate, comprehensive information for its more than 150,000 customers.

D&B's data provides insights which improve business decision-making and outcomes.

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