

Cash Flow and Profit Report

A quarterly survey produced by Euler Hermes UK and NTC Research

The Euler Hermes UK Quarterly Cash Flow and Profit Report 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.



As a company of Euler Hermes and rated AA- by Standard & Poor's, Euler Hermes UK is the UK's leading credit insurer. It protects businesses against insured trade credit risk whenever and wherever it occurs. Companies, whatever their size and sphere of operation, face financial risks when trading on credit terms in home or overseas markets.

Euler Hermes is the world-wide leader in credit insurance and one of the leaders in bonding and guarantees. With over 6,000 employees in 51 countries, Euler Hermes offers a complete range of services for the management of customer receivables. The group posted a 2.01 billion euro turnover in 2006.

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

Euler Hermes UK plc, 1 Canada Square, London E14 5DX
Tel: 0800 056 5452
www.eulerhermes.co.uk

NTC RESEARCH

Henley-on-Thames
Oxon, RG9 1EJ, UK
Tel: +44 (0) 1491 418 700
e-mail: ukresearch@ntc.co.uk
website: www.ntc-research.com

These reports are published quarterly, exclusively for Euler Hermes UK brokers and customers. Subscriptions are available to other organisations. For details contact: info@ntceconomics.com

Whilst every effort has been made in the preparation of this report to ensure accuracy of the statistical and other contents, the publishers and data suppliers cannot accept any liability in respect of errors or omissions or for any losses or consequential losses arising from such errors or omissions.

The information provided in this report is not intended as investment advice and investors should seek professional financial advice before making any investment decisions.

Trading conditions remained tough in Q1, leading to further contraction of profits and slower growth of cash flow. Payment delays up markedly.

The Euler Hermes UK Cash Flow and Profit Report signalled a further contraction of UK corporate profitability in the first quarter of 2008 alongside weakening growth of free cash flow as economic conditions remained tough. Although the decline in profits was only modest, it nonetheless marked the second consecutive quarter of declining profitability, with rising cost pressures, a weak sterling and softening demand conditions hitting margins.

Moreover, with cash flow reported to be generally tight, payment delays from customers continued to increase markedly, particularly from those clients based in the UK.

Further contraction of profits in Q1

Back-to-back falls in UK corporate profitability were recorded in the first quarter of 2008 for the first time since the thirteen-quarter run of decline ended in Q2 2003. The overall decline was only modest, however, and much weaker than Q4's marked fall. Performance varied by sector, with service providers and distribution (albeit to a much lesser extent than services) recording growth of profits in Q1, while manufacturers and, in particular, constructors fared less well. Both sectors recorded falls in profits, with the decline in construction the sharpest in two years.

Raw material prices were the principal factor depressing profitability during the quarter, as short-supply and the oil price shock continued to push up the costs of commodities. Moreover, companies appeared to be generally unable to absorb these higher costs, with output price discounting again a key factor depressing profitability as demand softened and competitive pressures remained prevalent.

The weakness of sterling was also noted as a key factor hurting profits during the quarter, though it may have helped to boost overseas demand, which was the only factor reported to have had a positive influence on profits in Q1.

Payment delays depress free cash flow

The latest survey showed that free cash flow continued to rise during Q1 although, at 3.4%, the rate of growth was the weakest since Q2 2006.

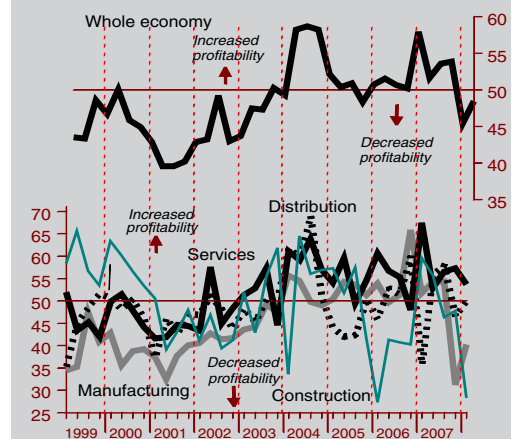
There were a number of reports that cash flow had been hit by continuing payment delays from customers. This was borne out by the latest data, which showed the incidence of payment delays from

Cash Flow at Q1 2008

	Average % change in cash flow over:	
	past 12 months	next 12 months
All companies	3.4%	3.1%
Services	4.9%	3.5%
Manufacturing	1.4%	3.6%
Distribution	2.1%	-0.4%
Construction	2.3%	6.7%

The Euler Hermes UK Profits Index

Indices, 50=no change on previous quarter



UK customers continuing to rise sharply over the quarter. The latest increase was in fact the second strongest in over ten years of data collection, and was only slightly lower than Q4's record increase. Panellists reported cash flow difficulties at customers in line with generally tougher economic conditions and continued credit tightness.

Delays in payments from overseas clients were also recorded. The increase in the incidence of delays was again marked, though it remained well below the rise seen amongst UK customers.

Cash flow expected to rise at solid rate

Forecasts for cash flow growth over the coming year were at their strongest for three quarters, although the expected rise of 3.1% remained historically low. Fears persist that trading conditions will remain difficult, especially in the distribution sector, where free cash flow is forecast to fall by 0.4% over the coming twelve months.

Cash flow

Free cash flow continued to grow during the first quarter of 2008...

...although the rate of expansion was the lowest in nearly two years.

Expectations remained positive, despite some forecasts that tough economic conditions are set to continue.

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 cashflow growth over the coming twelve-month period.

Free cash flow continued to rise in the first quarter of 2008, up 3.4% since twelve months ago with companies attributing growth to continued sales and rising turnover. However, the latest increase was the weakest since Q2 2006. Slower growth of free cash flow reflected in part tougher operating conditions, with a number of companies reporting that customers were taking longer to pay.

At the sector level, services continued to record the largest rises in free cash flow, registering growth of 4.9%. That was more than double the second best performing sector of construction (2.3%). The lowest rise in free cash flow was registered in manufacturing (1.4%).

Despite reports that tough trading conditions are likely to continue, panellists expect to see further growth in free cash flow over the coming year. Cash flow is expected to rise 3.1%. Whilst that was the strongest forecast for three quarters, it remained well below the five and a half year series average.

Construction companies were the most optimistic, forecasting growth of 6.7%. Distribution companies, in contrast, were on average negative, forecasting a decline of 0.4%.

The Euler Hermes UK Cash Flow Index*

Annual % change					
ACTUAL – % change over past twelve months					
	2007				2008
	Q1	Q2	Q3	Q4	Q1
All Companies	3.8%	7.5%	6.9%	5.4%	3.4%
1-100 employees	1.6%	3.4%	3.6%	4.3%	-0.8%
101-500 employees	4.3%	9.3%	2.2%	1.7%	2.5%
500+ employees	6.1%	8.3%	13.5%	9.2%	7.3%
Services	1.6%	8.1%	8.3%	4.8%	4.9%
Manufacturing	9.0%	7.1%	6.3%	6.4%	1.4%
Distribution	2.7%	7.2%	5.9%	6.8%	2.1%
Construction	4.5%	4.8%	2.4%	2.9%	2.3%
FORECAST – % change over next twelve months					
	2007				2008
	Q1	Q2	Q3	Q4	Q1
All Companies	3.2%	5.3%	0.5%	2.5%	3.1%
1-100 employees	7.7%	6.6%	2.1%	6.9%	-0.5%
101-500 employees	2.7%	3.8%	4.8%	3.5%	7.2%
500+ employees	1.3%	6.3%	-4.6%	-1.2%	1.9%
Services	1.3%	5.5%	-2.5%	2.5%	3.5%
Manufacturing	6.2%	5.5%	4.7%	1.7%	3.6%
Distribution	2.8%	3.8%	1.7%	2.8%	-0.4%
Construction	7.2%	7.2%	4.1%	3.6%	6.7%

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

Profits

UK corporate profitability continued to fall in the first quarter of 2008...

...with particular weakness recorded in the construction sector.

Rising cost pressures and price discounting were the principal factors depressing profits...

...while only overseas demand had a positive impact on profits in Q1.

The survey for Q1 2008 showed that profitability continued to decline as economic conditions remained tough. It was the second successive quarter in which profits have fallen, although a rise in the Euler Hermes UK Profits Index to 48.5, from 45.5 in the previous quarter, pointed to a slower rate of contraction.

Latest data showed a considerable divergence of trends at the sector level. Service providers continued to record profits growth, albeit at the slowest rate in nearly a year, while profit levels in distribution were broadly unchanged. In stark contrast, however, were further declines in profitability in the manufacturing and construction sectors, the latter faring particularly badly. The Q1 survey showed that constructors registered their sharpest contraction for two years as rising factor costs and discounting took their toll.

Overall, the greatest negative impact on profitability was provided by rising raw material prices in line with rapidly higher oil prices and the short supply of a number of commodities on world markets. Output price discounting also continued to have a strong negative impact on profits as did rising labour costs.

A weak sterling also had a strong negative impact on UK company profitability, though this may have been a factor boosting overseas demand, the only influence to actually have a net benefit on profits in the first quarter.

The Euler Hermes UK Profits Index

Index 50 = no change on previous quarter					
	2007				2008
	Q1	Q2	Q3	Q4	Q1
Profitability	51.7	53.6	53.9	45.5	48.5
1-100 employees	50.4	50.5	55.6	44.5	45.4
101-500 employees	54.8	58.3	38.9	38.0	65.5
500+ employees	70.2	75.9	76.6	63.8	41.8
Services	67.5	53.0	56.6	57.3	53.8
Manufacturing	51.8	54.3	54.4	31.3	40.3
Distribution	35.7	56.0	58.0	46.5	50.1
Construction	59.6	55.7	46.4	47.8	28.3

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	55.8
2	Competition	42.2
3	Domestic demand	42.2
4	Interest rates	40.4
5	Exchange rates	31.4
6	Labour costs	28.8
7	Price discounting	27.0
8	Raw material prices	18.0

Profits

Domestic demand continued to have a negative impact on UK company profitability in the first quarter of 2008...

...while, in contrast, overseas demand had a robust positive effect.

Raw material prices had the strongest negative impact on profitability.

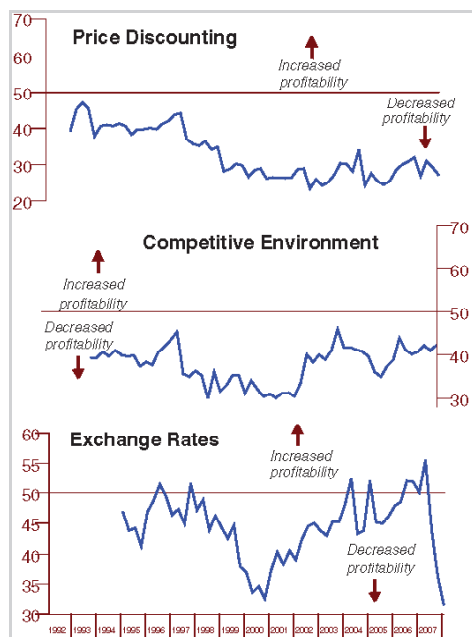
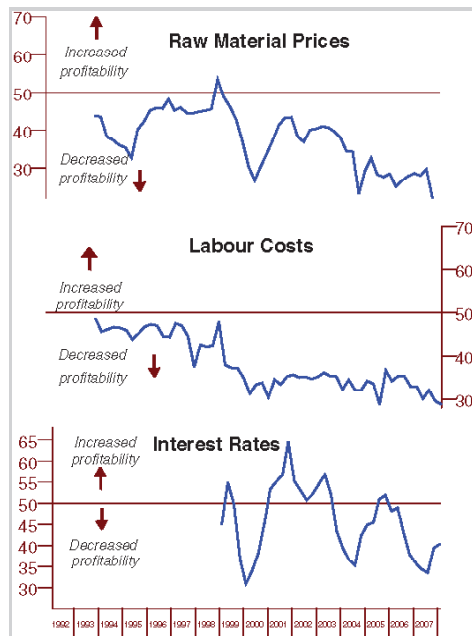
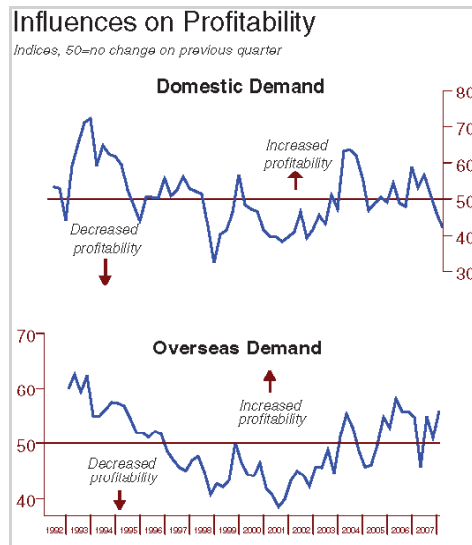
Labour costs continued to have an adverse influence on profits.

Borrowing costs continued to depress profits growth despite recent Bank of England rate cuts.

A weakened sterling meant that exchange rates had a strong negative impact on profitability.

Price discounting remained a principal depressor of profits in the latest survey period.

The competitive environment again had a strong negative effect on profitability in Q1 2008.



Influences on Profitability

Index 50= no change on previous quarter

	2007 Q1	Q2	Q3	Q4	2008 Q1
Demand Pressures					
Domestic Demand	53.0	56.5	51.3	46.3	42.2
Services	61.8	57.1	58.9	58.6	46.9
Manufacturing	54.7	56.5	49.8	43.0	38.9
Distribution	38.4	54.2	44.4	40.0	34.4
Construction	56.9	72.8	66.8	48.7	40.7
Overseas Demand	54.7	45.8	54.8	50.9	55.8
Services	55.1	56.3	57.4	59.5	76.1
Manufacturing	55.0	42.4	57.8	45.3	45.4
Distribution	50.4	41.1	52.7	54.0	56.0
Construction	n/a	n/a	n/a	n/a	n/a

Cost Pressures

Raw Material Prices	28.6	28.1	29.7	21.7	18.0
Services	36.5	36.3	41.0	33.3	21.4
Manufacturing	31.4	25.4	24.7	19.7	10.6
Distribution	22.0	30.7	30.0	25.7	26.2
Construction	13.4	7.1	23.5	1.5	8.0
Labour Costs	33.1	30.1	32.2	29.7	28.8
Services	35.7	25.8	32.3	24.2	24.9
Manufacturing	34.4	34.7	34.0	33.1	28.8
Distribution	35.4	35.7	36.4	34.6	34.7
Construction	15.9	4.9	22.1	9.6	21.1
Interest Rates	35.9	34.4	33.6	39.5	40.4
Services	44.4	41.8	38.5	35.5	35.9
Manufacturing	33.9	32.7	32.7	45.3	43.5
Distribution	33.1	32.5	31.4	39.7	43.8
Construction	35.3	26.5	22.1	39.5	30.5

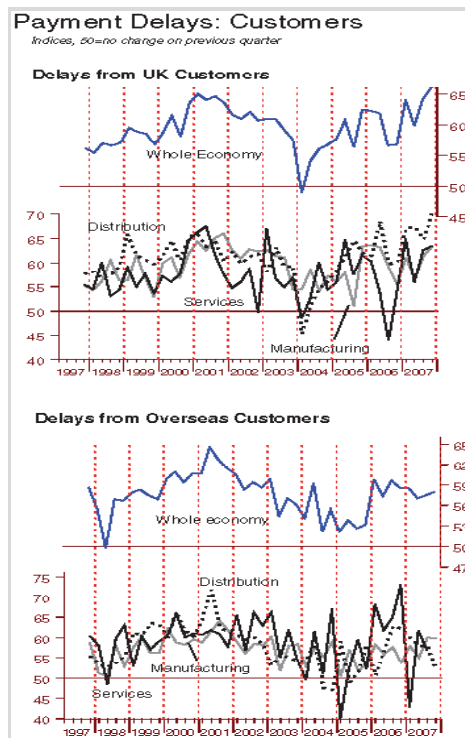
Competitive Pressures

Exchange Rates	50.1	55.5	43.9	36.2	31.4
Services	38.8	43.9	20.5	44.5	34.3
Manufacturing	53.6	55.4	53.7	33.3	39.9
Distribution	49.0	66.2	47.9	31.8	19.8
Construction	44.8	59.1	50.4	45.6	13.7
Price Discounting	31.9	26.8	30.9	29.2	27.0
Services	46.8	27.4	30.8	30.1	26.8
Manufacturing	29.2	23.2	38.6	26.0	28.4
Distribution	31.1	28.3	28.0	33.8	30.7
Construction	17.0	18.4	23.3	23.5	9.6
Competitive Environment	40.1	40.7	42.1	41.0	42.2
Services	40.7	40.3	42.4	39.9	49.0
Manufacturing	38.4	35.2	38.1	42.9	35.6
Distribution	42.6	44.2	44.2	42.0	42.7
Construction	32.2	45.8	40.3	43.3	48.8

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



UK delays

The incidence of payment delays from UK customers continued to rise markedly during Q1 2008. The seasonally adjusted index that measures the incidence of late payments from UK customers posted its second highest reading in over ten years of data collection, falling only very slightly from Q4 2007's record high. Panellists commented on tighter cash flow positions at customers, often attributing this to rapidly rising operating costs.

Latest data showed that payments were on average late by around 23 days, a slight improvement on the situation at the end of 2007, when the average was 25.

Payment delays were common across sectors, with all registering marked increases in the incidence of payment delays. The strongest rise was recorded in distribution.

Overseas delays

The incidence of payment delays from overseas customers also continued to rise markedly, albeit at a considerably slower rate than for domestic clients. The respective seasonally adjusted index was again broadly unchanged, with distribution companies reporting the strongest increase in the incidence of delays from overseas clients. On average, payments were late by 20 days.

Delays to suppliers

A further increase in payment delays to suppliers was signalled by UK private sector companies during the first quarter of 2008, with companies reporting that the latest growth reflected a combination of tightening cash flow and continued payment delays from their own debtors. However, the overall increase in payment delays to suppliers was only modest and weaker than observed at the end of 2007.

Payments: average number days late

	2007				2008
	Q1	Q2	Q3	Q4	Q1
from UK customers	21	19	22	25	23
...from overseas	21	24	26	24	20

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.

	2007				2008
	Q1	Q2	Q3	Q4	Q1
Delays from UK customers					
Whole Economy	64.1	59.8	63.9	66.3	65.7
Services	64.5	55.9	62.8	63.7	61.7
Manufacturing	59.7	56.8	62.0	64.3	65.7
Distribution	67.2	67.2	64.6	71.2	66.5
Construction	61.0	62.1	69.8	71.3	63.5

Delays from Overseas Customers

	2007	2007	2007	2007	2008
	Q1	Q2	Q3	Q4	Q1
Whole Economy	58.8	57.0	57.4	57.9	57.1
Services	42.7	62.4	57.4	65.1	56.6
Manufacturing	61.5	54.0	58.7	58.7	55.4
Distribution	59.4	58.2	58.2	52.5	57.7
Construction	n/a	n/a	n/a	n/a	n/a

Delays to Suppliers

	2007	2007	2007	2007	2008
	Q1	Q2	Q3	Q4	Q1
Whole Economy	54.5	51.9	52.0	54.0	52.1
Services	58.7	51.3	49.5	55.5	50.2
Manufacturing	53.2	54.7	52.7	57.2	53.7
Distribution	52.4	50.6	52.0	49.3	52.1
Construction	55.4	53.4	57.3	51.0	49.5

Payment Delays: By Country

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

	2007				2008
	Q1	Q2	Q3	Q4	Q1
Eastern Europe and Russia	0	92	38	0	99
Middle East	31	84	35	118	45
Spain	29	0	64	110	42
Far East	11	0	0	21	33
Italy	38	26	21	0	14
Eire	18	0	29	0	13
Germany	7	0	4	14	11
Other Western Europe	0	0	18	0	8
France	4	24	10	8	6
USA	4	0	4	7	6
Belgium	9	0	0	0	0
Rest of the World	55	60	12	21	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.

Tighter cash flow and credit conditions led to a further marked increase in the incidence of payment delays from UK customers in Q1 2008.

Overseas delays from foreign clients was also reported, although the increase was much lower than that for UK customers.

Modest rise in payment delays to suppliers signalled.