UK Quarterly Industry Report

QUARTER 2 2017

August 2017

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WITHIN THIS REPORT YOU CAN FIND ANALYSIS OF THE FOLLOWING KEY TOPIC AREAS:

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GLOSSARY OF TERMS

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.

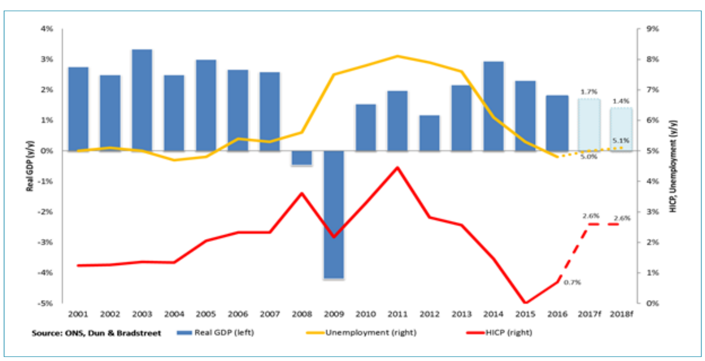
1.0 UK ECONOMIC OUTLOOK

CONSERVATIVE-LED GOVERNMENT SECURES SUPPORT IN PARLIAMENT

A month after the inconclusive snap election result that led to the Conservative Party under Prime Minster Theresa May losing its absolute majority in parliament, a so-called ‘confidence and supply’ deal has been agreed between the Conservatives and the Democratic Unionist Party (DUP) from Northern Ireland. In exchange for generous financial transfer payments from the British government to Northern Ireland over the coming years, the DUP’s ten MPs will provide the Conservatives with a parliamentary majority. As a consequence, Dun & Bradstreet has upgraded the UK’s political environment outlook from ‘deteriorating rapidly’ (to which it had fallen immediately after the election) to just ‘deteriorating’.

Political risk has fallen compared to the days immediately following the election, and Theresa May’s position now looks more tenable. However, the government is facing several tough challenges over the next few months: it still seems likely that the 2017-22 parliamentary term will be cut short because of another snap election. Problematically, May’s working majority in parliament is very slim, and there is no consensus in her party (let alone with her Northern Irish coalition partner) as to what post-Brexit UK-EU relations should look like. This is especially worrisome as Brexit talks between the EU, led by Chief Negotiator Michel Barnier, and the UK, led by Brexit Minister David Davis, started officially on 19 June, leaving just over a year until the negotiation results have to be brought before the British and European parliaments for approval.

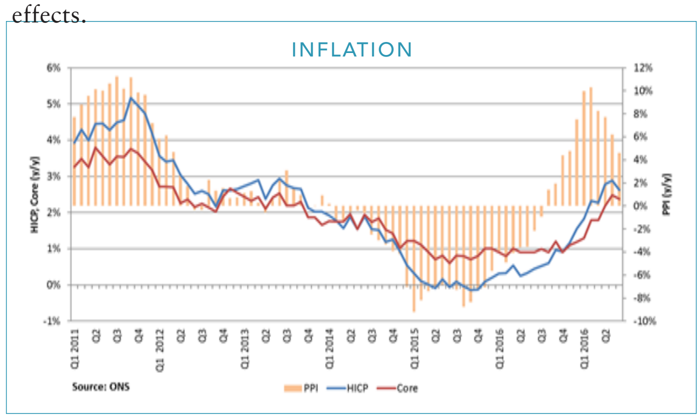
Dun & Bradstreet is maintaining its baseline forecast scenario in the light of the recent political events. We still expect the UK to leave the EU in March 2019, with a transitional arrangement bridging the gap until a free-trade deal comes into force. However, as implementation risks are high, we recommend monitoring the situation closely and frequently.



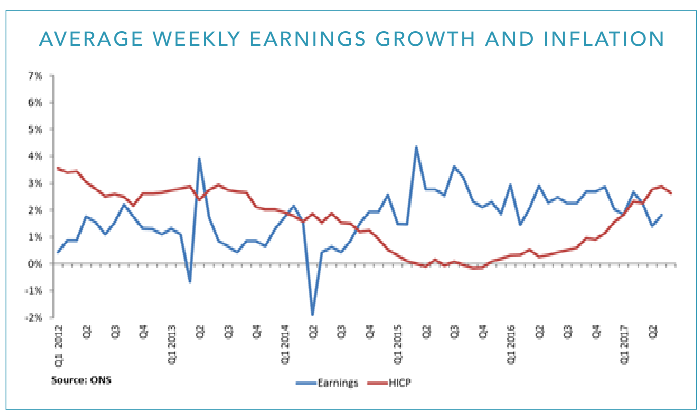
INFLATION IS RISING

Meanwhile, in the economic sphere, the outlook is clouding. Most worryingly, inflation reached 2.9% in May, the highest value in four years. This led to a fall in real wages of 1.2% in May, causing a drop in living standards and purchasing power. With inflation significantly overshooting the Bank of England’s (BoE) target rate of 2%, pressure on rate-setters is rising.

At their latest meeting, in June, the BoE rate-setters decided - in a closer-than-expected 5-3 vote - to maintain both the Bank’s record-low interest rates and the quantitative easing scheme. However, should inflation remain elevated, pressure on the BoE to raise rates will increase, creating additional potential headwinds for the British economy. Positively, our baseline scenario does not forecast interest rates to increase until the completion of the Brexit talks, as most of the inflationary pressures are caused by rising import costs (a result of the weaker pound), global commodity prices and base effects.



In the background to this, the UK fell by one position in the World Bank’s latest Doing Business 2017 report, slipping from 6th to 7th, albeit still outperforming most of its peers. Overall, seven out of ten sub-indices deteriorated and two stagnated. The only sub-ranking where the UK saw an improvement was ‘paying tax’; the country rose from an already high 11th spot to 10th. Compared with the OECD average, it takes fewer payments (8.0 versus 10.9) and less time (110.0 hours versus 163.4 hours) to settle tax bills, with the total tax rate (as a percentage of profits) in the UK also comparing very favourably with the OECD average (30.9% versus 40.9%).



2.0 GLOBAL ECONOMIC OUTLOOK: US GROWTH FALTERS BUT EUROZONE STRENGTHENS

Into H2 2017, we continue to forecast stronger growth for the year at 2.8%, up from 2.3% in 2016 and the strongest performance since 2011. However, over the past month we have noticed a change to trends in the major economies, with the US data indicating a weakening of growth as the year progresses, while the prospects for the eurozone, Japan and China are improving. We now forecast US growth will come in at 2.0% in 2017, up from 1.6% in 2016, while the eurozone will edge up from 1.7% to 1.8%, and Japan will rise from 1.0% to 1.3%; China, however, will slow from 6.7% to 6.3%.

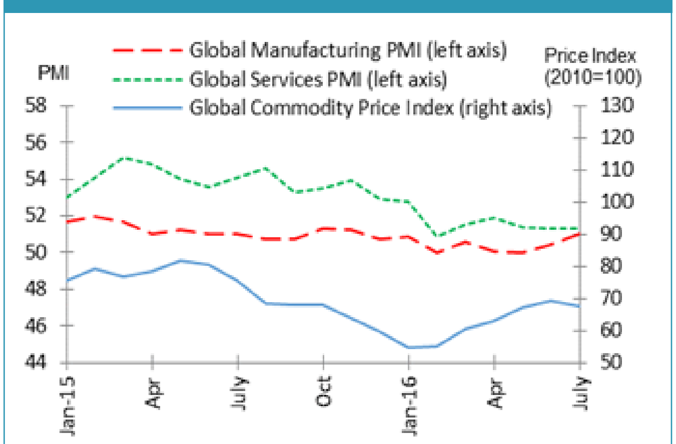
The weaker outlook for the US has raised market concerns about the timing of the next Federal Reserve interest rate. In June US interest rates were raised for a second time in 2017, with the Fed signalling one further hike this year. In addition, it indicated that it is liable to start unwinding its bloated balance sheet by year-end. While we are maintaining our forecast in line with the Fed, any uncertainty over the timing is liable to see increased volatility in global capital and currency markets, in turn impacting on business and household confidence - and therefore growth prospects.

KEY RISK: EMERGING MARKETS STILL DEPENDENT ON US FINANCIAL CONDITIONS

As of early August, Dun & Bradstreet was expecting countries producing an estimated 61% of global GDP to continue to exhibit stability; countries producing 25% of global GDP to experience deteriorating country risk conditions; and the remainder, responsible for 14% of global GDP, to undergo an improvement in country risk conditions. These trend groups reflect the combination of all country risk factors, not just economic ones. However, outside of the US and UK, where political frictions have contributed to confusion and sub-par economic growth, and excepting countries in more obvious crisis such as Venezuela, conditions are promising.

A number of important emerging markets are due to see accelerations in growth from Q1 levels over the rest of the year, including: Indonesia, from 5.0% to 5.6%; India, from 6.1% to over 7.0%; Russia, from 0.5% to 1.7%; and Argentina, from 0.3% to 3.0%. Many others – several of them in Eastern Europe – are forecast to decelerate slightly from stand-out Q1 2017 GDP growth results, but there is the clear possibility that growth will not revert to a lower trend so quickly: Poland's economy grew 4.4% year on year in Q1, and Romania's by 5.7%. An important reason has been that while the US Federal Reserve has acted to gradually edge up short-term borrowing costs, overall financial conditions have stayed highly accommodative (especially in the US itself, as seen in asset prices and long-term commercial borrowing rates), which has benefitted emerging markets significantly.

KEY GLOBAL GROWTH INDICATORS

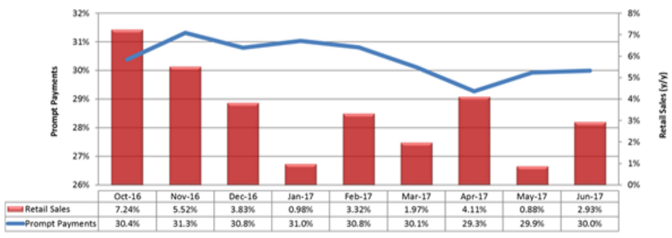


REAL GDP GROWTH (%)

	2016	2017f	2018f
World	2.3	2.8	3.0
Advanced economies	1.7	2.0	2.2
US	1.6	2.0	2.3
Euroland	1.7	1.8	1.9
Japan	1.0	1.3	1.3
UK	1.8	1.7	1.4
Emerging economies	3.4	4.2	4.5
Brazil	-3.6	0.5	1.8
Russia	-0.2	1.4	1.6
India	7.1	7.2	8.2
China	6.7	6.3	5.8

3.0 PAYMENT SNAPSHOT

PROMPT PAYMENTS TRENDLINE
OCTOBER 2016 TO JUNE 2017



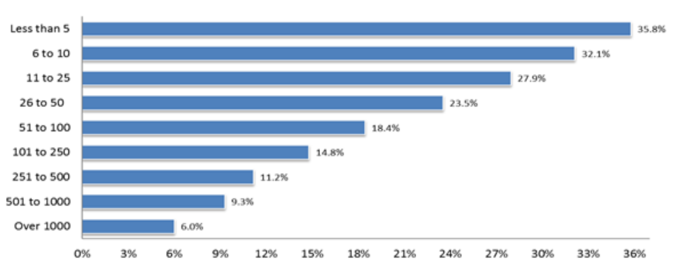
Source: Dun & Bradstreet; ONS

The chart above depicts how promptly all UK businesses have been paying their bills over the past nine months (blue line). Robust export growth (boosted by a weaker pound), as well as a rebound in retail sales volumes over Q2 (red bars), was not sufficient to compensate for the slowdown in the pace of overall economic growth in Q1 and Q2: after expanding by 0.7% q/q in Q4 2016, real GDP grew by a modest 0.2% q/q and by 0.3% q/q in Q1 and Q2 2017, respectively. As a result, prompt payments deteriorated slightly in the three months to June, according to Dun & Bradstreet's latest data. Furthermore, the uncertainty triggered by Brexit (which might have affected UK businesses' capacity – and/or willingness – to pay promptly) is also likely to have contributed to the deterioration of payment habits. Looking ahead, we expect a further deterioration in prompt payments due to rising headwinds triggered by the Brexit vote.

PROMPT PAYMENT BY EMPLOYEES

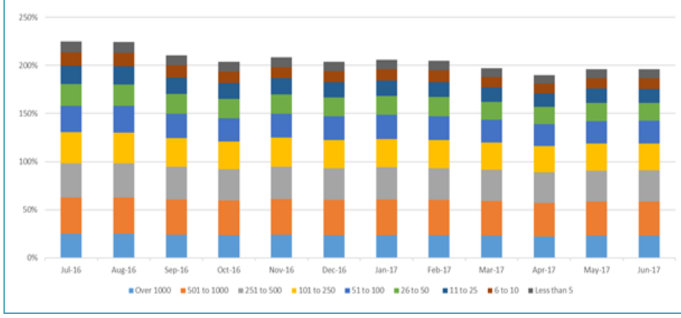
As the data in the charts below reflects, larger businesses continue to squeeze their suppliers by paying in a much slower manner than their smaller counterparts. The differential in payment habits between those companies employing 1,000 workers or more and those employing fewer than five is significant: 6.0% (it was 5.9% in Q1 2017) as opposed to some 35.8% (from 36.1% in Q1).

PROMPT PAYMENT BY EMPLOYEE SIZE FOR Q2 2017



Source: Dun & Bradstreet

PROMPT PAYMENT BY EMPLOYEE BAND

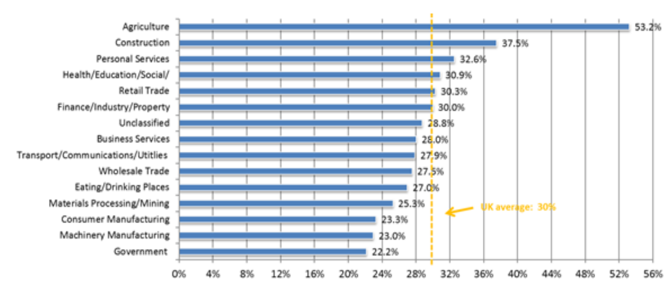


Indeed, late payments remain a major problem for UK-based small and medium-sized enterprises (SMEs). While legislation is in place to assist small businesses with their struggle against late payments, most businesses, especially SMEs, elect to take no action for fear of alienating their larger customers. 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.

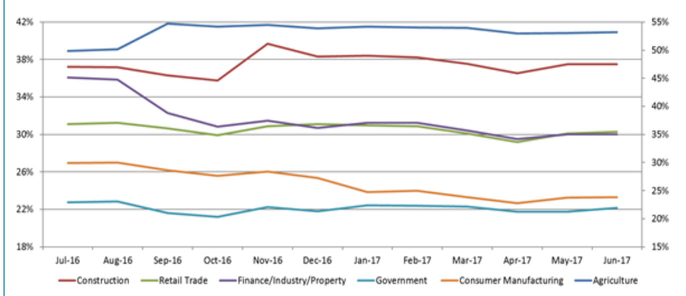
PROMPT PAYMENT BY INDUSTRY

As Dun & Bradstreet data show, payment habits by industry remained substantially stable on a quarter-on-quarter (q/q) basis in Q1 2017. The data, broken down by industrial sector, reveal that between Q4 2016 and Q1 2017 the largest deterioration in payment habits was recorded in the 'Consumer Manufacturing' sector, followed by the 'Eating/Drinking Places' and 'Personal Services' sectors. 'Health and Education', 'Government', and 'Eating/Drinking Places' sectors.

PROMPT PAYMENTS BY INDUSTRY, Q2 2017



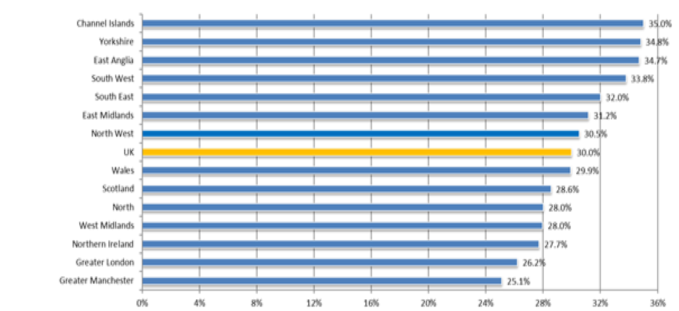
PROMPT PAYMENT EVOLUTION IN CRITICAL SECTORS (AGRICULTURE, RIGHT AXIS)



Source: Dun & Bradstreet

PROMPT PAYMENT BY REGION

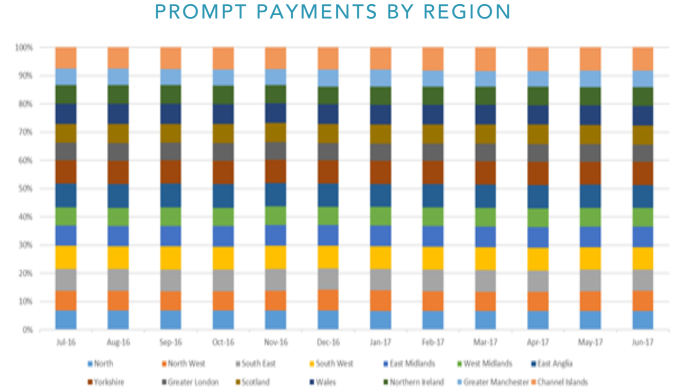
PROMPT PAYMENT BY REGION, Q2 2017



Source: Dun & Bradstreet

Dun & Bradstreet's Q2 data reveal that overall payment performance deteriorated by an average of 0.8 percentage points (pp) between Q1 and Q2 2017 across the regions. The Yorkshire area recorded the largest deterioration in average prompt payments (as a percentage of total payments), which dropped by 1.3 pp to an average of 34.6%. The Greater Manchester area, whose average of prompt payments dropped by 0.9 pp, continues to lag behind all the other regions (only 25.1% of payments were made promptly, compared to a UK average of 30%), while the East Anglia and the Channel Islands areas exhibit the best payment performance times (34.8% and 35%, respectively).

PROMPT PAYMENTS BY REGION



4.0 CORPORATE LIQUIDATIONS

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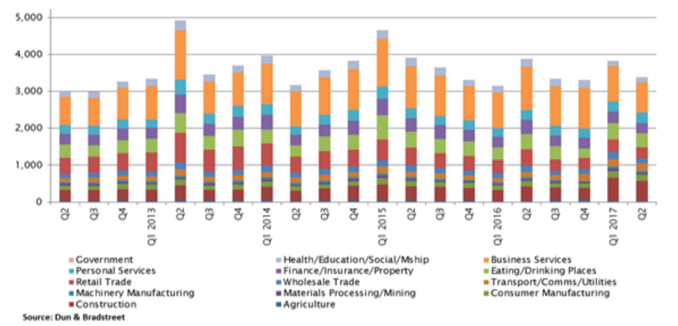
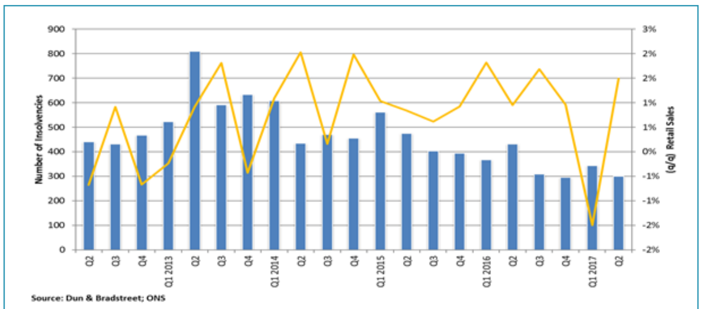


The number of corporate insolvencies fell by some 11% q/q in Q2 (and by 12.9 y/y), according to Dun & Bradstreet data: 3,372 companies liquidated in the three months to June, compared to 3,824 the previous quarter. Between Q1 2017 and Q2 2017, corporate insolvencies were down in almost all the sectors of the economy, with decreases of 28% q/q in 'Wholesale' and 18.5% q/q in 'Material Processing/Mining'. Meanwhile, 'Government', and 'Personal Services' were the only sectors recording an increase in the amount of liquidations, up by 50% q/q and 5.2% q/q, respectively.

CORPORATE LIQUIDATIONS : RETAIL TRADE

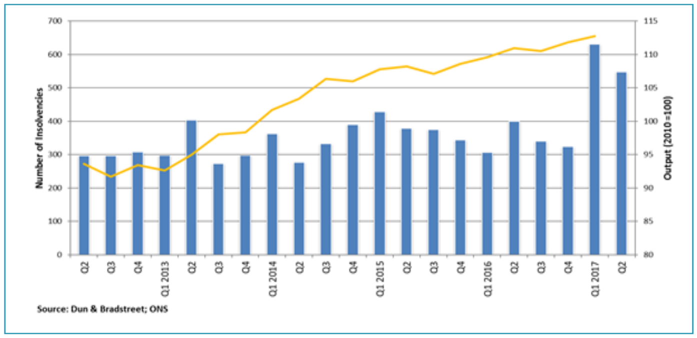


The Office of National Statistics' (ONS) data reveals a rebound in retail sales volumes in Q2 2017: retail sales volumes went up by 1.5% q/q in Q2, after dropping by 1.5% q/q in Q1. Tallying with positive retail trade data, Dun & Bradstreet's proprietary data shows a fall in corporate insolvencies in the retail sector – which accounts for almost 6% of the UK economy – in Q2 (down by 12.5% q/q and by 30.5% y/y).

Looking ahead, we expect a slight increase in the unemployment rate on account of slower GDP growth, and so we expect retail sales growth to decelerate in the quarters ahead. Lower sales growth could lead to a small rise in the number of liquidations in the coming quarters. Against this backdrop, the uncertainty surrounding the retail sales outlook remains high, with risks tilted to the downside. On the upside, the still-low unemployment rate will continue to provide a boost to domestic sales volumes. On the downside, a slowdown in overall economic growth, Brexit, and lower real wage growth (on account of rising inflation) could weigh on consumer spending.

Weakening consumer confidence will also exert downward pressure on consumer spending, and thus on sales growth: in June, consumer confidence fell to levels last seen in the aftermath of the Brexit vote.

CORPORATE LIQUIDATIONS: CONSTRUCTION



Dun & Bradstreet's data shows a drop in the number of construction companies liquidating in the second quarter of 2017: 547 companies failed in Q2, while 631 liquidated in Q1. The construction industry plays an important role in the UK economy; the entire sector contributes some £90bn in gross value added to the UK economy and supports 2.9m jobs. Lower momentum in this sector is likely to weigh on real GDP growth in the quarters ahead.

The latest seasonally adjusted Markit/CIPS UK Construction Purchasing Managers' Index (PMI) tallies with Dun & Bradstreet's positive data. Although the rate of sectoral activity expansion eased with respect to the first quarter, the PMI remained well above the 50-point expansion threshold, posting a reading of 54.5 in March, down from 56 in May.

Markit's report reveals business activity, new work and employment all expanded at slower rates than in May. Survey respondents commented on signs of renewed risk aversion among clients, reflecting concerns about the economic outlook and heightened political uncertainty. Softer growth momentum was recorded across all three broad categories of construction activity. Residential building continued to outperform commercial work and civil engineering in June. Moreover, the latest rise in housing activity was still the second-fastest since December 2015, according to Markit.

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 – 19% RETAIL – 11% CONSTRUCTION – 16% 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 – 3% 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 Minimal to above average risk (Delinquency Score >=11)	IDEAL CUSTOMERS – CULTIVATE UK AVERAGE – 77% RETAIL – 85% CONSTRUCTION – 79% 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 77% offer a low risk 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 19% 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

- Expect inflation to overshoot the central bank's target of 2.0% in the next few years, coming in at 2.6% in both 2017 and 2018.
- Prepare for an economic slowdown, with growth of 1.7% in 2017 and 1.4% in 2018.
- Expect labour market conditions to deteriorate, but to remain superior to those of most neighbouring European economies.
- Keep a close eye on the UK's negotiating position (which is still in flux in the aftermath of the snap election); a hard Brexit now seems less likely than it did in Q4 2016 and Q1 2017.
- Monitor negotiations between the UK and the EU; the outcome will have an immense impact on the UK's country risk rating and market access conditions.
- Firms should adopt a wait-and-see approach; it will be many more quarters before uncertainty about post-Brexit trade relations is lifted.
- As a baseline scenario, expect the UK to lose full access to the EU's common market once Brexit is completed...
- ...but also expect the EU and the UK to sign a free-trade arrangement that will keep market access regulations fairly uncomplicated post-Brexit.

dun & bradstreet

Marlow International
Parkway, Marlow
Buckinghamshire, SL7 1AJ

+44 (0) 800 001234

ABOUT COUNTRY INSIGHT

Dun and Bradstreet also have a team of economists dedicated to analysing the risks and opportunities of doing business across the world, monitoring 132 countries on a daily basis. For further details please contact Country Risk Services on 01628 492595 or email CountryRisk@dnb.com.
Classification: Commercial in Confidence