dun & bradstreet

UK Quarterly Industry Report
Quarter 3 2019

NOVEMBER 2019

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GLOSSARY OF TERMS

Dun & Bradstreet defines specific terms as follows:

Business failure - A 'Failed Business' means any business that seeks legal relief from its creditors or ceases operations without paying all its creditors in full.

Company* - A legal entity, made up of an association of people (be they natural, legal, or a mixture of both), for carrying on a commercial or industrial enterprise.

Corporations - A 'Corporation' is a company or group of people authorised to act as a single entity (legally a person) and recognised as such in law.

Non-registered business - A business that is not recognised as a separate legal entity and not registered at that country's official companies registry (e.g. Companies House in the UK).

Firm - A business organisation that sells goods or services to make a profit, regardless of registration status.

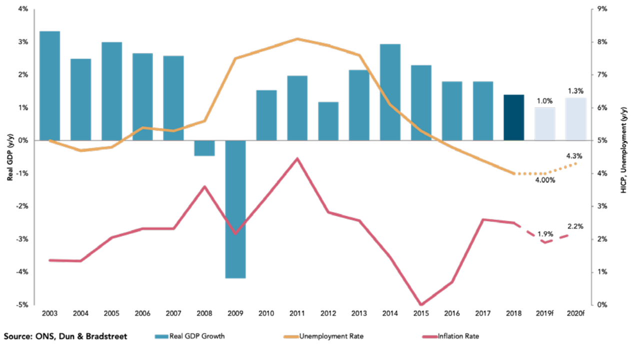
*Companies included in this report are those registered at Companies House.

1.0 UK ECONOMIC OUTLOOK

BREXIT UNCERTAINTY REMAINS HIGH

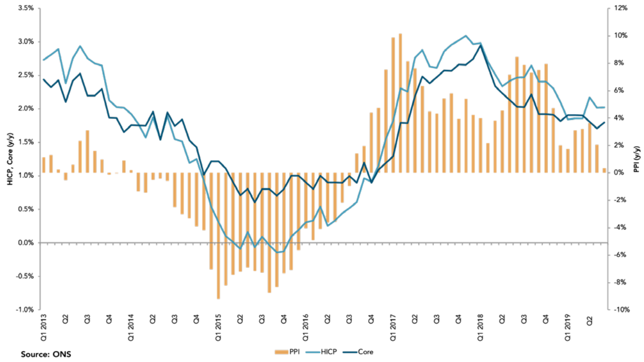
In mid-October, the UK government and the EU surprisingly reached agreement on Brexit terms. While this has reduced the risk of an immediate no-deal Brexit (which would have severe adverse effects on the British economy), the ratification process has been derailed immediately, with the UK parliament (in which the government no longer has a majority) objecting to the government's very tight timetable. For the time being, there is a lack of clarity about the next steps. EU leaders have approved another extension of the Brexit deadline, this time until 31 January 2020, but it remains unclear how the current deadlock in parliament will be overcome. The government has now scheduled an early election in December in an attempt to break the stalemate.

INFLATION, EMPLOYMENT & GDP



Dun & Bradstreet believes that the Conservative government under Prime Minister Boris Johnson is well placed to win a snap election given its double-digit lead in polls and the fragmentation of the 'remain' camp. This would enable Johnson to pass the Withdrawal Agreement Bill (WAB) later in December/January, leading to a managed Brexit in early 2020. However, the transition period (until December 2020) mentioned in the WAB, during which no changes to the legal framework between the EU and the UK would occur, is too short to negotiate the much-required free-trade agreement between the two sides. Without a longer transition period, there is an elevated risk of severe supply chain disruptions in early 2021. Also worryingly, the deal with the EU foresees a special status for Northern Ireland, which will lead to questions about the long-term future of the province: closer regulatory alignment with the EU and the Republic of Ireland, as well as demographic changes, could lead to Irish reunification over the coming decades.

INFLATION



PESSIMISM IS GROWING IN THE ECONOMIC SPHERE

While political uncertainty remains high in the context of Brexit, economic performance continues to disappoint. Monthly GDP data for August has significantly reduced the likelihood of the UK falling into a recession in Q3, but forward-looking indicators leave little room for optimism. September data for the Purchasing Managers' Index (PMI, compiled by Markit) shows that the service sector was contracting, for only the fifth time in the last decade. New order inflow declined (for the sixth time in 2019) and jobs were cut for the first time in five months (and by the fastest pace since August 2010).

AVERAGE WEEKLY EARNINGS GROWTH AND INFLATION

In the manufacturing sector, the PMI also stands below the neutral 50-points line that divides expansion in sectoral activity from contraction. Like the service sector, new order inflow and production levels deteriorated. For the year as a whole, Dun & Bradstreet forecasts that real GDP growth will expand by around 1.0%, followed by 1.3% in 2020 (assuming a managed exit from the EU). These would be the lowest growth figures since the financial crisis in 2008-09.

2.0 GLOBAL ECONOMIC OUTLOOK: HEADWINDS PREVAIL

Global economic growth is set to slow from 2.9% in 2018 to 2.4% in 2019 – the weakest level since 2009, during the global financial crisis. Supporting the fear of 'synchronised stagnation', only our MENA region is forecast to grow more quickly in 2019 than in 2018, primarily due to fragile improvements in security in Iraq and Syria. Furthermore, we are forecasting only a slight upturn in growth in 2020, to 2.5%, a forecast that will remain highly dependent on a resurgence in activity in non-China emerging markets including distressed economies such as Turkey and Argentina. The fact that China's growth will slow further into 2020 make such a resurgence a less likely outcome.

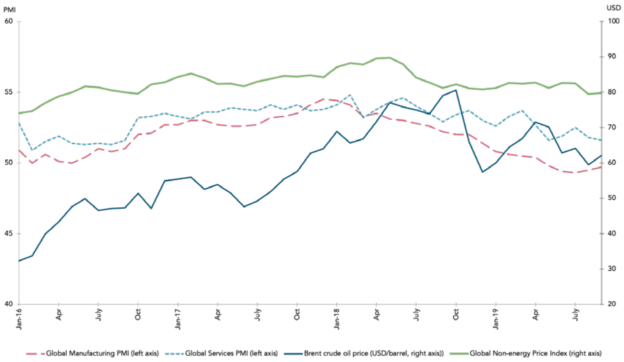
Weak growth is set to continue against a background of multiple headwinds, including trade tensions, despite the 'Phase I' US-China trade truce, as governments globally have implemented fewer liberalising and more restrictive measures – with a cost estimated by the IMF at 0.8pp of global GDP by 2020. In this context, we are doubtful of the ability of central banks to boost growth prospects in an era of negative interest rates, below-target inflation and increased sovereign, corporate and household debt. The scope for further monetary easing is extremely limited, and a majority of countries have little room for expansionary fiscal policies under current policy orthodoxy.

KEY RISK: CHINA, GLOBAL MANUFACTURING AND 'INVESTMENT GRADE' DEBT

China's y/y Q3 real GDP growth of 5.96% was lower than during the onset of the global financial crisis in Q1 2009 (6.3%) and in q/q seasonally-adjusted terms was estimated to be the lowest since Q4 2008. The reappearance of producer price deflation in China since July is a clear global warning signal. US consumer sentiment is in favourable territory, and US wages rose 3.9% y/y in Q1-Q2, but North American industrial production, home sales and durable goods orders seem to have peaked, and Dun & Bradstreet's US Overall Business Health Index has returned from 'low risk' to 'neutral' levels since 2018.

It is unclear how the global correction in manufacturing will translate into overall activity. Only in a few economies heavily exposed to China and global trade (e.g. South Korea, Singapore) has manufacturing employment kept falling in a clear trend. However, copper and cobalt prices, linked to global industrial and technology cycles, are signalling demand weakness, and output at the large Mutanda copper and cobalt mine in the Congo may be suspended by end-2019 if this continues. Manufacturing, with its large, 'lumpy' investments, is more vulnerable to trade war uncertainties than the services sector. Meanwhile, in a reflection of enhanced screening, less risk appetite, and idiosyncratic factors like Brexit, FDI globally fell 42% in Q2 2019 compared with Q1.s.

KEY GLOBAL GROWTH INDICATORS



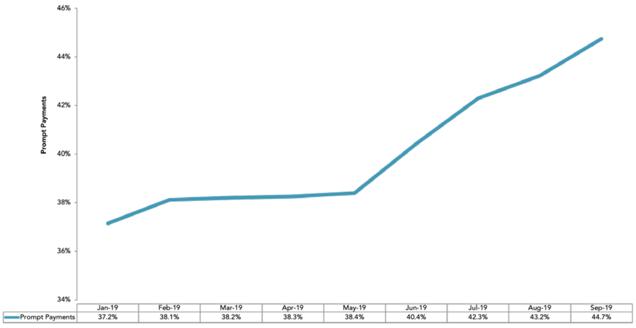
REAL GDP GROWTH (%)

	2019f	2020f	2021f
World	**2.4**	**2.5**	**2.8**
Advanced Economies	1.6	1.6	1.7
US	2.3	1.9	1.7
Euroland	1.2	1.3	1.4
Japan	0.9	0.3	1.0
UK	1.0	1.3	1.7
Emerging Economies	3.8	4.2	4.7
Brazil	0.9	1.8	2.2
Russia	1.3	1.6	1.8
India	6.4	6.7	7.3
China	6.1	5.8	6.2

The financial sector holds several negative wildcards. Quantitative easing and regulatory enhancements since the 2008 crisis are hampering the efficient functioning of bond and money markets, as Federal Reserve Treasury bill purchases since September show. The lowest-rated (but investment-grade) corporate bond layer represents a weak point for the global financial system, given growth from under USD1trn in 2007 to USD3trn in 2018.

3.0 PAYMENT SNAPSHOT

PROMPT PAYMENTS TRENDLINE
JANUARY 2019 TO SEPTEMBER 2019



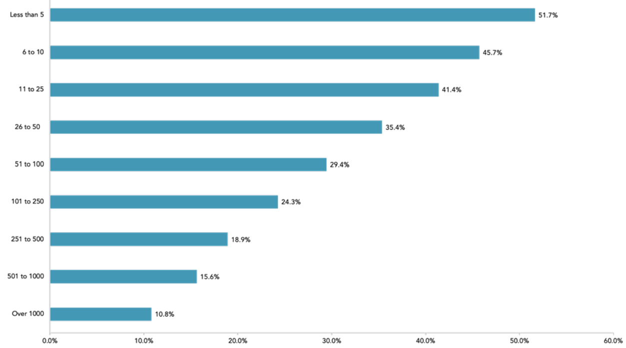
Source: Dun & Bradstreet; ONS

The chart above depicts how promptly all UK businesses have been paying their bills over the past nine months. Despite the relatively sluggish macroeconomic performance (real GDP contracted in Q2 2019), payments performance remained on its improving trend in the third quarter of 2019. Following significant increases in Q4 2018-Q2 2019, the share of prompt payments has increased even further in July-September and now stands at 44.7%, a multi-year high. This compares with 37.2% at the beginning of the year.

PROMPT PAYMENT
(CATEGORISED BY NUMBER OF EMPLOYEES)

As the data in the charts below reflects, larger businesses continue to squeeze their suppliers by paying in a much slower manner than their smaller counterparts. The differential in payment habits between those companies employing 1,000 workers or more and those employing fewer than five is significant: 10.8% in Q2 (it was 5.7% in early 2018) as opposed to some 47.1% (compared with 37.7% in early 2018).

AVERAGE PROMPT PAYMENT BY EMPLOYEE SIZE
Q3 2019



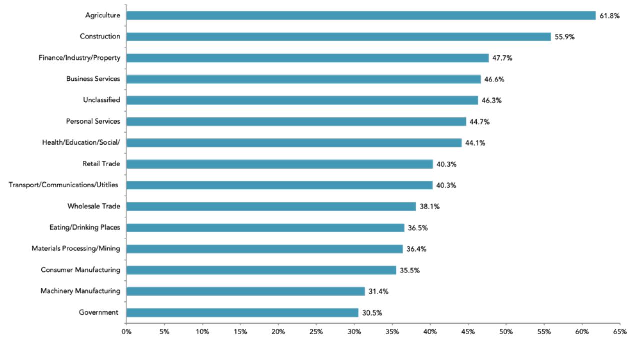
Source: Dun & Bradstreet

Late payments remain a major problem for UK-based small and medium-sized enterprises (SMEs). While legislation is in place to assist small businesses with their struggle against late payments, most businesses, especially SMEs, elect to take no action for fear of alienating their larger customers. Indeed, according to the Association of Chartered Certified Accountants (ACCA), firms with fewer than 50 employees are typically twice as likely as larger businesses to experience late payment issues. Besides giving rise to tighter financial conditions and higher administrative, transaction and financial costs (external financing may be necessary to manage cash flows), late payments can cause insolvency and ultimately lead to bankruptcy.

PROMPT PAYMENT
(CATEGORISED BY INDUSTRY)

As Dun & Bradstreet data shows, all 14 sectors covered in our Industry Report saw quarter-on-quarter improvements in the share of prompt payments in July-September (similar to Q1 and Q2, when all sectors also recorded a rise in the share of prompt payments). The smallest improvement were recorded in eating and drinking places (+1.0 percentage points (pp) q/q), government (+1.6pp) and agriculture (1.7pp). At the top of the league are health/education/social (up by 5.3pp), business services (+6.0pp) and the financial sector (+6.3pp). Despite the rise of prompt payments in all sectors, significant differences across industries remain clearly visible: while only 31.4% of all bills get paid on time in the machinery manufacturing sector, this percentage rises to 55.9% in the construction sector and an even higher 61.8 in agriculture. Meanwhile, the public sector remains at the bottom of the league, with only 30.5% of all bills having been paid on time in Q3 2019, significantly below the national average of 44.7%.

AVERAGE PROMPT PAYMENT BY INDUSTRY
Q3 2019

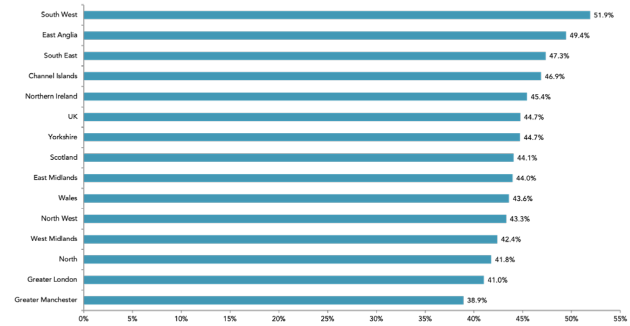


Source: Dun & Bradstreet

PROMPT PAYMENT (CATEGORISED BY REGION)

Dun & Bradstreet's Q3 data reveals that regional payment patterns have remained fairly stable, with the urban regions of Manchester and London still displaying the lowest share of prompt payments: only 39-41% of all bills are settled on time there, compared with the UK average of around 45%. At the other end of the spectrum are East Anglia (49.4% of all payments are paid promptly) and the South West where more than half of all bills are settled in a timely manner (51.9%).

AVERAGE PROMPT PAYMENT BY REGION Q3 2019



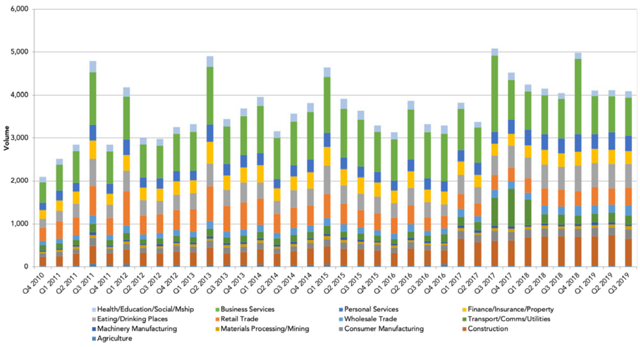
Source: Dun & Bradstreet

Positively, all 14 regions in the UK showed a rising share of prompt payments in Q3 2019. The biggest improvements were recorded in the South West (+5.2pp q/q) and the South East (+4.8pp). In a European comparison, proprietary data from Dun & Bradstreet and our World Wide Network confirms the UK's slightly below-average position: in July-September 2019 the average payment delay in the UK was 13.5 days (down from 15.0 days in Q3 2018), compared with the European average of 13.4 days. The UK lags some of its neighbours considerably, most notably the Netherlands (where the average payment delay stood at 4.6 days in Q3) and Germany (6.9 days). Positively, the UK outperforms Italy (18.4 days) and Portugal (25.8 days) and is ranked par with Spain.

4.0 CORPORATE LIQUIDATIONS

While payments performance improved in the third quarter of 2019, painting a picture of microeconomic strength, the number of corporate liquidations remained almost stable in the same period. In July-September, Dun & Bradstreet recorded 4,086 corporate liquidations, up by a marginal 0.7% y/y but down by 0.7% q/q. This follows very small changes in Q2 2019, which means that the risk of non-payment in the UK has remained unchanged for two quarters in a row.

BUSINESS LIQUIDATIONS

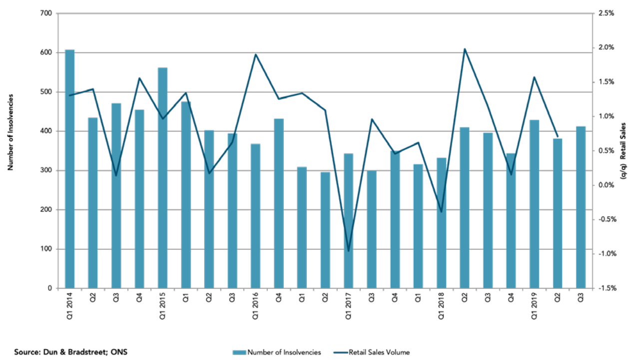


A sectoral breakdown shows that 7 of 14 sectors covered recorded a decrease in the number of liquidations in the third quarter of the year, ranging from a 3.4% q/q drop in eating and drinking places to an 11.4% reduction in machinery manufacturing (following a 15.0% drop in Q2). The remaining seven sectors saw an increase in the number of liquidations, with wholesale trade seeing a surge by 23.2% q/q, followed by consumer manufacturing (which was up 16.7% q/q). Similar to previous quarters, the sector with the most business failures was business services, where the number of liquidations stood at 883 in July-September.

CORPORATE LIQUIDATIONS: RETAIL TRADE

In the retail space, the number of corporate liquidations grew, both in a q/q and y/y comparison. Compared against prior year, numbers increased by 4.0%, and in q/q terms the number of liquidations went up by 7.9%. Although retail liquidations currently account for a tenth of all corporate liquidations in the UK (412 out of 4,086), they tend to attract a large amount of media attention. This was seen earlier this year when House of Fraser and Debenhams reported further financial trouble (which eventually led to the latter going into administration in April 2019). House of Fraser was eventually rescued from administration by Sports Direct (which is now also reporting financial problems), but its department stores reported an operating loss of GBP54.6m in July, and more stores have been earmarked for closure.

RETAIL SECTOR INSOLVENCIES & SALES VOLUME



Latest sales figures illustrate the problem most retailers are currently facing: while John Lewis department stores' sales figures remained almost stagnant in 2018 (up 0.08% for the year as a whole) and fell in Q1 and Q3 2019 (stagnating in Q2), online sales in the UK continue to expand rapidly, putting pressure on 'bricks-and-mortar' shops. According to the Office for National Statistics (ONS), online retail sales (excluding fuel) rose by 14.5% in 2018 and 15.0% y/y in Q1 2019 before growing by 10.6% in Q2 2019. This comes on top of 21.1% growth in 2016 and 16.0% in 2017.

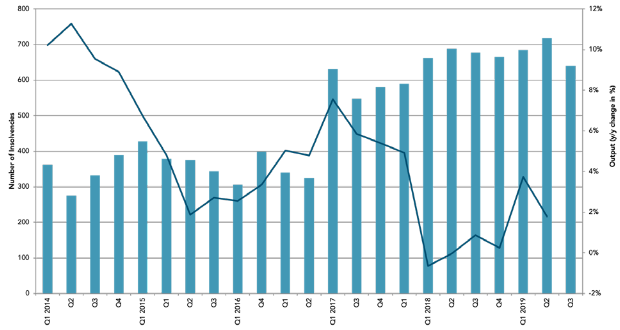
Since the start of the ONS data series in 2008, online retail sales (as a percentage of total retail sales minus fuel in the UK) have increased from 4.2% in January 2008 to almost 20% now. It seems likely that this trend will continue over the next few years, adding to the problematic operating conditions the sector is facing. Also worryingly, rising wages, higher fuel costs and more difficult access to credit also create problems for retailers, with consumer confidence dented by the political uncertainty around Brexit. At the same time, the number of personal insolvencies in England and Wales hit an eight-year high in 2018 – reaching 115,319 – also impacting on consumer spending. Positively in this light, Q1 and Q2 2019 figures fell slightly, but the last three quarterly readings are the highest since late 2010.

As a by-product of the decline of the high street, commercial property landlords are facing an uncertain future. Given the oversupply of retail space in town centres, rents are likely to fall over the medium term. In addition, troubled chains (such as the already mentioned Debenhams and House of Fraser) are likely to use so-called Company Voluntary Agreements, which will enable them to reduce rent payments. Latest data shows that one in nine shops in the UK's 650 biggest towns and cities is currently empty. Some 3.6% of all shops in the UK have now been empty for more than three years, with the North East of England and Wales displaying a much higher share (6%). An increasing number of landlords are converting shops into offices, warehouses or residential buildings.

CORPORATE LIQUIDATIONS: CONSTRUCTION

Dun & Bradstreet business failure data for the construction sector shows a different trend to retail: Q3 saw a fall of the number in liquidations, both in q/q terms (-10.9%) and in y/y terms (down 5.5%). Overall, 640 companies filed for insolvency in July-September, the lowest reading since Q4 2017. The sector is important for the UK economy, as it contributes some £90bn in gross value added and supports almost 3m jobs.

CONSTRUCTION OUTPUT AND INSOLVENCIES



Source: Dun & Bradstreet; ONS

Problematically, latest high-frequency indicators point towards a cooling in the construction sector. The Purchasing Managers' Index stood at 43.5 points in September, far below the neutral 50-points line that divides expansion in sectoral activity from contraction. Brexit and a generally high level of political uncertainty are all clouding the outlook, and the September reading saw the steepest cut in employment since 2010 (while new order inflow also remained negative). ONS data shows that housing starts have been falling since 2013, expanding by a meagre 2.4% in 2018 (compared with 19.6% in 2013). Worryingly, the phasing out of the 'help to buy' scheme over the next few years will put additional pressure on the sector, as it is likely to reduce the demand for newly built properties.

5.0 RISK OF FAILURE AND PAYMENT DELINQUENCY – INDUSTRY SECTOR COMPARISON

	RISK OF FAILURE	
	RISK (Rating 1,2,3) Minimal to above average risk	**HIGH RISK** (Rating 4)
RISK OF VERY SLOW PAYMENT – **HIGH RISK** (Delinquency Score <=10)	**CASH VULTURES** UK AVERAGE – 15% RETAIL – 6% CONSTRUCTION – 13% Offer discount for prompt payment Charge interest on late payments Reset payment terms accordingly Improve relationship with client to induce prompt payment	**TROUBLE – LET YOUR COMPETITORS HAVE THEM** UK AVERAGE – 4% RETAIL – 4% CONSTRUCTION – 4% Increase prices to cover risk Reduce exposure – stop orders until paid Take guarantees Monitor vigorously Avoid new clients with this profile Up-front payment
RISK OF VERY SLOW PAYMENT – **RISK** Minimal to above average risk (Delinquency Score >=11)	**IDEAL CUSTOMERS – CULTIVATE** UK AVERAGE – 80% RETAIL – 88% CONSTRUCTION – 82% Push for more sales Strengthen relationship with client	**MONITOR CLOSELY** UK AVERAGE – 1% RETAIL – 1% CONSTRUCTION – 1% Reduce exposure – minimise outstanding orders Monitor vigorously Take guarantees

Dun & Bradstreet's statistical analysis reveals that some 4% of UK businesses are deemed to be at high risk of liquidation and are highly likely to pay in a severely delinquent manner, while 80% offer a low risk both of failure and of slow payment. Sales emphasis towards these latter businesses will enhance opportunities and enable suppliers to reduce risks of non-payment. Additionally, some 15% of UK businesses fall within the lower risk categories and are thus less likely to fail; however, the payment habits they exhibit are somewhat slow, and while suppliers can be fairly secure in the knowledge that the business will not fail, payment may be somewhat protracted.

DUN & BRADSTREET'S OVERALL RECOMMENDATIONS

- Monitor the number of corporate liquidations carefully: the latest data shows an overall stagnation, but a sectoral breakdown reveals a mixed picture.
- In this light, monitor the retail sector closely: it is still experiencing a high level of stress, as consumer patterns are shifting and supply chains could become endangered amid Brexit.
- Keep in mind that average payment delays in the UK have been falling over the past quarters, but remember that sectoral differences still remain sizable.
- Base business decisions on the assumption that the UK's payments performance will be largely in line with the European average, but worse than the Netherlands and Germany.
- Assume that payments performance in the construction and agricultural sector will be good, but note that manufacturers tend to pay relatively slowly.
- Follow Brexit developments in parliament closely, as the UK's economic performance (including payments performance and insolvency risk) will depend on the nature of the UK's departure from the EU.
- With a Brexit deal now being negotiated between the EU and the UK (but not ratified yet), assume that a no-deal Brexit can be avoided.
- Even in the case of a Brexit deal, assume that real GDP growth will come in between 1.0% and 2.0% over the next five years – rather low figures by historical standards.
- Count on rising wage costs, as labour market conditions will remain good over the coming quarters.

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