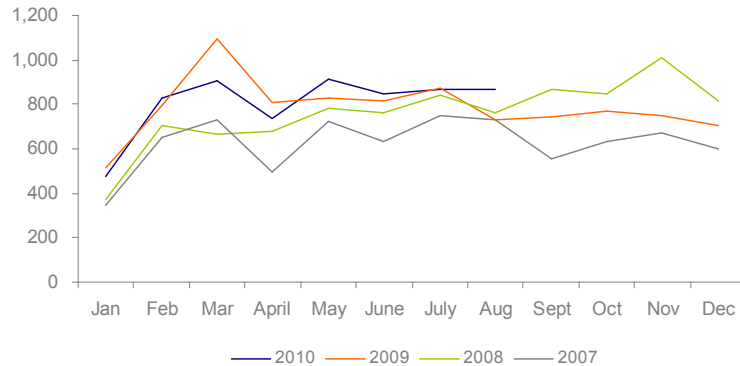


Insolvency Insights – August 2010

Taylor Woodings' analysis of ASIC's latest external administration appointments statistics



Companies Entering External Administration



The Figures

What these latest figures suggest

- The second month in the 2011 financial year has seen a further, albeit very small, increase in Australian company failures up by just 0.4% to 870 from 866 the previous month.
- Despite the minor increase, company failures are at a seven year high for the month of August.
- Historically, insolvency numbers dip in August. Over the preceding six years, the average number of August insolvencies stands at 702.
- This year, the number of companies entering external administration in August is 24% higher than the six year average and 19% higher than August last year.
- For the year to date, company collapses have totalled 6,439, less than 0.5% lower than the corresponding period in 2009 (6,468) when the effects of the GFC were thought to have their greatest impact.
- We believe the unusually high number of appointments for August is indicative of continued scepticism over the health of the Australian economy (other than mining and related industries) and the lag effect of the GFC.

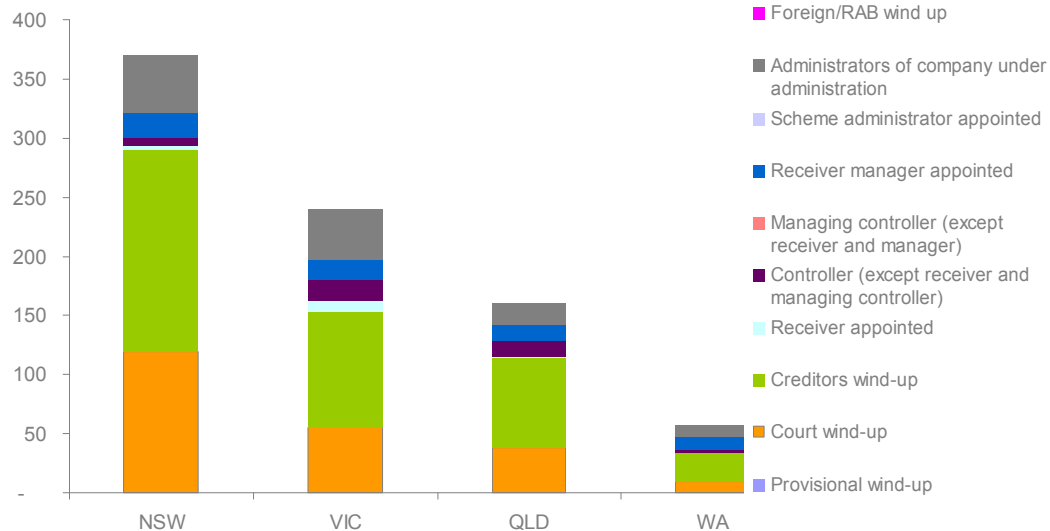
Economic Influences

What's happening in the broader market with particular attention to macro influences on insolvency?

- The economic data continues to provide mixed and unexpected messages as reflected by the RBA's surprise decision to keep interest rates on hold at 4.5% for the fifth month in a row.
- On the one hand, retail sales grew by a modest 0.3% in August (down from 0.7% in July) and the number of jobs advertised increased for the fourth consecutive month, by 2.4%.
- On the other hand, RP Data Rismark's figures show a decline in capital city house prices of 1.2% in the three months to August and the AIG/CBA Australian Performance of Services Index indicated a contraction in activity for the fourth consecutive month.
- Perhaps the greatest factor contributing to company collapses are the tight credit markets which, although slowly starting to loosen, are still having a profound impact on business, particularly SMEs.
- The tourism industry and property sector (especially in Queensland) are particularly affected due to the combined impacts of economic uncertainty, a very high Australian dollar and constricted credit markets.
- In Western Australia, the agricultural sector is quite distressed following record low rainfalls and limited access to credit.

Source: ASIC

Comparison of Appointments by State



Source: ASIC

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Change in Annualised Number of Appointment Versus Change in Average RBA Interest Rates



Source: ASIC and the RBA

For more information

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Comparative Analysis

Comparing the statistics with an economic indicator

- The RBA's monetary policy decisions are described as the target cash rate, which is the overnight money market interest rate. The cash rate is announced following the monthly meeting of the Reserve Bank Board and effective the following day.
- An analysis of Australia's average annual target cash rate against annualised insolvency figures over the last five years reveals a different pre and post-GFC relationship between the figures.
- Prior to the GFC, rates of company failures were relatively low and reflective of the booming economy. Rates of company collapses, matched or even decreased against the increasing cash rate as monetary policy was used in an attempt to manage the booming economy.
- With the onset of the GFC, this trend was interrupted and the relationship between the figures started to become inverted. In response to the GFC, and the accompanying increase in insolvencies, the RBA made deep cuts to interest rates. While this did not reduce company collapses, the steep upward trend was arrested.
- The 2010 figures have been annualised and show that, at this stage, the post-GFC inverse trend will continue.
- High insolvency figures, still trending upwards, pose a conundrum for central policy makers given the inflationary and political implications of further monetary easing and fiscal stimulus.

Outlook

What we predict for the future and what inferences we can draw

- There is still a lot of uncertainty over the state of the Australian economy with some indicators suggesting a positive outlook, while others, including company collapses, suggesting the effects of the GFC continue to be felt.
- Our analysis of the historical relationship between interest rates and insolvency numbers indicates that the September insolvency figures (released next month) will remain at a similarly high level and trending above 2009 figures.
- This week's unexpected decision by the RBA to keep rates on hold, shows the Board is perhaps not as optimistic as the majority of Australia's economists. As the RBA Governor recently reminded us, "the future is of course unknowable, and economic forecasts unfortunately are not very reliable."