Business DISTRESS Index fourth wave

Rescue
Recovery
Renewal

Debt worry and fear of insolvency at lowest levels yet

Signs of distress decreasing

Construction businesses cutting back

Retail sector at severe risk

Welcome to the fourth wave of insolvency trade body R3's Business Distress Index - a unique quarterly barometer of the financial position of UK businesses.

The overall picture for businesses is positive with signs of distress on the decline, concerns about debts diminishing, and fear of insolvency at its lowest level yet. However, results indicate that the retail sector is suffering badly, with worryingly high levels of distress. With the raft of high street collapses and acquisitions in recent weeks, the Index suggests there is more heartache in store for the beleaguered sector.

EXECUTIVE SUMMARY

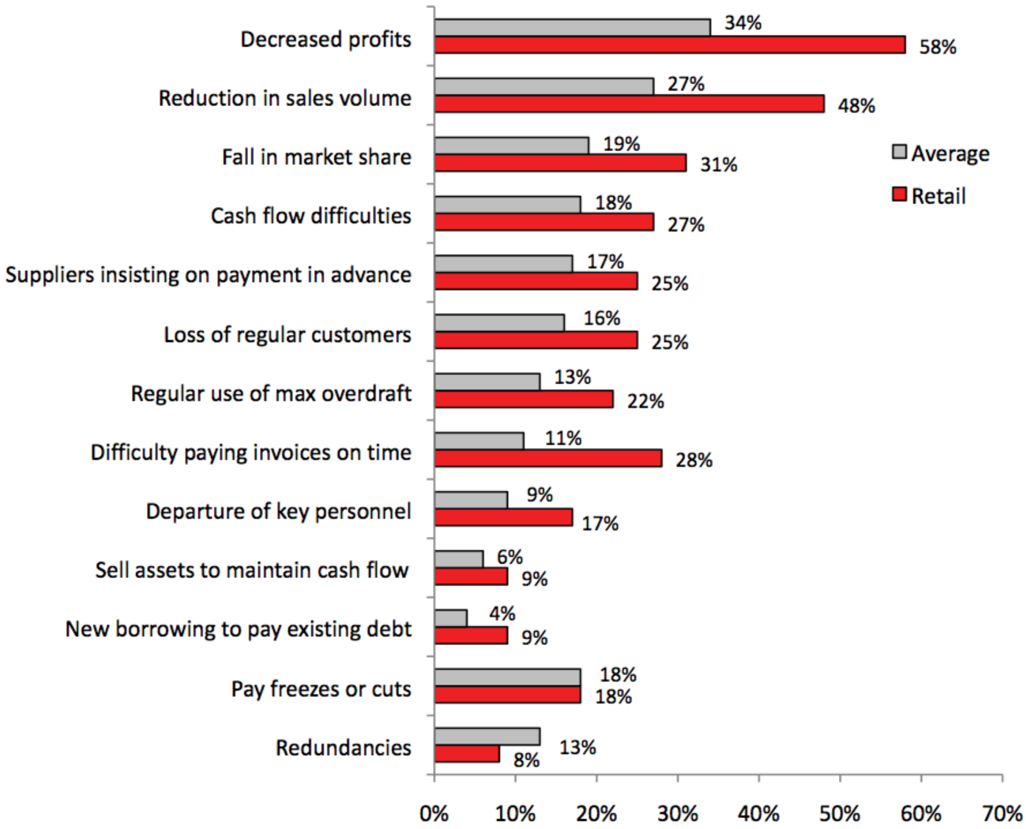
- **Fewer businesses are experiencing the signs of distress signs than at any** time since the Index began in September 2010.
- The number of **businesses worrying about their levels of debt has declined** to 18% (down 6% on last quarter), reaching the lowest level since the tracker began.
- Perceived **likelihood of insolvency is also at its lowest level** since September last year and down considerably on last quarter, with just 3% of businesses saying they are likely to go into insolvency in the coming twelve months.
- Businesses perceive each of their main creditors to be less supportive than they have been previously, perhaps because there has been a diminished need to call on them.
- Although the overall picture is positive for businesses, results indicate that the **retail sector is considerably at risk**:
  - The number of retailers experiencing signs of distress is significantly higher than the average across sectors:
  - 58% of retailers are experiencing decreased profits (compared to a cross-sector average of 34%);
  - 48% have seen a reduction in sales volume (cross-sector average of 27%);
  - 28% are finding it difficult to pay invoices on time (average of 11%);
  - almost one in ten (9%) have taken on new borrowing to pay off existing debts (average of 4%).
  - Retail businesses are more likely than those in any other sector to be concerned about their debt levels and 8% businesses in the retail sector think they are 'very likely' to enter insolvency in the coming twelve months (this compares to a cross-sector average of 2%).
- While retail dominates many signs of distress, **construction businesses are more likely to be making redundancies and introducing pay cuts and freezes** than any other sector - at 26% and 33% respectively, compared to the cross-sector averages of 13% and 18% - and to have seen a recent fall in market share (35% compared to an average of 19%).

Retail: an inevitable bloodbath?

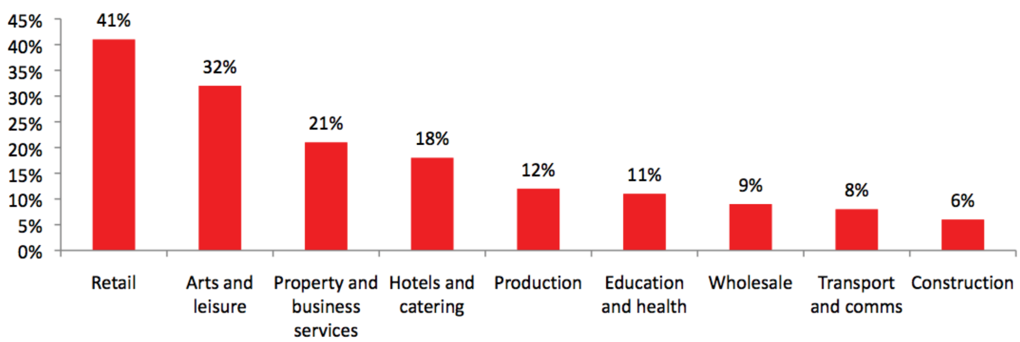
Although the overall picture is positive for businesses, results indicate that the retail sector is considerably at risk. The number of retailers experiencing signs of distress is significantly higher than the average across sectors (with just two exceptions, both employee related):

Only 24% of businesses in the retail sector and 22% in the wholesale sector say they are not experiencing any signs of distress. This compares to higher proportions in every other sector.

Retail businesses are more likely than those in any other sector to say they have debt in their business - only 33% of businesses in the retail sector do not have any debt, compared to the cross-sector average of 57%. Retailers are also more likely be concerned about their levels of debt than business in any other sector.



The following graph shows the number of businesses in each sector concerned about their debts:



Almost one in ten (8%) businesses in the retail sector believe they are 'very likely' to enter insolvency in the coming twelve months; this compares to a cross-sector average of 2%.

R3 President Frances Coulson explains:

"There is a two way pressure on retailers - consumers are reluctant to spend so retailers are continually discounting prices to remain competitive; meanwhile they are bearing increased costs as a result of inflation and rising commodity prices. It is extremely worrying to see around one in ten retailers taking on new borrowing and more than a quarter with cash flow difficulties. Generally retail businesses are paid cash immediately for purchases so unless they are holding large amounts of stock or lots of slow moving stock, they shouldn't need to borrow unless the debt is incurred to fund losses. The results clearly show a sector in distress and a swathe of retail insolvencies look inevitable."

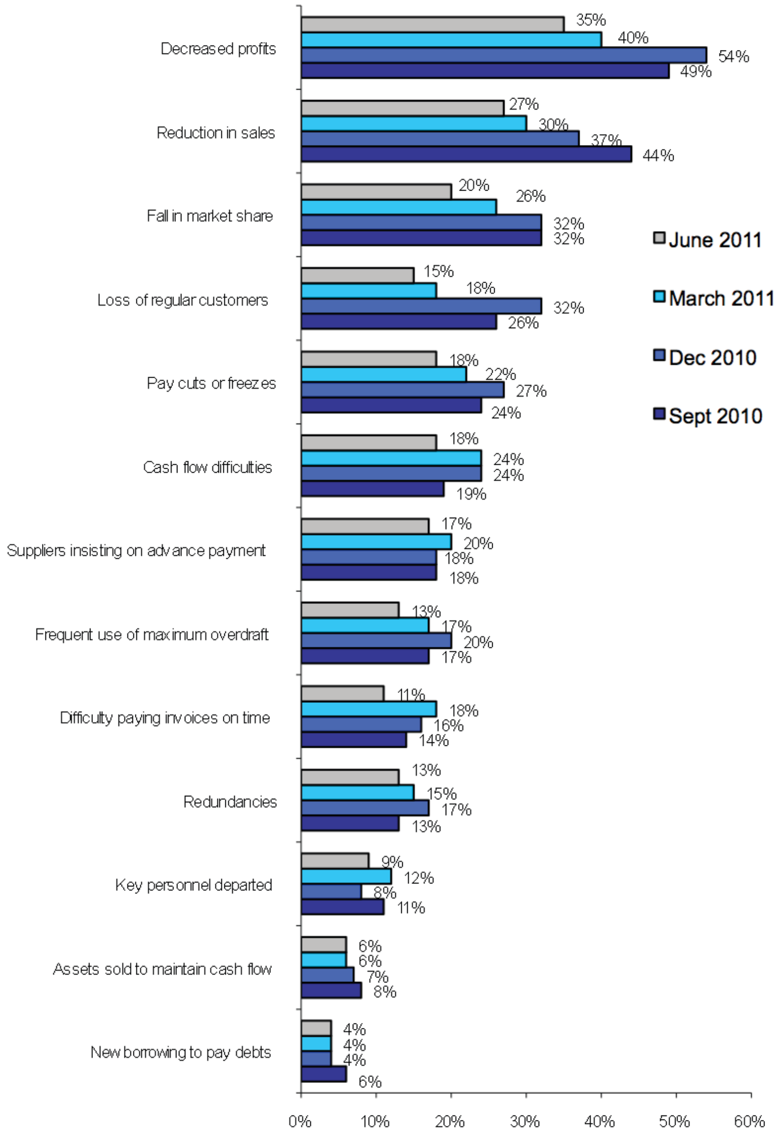
Signs of distress: recovery taking hold?

R3 has identified key signs of business distress, using this survey as a way of identifying how many UK businesses have recently experienced each sign. Businesses were asked which of the signs currently applies to their business.

Fewer businesses are experiencing signs of distress than at any time since the Business Distress Index began in September 2010, with decreases in eleven of the thirteen distress signs since last quarter.

There have been significant decreases in businesses finding it difficult to pay invoices on time (down 7% on last quarter), experiencing cash flow difficulties (down 6%) and experiencing falls in their market share (down 6%).

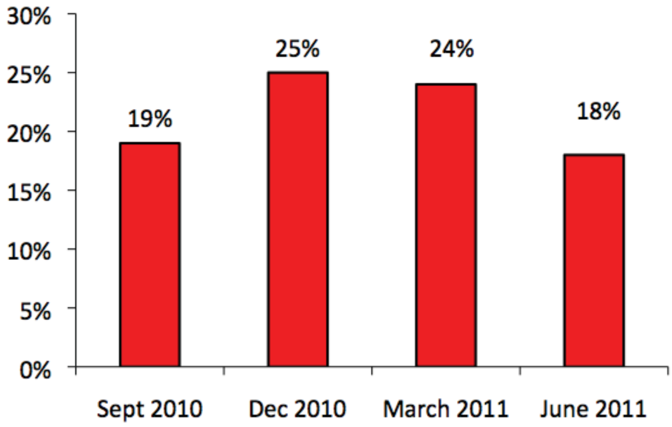
41% of businesses are not experiencing any signs of distress at all in this wave of research, compared to 28% in March, 23% in December 2010 and 25% in September 2010.



Debt worry on the decline

Businesses were asked 'How worried or otherwise are you abut the current level of your debt in your business: all debt; finance, bank loans and hire purchase; Crown debts and VAT; and debts owed to trade creditors'.

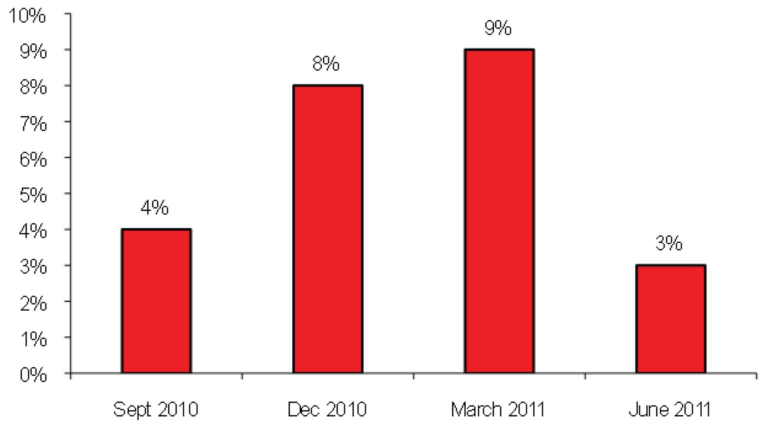
The number of businesses worrying about their levels of debt has declined by 6% since March to just 18%, reaching the lowest level since the tracker began:



Although overall concern about debt levels has decreased, bank debt continues to be the most significant worry for those who are concerned about their debts (at 26%), followed by trade creditors (20%) and Crown debts (12%). Concern among the businesses that are worried has marginally increased over bank debts (from 24% last quarter); while worry about trade debts has decreased considerably (from 32% last quarter to 20%), as has worry about Crown debts (from 18% to 12%).

Likelihood of insolvency reduced

Perceived likelihood of insolvency is also at its lowest level since the tracker began and down considerably on last quarter, with just 3% of businesses saying they are likely to go into insolvency in the coming twelve months:



R3 President Frances Coulson explains:

"While GDP remains sluggish, these results demonstrate the resilience of the businesses that have pulled through the recession. UK businesses have clearly moved to a much stronger footing."

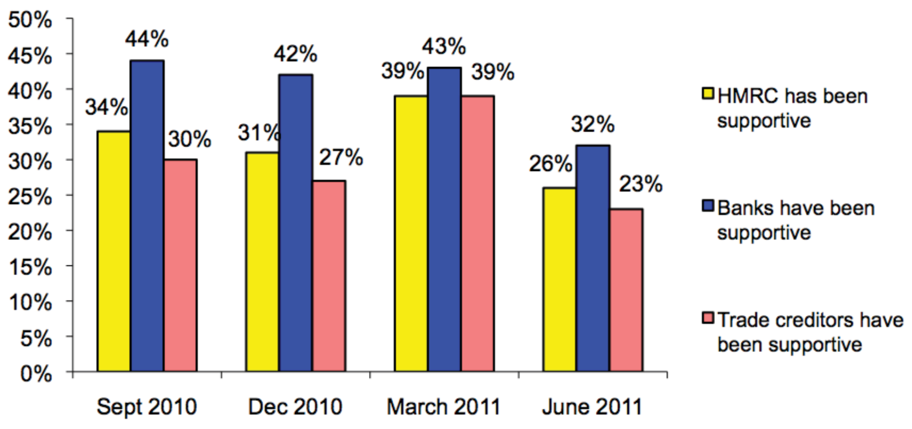
Creditor support lessens?

Businesses were asked whether they agree or disagree with the following statements:

- *'The banks have been generally supportive over the last 3 months'*
- *'Trade creditors have been broadly supportive in extending credit over the last 3 months'*
- *'On the whole, HMRC has been supportive over the last 3 months'*

Businesses perceive each of their main creditors to be less supportive than they have been previously. This may show a diminished need to call on their support due to lower levels of concern about debt and insolvency, as above. `

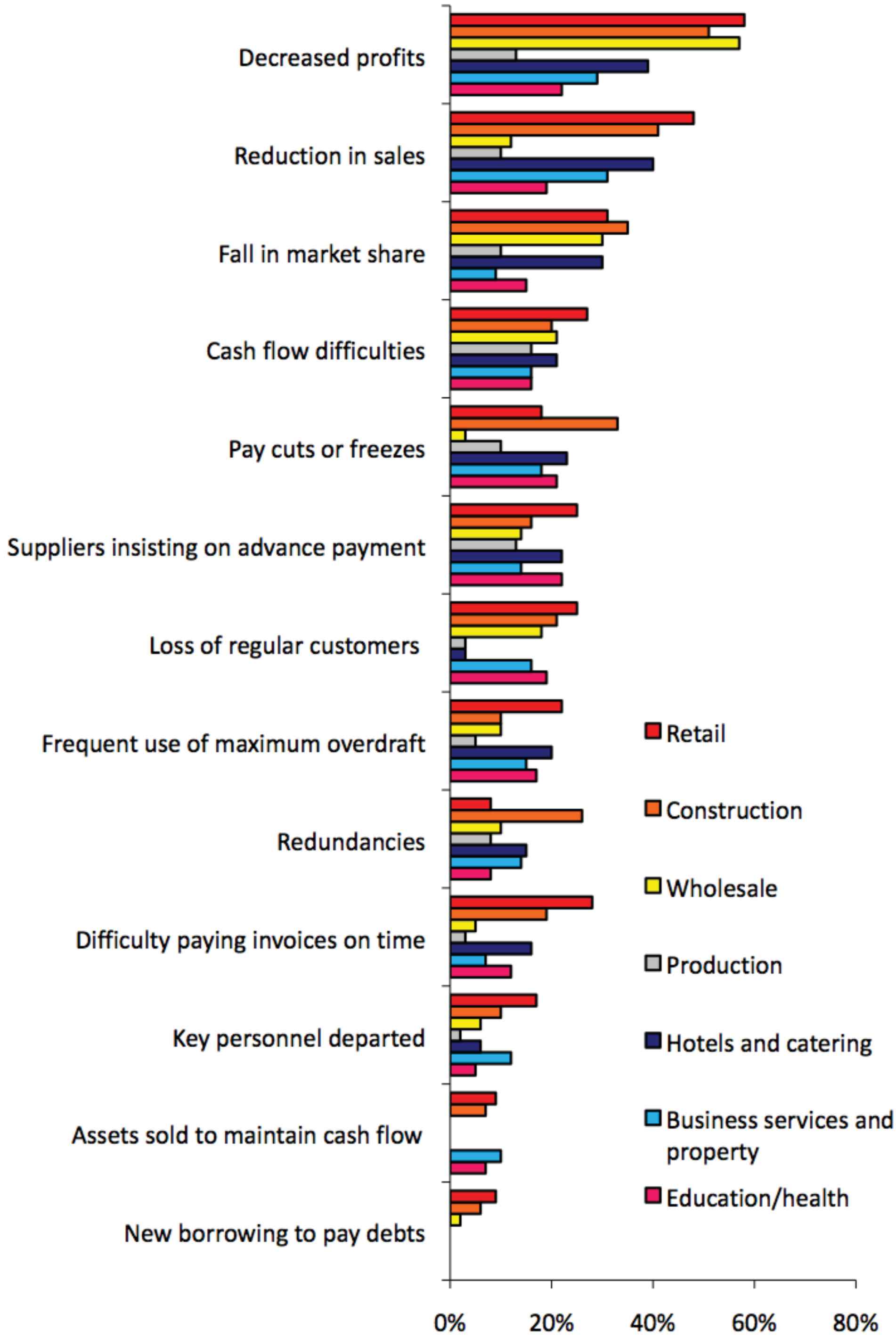
The graph below shows net agreement with each statement in each wave:



Signs of distress across the sectors

While retail dominates many signs of distress, construction businesses are more likely to be making redundancies and pay cuts and freezes than any other sector - at 26% and 33% respectively (compared to the cross-sector averages of 13% and 18%). Businesses in this sector are also more likely than those elsewhere to have seen a recent fall in market share - 35% compared to an average of 19%.

The arts and leisure sector records higher levels of loss of regular customers (29% compared to the cross-sector average of 16%) and frequent use of maximum overdraft (22% compared to an average of 13%) than other sectors. Perhaps as a result of its close relationship retail, the wholesale sector is suffering in certain areas, with 57% currently experiencing a decrease in profits (average 34%).

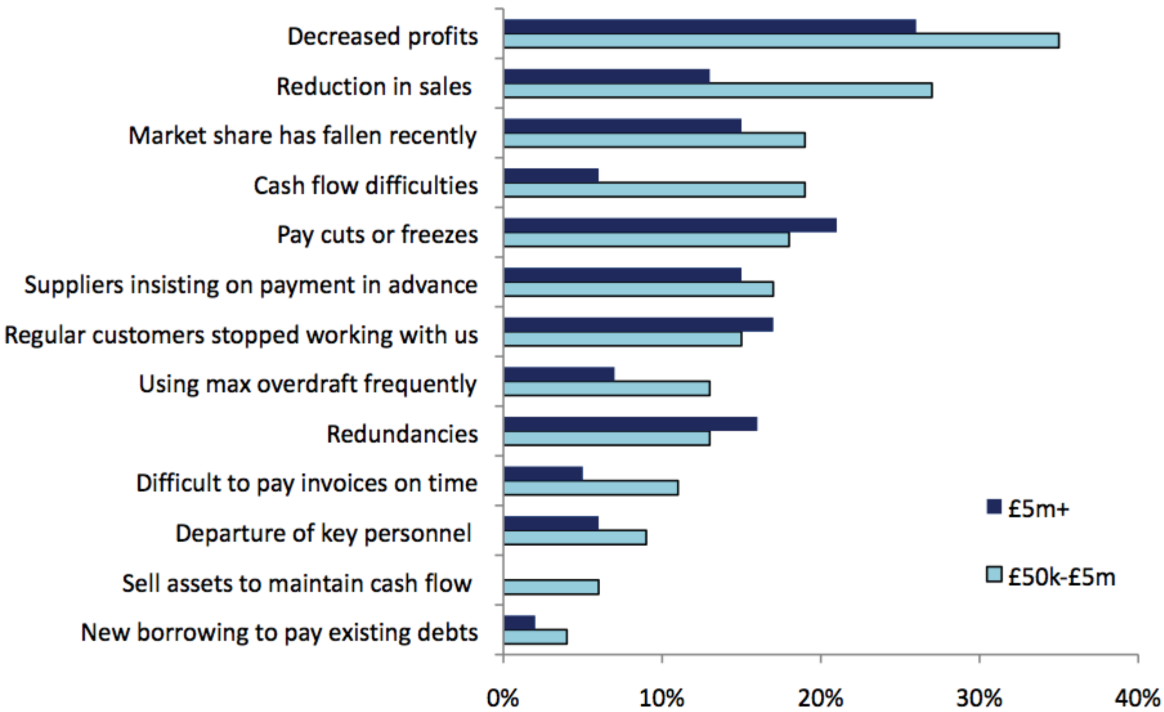


R3 President Frances Coulson explains:

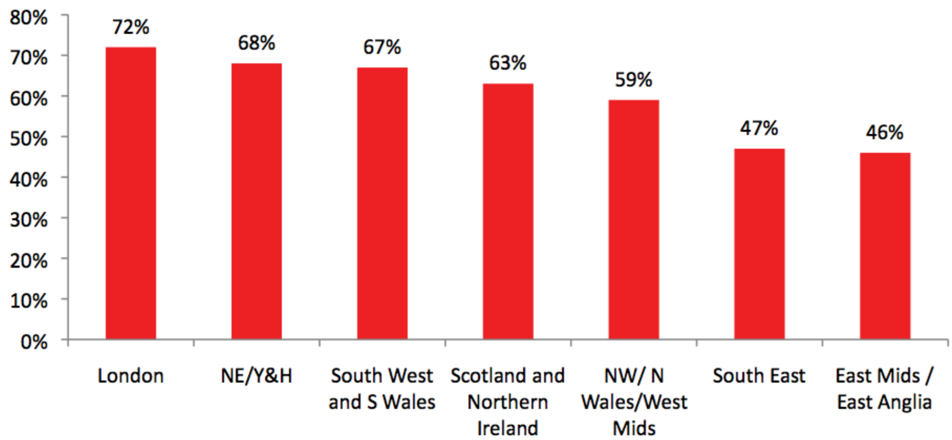
"The construction sector continues to suffer as a result of fewer building projects in public and private sectors. We have already seen vast redundancies in the sector during the recession and it seems as though cut backs are not abating as construction businesses cut their cloth to suit reduced demand."

Signs of distress across business size and regions

Smaller businesses are more likely than their larger counterparts to fall prey to ten out of the thirteen distress signs. However, larger businesses are more likely to be introducing pay freezes or cuts, making redundancies and to be losing regular customers.



The following graph shows the percentage of businesses in each region that are experiencing at least one sign of distress - the higher the number, the less positive the situation. Businesses in London are most likely to be experiencing at least one distress sign (72%), followed by those in the North East/Yorkshire and Humberside (68%) and the South West and South Wales (67%). Businesses in East Anglia/East Midlands and the South East are less likely to be experiencing distress signs, at 46% and 47% respectively.



Methodology note: BDRC Continental conducted 502 telephone interviews with small, medium and large business owners and Financial Directors between 6th and 16th June 2011. Quotas are set by size, region and sector and the data weighted to the profile of UK businesses. The respondent in each case is a senior financial decision maker.

BDRC has recently revamped its Business Omnibus. The sample has been expanded to include Northern Ireland businesses and some of the detailed sector and regional bands have been re-arranged to provide more robust sub-sample sizes for analysis. A 'control' survey was conducted showing no change in overall findings as a result of methodology change.

About R3

R3, the trade body for insolvency professionals, represents over 97% of Insolvency Practitioners. R3 members are trained and regulated accountants and lawyers who have extensive experience of helping businesses and individuals in financial distress.