Business Stress Report — July 2021

Research By: Dissolve

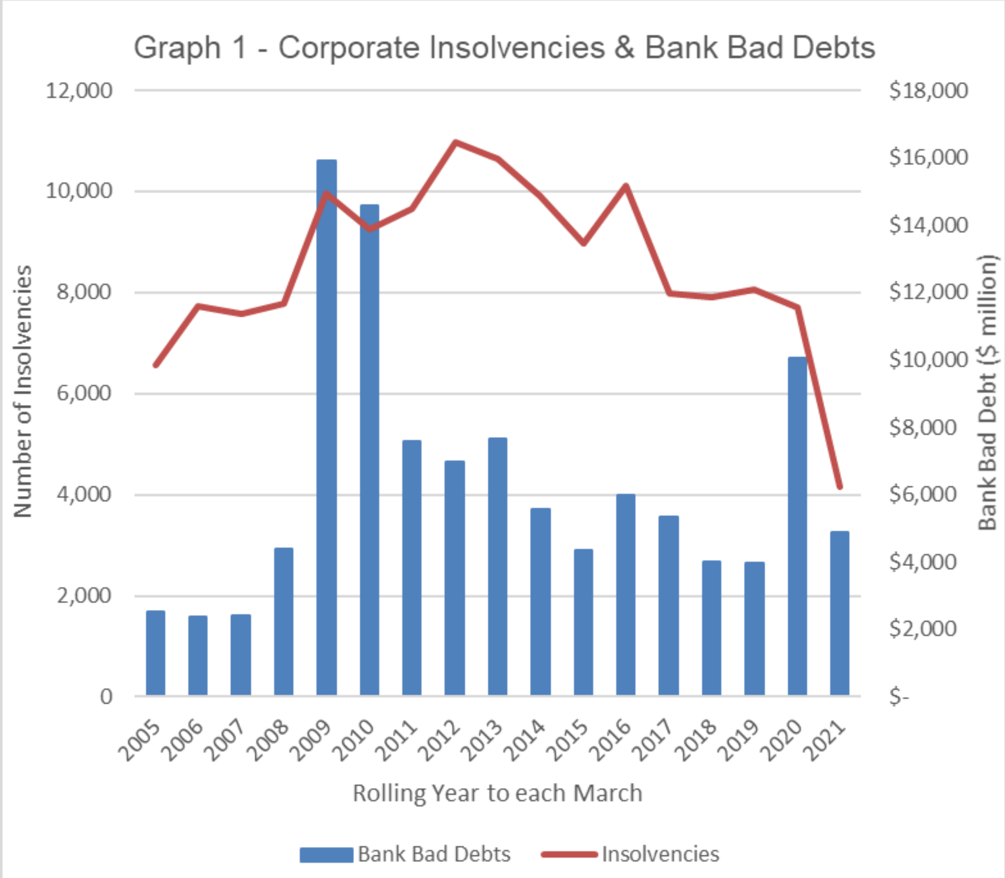
Spokesperson: Cliff Sanderson

1.0 OVERVIEW

The Dissolve Business Stress Report is a quarterly analysis of business failures in corporate Australia. The Report measures the number of company insolvencies, personal insolvencies and the cost of insolvencies to Australian Banks.

Key findings of the latest Business Stress Report are as follows:

- The **number of companies** entering some form of insolvency administration in the 12 months to May 2021 a 49% decrease from the 12 months to May 2020. Initial Data through to the end of June 2021 shows a slight uptick in corporate insolvency numbers but remains low.
- The Australian post-COVID drop in corporate insolvencies greatly exceeds the drops in the UK and USA which were 18% and 7% respectively.
- **Personal Insolvencies** started a sharp decrease following the release of the Banking Royal Commission in mid 2018, when they ran at 8,266 per quarter. Since COVID there has been a further significant decrease with 2,545 personal insolvencies for the March 2021 quarter, being the lowest for decades.
- Immediately after the onset of COVID, Australian Banks made large provisions for bad & doubtful debts, which exceeded the previous record provisions made in 2008 for the GFC. However, those provisions are now being reversed for the first time on record. The **Charge for Bad or Doubtful Debts for Australian Banks** in the Quarter to March 2021 is -$498 million, (yes negative!) a writeback to reverse provisions from 2020.
- In the year to March 2021 appointments by Secured Creditors, which will be predominantly Banks appointing Receivers are down 42% from the previous year, and is a 24% decrease from the average of the previous 5 years.



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2.0 OUR COMMENTS

Since the onset of COVID around March 2020 there were widespread predictions of a significant increase in corporate insolvencies, personal insolvencies and bank bad debts. That has not eventuated. In fact, far from increasing, corporate and personal insolvency numbers have dropped significantly lower than pre-COVID numbers. Comparisons with the USA and UK Corporate Insolvency statistics shows that Australian corporate insolvency numbers have dropped much more than those other countries. Further, Banks have now started reversing bad debt provisions they made in March 2020.

The “insolvency cliff” was variously expected throughout 2020, in January 2021 when a number of legal protections were removed and in April 2021 being just after JobKeeper finished. All Government support measures have now been removed and new insolvency regimes for small businesses are now in place to assist with easier liquidations and small business restructurings. But those new regimes have been used in only a handful of cases and overall insolvency numbers continue to run at about half of pre-COVID levels.

How can this be the case? The factor that is little discussed is that the three major creditor groups have been extremely accommodating in providing deferral of payments and have initiated almost no formal enforcement actions against debtors. We note the following:

- The Australian Tax Office has been very accommodating. Since March 2020 the ATO has assisted with easily obtainable Payment Arrangements, gentle reminders regarding due dates for payment of tax liabilities and has initiated only six wind-up petitions against companies, when they usually average 1,500 per year. To date the ATO remains very accommodating to any taxpayer that asks for extended terms. The ATO has recently indicated it may “start” initiating some legal recovery actions in September 2021.

- Banks greatly softened their approach to debt enforcement actions in 2018 following the Banking Royal Commission and since COVID they have been extremely accommodating in extending terms wherever that is practical.

- Landlords could not evict tenants for non-payment of rent for most of 2020 and, in any case, most Landlords have been willing to work with tenants to come to a mutually beneficial agreement.

With the big three creditor groups not applying pressure to debtors, there has been no imperative for directors of insolvent companies or individuals facing insolvency to consider any type of formal insolvency. This, of course does not mean that those debtors are solvent, it just means they are not using formal insolvency measures such as voluntary administration, liquidation or bankruptcy.

The result, however, is that there are likely to be many insolvent companies currently trading (“zombie companies”). Zombie companies are a problem. They continue to use resources and compete against healthy companies. Zombie companies may end up in insolvency eventually, but where there are significant time delays, assets will have been dissipated and the possibility of a successful recover action to correct wrongdoing is reduced.

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3.0 CORPORATE INSOLVENCY INDEX

The Insolvency Index measures the number of companies entering some form of insolvency administration such as Liquidation, Voluntary Administration or Receivership.

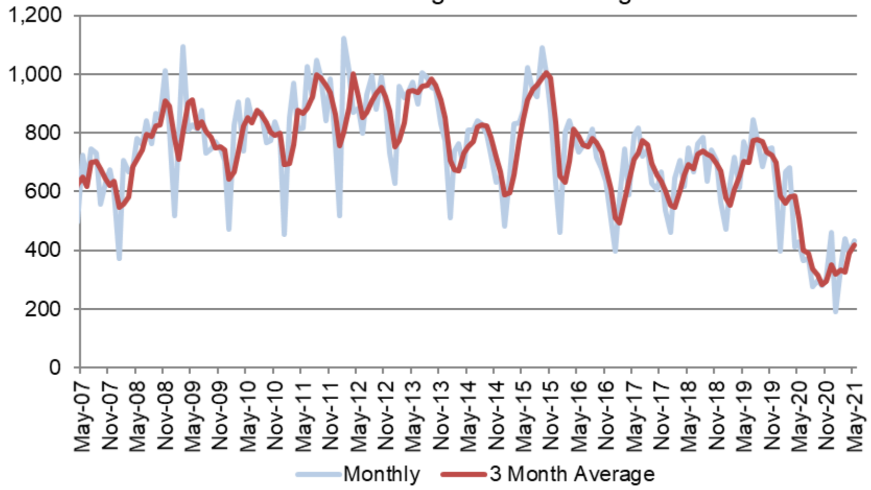
The number of companies entering some form of insolvency administration fluctuates significantly from month to month. We have applied a rolling three month average to the data to show the underlying trend (see Graph 2). This analysis shows a steady decrease in corporate insolvency numbers since the post GFC peak in 2011 and then a large drop in numbers post-COVID.

The number of companies entering some form of insolvency administration in the 12 months ending May 2021 was a 49% decrease from the 12 months to May 2020.

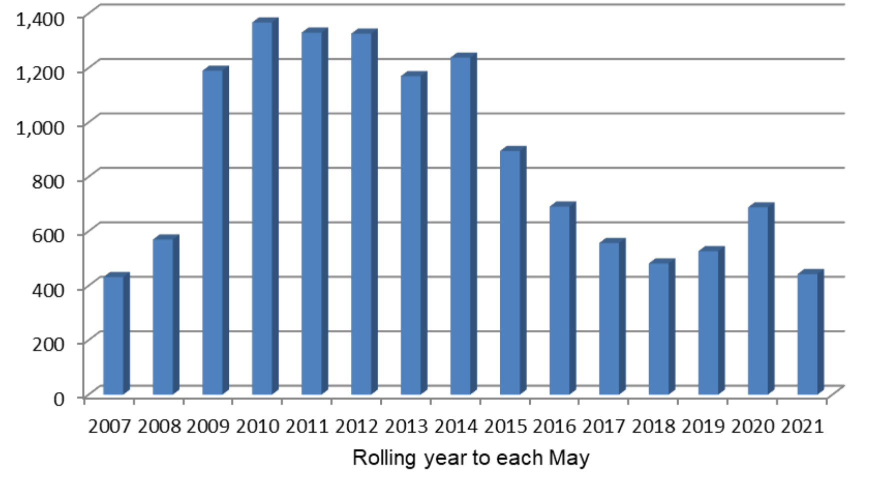
The number of insolvencies in the month of May 2021 was two insolvencies more than the prior year May and a 20% increase over the average of the previous 12 months.

Included in the total number of insolvencies is the number of appointments by secured creditors which will include Receiverships, where a secured creditor appoints an external party, and Controllerships, where a secured creditor takes control of an asset itself. These appointments were down 25% on the average of the previous five years (see Graph 4).

Graph 2 - National Corporate Insolvency Appointments per Month with Rolling 3 Month Average



Graph 3- Insolvency Appointments by Secured Creditors per Year

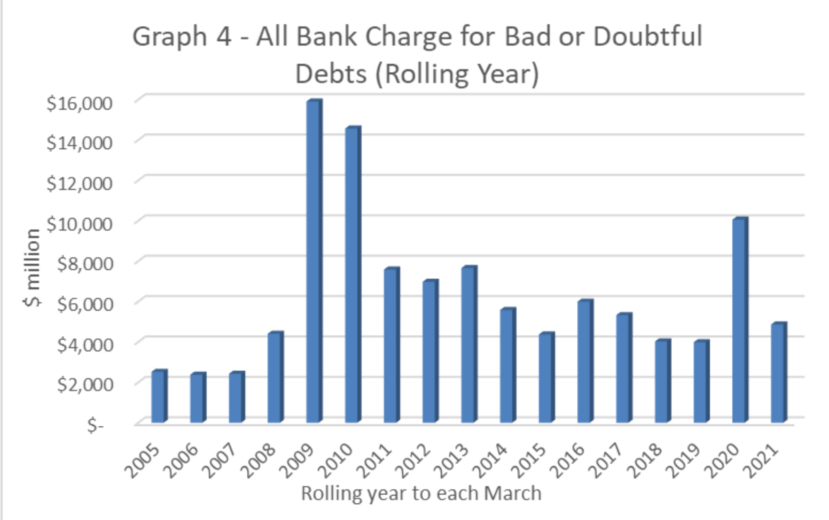


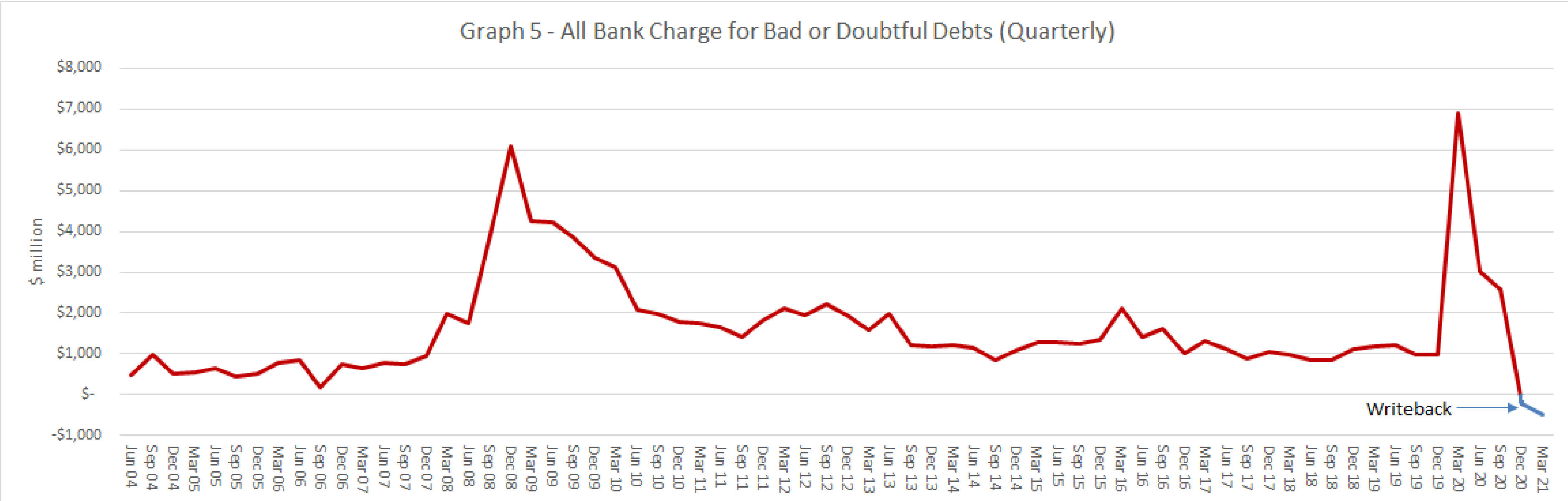
4.0 ALL BANK CHARGE FOR BAD & DOUBTFUL DEBTS

The best way to obtain an understanding of the cost of insolvencies is to examine the level of All Bank Charge for Bad or Doubtful Debts declared by Australian Banks as published quarterly by APRA. That figure will exclude all non-Bank bad debts but still provides a very useful indicator of the cost of insolvencies.

The annual cost of All Bank Charge for Bad or Doubtful Debts, by Australian Banks for the year to March 2021 has dropped to $4.86 billion from $10.05 billion in the year to March 2020. That compares to an average of $4.7 billion per year for the years 2015 to 2019 (Graph 4). In the quarter to March 2021, which is the latest available information, the cost was negative $498 million which is a decrease from the quarterly peak of $6.9 billion in the March 2020 quarter (Graph 5)

When COVID hit, the Banks immediately made record provisions of $6.9 billion, exceeding the December 2008 peak of $6.1 billion which was caused by the GFC. As it became apparent the effect of COVID on the economy was not as bad as expected, the Banks reversed course, and wrote back provisions in the December 2020 and March 2021 quarters. Those are the first write-backs since APRA data started in 2004.





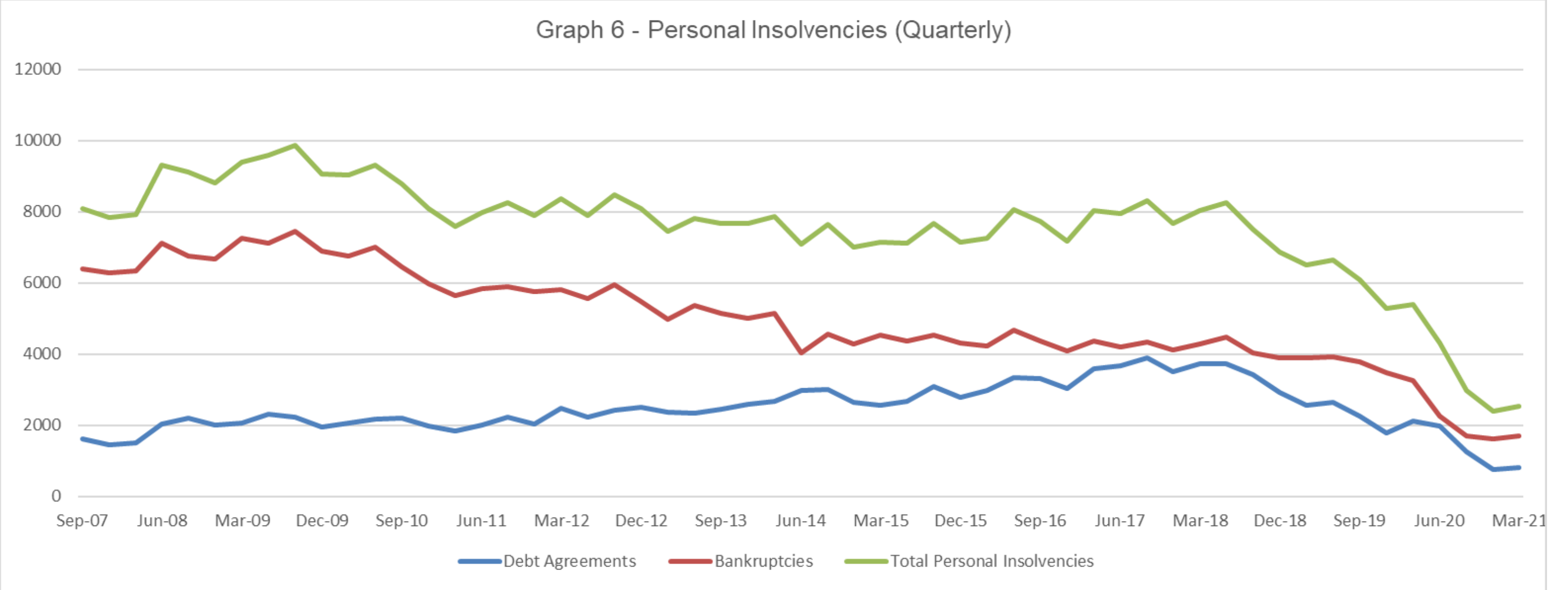
5.0 PERSONAL INSOLVENCY INDEX

Personal insolvency numbers are essentially made up of two components—bankruptcies and debt agreements. Debt Agreements are an alternative to bankruptcy whereby a debtor comes to a formal agreement with their creditors.

Looking to Personal Insolvency as an indicator, we see an already declining number further accelerated by the effects of COVID-19. Statistics released by the Australian Financial Security Authority (AFSA) show from June 2018 to March 2021, total Personal Insolvencies have fallen by 69% from 8,266 to 2,545 insolvencies per quarter.

Personal Insolvencies started a noticeable decrease in June 2018, which was a recent high of 8,266 insolvencies per quarter. By the time COVID took effect in March 2020 (5,404) total personal insolvencies had already begun a significant reduction being down 35% to 5,404 insolvencies per quarter. This decline was likely due to the Banking Royal Commission which caused banks and other financial institutions to adopt a softer approach to debt collection. The AFSA statistics reported that bankruptcies for the 2019 financial year were at their lowest level in 24 years.

In the COVID period from March 2020 to March 2021, total personal insolvencies dropped a further 53% to 2,545 insolvencies per quarter. The further decline in 2020 (in contrast to expectations of an increase) is most likely due to legislative changes introduced in March 2020 and extended in September 2020 in response to the COVID-19 pandemic. Mortgage repayment deferrals and other accommodations by banks will have also contributed to the reduction in personal insolvencies.

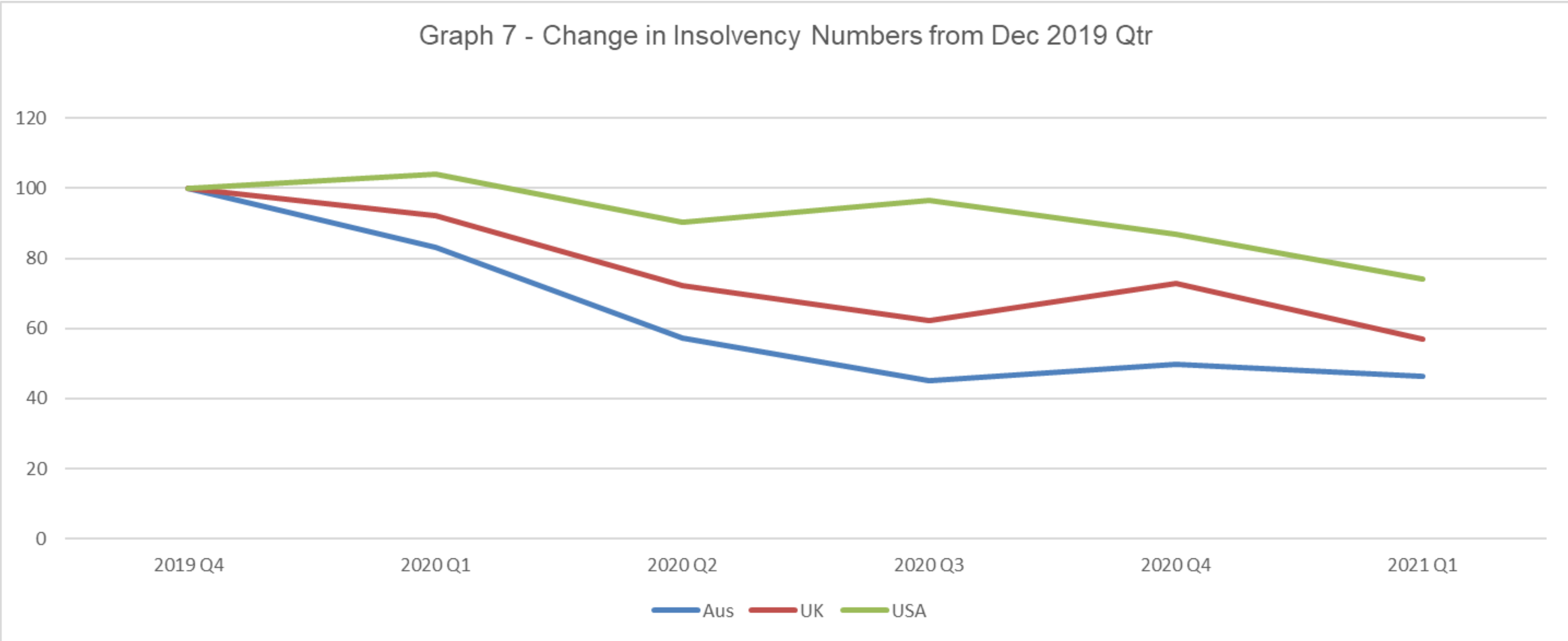


6.0 AUSTRALIA v UK & USA DATA

When comparing Corporate Insolvency Levels to the USA and UK, we see a similar trend of significant decreases in 2020. However the decrease from pre-COVID averages is noticeably larger in Australia.

Australian Insolvency appointments decreased by 42% in the 2020 calendar year when compared to the average of the previous 5 years. Whereas in the UK, the same comparison showed an 18% decrease (12,559 in 2020 down from an average of 15,403) and in the USA, a 7% decrease (21,655 in 2020 down from an average of 23,404).

Graph 7 shows the quarterly decrease in each economy with Q4 2019 set to a base of 100.



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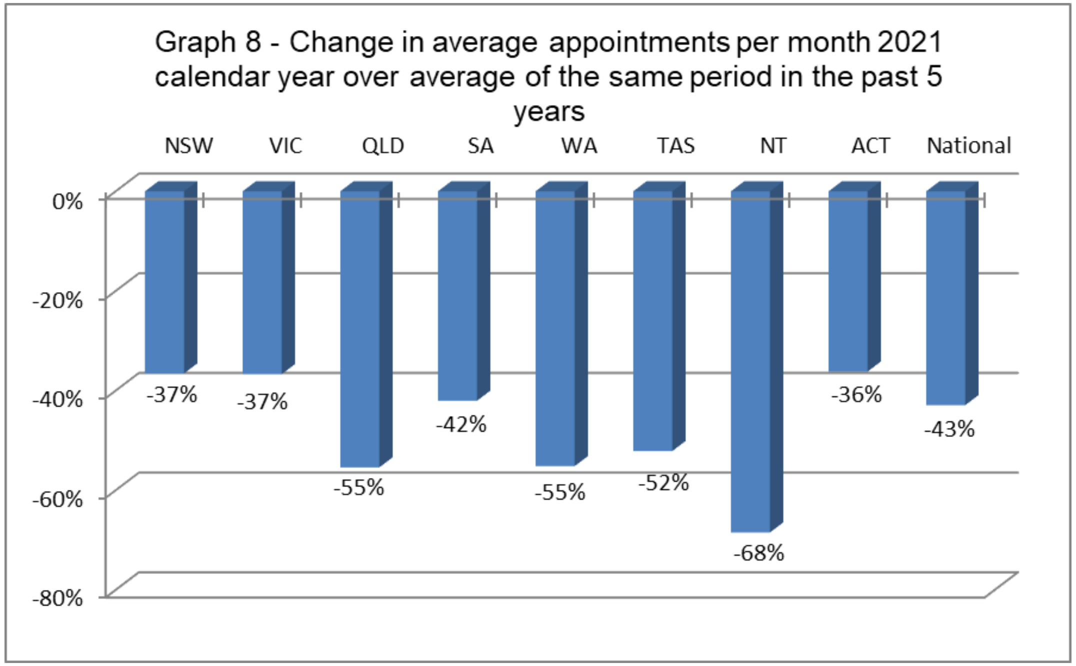
7.0 STATE BY STATE ANALYSIS

We have analysed the ASIC Insolvency appointment data by state. We have examined the number of insolvencies by state for calendar year 2021 and compared that to the average of the same period over the previous five years. Below is a graph of the percentage decrease in 2021.

The statistics show that every state has experienced a decrease in insolvency numbers in 2021 but the results vary significantly.

The standouts are Queensland, Western Australia, the Northern Territory and Tasmania which all experienced significant reductions in the number of corporate insolvencies.



ABOUT DISSOLVE

Dissolve specialises in low cost company liquidations. Dissolve initially provides online and telephone advice to directors of companies in financial distress.

The Dissolve website www.dissolve.com.au provides some unique tools to assist directors of companies in financial distress including:

Information Centre. A raft of information and tools to assist Directors of companies in financial distress

Is my company insolvent? A simple "tick box" page that simplifies the extremely complicated question of whether or not a company is insolvent.

2021 Insolvency Guide An easy to follow Insolvency Solutions Guide for 2021 with a flow chart to help quickly understand the current available options.

Dissolve can be contacted by phone on (02) 9290 2220 or directors can request a call-back by filling out the forms at www.dissolve.com.au.