Business Debt Index

Quarterly Summary

Q2 2019

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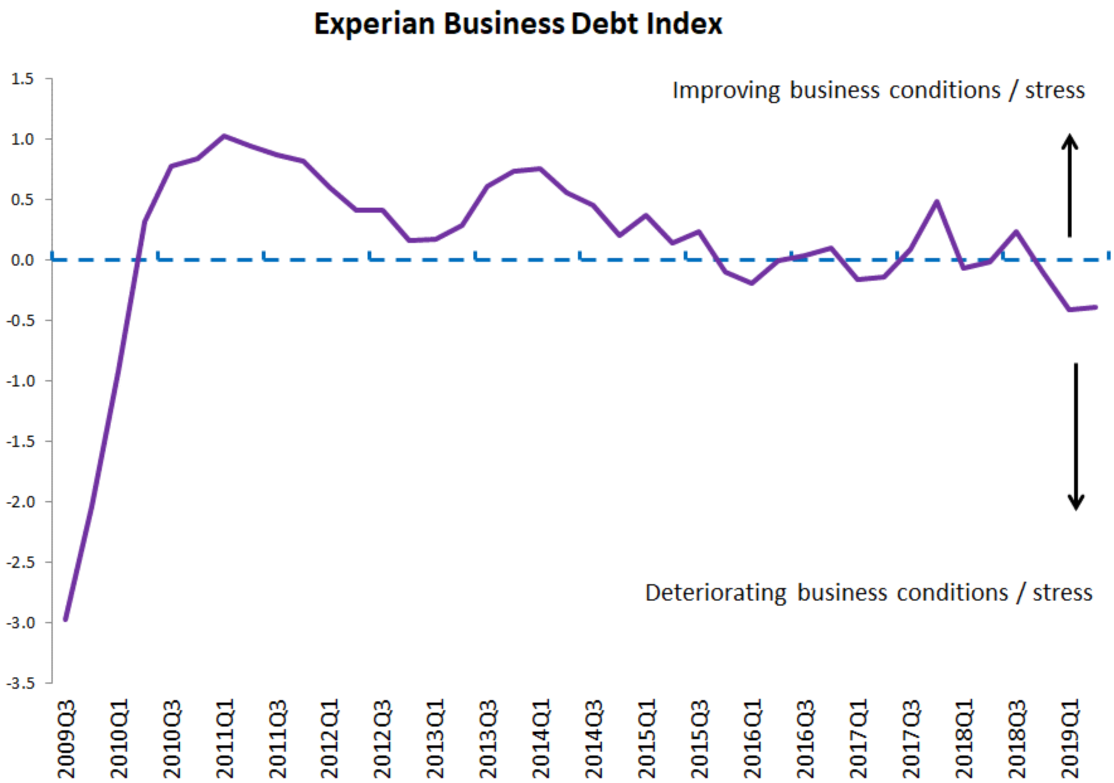
EXPERIAN BUSINESS DEBT INDEX (BDI) RESULTS FOR Q2 2019

BDI reflecting deteriorating business conditions in second quarter of 2019

The Experian Business Debt Index (BDI), which reflects the level of health of businesses in the economy, improved marginally in Q2 compared with Q1, but still reflected a significant deterioration in business debt conditions. The BDI rose to -0.388 from -0.419.

A substantial revision of historical data meant that the Q1 BDI reflected the weakest business debt conditions since the global financial recession in 2009, with the Q2 BDI showing only a very small recovery from Q1. It should be emphasised that a positive reading for the BDI reflects improved business debt conditions and a negative figure, a deterioration. In the context of the BDI of recent years, the BDI readings for Q1 and Q2 do nonetheless reflect a significant worsening of the financial position of companies in South Africa in relation to conditions which had prevailed in recent years.



	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Index >0= Improving business conditions <0 = Deteriorating business conditions	-0.018*	0.228*	-0.099*	-0.419*	-0.388

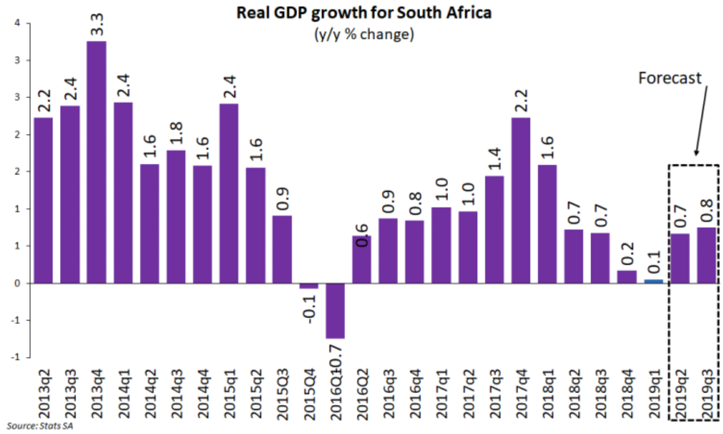
* *Revised*

The latest figures appear to reflect more accurately the pain which cursory evidence of financial conditions in the business sector has exposed over the past year in lagged response to a persistently underperforming domestic economy. The impact on the financial state of companies of poor domestic economic conditions has been further exacerbated by growing signs of a slowdown in the global economy as well.

Macroeconomic factors influencing Q2 2019

Prior to the revision of historical data, both in terms of the macroeconomic indicators and in terms of the number of outstanding debtors' days, the BDI had reflected a marginally positive picture.

However, in the wake of the historical revisions, the deterioration in the BDI in Q1 and Q2 2019 has taken the index down into significantly negative territory. Both the historical macroeconomic inputs, and the historical data on outstanding debtors' days, have been revised downwards for the latest release.

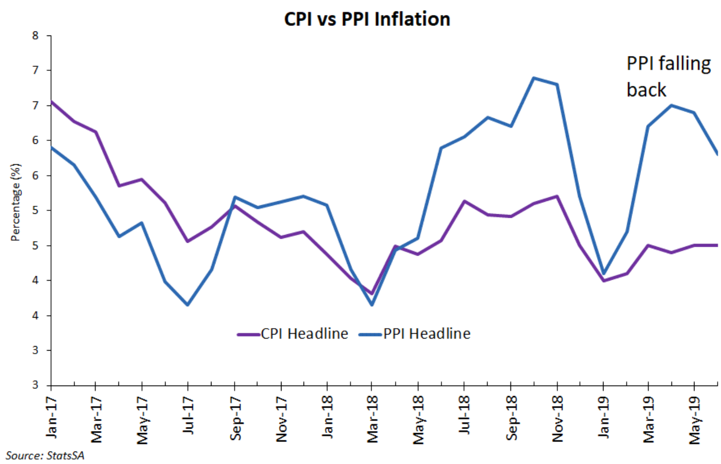


The overall BDI in Q2 2019 was supported by macroeconomic factors, with downward pressure from Experian data regarding debtors' days

Historical revision

Macroeconomically, the main deterioration of inputs relates to South African Q1 GDP, which came in substantially softer than had been estimated in the original calculation of the Q1 BDI. The Q1 GDP q/q annualised growth rate of -3.2% turned out to be considerably worse than virtually all economic forecasts of this outcome. The impact of intensified load-shedding, especially on electricity-intensive sectors such as agriculture, mining and manufacturing, had been generally underestimated in the marketplace, where growth had been expected to come in at no worse than -1.0% to -1.5%.

US GDP also saw some historical revisions, which impacted on data from Q3 2018 through to Q1 2019.



As mentioned, outside of macroeconomic inputs, the downward revision of historical BDI data was also influenced by a substantial upward (deterioration) revision of historical outstanding debtors' days' figures as measured by Experian.

As a result, the historical BDI declined significantly more sharply than would otherwise have been the case, i.e. with only macroeconomic revisions.

Q2 2019

Positive q/q seasonally-adjusted growth in GDP for Q2 2019 is anticipated mainly in light of the fact that the load-shedding that depressed Q1 GDP growth so badly did not occur in Q2. Several of the high frequency monthly data released thus far such as mining, manufacturing and electricity production, as well as wholesale and retail sales, reflect an increase in growth in April and May compared with what had been recorded during the first three months of the year

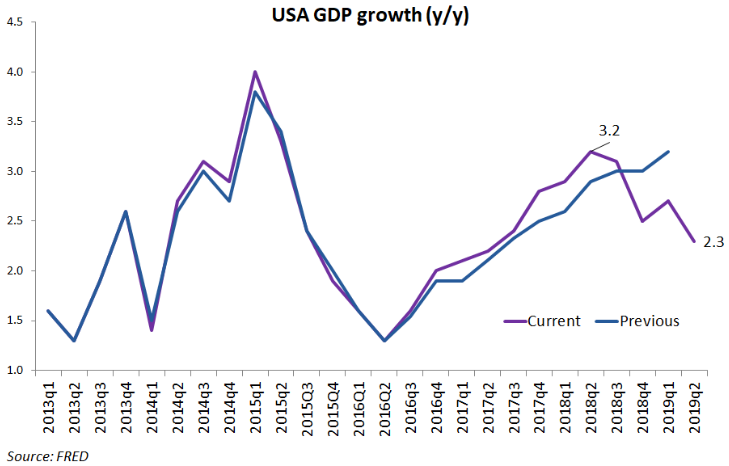
Nonetheless, the extent to which domestic growth turned out to have weakened in Q1 contributed towards generating a BDI which was so negative that the relative improvement in growth anticipated in the BDI in Q2 still leaves the Q2 BDI reflecting a continued substantial deterioration in business debt conditions.

The impact of the other macroeconomic inputs prevented the relative improvement in Q2 compared with the dreadfully disappointing Q1 GDP figure being as strong as might otherwise have been the case.

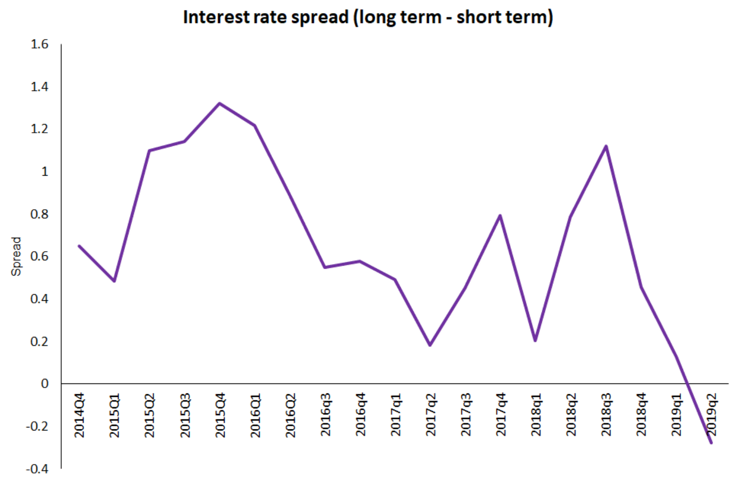
For example, growth in US GDP fell back in Q2 to 2.1% on a q/q annualised basis, from 3.1% in Q1, preventing the recovery in the Q2 BDI. The differential between the PPI and CPI inflation rates increased in Q2, suggesting a squeeze on corporate profit margins. On the interest rate front, long-term interest rates fell quite sharply relative to short-term interest rates, indicative of an increasingly gloomy view of longer-term economic growth conditions.

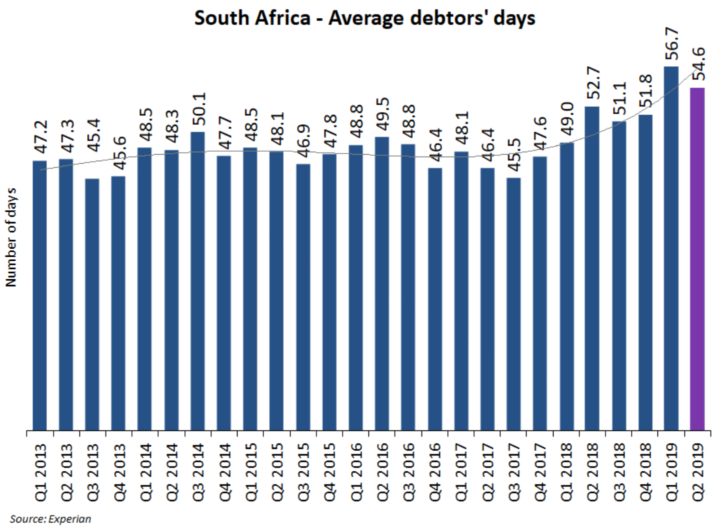
Business debt metrics in Q2 2019

This outcome suggests that business debt conditions as reflected by the number of outstanding debtors' days had been considerably worse than believed a few months ago.



Experian data showed there was another deterioration in the debt age ratios of South African companies

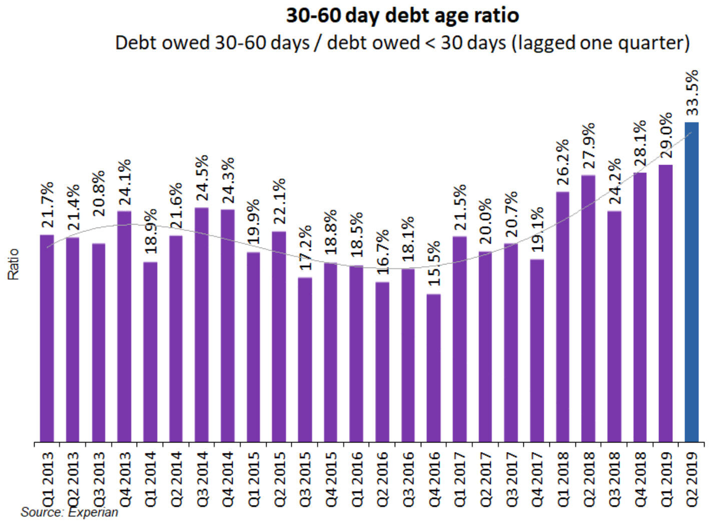




Debtors' days

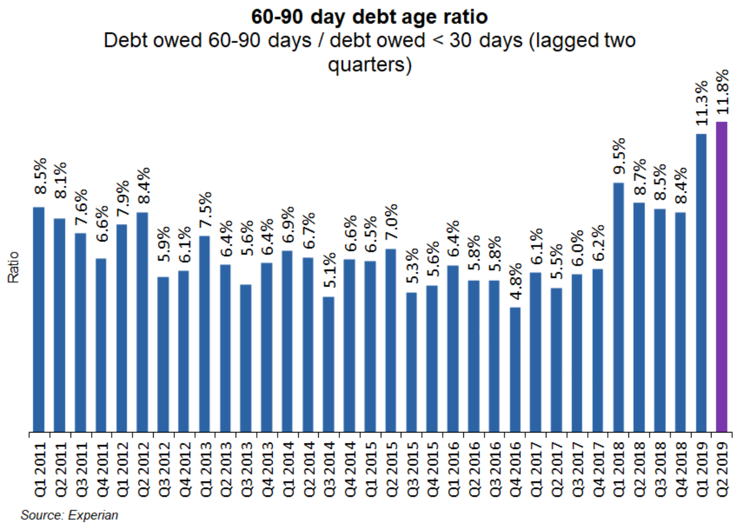
Unfortunately, there was a further deterioration in the number of outstanding debtors' days in Q2 in the latest measurement of these figures.

On the positive side, there was a slight improvement in the average overall number of debtors' days outstanding, to 54.6 days in Q2, from 56.7 days in Q1, but it should be recalled that the latter figure was the highest number of outstanding debtors' days since the global financial recession. The slightly lower Q2 average number of outstanding debtors' days was still the second highest in the past decade



Debt age ratio

The outstanding debtors' days in the 30-60 day ratio[1] increased further to 33.49% in Q2 from 29.03% in Q1. The deterioration in the 60-90 day ratio[2] was less marked, rising to 11.76% in Q2 from 11.33% in Q1.

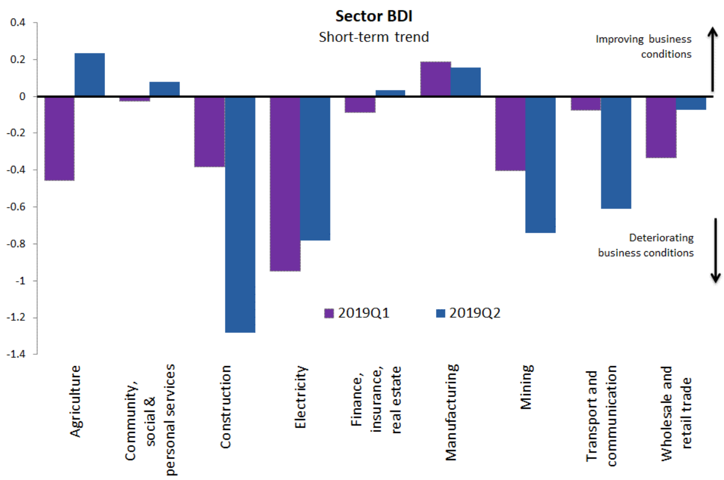


It is apparent that the cumulative effect of weak economic activity extending over several years now, with economic growth less than 1.5% per annum in each of the past four years, has finally begun to compel businesses to hold back from meeting their debt commitments for as long as possible in order to survive.

Severe deterioration in business conditions was reported in the construction sector

BDI by sector

Analysis of the BDI by sector displays considerable variance from sector to sector. The most dramatic improvement was recorded in Q2 in respect of agriculture, in line with a normalisation of domestic agricultural conditions following the severe droughts in the north-eastern regions in 2015/16 and that of the Western Cape in 2017/18. The BDI for agriculture shot up from a heavily negative -0.456 in Q1, to a positive 0.236 in Q2.



[1] *The ratio of outstanding debt owed of 30 to 60 days relative to that owed of less than 30 days lagged by one quarter*

[2] *Outstanding debt owed of 60 to 90 days relative to debt owed of less than 30 days lagged by two quarters*

There was also some improvement in the BDI for the trade (retail and wholesale) sector, which unfortunately still remains negative. The financial sector and community services also saw some improvement, but these were not dramatic.

Business debt conditions remained positive for manufacturing, but slightly less so than in Q1. Whilst business debt conditions in the retail sector remained negative in Q2, they were significantly less so than in Q1.

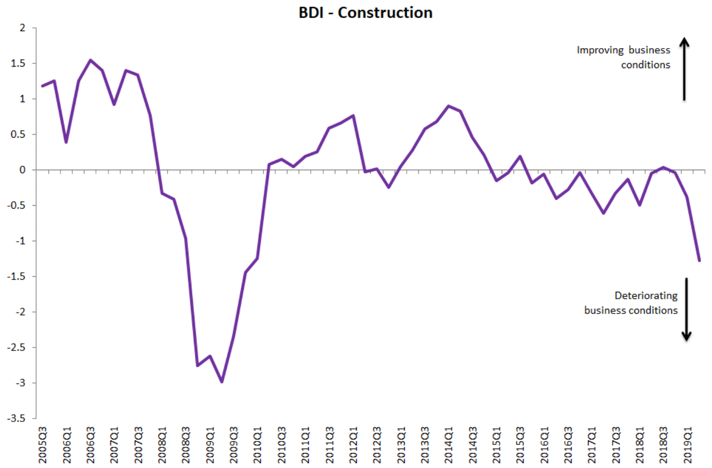
On the other hand, severe deterioration in conditions was reported in the construction sector, where the average number of outstanding debtors' days rocketed to over 90, from levels of around 60 or less in recent years. As a consequence, the BDI for the construction sector fell from an already significantly negative -0.381 in Q1, to a horrific -1.280 in Q2. This is not altogether surprising bearing in mind that three of the country's largest construction companies are on the point of going bankrupt as well as the continuing complaints about the inability of the public authorities to undertake appropriate infrastructural development.

There was also a significant further deterioration in business debt conditions in mining and transport, with both sectors affected negatively by industrial action. Not surprisingly, conditions in the electricity sector continued feeling the pinch of intensified load-shedding in Q1. Business debt conditions in this sector remained negative even if slightly less so than in Q1.

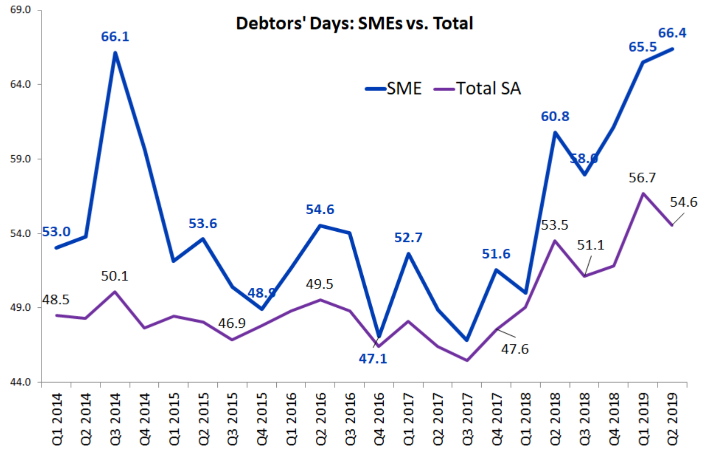
BDI by company size

Whilst the overall debt situation amongst businesses might not have been favourable in the first half of 2019, that of SMEs posted a significant further deterioration.

Whereas the number of outstanding debtors' days on average decreased slightly in Q2, to 54.6, from



The brunt of the weak domestic economic conditions has been borne by small businesses

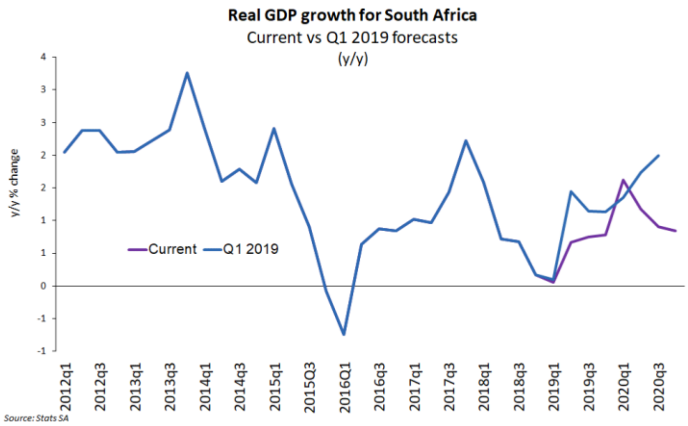


56.7 in Q1, it increased still further in the case of SMEs, with their outstanding debtors' days rising to a record 66.4 in Q2, from 65.5 in Q1 and levels of below 60 a year ago.

It is clear that the complaint about SMEs not being paid timeously by government or big business, is not a myth.

SMEs are struggling to sustain cash flows with which to survive in the face of tardiness on the part of their bigger counterparts to pay them for work done. This cuts across government's avowed goal to public authorities to pay small business suppliers on time.

It is clear that the brunt of the impact of the weakness of domestic economic conditions has been borne by small businesses, with many of these being forced to close down after struggling to remain in operation for as long as possible.



Summary and Outlook

In assessing business debt conditions, one should not be surprised to see the stress being experienced financially. The slump in economic conditions in South Africa experienced since 2014 represents the longest sustained period of economic weakness in almost a century.

Per capita GDP growth will have been negative on average for four consecutive years. Although the slump in economic growth has not taken the economy into deep recession, it has been sufficiently punitive in its duration to be exacting attrition on the ability of businesses, especially smaller ones, to survive.

Even if one were to become more optimistic in forecasting a significant improvement in economic growth over the next few years, business debt conditions are likely to remain under stress for a considerable period of time. It is likely to take a significant while for this stress to be lifted. The BDI reflects this sober outlook for financial conditions in the business sector.

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 their 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 Experian BDI, as an indicator of the overall health of businesses, measures the relative ability of businesses to pay their outstanding creditors on time. It also incorporates trends in macroeconomic indicators, insofar as these impact on the ability of companies to pay their creditors. 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 costs 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 index is constructed by first demeaning the individual indices - 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. Next, 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 because of a change in the actual values of the variables in the sample. Because the data are demeaned and standardised, the value of the original sample will change as the sample mean and sample standard deviation of the underlying variables change.

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 2016, for the third year running, we were named one of the "World's Most Innovative Companies" by Forbes magazine.

We employ approximately 17,000 people in 37 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, 2016, was US$4.6 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 more than 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 complementary 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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Next release date for the BDI: August 2019

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.