

THE BUSINESS STRESS REPORT (April 2009)

Research By: Restructuring Works

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1.0 OVERVIEW

This is the second of the Restructuring Works Business Stress Reports. The Report is released quarterly and measures the number of company insolvencies, the cost of insolvencies to Australian Banks and how often financially distressed companies successfully restructure.

The first Business Stress Report (January 2009) showed that the number of corporate insolvencies increased significantly in 2008. What had not previously been appreciated was that the value of insolvencies had more than tripled and that Secured Creditors were taking possession of assets far more commonly.

This second Business Stress Report (April 2009) shows a further material depreciation in the health of corporate Australia.

Key Factual Findings

The research revealed four key findings.

- The value of All Bank New Assets Impairment Charges, which is essentially bank bad debts, has increased dramatically to \$20.7 billion in the calendar year 2008. That is more than a four-fold increase on 2007 which was \$4.4 billion. The last quarter of 2008 saw Banks make new asset impairment charges of \$7.8 billion which is the highest quarter recorded since the Reserve Bank began collected this data in 1994.
- The number of companies entering some form of insolvency administration in the year ended February 2009 was 9,348 which is an increase of 30% on the average of the previous 5 years and 23% more than the immediately prior year. February 2009 was the worst February recorded since 1999 when ASIC started releasing data in the current format.
- The number of appointments by Secured Creditors, most commonly receiverships, continues to increase dramatically. There were 1,043 appointments by Secured Creditors in the year to February 2009 which is up 140% on the average of the previous five years.
- The percentage of companies successfully restructuring remains very low. Only 6.4% of companies entering some sort of insolvency administration successfully restructured in the year to February 2009. This compares to a high of 14% in 1999.

Key Lessons from the Research

This quarterly Business Stress Report reveals new highs in both the number and value of insolvencies. The standout number is the value of new impairment charges in Australian Banks, or viewed another way, their problem loans. In 2008 those charges exceeded \$20 billion, with \$7.8 billion of that in the last quarter of 2008. Since 1995 the yearly impairment charges commonly run between \$3 and \$4 billion. So 2008 saw a dramatic increase in bad assets in Australian Banks.

The other standout number is the number of insolvency appointments by Secured Creditors, most commonly Banks, which have risen a dramatic 140% on the average of the previous five years. Over the last nine years the number has usually been around the 400 to 500 mark but in the year to February 2009 it reached 1,043.



The insolvency statistic most commonly quoted is simply the number of companies entering some form of insolvency. That number is concerning, being up 30% on the average of the previous five years, but it is not outrageously bad in itself. This supports anecdotal evidence from Insolvency Practitioners and auctioneers that there were a limited number of very large insolvencies in the last year but the total number of insolvencies is yet to take off. So there are indicators that troubled times are looming for medium and small businesses but so far the statistics are not too bad.

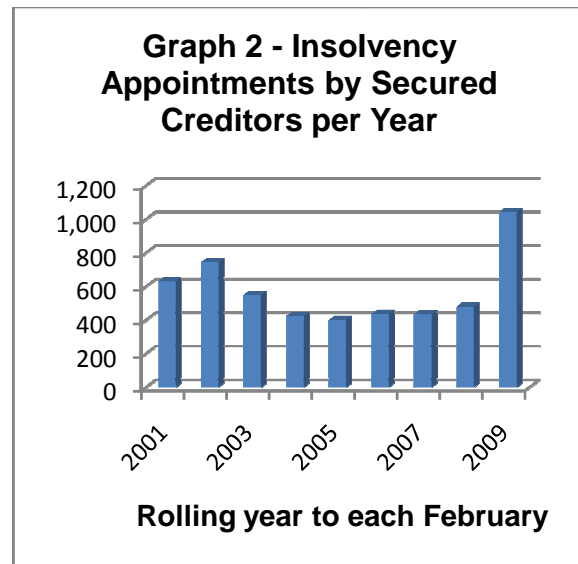
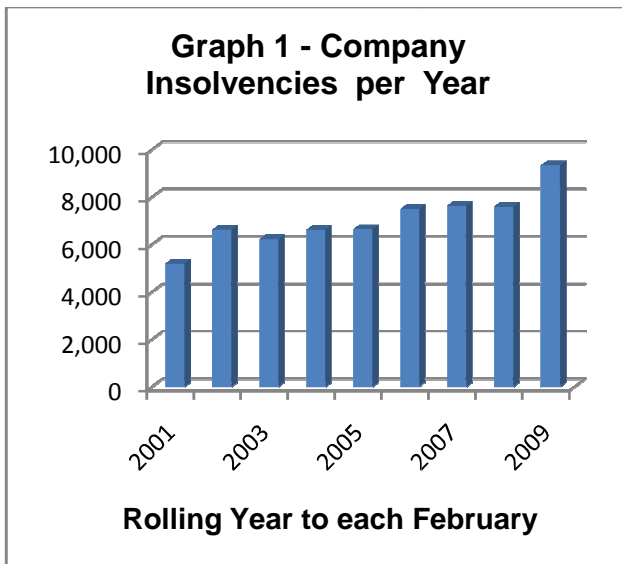
2.0 INSOLVENCY INDEX

The Insolvency Index measures the number of companies entering some form of insolvency administration such as Liquidation, Voluntary Administration or Receivership.

The source data is the Australian Securities and Investment Commission (“ASIC”) monthly insolvency statistics. The data is released monthly with the latest available data being to February 2009. We collate the data on a rolling 12 month basis hence our data is for the year ended February 2009. Prior to 1999 the ASIC data was released in a different and less useful format.

The number of companies entering some form of insolvency administration in the year ended February 2009 was 9,348 which is an increase of 30% on the average of the previous 5 years and 23% more than the immediately prior year (see Graph 1). February 2009 was the worst February since records have been released by ASIC in the current format, being since 1999.

Included in the total number of insolvencies is the number of appointments by secured creditors which will include Receiverships, where a secured creditor appoints an external party, and Controllerships, where a secured creditor takes control of an asset itself. There were 1,043 appointments by Secured Creditors in the year to February 2009 which is up 140% on the average of the previous five years (see Graph 2).



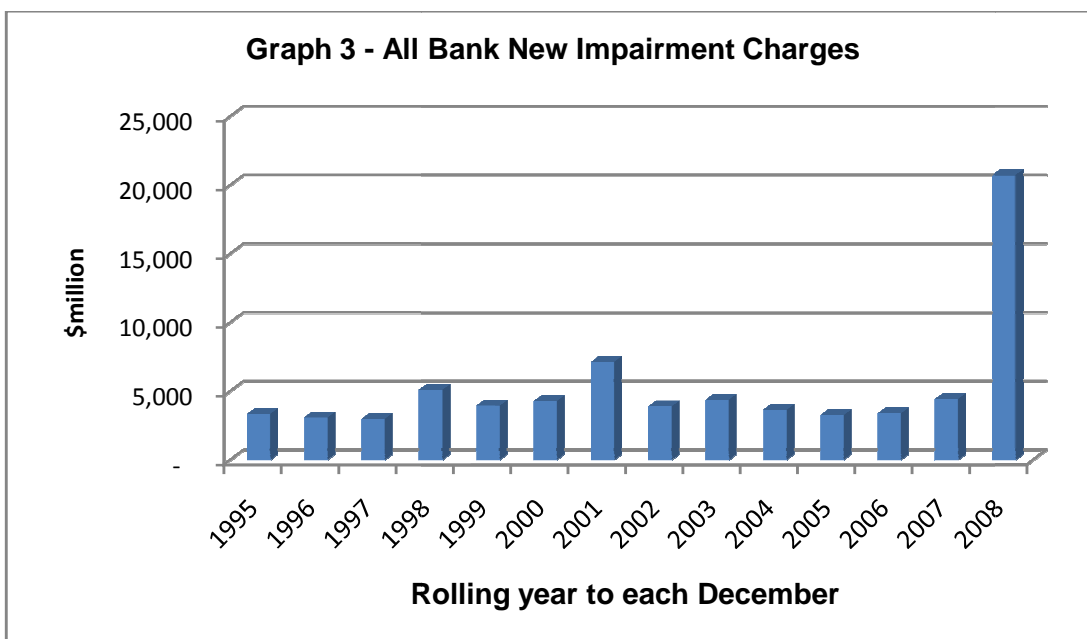


3.0 BANK ASSET IMPAIRMENT INDEX

The ASIC data analysed above reveals the number but not the value or level of debt of companies that enter some form of insolvency administration.

The best way to obtain an understanding of the value of insolvencies is to examine the level of new Impaired Assets declared by Australian Banks. That figure will exclude all non-Bank bad debts but still provides a very useful indicator of the value of insolvencies. The relevant data is released by the Reserve Bank of Australia which obtains the information from the Australian Prudential Regulation Authority. The information is released quarterly, with the latest information available being up to the end of December 2008. The value of new impaired assets will include all Bank impaired assets, including corporate and personal. We collate the data on a rolling 12 month basis.

The value of All Bank New Assets Impairment Charges has increased dramatically to \$20.7 billion in calendar year 2008. That is a more than four-fold increase on 2007 which was \$4.4 billion. (see Graph 3).



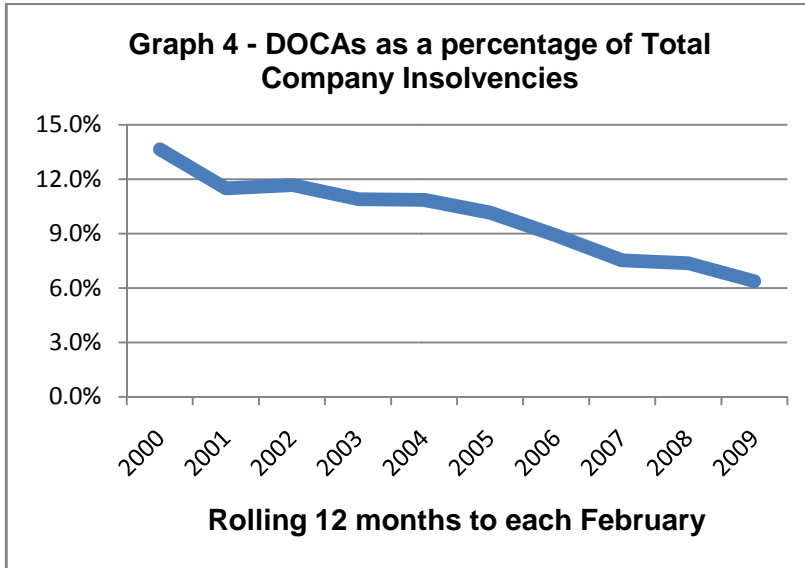
4.0 RESTRUCTURING RATIO

Having established indicators of the number and value of companies in financial distress, the next question is what proportion of companies in financial difficulty successfully restructure. There is no way of measuring the number of companies that successfully restructure using informal restructuring methods such as Informal Workouts or Debt Moratoriums as those negotiations are conducted in secret and not reported.

We have therefore developed a reliable measure of the ratio of successful corporate restructurings by comparing the number of companies that successfully execute a Deed of Company Arrangement against the number of companies that enter some form of insolvency administration. A Deed of Company Arrangement, or DOCA, is essentially a deal agreed by a company with its creditors as part of the Voluntary Administration procedure.

We found that only 6.4% of companies entering some sort of insolvency administration successfully executed a DOCA in the year to February 2009. There has been a decline from 14.2% in 1999 to the current level (see Graph 4).

This reveals a very low success rate in restructuring Australian companies that strike financial difficulties with only 1 in 15 companies entering a formal insolvency administration finding their way through the insolvency legislation and creditor negotiations to agree a restructuring.



Clearly, many companies cannot be saved and liquidation is the appropriate outcome. So it is worth examining the restructuring success rate of companies that enter Voluntary Administration. The legislation states that the purpose of the Voluntary Administration legislation is to maximise the chances of a company being restructured. That is done by executing a DOCA. The percentage of companies that entered Voluntary Administration and then successfully agreed a DOCA with their creditors was 28.5%. That is a mild improvement on recent years where it has ranged between 23% and 28% but we regard all of these percentages as well below what should be expected.

In summary, we regard the success rate in restructuring insolvent companies as being very poor. That conclusion applies whether we look at the success rate as being a percentage of total insolvencies or as a percentage of voluntary administrations.

ABOUT RESTRUCTURING WORKS

Restructuring Works is a group of corporate restructuring professionals. Restructuring Works initially provides online and telephone advice to directors of companies in financial distress then leads companies through the restructuring process.

The Restructuring Works website www.restructuringworks.com.au provides some unique tools to assist directors of companies in financial distress including:

Inform>Assess>Solve. A raft of information and tools to assist Directors of companies in financial distress

Is my company insolvent? A simple "tick box" page that simplifies the extremely complicated question of whether or not a company is insolvent.

Ask IRA! An online tool that asks directors four questions and, depending on the answers given, provides directors with an assessment of where their company sits in the Restructuring Spectrum and what solutions are available to a company in that position.

Restructuring Works can be contacted by phone on (02) 9290 1110 or directors can ask a question online at www.restructuringworks.com.au.