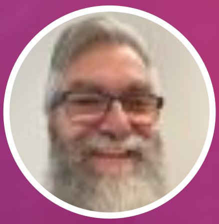
Commercial Risk Barometer



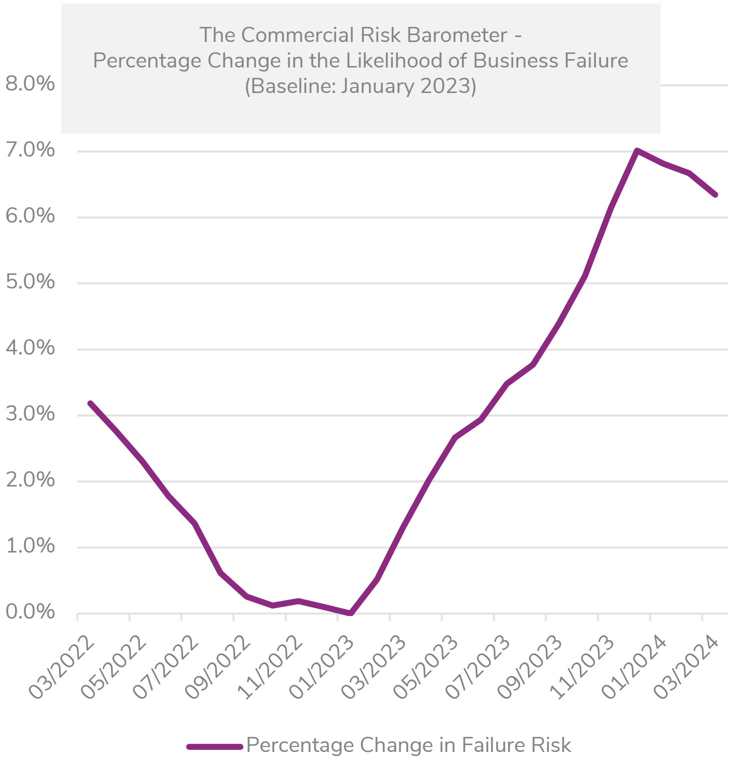
Authored by
Michael Landgraf
Manager, Bureau Analytics

Australia

April 2024

illion

Business risk deteriorated substantially in 2023, and while Christmas offered some respite, the longer-term trend is still problematic.



The illion Business Failure Risk Index for March 2024 shows that, on average, businesses conditions have deteriorated significantly, with business failure risk (ie. the likelihood of failure within 12 months) rising about 7% over 2023. While there has been a recent moderation in this risk in Q1 2024 (0.6% improvement), this correction is not particularly significant (yet) when we factor in the higher levels of consumer spending that typically occur around Christmas and, given that it follows a period of higher failure risk pre-Christmas in 2023.

Year-on-year, this failure risk has risen over 5% to March 2024; the largest deterioration noted post-COVID and may be due, in part, to lower levels of government support for business now.

Equally, it may be due to creditors, lenders and government offices (such as the ATO) calling a halt to amnesties on the repayment of liabilities. That said, it is also a consequence of significantly lower levels of consumer confidence and spending in 2023, as Australians struggled with their household budgets. The overall deterioration in business conditions has tracked the change in consumer credit risk, consumer spending and consumer confidence quite closely, with worsening business activity showing around 3-6 months after economic conditions impacted consumer behaviour. Notable observations follow:

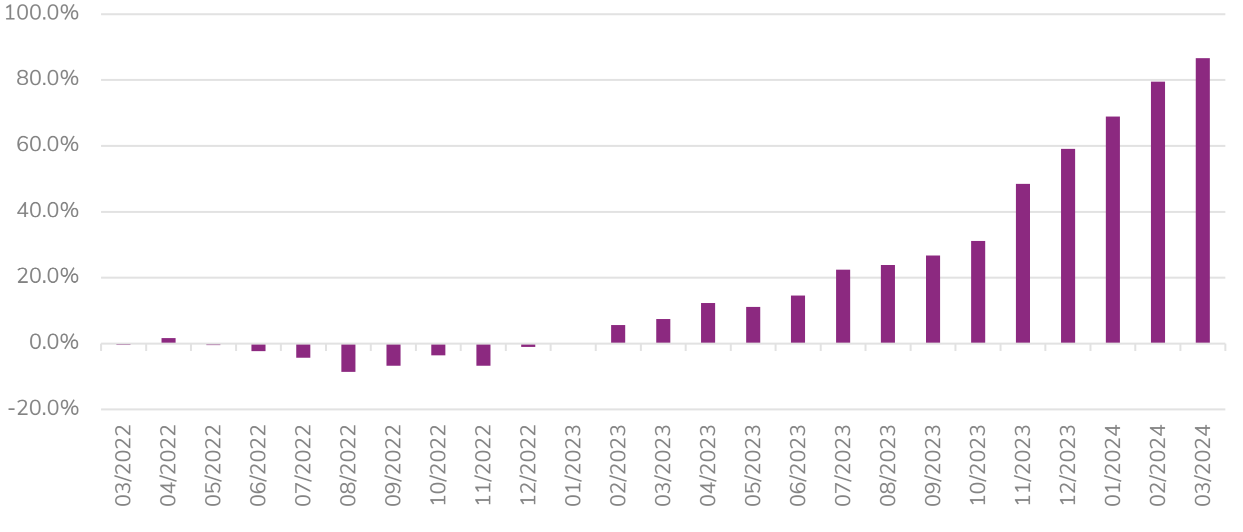
- The general rise in business failure risk has led to a significant increase in the number of businesses that are at imminent risk of failure. As such, 2024 is likely to see a material rise in businesses becoming insolvent, liquidated and being deregistered after litigation by creditors.
- Retail and food services businesses as well as businesses operating in construction and transport appear most at risk with these industries likely to have the largest rise in business failures in 2024; this rise coming on the back off their already high baseline risk in 2023.
- VIC and NSW lead the way, with the highest levels of business failure risk nationally, due most likely to a higher cost burden on both renters and mortgage holders..
- The improvement in business failure risk has been minimal in Q1 2024, tracking the rise in consumer confidence during H2 2023 It may however be short-lived if consumer confidence begins to fall, and consumer credit risk starts climbing again in 2024.
- The change in business failure risk is not uniform across all businesses. In the retail and food sectors especially, there appears to be a two-speed economy, with smaller retailers suffering hardest and large corporations withstanding the headwinds.

The Percentage of Businesses at Severe Risk of Failure has risen substantially in 2023. This heightened risk has followed a period of Consumer Credit Stress

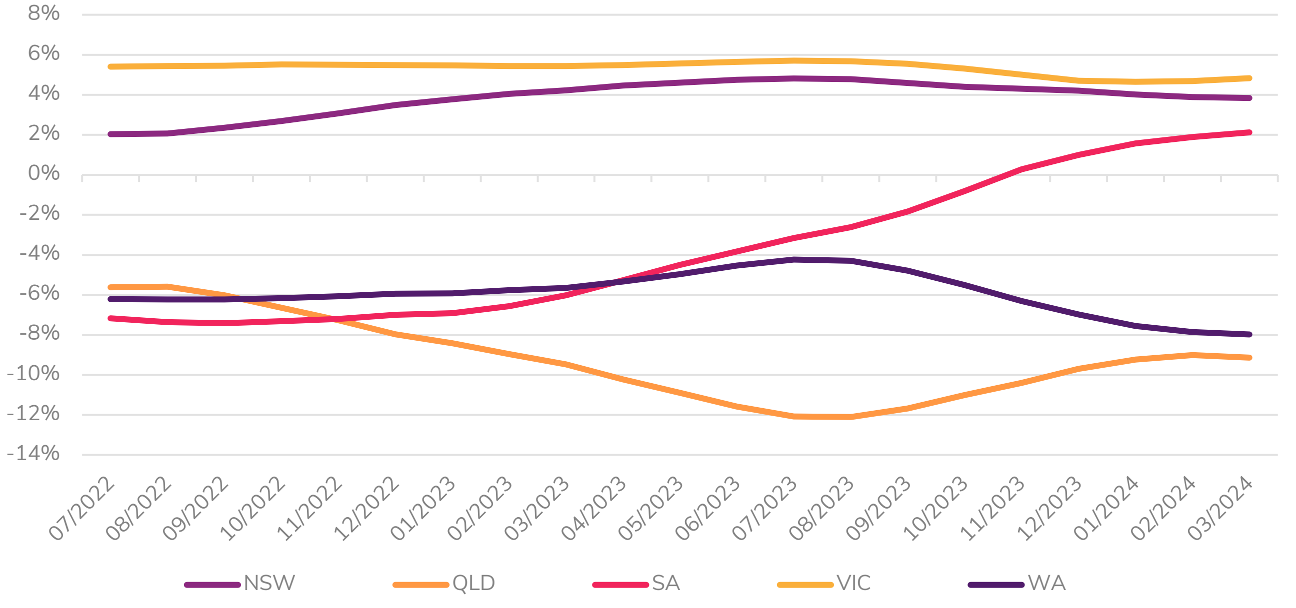
The number of businesses at severe risk of failure has near doubled over 15 months; being felt particularly in VIC and NSW. This has followed a period of increased consumer stress.

- The percentage of Australian businesses that are now at severe risk of failing is 90% higher since January 2023 and 50% higher since September 2023. Businesses in NSW and VIC have the highest level of stress (4% to 5% higher than the national average), although this has remained broadly flat in VIC over 18 months. NSW has however seen significant deterioration (from 2% to 4% above the national average in 18 months). The higher risk in these states may be due to higher living costs and sizeable increases in residential rents and mortgage servicing; also, from higher business input charges (e.g. rent, wages, utilities). The situation in NSW and VIC is in-line with the observed deterioration in consumer default risk, as was released in illion's Consumer Stress Barometer in March 2024. In that report, we noted a material rise in the default risk of credit card holders in both VIC and NSW. While SA has had a traditionally lower level of failure risk, we have seen it deteriorate recently (from 7% lower than the national average in January 2023 to 2% higher in March 2024). In contrast, while we've seen some volatility in QLD and WA, businesses in both states are much lower risk (8% lower than the national average in March 2024).
- The nationwide rise in business failure risk has coincided with an equally stark deterioration in consumer credit stress. This is most likely due to the financial strain on consumers in 2023 and its substantial impact on both debt servicing and broader consumption. While business failure risk and consumer credit risk were both quite stable in 2022, they have both risen substantially since then. For the business sector, failure risk firstly rose by around 4% in the first half of 2023, as consumers were swamped with rising debt servicing obligations, and secondly, by another 4% in the latter half of 2023 as consumers started to 'get back on track' with their existing debts. The effect on businesses was a two-fold economic 'punch' as broader consumption was sacrificed when consumers couldn't service their debts and then again, when they were at least able to prioritise debts over consumption.

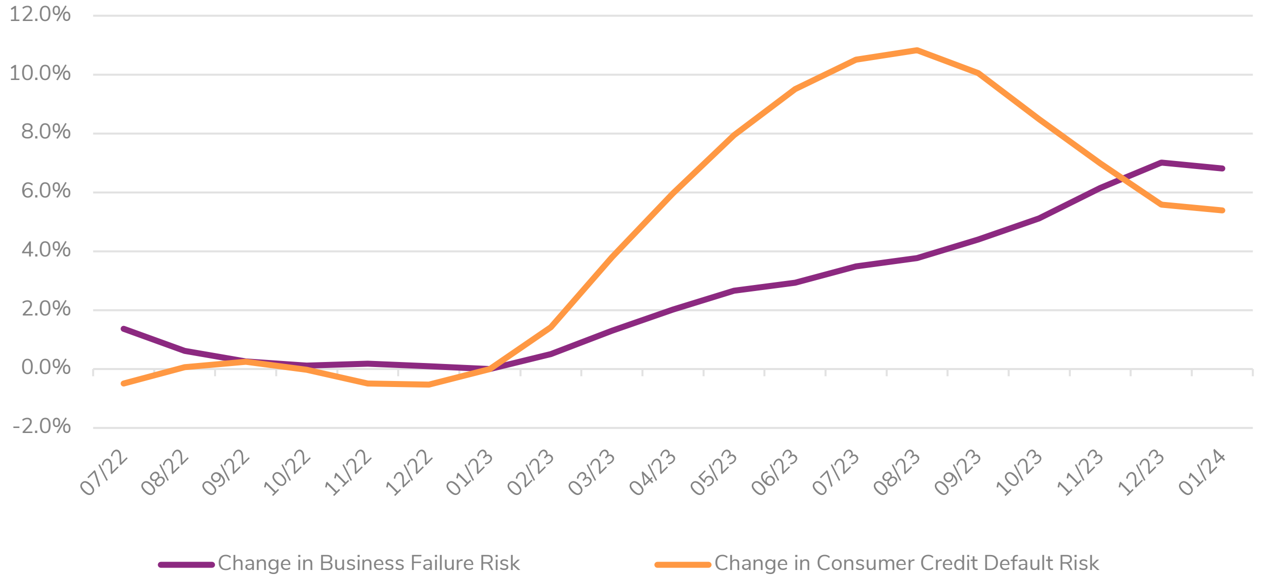
Percentage Increase in Businesses at Severe Risk of Failure (Baseline: January 2023)



Business Failure Risk Relative to National Average per Month (% higher/lower)



Percentage Change in Consumer Default Risk and Business Failure Risk (Baseline: January 2023)

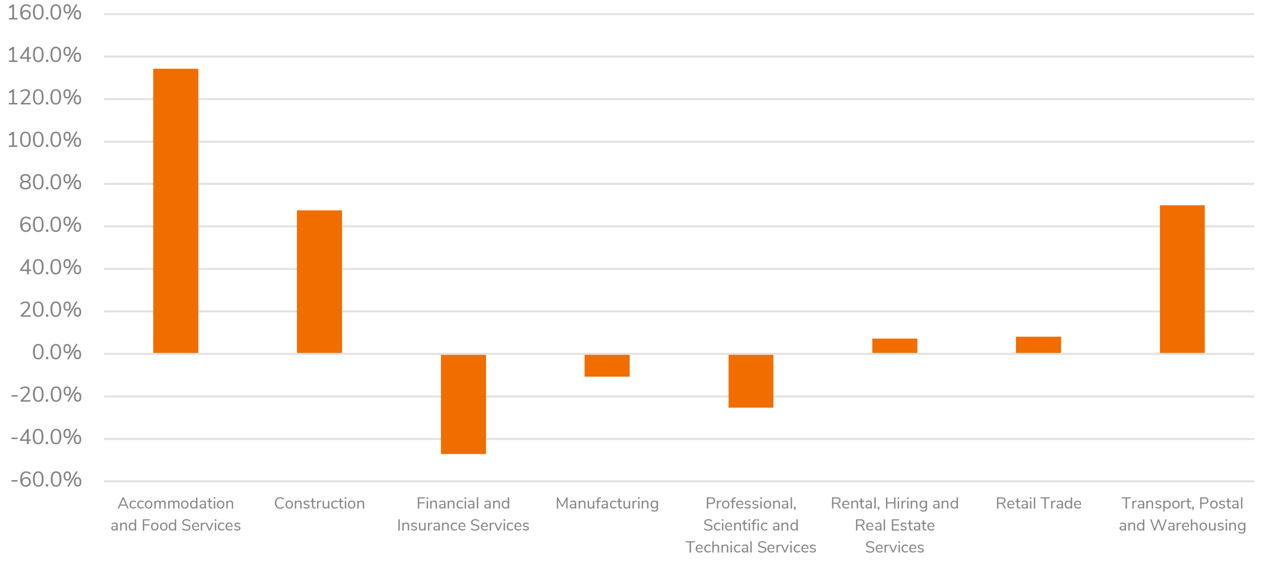


Deterioration observed in all industries but most severe in the highest risk industries.

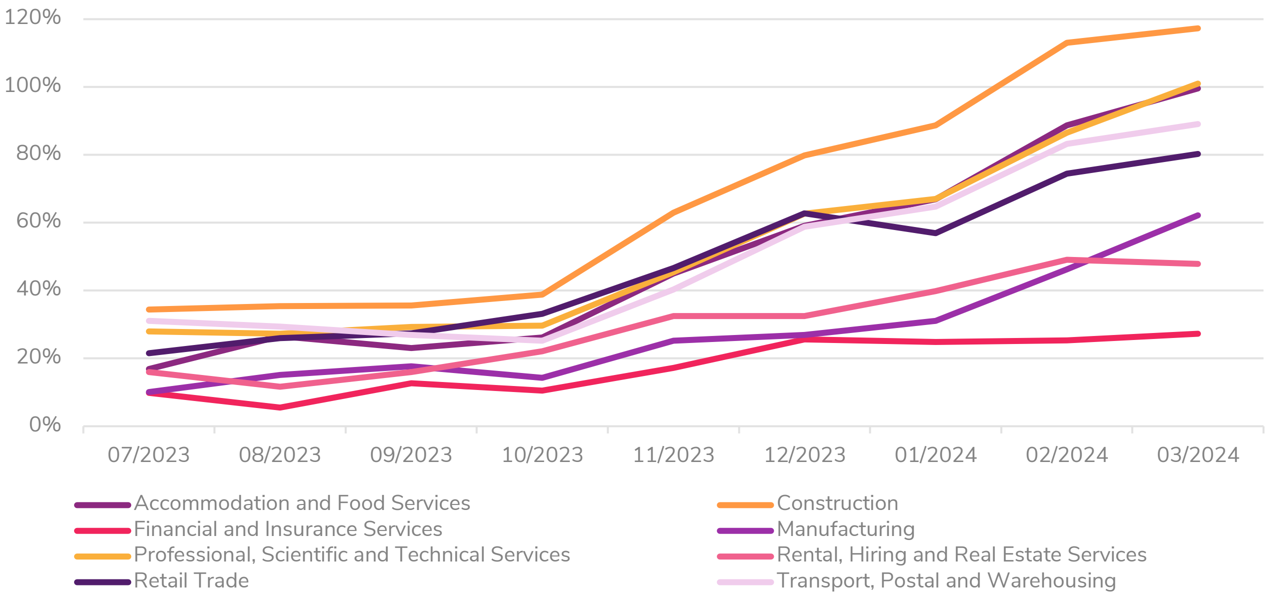
Highest Risk Industries have deteriorated most in 2023/24.

- **Highest Risk Industries:** Food Services, Construction and Transport businesses have the highest risk of failure in March 2024. The Food services sector (comprising Restaurants, Bars, Cafes, Pubs) has a 140% higher percentage of businesses at severe risk of failure when compared to the national average, the Construction and Transports sectors, both 70% higher. This is followed by the Retail and Rental sectors (10% higher than the national average).
- **Greatest Deterioration:** The four highest risk industries have also deteriorated the most in the last 15 months – with the number of Construction businesses at severe risk of failure rising by 120%, Food Services businesses rising by 100%, Transport businesses rising by 90% and Retail businesses by 80%. As such, there is no clear sign that these industries are likely to experience a turnaround in the short-term.
- **Changing Behaviour:** Australian businesses have suffered significant financial strain in 2023, with trade payment obligations generally being paid 25% later than 12 months ago; specifically, Food Services businesses are now paying invoices 18 days late on average, Construction firms and Retail businesses 14 days late, and the Transport sector 12 days late. Even businesses in low-risk industries, such as Financial Services, are now paying invoices around 20% later YOY.
- **Financial Stress:** Food retailers, clothing retailers, restaurants, pubs, cafes, builders have been hit by high input costs (rents, materials, utilities, freight, wages) and lower levels of consumption (discretionary spend on dearer goods/services) and fixed prices (building contracts).

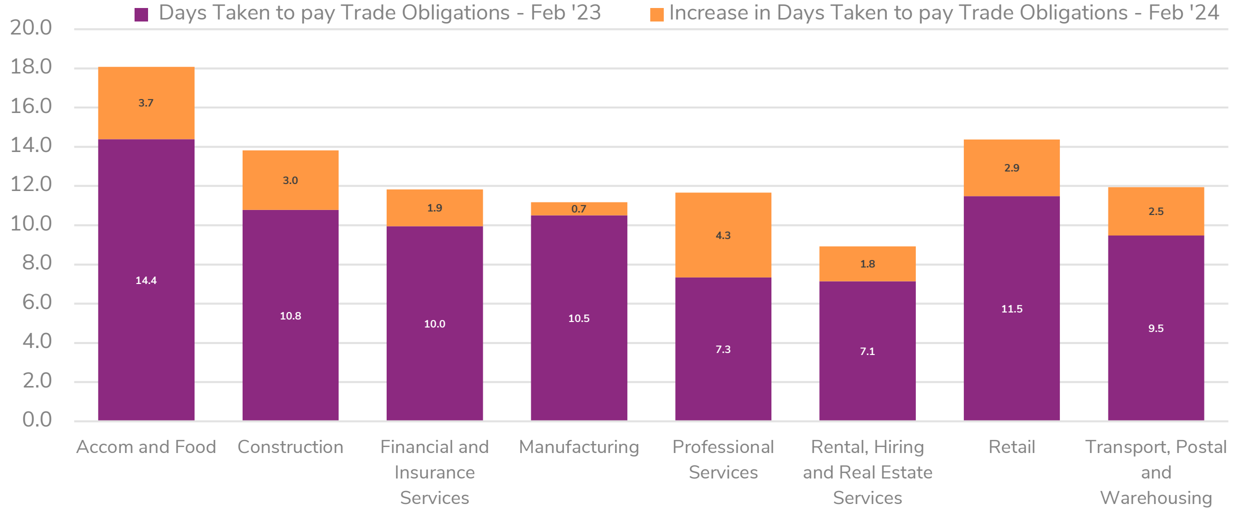
Severe Failure Risk by Industry –
Percentage Higher/Lower than National Average in March 2024



Percentage Change in Number of Active Businesses at Severe Risk of Failure - July 2023 to March 2024 (Baseline: January 2023)



Late Trade by Industry : Days Late in Feb 2023 / Deterioration by Feb 2024



Business Stress broadly aligned to business size, consumer confidence and spending

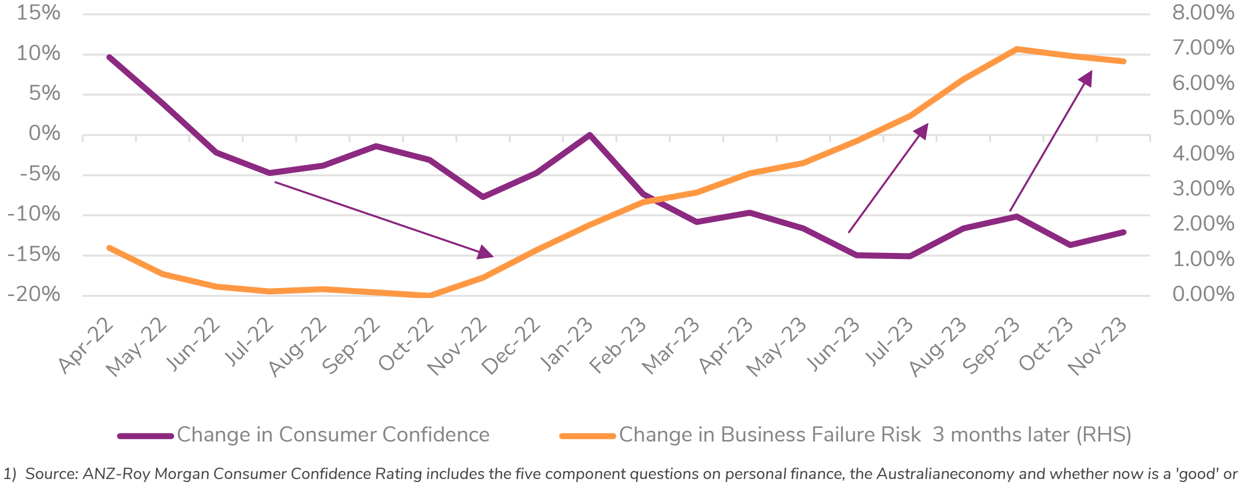
Business Failure Risk is affected by Consumer Confidence, but Larger Businesses are bucking this trend while Smaller Businesses are suffering.

- **Consumer Confidence as a Leading Indicator:** Consumer confidence fell 15% in Q2 2022 and then again by a further 15% in H1 2023 (pre-dating mooted CPI and/or Interest Rates increases). While businesses were not immediately affected, the loss in confidence did have a knock-on effect as business failure risk stopped improving by end 2022, increasing substantially (7%) through 2023. A moderate improvement in consumer confidence in H2 2023 coincided with stabilising interest rates - businesses failure risk is seen to improve modestly in late 2023 (0.6% better by early 2024). In each case, changes in confidence were soon followed by changes in failure risk.

- **SME's are most Vulnerable:** While business failure risk has been broadly higher in the year to March 2024 (5% higher), smaller businesses have suffered the most, while larger businesses have remained resilient. For businesses up to $10mill turnover (small businesses), failure risk has risen by up to 20% in the year to March 2024, whereas the risk of medium sized businesses (up to $100mill) has deteriorated by only 10%. Even more pertinently, the failure risk of larger companies and corporations has improved significantly (20%+ improvement for businesses with a turnover above $250mill). Therefore, we are seeing a two-tier economy in Australia, where smaller businesses are at significant risk of 'going to the wall' while larger businesses are benefitting from the change in consumer spending habits during these harder economic conditions (possibly through more competitive pricing and a lower per-unit cost base).

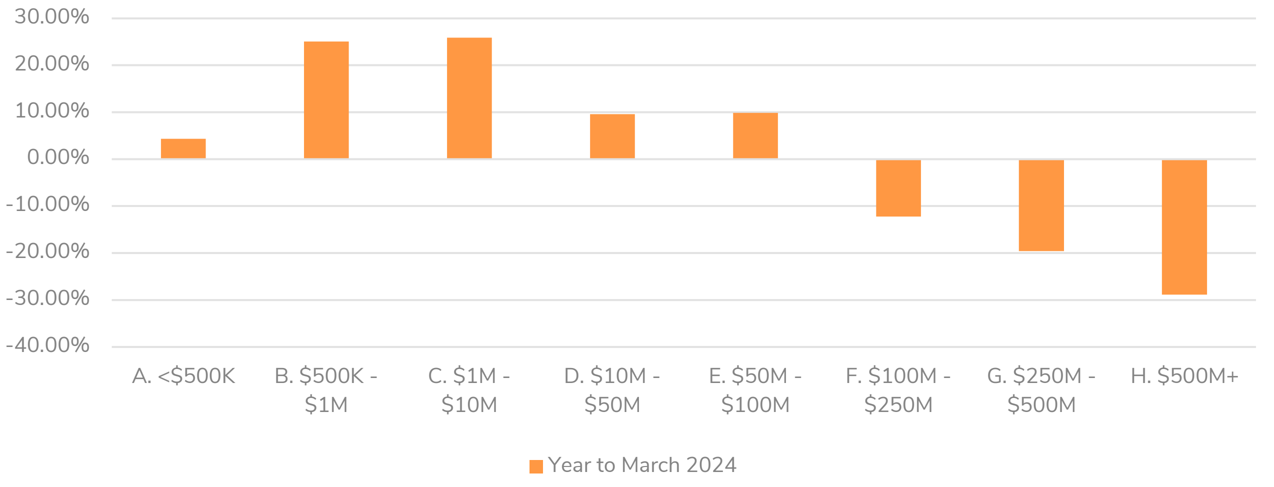
- **Illustration of SME Business Stress:** Consumer confidence has contributed to a two-speed economy, with spending decisions shifting away from smaller retailers to larger, mainstream corporations and from premium services to more basic (affordable) services. For example, even while essential spending on rent and health has increased substantially YOY to February 2024 (up 10%), so too has spending on fast-food and take-away food (up 10%), whereas eating out in restaurants and pubs has not kept up with CPI (only up 4% and substantially lower than spending on cheaper fast-food and take-away food). Equally spending in supermarkets (up 5%) has been to the detriment of butchers (down 1%) and green-grocers (down 2.5%), while spending in department stores has been at odds with retail clothing stores (down 8%).

Consumer Confidence and Business Failure Risk (3 months later) (% change to Baseline: January 2023)



1) *Source: ANZ-Roy Morgan Consumer Confidence Rating includes the five component questions on personal finance, the Australianeconomy and whether now is a 'good' or 'bad' time to buy. Figures baselined to Index @ January 2023.*

Change in Business Failure Risk by Annual Business Revenue – Year to March 2024



Change in Spend by Category - Year to Feb 2024

Background Notes: Basis of Business Failure Risk Index

illion's Business Failure Risk Index tracks the risk of Australian businesses being unable to trade within the next 12 months with money owing and forced into closure – this includes businesses entering liquidation and/or being involuntarily deregistered. The index is

- a metric, showing the percentage change in the probability of businesses failing with monies owing
- a 12-month forward looking prediction of this failure risk
- a trend-line, showing the changing nature of this risk, both directionally and in percentage magnitude
- smeared over all active businesses operating at the time of risk assessment.

The index is created by modelling leading indicators against subsequent business performance. These indicators include,

- Current and historical legal actions taken out on businesses and their directors
- Current and historical debt collection activity on businesses
- Changes in trading activity including the aggregate value of business invoice payments
- Changes in financial stress through the late payment of trading obligations
- The Underlying Risk of the Business's Profile – e.g. Industry and Geographic Level of the Business Profile
- Credit Risk of Business Directors on their business and consumer credit holdings – including their credit exposure and payment delinquency.

The Index is shown as the percentage change failure risk, with the percentage calculated relative to the risk observed at the baseline point in time in January 2023. This baseline has been chosen to a) remove the early biases/effects from COVID and to b) focus on current economic impacts from broad-based inflationary pressures and higher interest rates on consumers and businesses.

To smooth monthly fluctuations, these trends are calculated as moving averages over a rolling 3-month period to the month shown in the trend diagram (Slide 2).

Additional insights into business trading activity, business and director legal actions, industry risk, business size, consumer confidence and expenditure patterns may be incorporated in this insights pack to show trends that are likely to have an impact on the failure risk of businesses.
The data used to create the risk index is derived from illion's proprietary commercial databases, comprising the largest commercial information bureau and trade credit payment program available on Australia's 2.5mill+ active businesses.

About illion

As one of Australasia's leading consumer and commercial credit bureaus, our unique data, software, analytics and risk management solutions form an integral part of the region's financial ecosystem.

Empowering Intelligent Decision Making

Disclaimer

This Report ("Report") is provided by illion Australia Pty Limited ("illion") as general information, and it is not (and does not contain any form of) professional, legal or financial advice. illion makes no representations, warranties or guarantees that this Report is error-free, accurate or complete. You are solely responsible and liable for any decision made (or not made) by you in connection with information contained in this Report. illion (and its related bodies corporate) exclude all liability for any and all loss, cost, expense, damage or claim incurred by a party as a result of or in connection with (whether directly or indirectly), this Report or any reliance on the information contained within it. illion owns (or has appropriate licences for) all intellectual property rights in this Report and the Report must not be edited, copied, updated or republished (whether in whole or in part) in any way without illion's prior written consent.

www.illion.com.au

illion

Empowering Intelligent Decision Making

Michael Landgraf
0411 450 175
michael.landgraf@illion.com.au
illion.com.au