

WINTER 2012



Unemployment's up. The Office for Budget Responsibility is cutting growth forecasts We're not building enough houses and the eurozone's in a state of near collapse.

We're all going to hell in a handcart aren't we? Well, perhaps not. Because business failures as yet have not spiked as the macro-economic picture might have predicted. And trade credit for the right companies is readily available.

As CIFS' Underwriting Manager, Neil Payton, explains: 'Since the initial recession of 2008-09, many sound companies have increased their cash balances – albeit at the expense of scaling back their investment plans.

"In addition many have taken advantage of record low interest rates to refinance their business and significantly reduce financing costs.

"...this is no time to be pulling the blanket over our heads."

"The impact of these developments is that many companies are now far better set up to withstand future economic shocks than they were 2-3 years ago.

"No one can pretend that the next 2-3 years will be anything but tough," says Payton, "but this is no time to be pulling the blanket over our heads. Business growth remains achievable and with a positive sales outlook, allied to the credit control infrastructure and procedures in place to allow an agile response to sales opportunities as they arise, perhaps it's not time to panic just yet."



CIFs approach under FT scrutiny
Page 2



Seeing's believing
Page 3



The danger of unintended consequences
Page 4



Blackman on retail
Page 5

CIFS' approach under FT scrutiny



In a recent Financial Times article respected commentator Tony Jackson contrasts the intuitive judgement of market analysts with the more empirical perspective developed for CIFS by Professor Richard Taffler of Warwick Business School. Which do you choose?

Jackson – a former analyst himself – charts the shift in emphasis in his profession from describing current conditions to predicting the future. The focus now is for them to home in on profit forecasts and share price predictions. For some critics this amounts to buying in to a corporate narrative.

Professor Taffler's approach, however, is more credit-based. It asks the question: "How robust are a company's finances in the face of unknown future shocks?" and attempts to answer it by using a sophisticated version

of the Z-score, which seeks out financial characteristics – for example profit in relation to short-term liabilities – among failed companies and compares them with existing firms.

Among some strategists this kind of perspective works best in recessions and bear markets. Jackson makes the point that Taffler's analysis is even now questioning traditional notions of defensiveness. "In the UK.....the most financially robust sector is mining (generally thought to be cyclical). And supposedly non-cyclical (defensive) industries

such as food or electricity are less robust than chemicals or IT hardware."

Of course, CIFS assessments partly rely on historic data which many analysts are sceptical of, but Jackson concludes: "While balance sheet analysis may seem backward looking it has real predictive power in times like these. For while it is no guide to future earnings or dividends it indicates a company's capacity to resist shocks that we cannot yet specify.....They (analysts) should give it a try."

Seeing's believing



Early adopters of CIFS' First Limit system for automatic DL decisions are reporting increasing use as the benefits of the product become increasingly apparent. As a CIFS policyholder now you can access a **FREE First Limit demonstration**

What they say about First Limit:

“The service is extremely easy to use. We get an instant decision – which importantly allows us to trade straightaway – and we’ve had very few requests for limits declined. In current conditions this ability to take on new business quickly and securely is very important to us.”

Sam Grimwood. Credit Controller,
Geaves Surface Solutions.

“We were one of the earliest companies to use the service and now have more than 40 First Limits in place. It’s an excellent addition to the CIFS system.”

Rod Scholes, Director, T Brewer
& Co.

The danger of unintended consequences



If audit requirements for smaller companies are relaxed, the Government may find insurers are no longer able to assess their credit risk accurately. In which case there's a danger cover may be hard to find, warns Bob Lilley. Presumably not what our legislators are seeking to achieve.

Here's a warning for the 36,000 SMEs that the Government is trying to help with its consultation on relaxing audit requirements and their accounting framework: Be careful what you wish for.

This well-intentioned move – part of the coalition's drive to reduce red tape – could result in a restriction of the ability of your suppliers to secure credit insurance cover on your business.

Says CIFS Managing Director Bob Lilley: "The consultation document shows a lack of awareness of the different information available to banks (who can access confidential data) and trade creditors, who are parties to a far greater number of transactions and are hence at greater risk.

"Credit insurers – and credit reference agencies – rely on publicly available data. If that data is to be supplied in less granular detail, our ratings algorithms will have to be re-written – at a cost that's likely to be reflected in insurance premiums – or alternatively insurers will move to restrict their risk exposure by reducing credit limits.

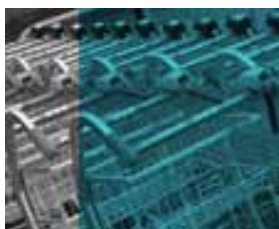
"I can't believe this is what the Government intended when it put forward these proposals. Perhaps, in a more stable environment they could have been introduced less contentiously, but they come at a time of unparalleled economic uncertainty, when the Insolvency Service has been impacted by cutbacks and when the number of prosecutions for fraudulent directors is declining."

Other proposals in the consultation are, however, welcomed by CIFS.

The relaxation of audit requirements for subsidiary companies is a positive step as long as their debts are explicitly guaranteed by their parent company. A five-year, non-removable undertaking to this effect is an important step.

However, the company believes that projected savings of audit fees are significantly overstated, while a result of the proposals will be to loosen the relationship between businesses and their accountants – in CIFS' view a retrograde move in the current climate.

Blackman on retail



Derryck Blackman puts KPMG’s warnings for the retail sector under the microscope. Just what do you need to do to manage the growing risks of trading in this sector.

KPMG present a picture of almost unrelieved gloom for the retail sector. October sales were “worryingly weak” and were nearly 1 per cent lower than a year previously. And they predict that their Retail Health Index will hit its lowest level for five years in the fourth quarter. That picture worsened in November with sales down 1.6 per cent – a six-month low.

It’s difficult to quarrel with KPMG’s analysis. Certainly the next twelve months are likely to be extremely “challenging” as constraints on disposable income caused by wider economic pressures are compounded by fundamental shifts in consumer behaviour.

Chief among these, of course, is the continuing march of e-commerce. But in addition Morrisons, for example, are reporting customers leaving their credit cards at home and there is a widespread move towards more “value” goods in the food sector. In non-foods big ticket items are suffering dramatically. It’s clear that in the near term,

where possible, suppliers should be considering strategic decisions to reduce their exposure to the retail sector as well as curtailing any over-reliance on individual customers.

At CIFS we’re anticipating a further significant dip for the retail sector next year. While we can’t ignore business fundamentals it’s not our style to initiate a blanket removal of cover. That said, we’d urge policyholders to:

- Continue to tighten credit control procedures and keep a sharp eye on sudden changes in payment patterns
- React swiftly to late payment. It’s a most accurate predictor of business failure so don’t be tempted to extend agreed terms.
- Be aware of your suppliers and their operating base. Changing economic landscapes and political uncertainty can very quickly lead to problems in the supply chain.

- Grow business levels with new customers steadily and incrementally (our First Limit service can help here)
- Be wary of customers characterised by excessive levels of discounting. The British Retail Consortium reports high levels of discounting and consultants PwC say average price discounting is no less than 39 per cent. But suppliers must use their judgement on whether such initiatives are fire sales that should cause them to worry about their customers cash position and their ability to pay for goods supplied to them.
- Talk to us when you feel there are reasons to go behind published data to grant trade credit.

But be agile. These are unprecedented times but the sector will bounce back and it’s important to retain the flexibility to benefit from growth when it comes.