Experian[SM]

Moody's Analytics

SMALL BUSINESS CREDIT INDEX

Q1 2012

Small-Business credit conditions improve as economy slowly recovers

About the index

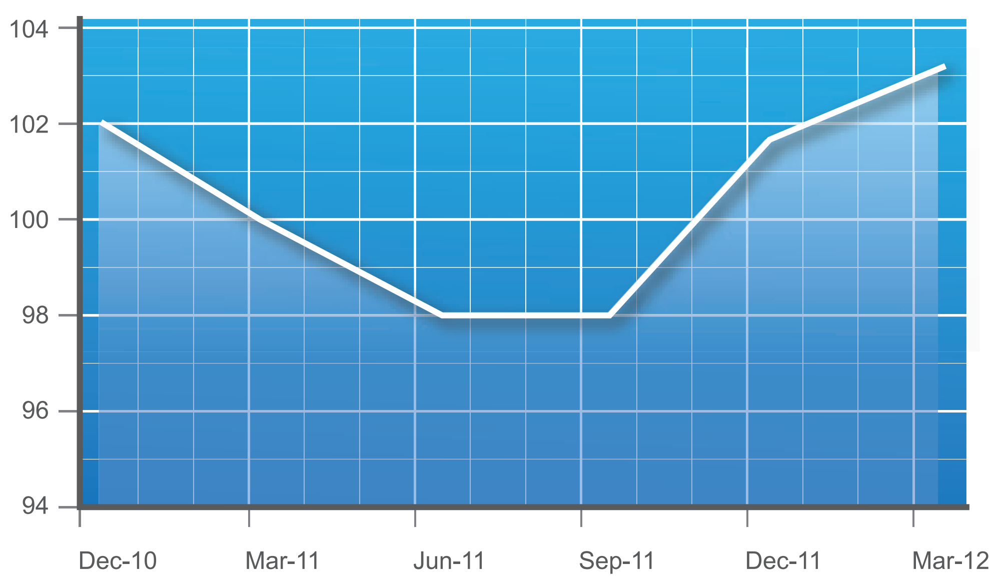
Experian has joined forces with Moody's Analytics to create a business index and detailed report that provides insight into the health of U.S. businesses. The new Experian/Moody's Analytics Small Business Credit Index is reported quarterly to show fluctuations in the market and discuss factors that are impacting the business economy.

Executive summary

Although access to credit remains tight, U.S. credit conditions are improving, with fewer small businesses falling behind on bill payment.

- The overall health of U.S. small businesses has improved, thanks to rising consumer confidence and spending, but balance sheets are strengthening unevenly.
- Most metrics of small-business credit quality were essentially unchanged from last quarter, but the average commercial risk score improved on a year-ago basis due to a drop in the percentage of dollars delinquent.
- States where the labor market is healing more vigorously are typically home to small businesses with stronger credit standings. Small firms in states with high unemployment and lackluster housing markets are struggling.

Experian/Moody's Analytics Small Business Credit Index



Current quarter (2012 Q1): 103.2 Previous quarter (2011 Q4): 101.9

Overall, the percentage of dollars delinquent dropped 4.2 percent in the first quarter.

Behind the numbers

The Experian/Moody's Analytics Small Business Credit Index improved in the first quarter of 2012 to 103.2, up from 101.9. This is the index's second consecutive quarterly improvement, after it fell through much of last year. The index is riding on a wave of increased consumer spending, which is boosting small business's balance sheets.

Overdue balances have fallen 6.5 percent since last July. After creeping up during the latter part of last year, the 30-day delinquency rate improved significantly this past quarter, falling 0.8 percentage point to 1.8 percent. The 60-day delinquency rate has also receded, if more slowly than the 30-day rate.

A less sanguine trend is seen in the severely delinquent bucket, which has experienced a nearly 20 percent run-up since September 2010. Businesses at least 60 days behind on their payments appear to be struggling to pay off balances, spilling into the severely delinquent bucket.

Overdue balances have come down in fits and starts, falling nearly 9 percent from January 2010 to March 2011 before reversing course in the second quarter of last year. Balances spiked more than 6 percent between March and June of 2011 before resuming a steady decline, which has remained intact to the present.

The jump in overdue balances last year was mainly tied to the escalation of the European debt crisis, combined with the tsunami in Japan and Congress' battle over raising the U.S. debt ceiling. The subsequent slide in equity markets rattled buyers' nerves, sending the Rasmussen consumer confidence index almost 20 percent lower from April to July. Retailing and consumer spending weakened more broadly, hurting smaller businesses.

Risk score

The average commercial risk score in March 2012 was 57.3, holding stable over the first quarter and improving 4.8 percent on a year-ago basis. Businesses with more than 1,000 employees experienced the greatest improvements in their scores over the quarter, posting a gain of 3.9 percent. Year over year, businesses employing fewer than nine workers saw the greatest improvement, adding 5.7 percent.

Stability was seen across industry groups. On a year-ago basis, finance, legal services, insurance, healthcare, real estate and hospitality all showed improvement. Commercial risk scores also were stable regardless of geographic region. Year over year, the Southwest and South Central regions pulled ahead markedly, by 9.4 percent and 6.7 percent, respectively.

Percentage of dollars delinquent

Overall, the percentage of dollars delinquent dropped 4.2 percent in the first quarter. Companies employing between 250 and 499 people and those with more than 1,000 employees improved most. Further, businesses with 250 to 499 workers were able to draw down severely delinquent account balances by 13 percent. Leisure/hospitality companies fared best over the quarter, whittling away 10.8 percent of their delinquent balances.

The overall trend in small-business credit quality is positive but varies significantly across the country.

Communications firms saw delinquent balances grow 7.6 percent on the quarter, with an 11 percent jump in severely delinquent balances last quarter. Public service businesses and law firms had a tough year. The former experienced a 37.2 percent spike in delinquent balances since last year, whereas the latter saw theirs rise 25.5 percent.

Average days beyond terms (DBT)

The trend in average DBT is a dark spot. On average, U.S. small businesses paid their bills 7.6 days beyond contracted terms in March 2012, compared with fewer than seven days this time last year. Firms of all sizes showed an increase in average DBT on a year-ago basis, with those employing more than 1,000 or fewer than nine employees showing the greatest increases. Further, DBT has worsened for all industry groups, with transportation, communications and public services sectors spiking as much as 17.2 percent. In keeping with this trend, all regions showed an increase in DBT, with the greatest jump seen in the Midwest, which deteriorated 27.1 percent.

Regional performance

The overall trend in small-business credit quality is positive but varies significantly across the country. Several states are enjoying extremely low delinquency rates, while others have severe delinquency rates close to 30 percent. Much of this has to do with how quickly each state's labor market is healing. In states with low unemployment and high labor force participation, per-capita income is rising, spurring consumer spending.

States experiencing high rates of small-business delinquency tend to suffer from a combination of high unemployment, a high share of discouraged workers and a soft housing market.

Fueled by high energy prices, mining payrolls in North Dakota and Texas rose rapidly in 2011, putting both states in the top 10 for per-capita income growth in 2011. In North Dakota, per-capita income increased 6.7 percent, and in Texas grew 4.9 percent from 2010. Nebraska was another big winner; per-capita income there advanced 5.2 percent on the back of mining and farming.

In each of these states, spending increased considerably as workers enjoyed steady employment and pay raises. Sales tax revenues increased an astounding 40 percent in North Dakota last year and rose 11 percent in Texas. Nebraska experienced a 6 percent increase in sales tax revenues last year, above the national average of 4.6 percent. This has contributed to below-average small-business delinquency rates in those states. Delinquency is essentially 0 percent in Texas and Nebraska.

North Dakota does not have a 0 percent delinquency rate like Texas and Nebraska, but small businesses there are paying down 60-day delinquent debt, thereby setting them back into the 30-day delinquent bucket. The 30-day delinquent rate has risen steadily over the past nine months, nearing 8 percent in March, but given this context, it is a step in the right direction.

Another state in which small-business credit quality is faring well is Nevada, but this has less to do with a healing

> At least part of the skittishness exhibited by consumers in Florida stems from slower deleveraging of mortgage debt.

labor market than it does with explosive tourism. The Nevada unemployment rate hovers at 12 percent, and per-capita income growth was below average in 2011. Still, sales tax revenues rose 32 percent in 2011. Like Texas and Nebraska, Nevada's small-business credit accounts are mostly up-to-date.

Tourism has not been a cure-all for small-business balance sheets in Florida, as it has in Nevada. Despite strong tourism, Florida's delinquency rate for accounts more than 90 days past due is approaching 28 percent, climbing 4 percentage points since last July.

At least part of the skittishness exhibited by consumers in Florida stems from slower deleveraging of mortgage debt. Florida uses a judicial foreclosure process, whereas Nevada and most states in the West do not. This process keeps foreclosures in the pipeline longer, holding borrowers underwater on mortgage obligations longer.

Consequently, homeowners in Florida are spending cautiously, which adds stress to already beleaguered small companies. Average DBT for small construction firms in Tampa is 17.2 days; in Miami, builders are running an average of 22.5 days behind on payments. Combined with subpar per-capita personal income growth, high unemployment and low labor force participation, this weighs on small-business revenues and hence small-business credit quality.

The average DBT for construction firms in Miami is second only to that of Chicago, where the housing bust there has contributed to pushing average DBT up to a lofty 25.7 days. Illinois is struggling with delinquency rates similar to Florida, where severely delinquent account volumes comprise about 30 percent of all overdue balances. Like Florida, Illinois uses judicial foreclosure, which not only lengthens the time it takes homeowners to get out of their underwater mortgages, but also can keep foreclosure inventories elevated longer. The foreclosure inventory per 1,000 households in Illinois is nearly double that of the United States, and Chicago's is close to 2.5 times the United States' inventory.

Illinois' struggles do not end with construction. Chicago leads large U.S. metro areas in average DBT in nearly every industry. While the state's unemployment rate is slightly above that of the United States at 8.8 percent, per-capita income and sales tax revenues grew at an above-average pace in 2011. Illinois taxes food purchases, however, so growth in sales tax revenues likely reflects spending that is not benefiting the state's small businesses.

Small businesses in Indiana and Ohio are struggling with delinquency as well, but these two states do not follow the same patterns exhibited above. The unemployment rate is about average in Indiana and below the national rate in Ohio. Further, each of these states experienced above-average per-capita income growth last year. Yet Indiana's share of severely delinquent balances is pushing 20 percent, and Ohio's is about 15 percent.

It is not a lack of consumer spending that is driving the downward trend in these states. Both posted above-average gains in sales tax revenues last year.

The economy is more resilient now than it was at this point last year.

The likely culprit driving up severely delinquent balances is agriculture, which is a major driver in these states. The over-90-day delinquency rate for small agricultural firms is close to 10 percent nationally, second only to construction. Where farming was a boon to Nebraska's economy, the industry could not sustain strong growth in Indiana and Ohio through the end of the year in 2011. Farm earnings were up on the year in 2011 in those states but fell 19 percent and 11 percent, respectively, in the fourth quarter. By comparison, farm earnings only dropped about 4 percent in Nebraska during that time.

The road ahead

Small-business conditions are expected to continue slowly improving. There may be a pause this spring and summer given recently softer conditions in the job market and renewed financial and economic problems coming out of Europe.

Any pause should prove temporary, as much of the slowdown in the labor market is payback for a mild, storm-free winter and is not expected to derail the recovery. In other words, hiring that normally would have been put off until the warmer spring months was done earlier in the year, so we now are experiencing a slowdown relative to that measure. Also, while net job gains were essentially halved in March from February, job growth in higher-paying industries remained intact. Consequently, the job market will resume stronger hiring within the next couple of quarters.

Moreover, much like last year, the effects of a potential European fiscal meltdown on consumers will be temporary and should not deflate the longer-run patterns that have allowed small firms to reinforce their balance sheets in past months.

The economy is more resilient now than it was at this point last year. With the United States on firmer footing, economic cross-currents will favor positive progress here. This is not to say that events in Europe will have no effect, but that the recovery will not suffer as much as it did last year as a result. Barring unforeseen shocks, the recovery in small-business credit quality will remain intact.

CONTACT EXPERIAN BUSINESS
INFORMATION SERVICES

T: 1 877 565 8153
W: experian.com/b2b

CONTACT MOODY'S ANALYTICS

T: 1 866 275 3266
E: help@economy.com
W: moodysanalytics.com

Experian Moody's Analytics

SMALL BUSINESS CREDIT INDEX