The 333 Australian Corporate Health Index 2009

Corporate health declines further – the crisis is not over yet

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The 333 Australian Corporate Health Index

The 333 Australian Corporate Health Index is a pulse check that assesses the health and resilience of corporate Australia. Based on members of the ASX All Ordinaries Index between 2003 and 2009 (see page 6 'About the Sample'), it uses changes in the Altman Z-Score (see page 6, 'About the Altman Z-Score') as a measurement of corporate health. As the Altman Z-Score is the most widely used and most commonly understood predictor of financial failure, the 333 Australian Corporate Health Index is able to provide insight into the current level of health and resilience of corporate Australia.

As the world navigates and exits the biggest recession since the 1930's, Australia continues to be in a critical period in our economic history. While there is optimism in our resource-based economy, we must not shy away from asking "What is the financial health of corporate Australia? And is there a systemic risk that may lead to a "double-dip' recession – where already stressed companies may be pushed 'over the edge'?"

To answer this, we used the 333 Australian Corporate Health Index to provide insight into three key issues:

1. How healthy is corporate Australia?
2. Is the health of Corporate Australia improving or deteriorating?
3. What should companies be doing to improve corporate health and resilience?

Key Findings

Only one in three companies remains in good financial health: In 2007, Australian corporate health achieved a record high, with 63% of Australian companies found to be healthy. By 2009, this has dropped to 36%.

More than two out of three companies declined in health - again: Of concern is our finding that 71% of companies declined in health, compared to 66% in 2008. This is the largest percent of companies in the six years of data analysed.

Consumer industries have been relatively more resilient than the overall economy. While the government's stimulus may be working on high street, the positive signs of consumer confidence are not representative of the economy as a whole.

The key message is that the financial crisis is not over. The laggards need to act urgently and the others need to continue to focus on improvement. Our advice is to get control and create options:

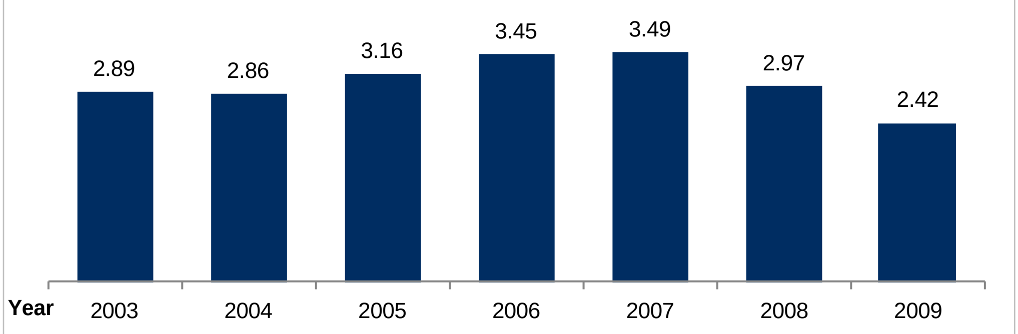
- Be Realistic and Assess Risk – Take a hard look, identify risks and make appropriate plans
- Manage for Cash – Cash buys you time to execute
- Fix the Core Business – The ability to deliver will allow you to grab share when the market grows
- Be Holistic – Address the complex high-impact issues
- Don't Ignore Strategy – Focus on your strengths and don't be afraid to shrink to profitability

Overall corporate health sees another precipitous drop in 2009

2008 saw the first decline in the median Z-Score since the brief and mild drop from 2003 to 2004. Despite recent optimism in the markets, our 2009 analysis shows a further fall in the median Z-Score of 19% relative to 2008.

This continued fall in the median Z-Score suggests that many Australian companies are vulnerable to further economic shocks.

Australian Companies Health (Median Z-Score)



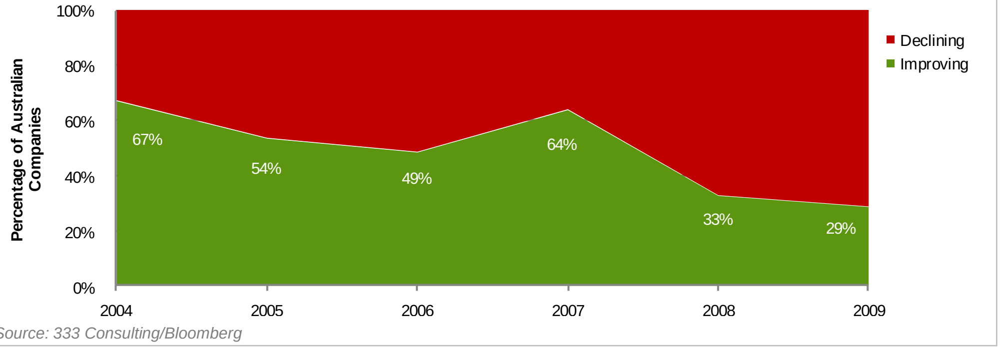
Source: 333 Consulting/Bloomberg

Greater than two thirds decreased in health – again

Underlying the 19% fall in overall corporate health (Z-Score 2.97 to 2.42) are 71% of Australian companies that declined in financial health over the last year – an even bigger number than 2008.

This is the largest percentage of companies to reduce their corporate health since 1999. It suggests that the impact of the downturn is deeper and longer than generally acknowledged and that many companies are closer to the edge than it would seem – with a real risk of failure.

Australian Companies Health (Improving or Declining)



Source: 333 Consulting/Bloomberg

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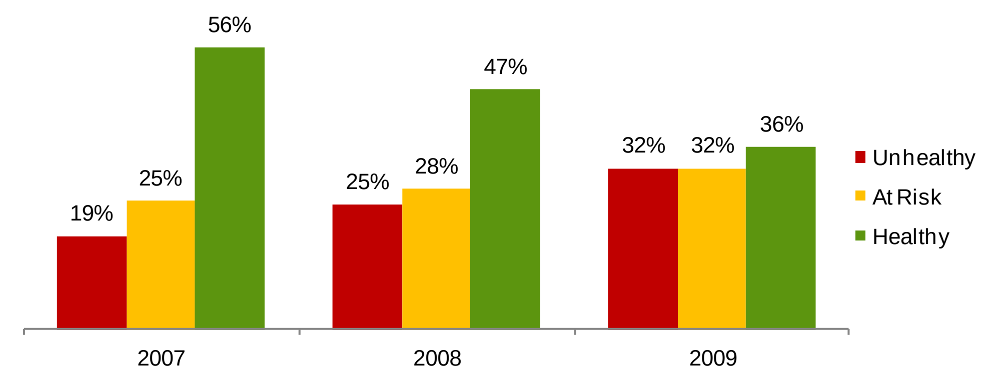
One in three Australian companies left in a healthy state

The risk profile of corporate Australia, measured by the percentage of companies in each Z-Score category, has worsened to a point where there is significant systemic risk in the economy:

- In 2009, the number of Australian companies considered healthy dropped to 36%;
- The percentage of unhealthy companies increased further from 25% to 32%; and
- The number of companies measured to be 'at risk' increased from 28% to 32%.

Australian Corporate Health (Unhealthy, At Risk or Healthy)



Source: 333 Consulting/Bloomberg

'Unhealthy' and 'at risk' companies are in worse shape

49% of Australian companies are both declining in health, and either 'at risk' or 'unhealthy'. This compared to 43% in 2008 report.

Of the healthy companies, 61% are declining in health (22% of the overall sample). This is in line with last year's results where 58% of healthy companies were declining in health.

Unhealthy and Improving 6%	At Risk and Improving 9%	Healthy and Improving 14%
Unhealthy and Declining 26%	At Risk and Declining 23%	Healthy but Declining 22%

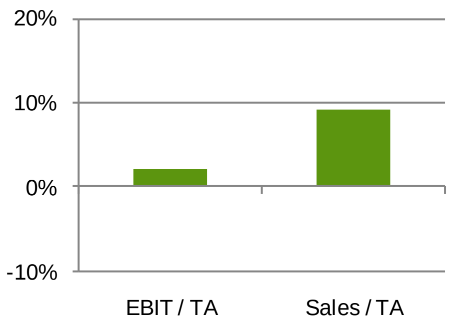
49% of companies declining and 'at risk' or 'unhealthy'

Companies with improving health have increased both sales efficiency and profitability

There is a clear trend across all companies that have improved in health: they have significantly increased sales efficiency (reflected in their Sales to Total Assets ratio) and also improved their profitability (reflected through their EBIT to Total Assets ratio).

Hence, increasing health has not been all about raising capital or cost cutting.

Companies with Improving Health (Median Z-Score change)

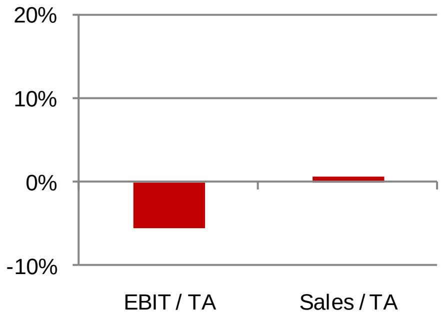


Source: 333 Consulting/Bloomberg

Companies with decreasing health have not adapted cost bases quickly to maintain EBIT-total assets ratios

Companies with deteriorating health also showed a common trend: they remained stagnant on sales efficiency, indicating that they did not raise their game to keep up with a changing or shrinking marketplace. In particular, declining companies saw their profitability slide, suggesting that they were not able to adapt their cost base or margins to adapt.

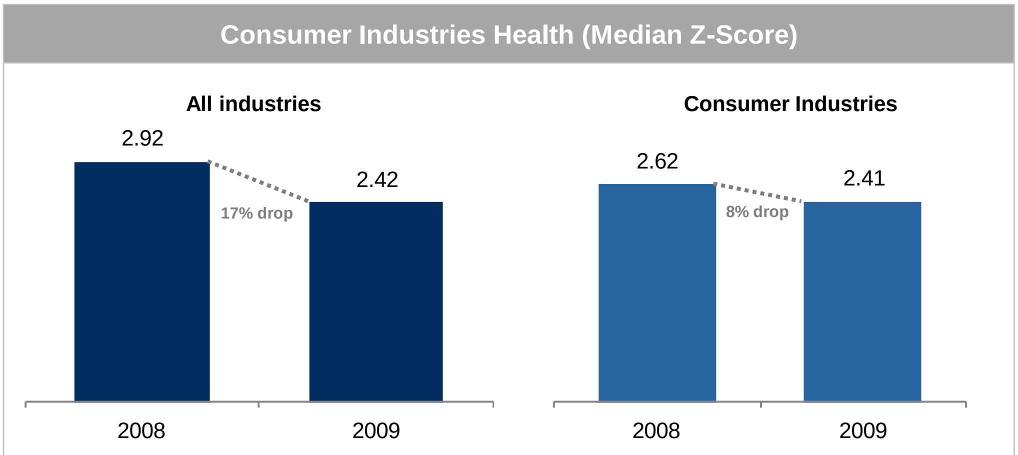
Companies with Deteriorating Health (Median Z-Score change)



Source: 333 Consulting/Bloomberg

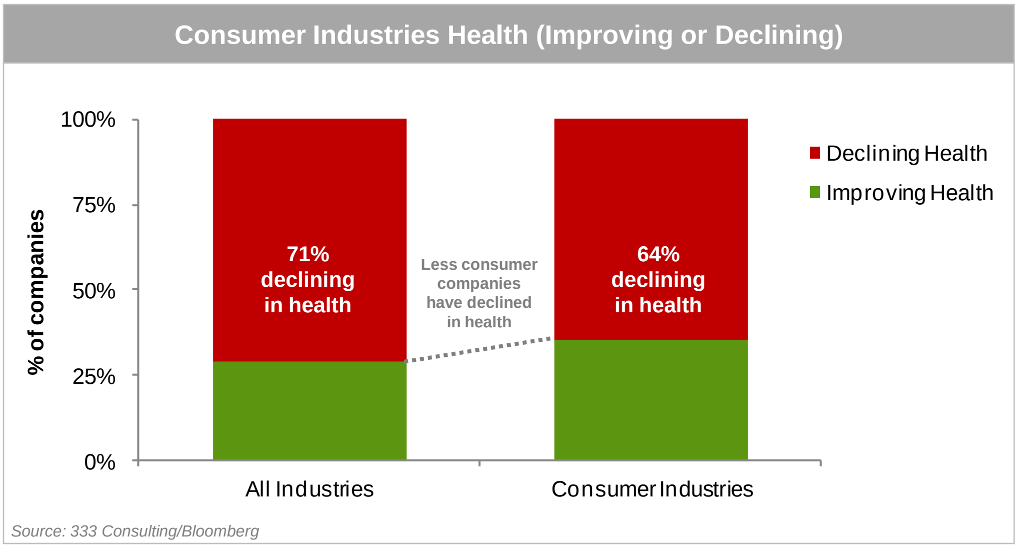
Consumer Industries have decreased less than the Australian industry average

Consumer industries have been relatively resilient and have dropped only 8% in Z-score vs. a 17% drop across all industries – most likely positively impacted by the government's stimulus package.



Source: 333 Consulting/Bloomberg

This is consistent with our finding that 64% of companies in consumer-facing industries declined in health compared to 71% for all industries.



Source: 333 Consulting/Bloomberg

What should companies be doing now?

Don't be complacent – as a leaky boat doesn't always rise with the tide. Many companies are still at risk today or at risk of falling behind as the tide rises.

Our advice – be realistic, get control and build sustainability and performance into your core business.

1. **Be Realistic and Assess Risk** – Take a hard look at how your company, competitors, suppliers, staff and customers are tracking. Identify potential scenarios and mitigate risks to keep your goodwill intact.
2. **Manage for Cash** – Cash buys you time to execute. Use multiple cash generating strategies – if you raise capital, combine it with tight cash and working capital management . Don't substitute capital raising for improving the operating cash flow of your business.
3. **Fix the Core Business** – Fix core business issues that impact your ability to compete. When the economy recovers and the market grows, market share will be available to those companies who are the best in their industry. A robust core business that delivers what your customers value – consistent product quality, on-time-delivery, innovation and short order-to-delivery cycle – will help you win more and grow faster as the tide rises. Don't be the leaky boat.
4. **Be Holistic** – The most successful responses do not focus on cost alone – they address a targeted number of financial, organisational, operational and strategic issues in parallel.
5. **Don't Ignore Strategy** – Identify your profitable core business, determine your strategic options, develop your plan and don't be afraid to shrink to profitability. Rebalance your capital structure to meet your strategy – not the other way round.

About the Altman Z-Score

The Z-Score was developed in 1968 by Edward Altman, one of the pioneers of modern credit analysis. Altman is Professor of Finance at New York University's Stern School of Business. His Z-Score has been shown to have high reliability in predicting bankruptcy. In his original work, Altman worked from a paired sample of 66 manufacturing firms. At the time, Altman was looking for a single score that could determine the likelihood that a company will fail.

Altman's study identified the following three bands:

- Not Bankrupt – Healthy (Green) — Z-Score > 2.99
- Grey Area – At Risk (Amber) — Z-Score between 1.81 and 2.99
- Bankrupt – Unhealthy (Red) — Z-Score < 1.81

The Altman Z-Score was calculated from a company's financial data based on five ratios with fixed coefficients that are added to determine a single score. The ratios used are:

- Working capital / total assets (weighting 1.2)
- Retained earnings / total assets (weighting 1.4)
- Earnings before interest and tax / total assets (weighting 3.3)
- Market value of equity / book value of debt (weighting 0.6)
- Sales / total assets (weighting 0.99)

About the sample

The 333 Australian Corporate Health Index is based on companies which were members of the ASX All Ordinaries Index and had the required figures available from 2003 (119 companies) to 2009 (325 companies). The three year analyses, 2007-09, were performed as a like-for-like comparison for companies that reported the required data in all three years.

Our sample excludes financial services sector firms where the Z-Score is considered to be a low predictor of failure.

By excluding these industries, the 333 Australian Corporate Health Index becomes a much stronger measure of health in corporate Australia.

We believe that the 333 Australian Corporate Health Index provides a powerful insight into the level and likelihood of success or failure in corporate Australia.

About the analyses

In addition to analysing the Z-Scores of Australian companies over the period, we have also analysed the directional changes in Z-Score for the sample over the period in the belief that directional changes are a lead indicator of Australian corporate health. As a result we have included directional changes as a key component of the 2009 333 Australian Corporate Health Index.

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