February 2010

Euler Hermes Cash Flow & Profit Survey of UK Companies

The Euler Hermes Cash Flow & Profit Survey of UK Companies is a survey of financial trends based on questionnaire responses from financial directors or persons in similar roles in around 300 UK based companies. The panel of companies is carefully monitored to accurately reflect the true structure of the UK private sector economy, covering manufacturing, services, construction and distribution (retail and wholesale).

The survey is designed to provide a unique insight into cash flow and profitability trends and thereby fills a gap in the existing financial and economic data available to business decision makers and economic policy makers.

EULER HERMES United Kingdom

1 Canada Square
London E14 5DX

Tel: 0800 056 5452

e-mail: **enquiries@eulerhermes.com**
web: **www.eulerhermes.co.uk**

Euler Hermes is the worldwide leader in credit insurance and one of the leaders in the areas of bonding, guarantees and collections. With 6,100 employees in over 50 countries, Euler Hermes offers a complete range of services for the management of B-to-B trade receivables and posted a consolidated turnover of €2.1 billion in 2009.

Euler Hermes has developed a credit intelligence network that enables it to analyse the financial stability of 40 million businesses across the globe. The group protects worldwide business transactions totalling €700 billion.

Euler Hermes, a member of the Allianz group, is listed on Euronext Paris. The group and its principal credit insurance subsidiaries are rated AA- by Standard & Poor's.

Markit Economics

Henley on Thames
Oxon RG9 1EL, UK

Tel: +44 1491 461000
Fax: +44 1491 461001

e-mail: **economics@markit.com**

The Euler Hermes Cash Flow & Profit Survey of UK Companies is produced on a quarterly basis by Markit Economics, an independent research company that produces highly-regarded surveys of business conditions in nations around the world.

Fastest rise in cash flow since Q3 2007 despite further decline in profits.

Key findings:

- Cash flow increased at sharpest pace for nine quarters.
- Further reduction in profits.
- Payment delays rose at faster rate.

The latest Euler Hermes survey of UK companies' financial health signalled the third successive annual increase in free cash flow during Q4. Moreover, the rate of growth accelerated to its steepest since Q3 2007. Profits fell at a broadly similar pace to that registered in the previous quarter, principally reflecting heavy discounting. Profitability at UK companies has now decreased in each of the past nine quarters.

Further rise in cash flow

Q4 data indicated that cash flow was 6.1% higher than twelve months earlier, the strongest rise since Q3 2007. Lower stock holdings were the principal factor behind the increase, although there were some reports that improving profitability had helped to boost cash flow.

Rising cash flow was driven by the manufacturing sector, where the increase of 15.0% was by far the steepest since data were first collected in Q4 2002. Services posted a marked rise in cash flow, while in contrast construction and distribution companies registered declines. By company size, large firms saw the strongest rise in cash flow. Moreover, at 16.0% the rate of growth was a series record. Medium-sized firms posted a solid increase in cash flow, although it was slightly weaker than that seen in the previous quarter. Small companies posted a marginal rise in cash flow, following seven successive quarters of reduction.

UK companies expect cash flow to rise modestly over the next twelve months. The latest forecast is in contrast to the previous survey where firms predicted a small reduction in free cash flow. Anecdotal evidence suggested that firms expect cash flow to rise as sales increase. Construction companies forecast the strongest growth of cash flow of the four monitored sectors, with distribution the only category to predict a fall. Both large and small companies expect cash flow to be higher in twelve months' time.

Profits fell during Q4

UK companies posted another reduction in profits in Q4. The pace of decline was solid, and broadly similar to that registered in the previous quarter. Profitability has decreased in each quarter since Q4 2007. Manufacturing was the only sector to record higher profits in Q4, while the contraction at construction firms was particularly sharp. Services posted a marked fall in profits, following a slight increase in the preceding quarter, while distribution profitability was broadly unchanged. Large companies registered a marginal rise in profits, while small- and medium-sized firms posted further declines.

Each of the eight factors monitored by the survey had a negative impact on the profitability of UK companies during the quarter. Price discounting was the main factor driving down profits, with competition and raw material prices also imparting marked negative impacts.

Interest rates impacted negatively on profits in Q4, as the positive effects seen in the previous quarter wore off. The weakest negative impact was from overseas demand, followed by labour costs.

Payment delays continued to increase

A lack of available cash flow at customers during the economic downturn led to a further increase in payment delays from both UK and overseas clients in Q4. Incidents of payment delays from UK customers rose more quickly than from overseas clients and the average length of delays remained longer. The sharpest increase in payment delays from UK customers was in the construction sector.

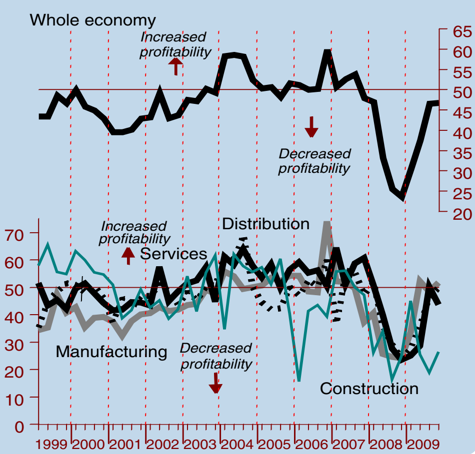
Payment delays from clients in Q4 led in turn to UK companies delaying payments to suppliers. Instances of delays to suppliers increased at a sharp rate that was the fastest in a year. The rise was steepest at construction companies, where the pace of increase quickened to its highest in the series

Cash Flow at Q4 2009

	Average % change in cash flow over: *past* 12 months	*next* 12 months
All companies	**6.1%**	**1.6%**
Services	5.8%	2.0%
Manufacturing	15.0%	1.7%
Distribution	-0.2%	-0.5%
Construction	-4.4%	3.1%

The Euler Hermes UK Profits Index

Indices, 50=no change on previous quarter



Cash flow

Strongest rise in cash flow since Q3 2007.

Higher cash flow partly reflected reduced inventories.

Cash flow expected to rise over the coming year.

The Euler Hermes UK Cash Flow Index tracks the percentage change in current cash flow with that of twelve months ago. Companies are also asked to provide their best estimates of future expected cash flow growth over the coming twelve-month period.

Q4 data signalled that free cash flow at UK companies rose again, extending the current sequence of growth to three quarters. Moreover, the latest increase was the fastest since Q3 2007. According to respondents, rising cash flow was partly reflective of reduced stock holdings over the year, although there were some reports of strengthening profits.

The overall rise in free cash flow was driven by large companies where the rate of increase accelerated to its steepest in the series history. Cash flow at medium-sized firms rose for the third quarter in a row, while the modest increase in cash flow at small companies ended a seven-quarter period of decline. On a sectoral basis, manufacturers recorded a strong increase in cash flow that was comfortably the sharpest in the series history. Services cash flow rose at the fastest pace since Q3 2007, while construction and distribution companies continued to post falls.

UK companies forecast a slight rise in cash flow over the next year in line with forecasts of improved sales and continued restrictions on capital expenditure. Both large and small companies predict increasing free cash flow, while medium-sized firms expect a marginal reduction.

Construction firms predict the strongest rise in cash flow over the coming year, with only the distribution sector expecting a fall.

The Euler Hermes UK Cash Flow Index*

Annual % change

ACTUAL – % change over past twelve months

	2008 Q4	2009 Q1	Q2	Q3	Q4
All Companies	**-1.7%**	**-5.2%**	**0.6%**	**2.4%**	**6.1%**
1-100 employees	-1.3%	-3.7%	-1.7%	-4.2%	0.5%
101-500 employees	-3.0%	-0.3%	2.5%	4.1%	3.7%
500+ employees	0.1%	-9.9%	5.0%	7.3%	16.0%
Services	-0.9%	-3.5%	1.2%	1.6%	5.8%
Manufacturing	-0.5%	-6.5%	3.1%	9.2%	15.0%
Distribution	-5.7%	-7.4%	-0.4%	-1.6%	-0.2%
Construction	-1.8%	-7.5%	-8.6%	-4.2%	-4.4%

FORECAST – % change over next twelve months

	2008 Q4	2009 Q1	Q2	Q3	Q4
All Companies	**-0.3%**	**-0.2%**	**4.4%**	**-1.4%**	**1.6%**
1-100 employees	-0.4%	1.1%	3.6%	-1.5%	2.8%
101-500 employees	-3.4%	-2.6%	2.2%	1.0%	-0.4%
500+ employees	3.7%	1.9%	8.4%	-4.3%	2.8%
Services	0.0%	-2.1%	7.1%	-2.7%	2.0%
Manufacturing	0.7%	5.4%	2.7%	-1.3%	1.7%
Distribution	-0.1%	-1.1%	-0.7%	3.3%	-0.5%
Construction	-6.0%	-3.6%	3.3%	-3.5%	3.1%

** CASH FLOW is calculated as Operating Cash Flow (before changes in working capital) less total capital investments.*

Profits

Further decline in profits in Q4...

...at broadly similar pace to Q3.

The greatest negative influence on profitability was price discounting, followed by competition.

Profits at UK companies continued to decrease during the final quarter of 2009, extending the current sequence of reduction to nine quarters. The rate of contraction remained solid in Q4, and was broadly similar to that recorded in the previous quarter.

As has been the case in each of the past three quarters, the sharpest fall in profits was in the construction sector. Manufacturing was the only category to record higher profitability in Q4, although the expansion was only slight. After posting a marginal rise in profits in the previous quarter, the service sector posted a marked reduction during Q4. Profitability at distribution companies was virtually unchanged during the latest three-month period.

The overall decline in profits was centred on small companies, which posted a substantial fall that was steeper than seen in the previous quarter. Large companies registered a slight increase in profits in Q4, ending a seven-quarter sequence of decline, while medium-sized firms posted a marginal reduction.

A number of factors exerted negative influences on profitability during Q4, with price discounting the major depressor of profits. After having a positive influence on profits in Q3, interest rates had a negative influence in the fourth quarter. Domestic demand imparted a broadly similar degree of negative influence on profitability.

The Euler Hermes UK Profits Index

Index 50 = no change on previous quarter

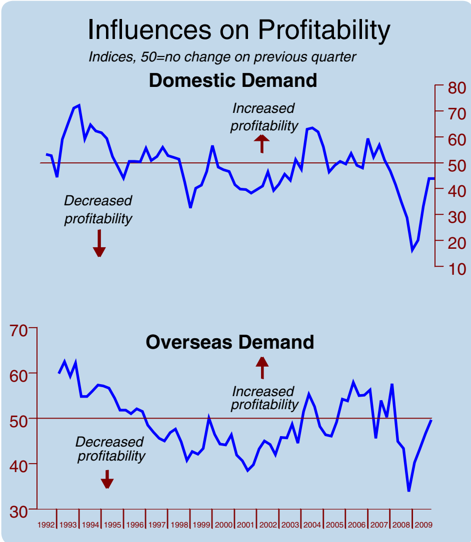
	2008 Q4	2009 Q1	Q2	Q3	Q4
Profitability	**23.7**	**30.4**	**37.6**	**46.6**	**46.8**
1-100 employees	23.4	30.2	36.3	43.2	38.0
101-500 employees	23.3	26.9	41.4	48.4	49.3
500+ employees	11.7	49.7	37.7	45.8	51.3
Services	23.6	25.2	28.7	50.2	43.8
Manufacturing	24.2	33.7	52.3	48.5	51.8
Distribution	23.9	27.8	36.5	46.3	49.9
Construction	24.8	45.2	25.6	18.9	26.5

Influences on profitability: summary

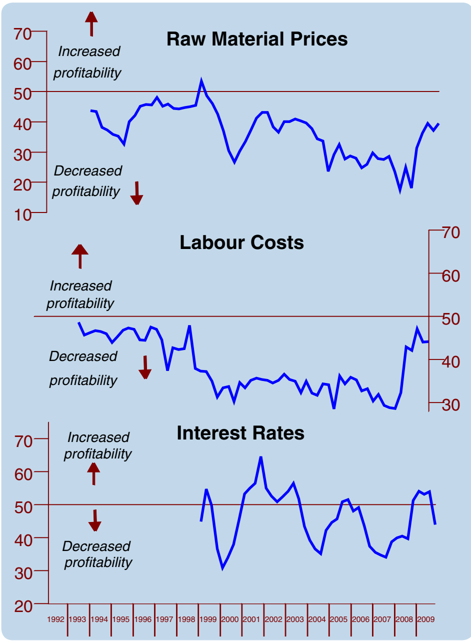
Ranked according to greatest positive influence

Index of 50 = no influence on profits; above 50 = positive influence on profits; below 50 = negative influence on profits

1	Overseas demand	49.7
2	Labour costs	44.2
3	Interest rates	44.0
4	Domestic demand	44.0
5	Exchange rates	42.6
6	Raw material prices	39.5
7	Competition	38.8
8	Price discounting	24.1

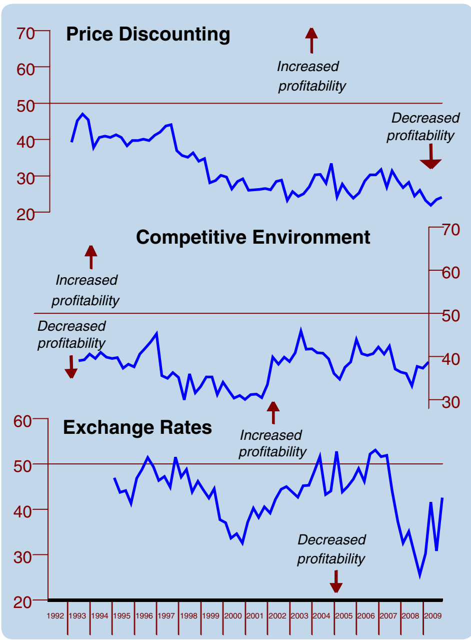


Overseas demand had only a slight negative influence on profits in Q4, while the negative impact of domestic demand remained marked.



Raw material prices and labour costs had weaker negative influences on profits.

Interest rates had a marked negative influence, after supporting profits in Q3.



Price discounting remained the greatest depressor of profitability at UK companies.

The negative influences of both exchange rates and the competitive environment eased in the fourth quarter.

Influences on Profitability

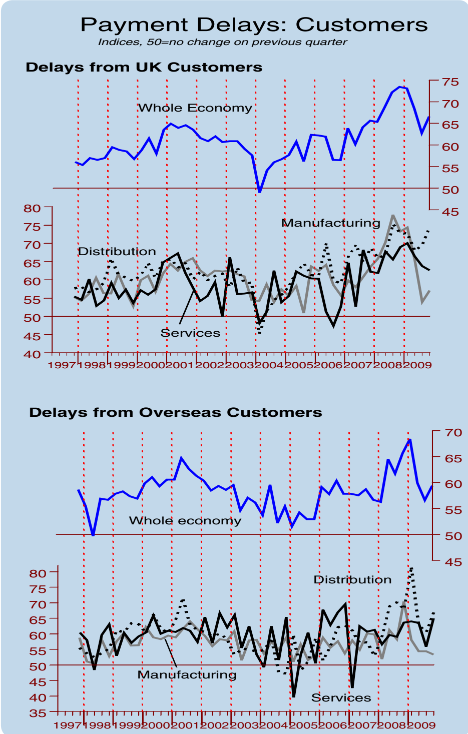
Index 50= no change on previous quarter

	2008 Q4	2009 Q1	Q2	Q3	Q4
Demand Pressures					
Domestic Demand	**16.5**	**20.2**	**33.2**	**43.9**	**44.0**
Services	16.5	10.6	28.5	45.5	36.0
Manufacturing	19.9	24.1	38.2	45.4	53.3
Distribution	15.8	25.8	31.8	47.6	42.2
Construction	9.9	31.5	38.0	15.5	30.4
Overseas Demand	**33.9**	**40.3**	**43.3**	**46.7**	**49.7**
Services	37.3	37.6	47.0	51.6	53.0
Manufacturing	32.1	43.0	45.8	48.1	50.6
Distribution	33.2	35.0	36.1	42.2	46.4
Construction	n/a	n/a	n/a	n/a	n/a
Cost Pressures					
Raw Material Prices	**31.4**	**36.4**	**39.5**	**37.3**	**39.5**
Services	37.6	40.9	35.2	45.5	38.3
Manufacturing	23.8	36.5	50.8	44.0	45.5
Distribution	39.1	30.2	33.5	39.0	34.4
Construction	12.0	11.3	27.3	18.9	31.5
Labour Costs	**43.0**	**42.1**	**47.1**	**44.1**	**44.2**
Services	43.9	39.0	50.2	48.5	39.3
Manufacturing	41.1	46.9	50.4	46.2	39.1
Distribution	37.5	38.4	45.4	45.9	49.3
Construction	28.3	71.6	37.4	27.6	43.3
Interest Rates	**51.3**	**54.1**	**53.2**	**54.0**	**44.0**
Services	65.5	46.6	48.7	45.9	40.0
Manufacturing	51.7	55.9	51.6	54.4	48.4
Distribution	49.7	55.5	55.8	60.3	52.5
Construction	32.7	71.3	60.1	49.4	43.2
Competitive Pressures					
Exchange Rates	**25.7**	**30.3**	**41.6**	**30.9**	**42.6**
Services	29.5	38.4	39.6	43.0	51.7
Manufacturing	34.6	32.5	45.6	28.3	43.6
Distribution	20.4	19.7	35.9	26.7	36.5
Construction	22.7	15.1	43.3	22.9	32.4
Price Discounting	**26.1**	**23.3**	**21.9**	**23.5**	**24.1**
Services	28.6	23.0	18.5	17.2	16.8
Manufacturing	26.4	27.0	28.1	31.5	35.3
Distribution	25.8	24.4	19.9	25.8	26.0
Construction	2.0	7.1	18.4	8.2	7.4
Competitive Environment	**36.2**	**33.3**	**37.8**	**37.3**	**38.8**
Services	44.6	30.5	35.3	39.7	43.8
Manufacturing	35.6	35.8	44.9	39.5	40.0
Distribution	31.5	35.7	35.5	35.2	35.2
Construction	24.6	20.0	29.8	19.1	30.9

The tables present the survey results in the form of diffusion indices. These indices are calculated from the percentage of survey respondents stating whether the specified factor (e.g. the level of domestic demand) had increased, decreased or not affected profitability compared to the previous quarter.

An index reading of 50.0 indicates a neutral effect on profitability. Readings above 50.0 indicate an increase in profitability resulting from the specified factor.

Payment Delays: From UK & Overseas Customers & to Suppliers



Payment delays from UK customers increased but the average length of delays was the smallest for over a year.

UK delays

Payment delays from UK companies rose again in the final quarter of 2009, reflecting the economic downturn and a lack of available cash flow. The latest increase extended the current sequence of higher delays to twenty-three quarters and was stronger than that seen during Q3.

The average length of payment delays from UK companies shortened to 25 in Q4, the lowest in more than a year. Despite this, average delays from UK customers remained longer than from overseas clients.

The construction sector again posted the steepest rise in payment delays, although the rate of increase in Q4 eased from the series record registered in Q3. The growth in payment delays at distribution companies was the sharpest in five quarters, while both manufacturing and services also posted rising payment delays from UK customers.

Delays from overseas customers rose at a steeper pace.

Overseas delays

Q4 data signalled a marked increase in payment delays from overseas clients, and at a steeper rate than seen in Q3. Delays from overseas customers have risen in each quarter since Q3 1998.

At 23 days, the average length of payment delays was higher than in the previous quarter.

The most common delays during Q4 were from the Middle East, the Far East and Scandinavia.

Delays to suppliers

UK companies recorded a steeper increase in payment delays to their suppliers in Q4, mainly in response to delays from customers. The rate of growth accelerated to its steepest in a year.

Delays in payments to suppliers rose most quickly at constructors, where the rate of increase was a series record. Distribution and services posted marked rises in payment delays, while in manufacturing they were broadly unchanged.

Payments: average number days late

	2008 Q4	2009 Q1	Q2	Q3	Q4
from UK customers	26	28	26	26	25
...from overseas	25	30	23	20	23

Payments: incidence of late payments

Index 50 = no change on previous quarter. Readings above 50.0 signal an increase in the number of delays. Readings below 50.0 signal a decrease in the number of delays.

	2008 Q4	2009 Q1	Q2	Q3	Q4
Delays from UK Customers					
Whole Economy	**73.4**	**73.1**	**68.5**	**62.8**	**66.6**
Services	69.0	70.1	66.4	63.8	62.7
Manufacturing	73.3	74.4	65.5	54.0	57.1
Distribution	72.7	72.8	67.9	69.8	74.6
Construction	93.1	79.2	83.3	94.1	85.9
Delays from Overseas Customers					
Whole Economy	**65.7**	**68.5**	**59.9**	**56.6**	**59.4**
Services	63.7	64.1	63.6	55.9	65.0
Manufacturing	70.5	58.2	54.5	54.4	53.4
Distribution	67.9	81.6	62.6	60.7	67.0
Construction	n/a	n/a	n/a	n/a	n/a
Delays to Suppliers					
Whole Economy	**62.6**	**57.6**	**55.8**	**54.9**	**57.9**
Services	63.1	58.5	60.4	60.8	58.9
Manufacturing	58.8	59.9	51.9	49.5	50.1
Distribution	64.0	53.7	56.0	52.3	57.2
Construction	63.7	70.0	41.0	73.9	79.6

Payment Delays: By Country

Ranked in order of highest incidence of payment problems (trade weighted, base = 10)

	2008 Q4	2009 Q1	Q2	Q3	Q4
Middle East	30	0	0	0	66
Far East	11	70	53	23	47
Scandinavia	0	0	0	0	24
Eire	17	18	14	55	18
Other Western Europe	16	0	0	0	12
France	13	9	0	9	9
USA	4	8	0	0	8
Germany	3	8	6	8	8
Belgium	8	0	14	0	0
Eastern Europe & Russia	32	72	0	72	0
Italy	1	2	3	20	0
Japan	0	0	0	38	0
Netherlands	5	0	0	0	0
Rest of the World	1	2	3	0	0
South America inc. Mexico	0	0	50	0	0
Spain	55	0	91	0	0

The table above lists countries from which survey panel members reported significant payment delays from export customers. The number of payment delays has been adjusted to take into account the amount of trade conducted between that country and the UK, with 10 delays being set as the number of delays that would be expected from each country given the volume of trade with that nation.