Experian Business Debt Index (BDI) Results. Q3 2015

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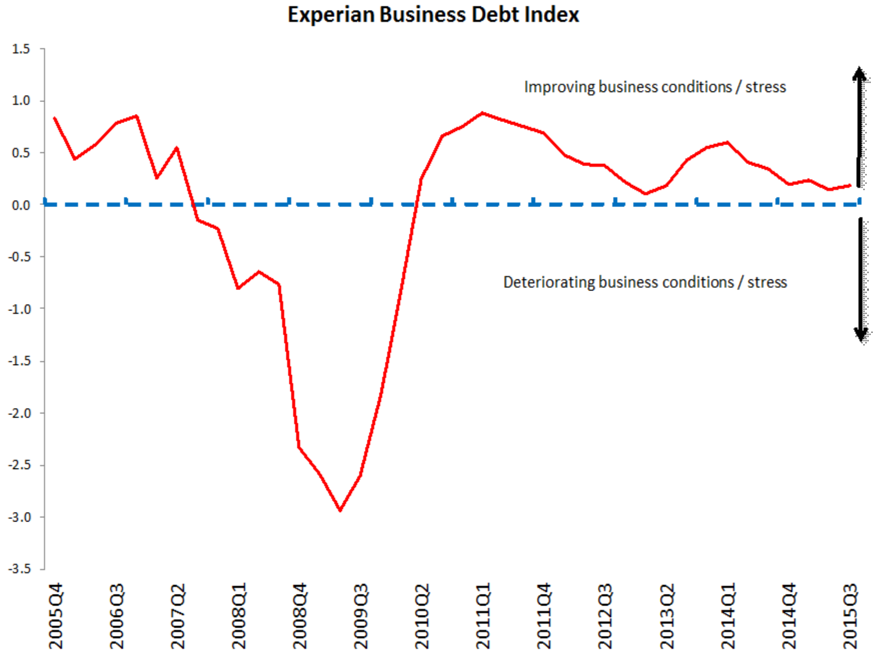
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q3 2015

Financial health of businesses records slight improvement in Q3 2015

Chart 1



	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015
Index >0= Improving business conditions <0 = Deteriorating business conditions	0.344*	0.197*	0.230*	0.144*	0.188

* *Revised*

Outcome for Q3 2015

The Experian Business Debt Index (BDI) for the 3rd quarter of 2015 posted a slight improvement, to a reading of 0.1884, from 0.1443 in the 2nd quarter.

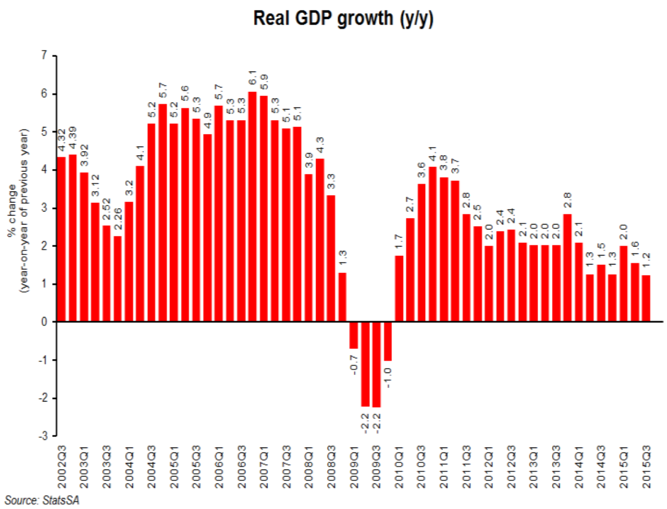
With the exception of the 1st quarter of 2013, the BDI for the 2nd quarter of 2015 was the weakest level for the index since the economy extricated itself from recession in 2010. The gradual deterioration in the BDI from the beginning of 2014 onwards had not been surprising given the deterioration in overall economic conditions in the country, starting with the debilitating platinum mining strike, which kicked off in January 2014.

Softer economic conditions implied an increasing number of businesses were coming under financial pressure and therefore finding it ever more difficult to meet their debt commitments timeously.

Despite the perceptions that economic activity has carried on weakening to the present, a further deterioration expected for the BDI in the 3rd quarter did not transpire. Instead, the index recorded a slight improvement. Even though the q-o-q seasonally adjusted growth in GDP of the economy succeeded in improving to 0.7% in the 3rd quarter from -1.4% in the

2nd quarter, with the economy avoiding an outright technical recession, interpretation of the GDP figures was nonetheless that the economy was still woefully weak. Y-o-y growth weakened to 1.2% in the 3rd quarter from 1.6% in the 2nd quarter of 2015 (see chart below).

Chart 2



If one examines the sectoral breakdown of economic growth in the 3rd quarter, however, one recognises that the overall GDP figure in the 3rd quarter was dragged down quite heavily by three specific sectors, viz. the drought-ridden agricultural sector, mining and electricity, with q-o-q seasonally adjusted growth rates of -12.6%, -9.8% and -8.0% respectively.

Excluding agriculture and mining, q-o-q seasonally adjusted and annualised growth actually improved significantly in the 3rd quarter, to 2.2%, from -0.4% in the 2nd quarter. The 3rd quarter growth rate excluding the primary sectors was in fact the second best for any quarter in the past two years.

There was a particularly robust improvement, albeit in part for statistical reasons, in manufacturing (from -6.3% growth in the 2nd quarter, to 6.2% in the 3rd quarter) and there was also a fairly strong improvement in the retail and wholesale trade, restaurants and accommodation sector (from -0.6% growth in the 2nd quarter, to 2.5% in the 3rd quarter).

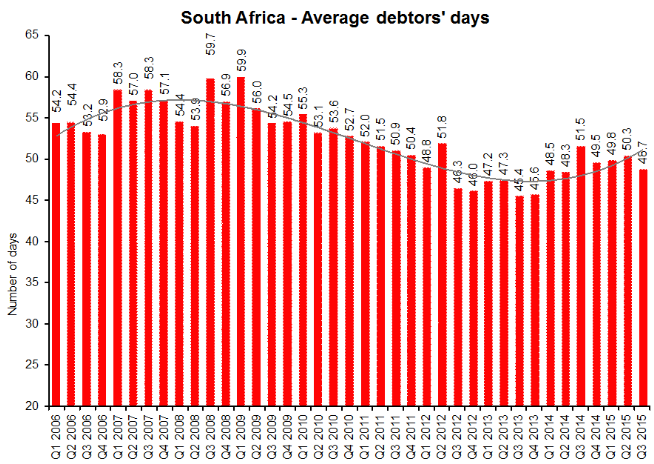
Interestingly, together with transport and communication (which recorded marginal growth in both the 2nd and 3rd quarters), these represent the most important sectors from which data on outstanding debts are sourced. Together, the three sectors account for almost 70% of the companies on which data on outstanding business debts are recorded.

Business debt metrics in Q3 2015

Given the fact that the manufacturing and retail sectors recorded significant improvements in growth in the 3rd quarter and they are dominant in terms of the number of companies with outstanding debtors, it follows that one should not be surprised at the fact that the data on outstanding debts improved somewhat in the 3rd quarter.

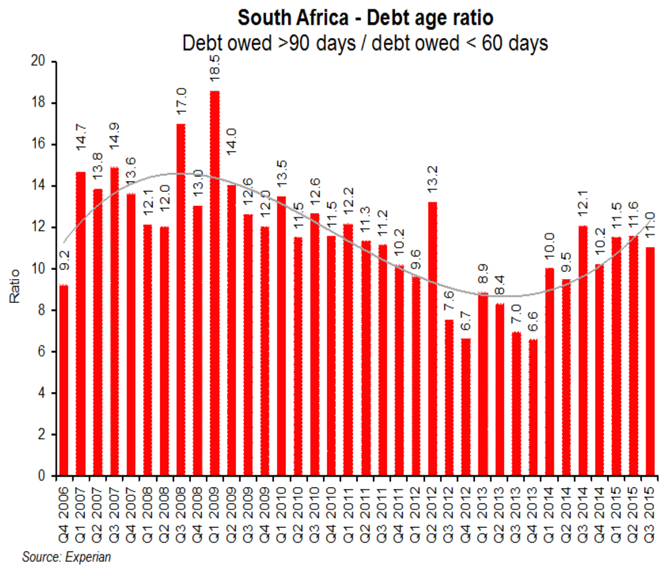
After rising from a low point of 45.4 average debtors' days outstanding in the 3rd quarter of 2013, to around 50 days in the previous four quarters during tough economic times, the 3rd quarter witnessed a welcome reduction in outstanding debtors' days to an average of 48.7, from 50.3 in the 2nd quarter.

Chart 3



This pattern was mirrored in a corresponding decline in the ratio of outstanding debts of more than 90 days relative to outstanding debts of less than 60 days, from 11.6% to 11.0% between the 2nd and 3rd quarters.

Chart 4



Similarly, the ratio of outstanding debts of between 30 and 60 days to debts owed of less than 30 days, declined from 19.6% in the 2nd quarter, to 16.6% in the 3rd quarter.

In fact, the latter figure was encouragingly the lowest such ratio recorded ever since the data series started being collected in 2006.

BDI by sector

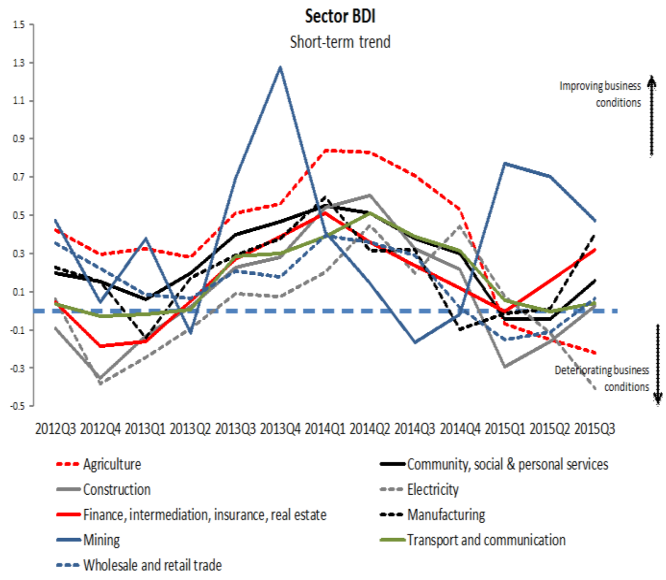
It is apparent, therefore, that there was a modest improvement in business debt conditions in the 3rd quarter if one excludes the primary sectors (agriculture and mining) and focuses instead on manufacturing, construction and a variety of services sectors.

These circumstances are reflected in the fact that the BDI improved for most sectors with the exception of agriculture, mining and electricity in the 3rd quarter.

It is of course possible to argue that the prognosis of continuing low growth with no meaningful recovery in the economy over the coming year may have encouraged businesses to refrain from stretching themselves financially, refraining from undertaking substantial new investment.

Instead it appears as though they were driven to reduce outstanding debts as much as possible. The prospect of an increase in interest rates might also have encouraged them to tighten their belts and this too may be reflected in the reduction in outstanding debtors' days.

Chart 5



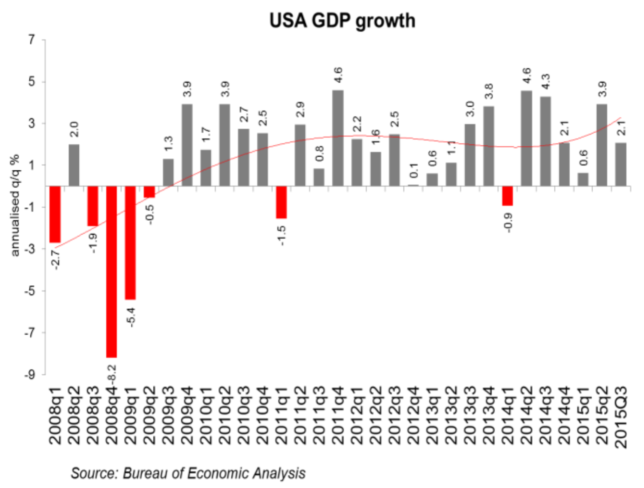
Macroeconomic factors influencing the Q3 2015 BDI

The BDI is of course derived not solely from outstanding debtors' days, but also from a variety of macroeconomic data including economic growth both domestically and internationally, interest rate spreads and the difference between CPI and PPI inflation as a proxy for the ability of businesses to pass on cost increases and retain margin.

Nonetheless, it would appear as if the improvement in the BDI was driven more than anything in the 3rd qtr by the reduction in outstanding debtor days.

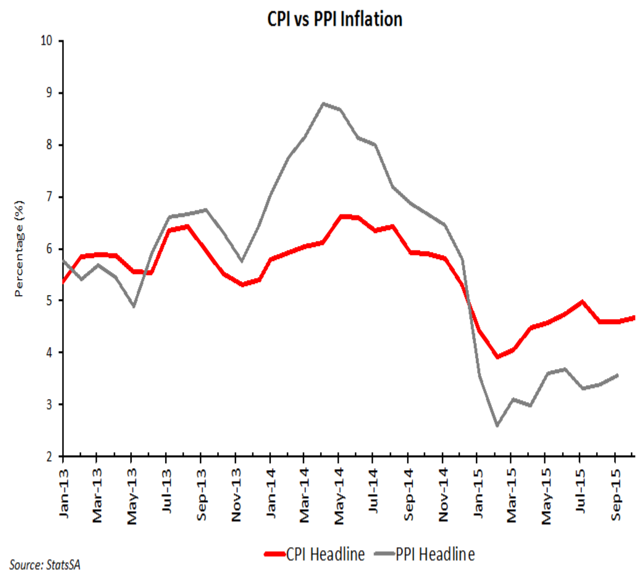
Whilst growth both domestically and overseas slowed slightly on a y-o-y basis, some of the negative impact on the BDI was neutralised by a fall in CPI inflation, which eased some of the erosion of disposable incomes in the economy.

Chart 6



Clearly, a renewed reduction in fuel prices was helpful, whilst the fall in the value of the Rand at the margin may have provided relief to some export-oriented businesses, especially in manufacturing.

Chart 7



Summary and Outlook

The encouraging inference to draw from the improvement in the BDI in the 3rd quarter is that whilst the economy remains very weak, it is not collapsing in any way.

On the contrary, the fact that businesses seem to be ensuring that they remain relatively cash flush and do not incur an unduly stretched debtor profile, is helping them withstand the ravages of low revenue growth.

Nonetheless, on the basis of certain assumptions about economic growth and other macroeconomic indicators, it still appears likely that one will see a further marked deterioration in the rate of improvement in business debt conditions in coming quarters.

Unfortunately, unlike the situation which prevailed during the depths of the global financial recession in 2008/09, there is little hope of any marked turnaround in the deteriorating fortunes of the economy any time soon.

Internationally, commodity prices remained subdued in the context of weak Chinese economic growth and an oversupply of several commodities resulting from a massive wave of investment into new sources of supply over the past decade.

Domestically, there is a lack of major structural reforms of the economy related to education, the labour market, the encouragement of small business activity, deregulation, empowerment practices and the management of parastatal organisations.

It is difficult to believe that there might be an improvement in the country's sustainable growth rate. Under such circumstances, businesses have no option but to adopt a very conservative approach to the management of their finances and to reduce risk taking to a minimum.

On reflection it is interesting to note that, notwithstanding the reduction in the ratios recorded in the 3rd quarter, the escalation over the past two years in the ratio of debts outstanding of more than 90 days relative to those outstanding of less than 60 days has been much more pronounced than that relating to the ratio of debts outstanding of between 30 and 60 days and those of less than 30 days.

This implies that there is indeed a minority of companies that is taking severe strain at present. Such companies are increasingly tardy in meeting their debt commitments as they try to survive in difficult times.

Explanatory notes regarding the Experian Business Debt Index

What is the Experian Business Debt Index?

The Experian Business Debt Index (BDI) is an indicator of the overall health of businesses, as well as the South African economy. It measures the relative ability for business to pay its outstanding suppliers/creditors (i.e. amounts owed to other businesses) on time and tracks macro-economic indicators that can impact on the ability of companies to pay its creditors. A number of debtors and macro-economic variables are combined into a single indicator of business debt stress.

In other words, the BDI is a reflection of the overall health of businesses and the position of debt settlement between businesses in the economy.

How to interpret the index

The index is constructed around a mean value of zero.

Values above zero indicate less business debt stress and values below zero indicate business debt stress.

Given the underlying data of the index, relative higher levels of debt indicate a weakening in the ability to pay outstanding creditors. Higher interest rates result in higher borrowing costs and an increase in business stress. Relatively higher production costs vs consumer cost decrease operating margins of business, while higher domestic and international growth could result in a better trading environment for businesses.

Measured by using principle components

The Experian Business Debt Index (BDI) is constructed using principal components analysis. This is similar to the St. Louis Fed's Financial Stress Index (STLFSI) and the Kansas City Fed's FSI (KCFSI) in the USA. The principal components analysis is a statistical method that is used to extract factors responsible for the co-movement of a group of variables. As such, it is assumed that business stress is the primary factor influencing the co-movement and by extracting the principal components, it is possible to build an index with a useful economic interpretation.

Variables included

The Experian Business Debt Index is made up of Experian business debtors' data and public domain data. Variables include the following:

- 30 – 60 debtor days ratio (debt compared to initial amount invoiced 30 days ago);
- 60 – 90 debtor days ratio (debt compared to initial amount invoiced 60 days ago);
- South Africa consumer inflation and producer inflation spread;
- Interest rate spread (Repo vs US Federal Fund rates);
- Interest rate spread (R157 vs Repo);
- Real SA GDP (year-on-year percentage change);
- Real US GDP (year-on-year percentage change).

No provision is made for any leads or lags in any of the variables.

Methodology used to construct the index

The way the index is constructed is first to demean the individual indices by subtracting the index value from the index average and dividing it by the sample standard deviation (SD). The indices can now be expressed in the same units. Secondly, the method of principal components is used to calculate the coefficients of the variables in the EBSI. These coefficients are scaled so that the standard deviation of the index is 1. Lastly, each of the indices is multiplied by its respective adjusted coefficient.

When the index is updated quarterly, the values of the Experian Business Debt Index can change. This can occur either through a change in the coefficients (an updated re-estimation) or as a result of the change in the actual values of the variables in the original sample. This happens because the data are demeaned and standardised and as a result the value of the original sample will change as the sample mean and sample standard deviation of the variables changes.

About Experian

We are the leading global information services company, providing data and analytical tools to our clients around the world. We help businesses to manage credit risk, prevent fraud, target marketing offers and automate decision making. We also help people to check their credit report and credit score, and protect against identity theft. In 2015, we were named by *Forbes* magazine as one of the 'World's Most Innovative Companies'.

We employ approximately 17,000 people in 38 countries and our corporate headquarters are in Dublin, Ireland, with operational headquarters in Nottingham, UK; California, US; and São Paulo, Brazil.

Experian plc is listed on the London Stock Exchange (EXPN) and is a constituent of the FTSE 100 index. Total revenue for the year ended March 31, 2015, was US$4.8 billion.

To find out more about our company, please visit http://www.experianplc.com or watch our documentary, 'Inside Experian'.

About Econometrix

Econometrix is South Africa's largest independent macro-economic consultancy based in Johannesburg. We are privately owned and therefore totally independent of any official organisation or pressure groups. Econometrix – which has a successful track record of close to 30 years - is committed to on-going research and analysis of economic fundamentals thereby ensuring a sound basis for future business decisions. These services are provided through a range of complimentary products to more than 150 South African and international organisations.

Our approach is to empower our clients with quality decision support intelligence and assistance regarding the economic and financial environment, and assist them in their strategic and financial planning processes. Our in-depth analysis of economic fundamentals aims to assist our clients in commanding the economic environment and in identifying opportunities and risks.

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To be added to the mailing list for the quarterly BDI release please email Taryn.Stanojevic@experian.co.za.

Next release date for the BDI: 18 February 2016

For more detailed analysis on the debt stress by sector, Experian publishes the *Business Debt Overview* report. Please contact Taryn Stanojevic at Experian for more information.