Report for February 2010

Issued March 1, 2010
National Association of Credit Management

Combined Sectors

The growth manifested in January has been interrupted. However, the drop in activity in February was not enough to plunge the Credit Managers' Index (CMI) back into negative territory. In fact, a marginal gain moved the combined index from 55.1 to 55.2 and was somewhat anticipated due to the inspiring recent expansion in the manufacturing sector. Still, it feels more like a decline when compared to the big gains made in January.

"Starting in the latter part of 2009, manufacturing sector businesses began rebuilding inventories back to respectable levels; a process the CMI predicted," said Chris Kuehl, Ph.D., economist for the National Association of Credit Management, which issues the CMI report each month. During the depths of this recession, most businesses did everything possible to reduce costs and protect cash flow. For several months, the CMI illustrated this point with reports of worsening unfavorable factors: more disputes, rejections of credit applications and dollars beyond terms. By the end of 2009, the CMI began to show a shift—businesses that owed money started the process of paying down debt in anticipation of needing access to credit in the near future. This shift in attitude has historically shown that expansion begins within a month or two, which is what started to transpire in December 2009 and January of this year.

"The development in manufacturing was matched to a lesser extent by similar movement in the service sector, and other economic indicators added to the notion that something was stirring in the economy," said Kuehl. Fourth quarter GDP numbers for 2009 were up 5.9%, and the Purchasing Managers Index climbed to the mid-50s with new orders all the way up to the mid-60s. "There now appears to be a reversal under way, but it may be more accurate to refer to this as a breather," Kuehl said.

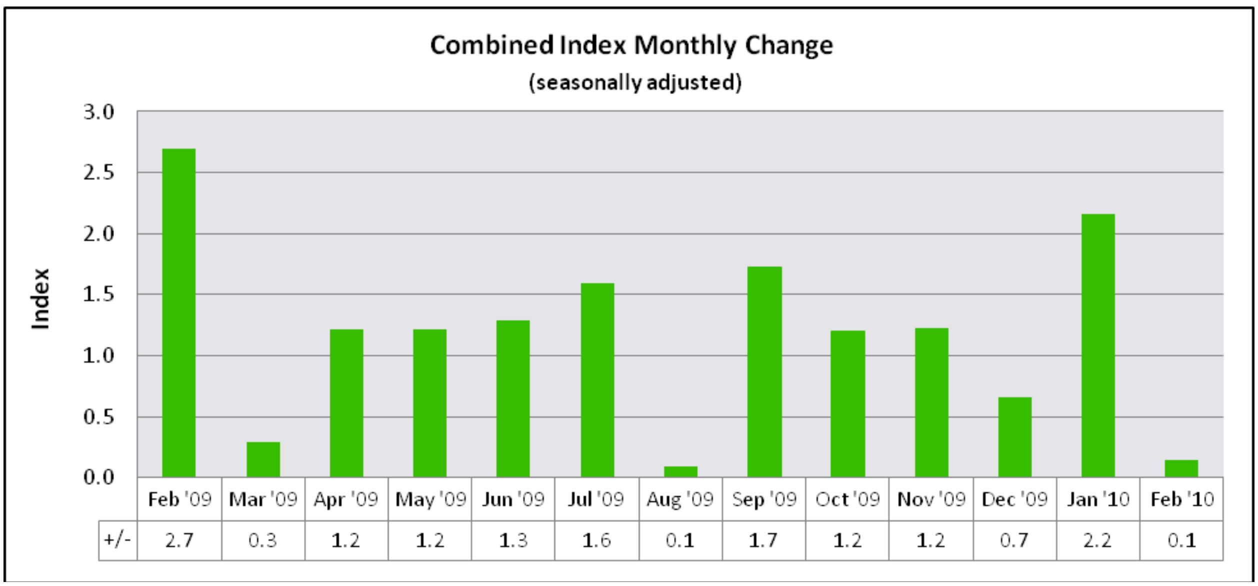
"The first phase in an economic recovery is the replenishment of reduced inventory and there can't be growth without the supply to meet expected demand," said Kuehl. "If there had been no effort to bolster inventory levels, the arrival of demand would have provoked massive shortages, bottlenecks and ultimately inflation. For now, businesses are looking at low interest rates, commodity prices and labor costs. This is the safest time to build that base, but now they have to wait for the second phase—consumer confidence, which remains in the doldrums to an extent."

Conference Board reports show a big drop in consumer confidence because of concerns about the employment situation. At the same time, there are reports coming in from big retailers such as Lowe's and The Home Depot suggesting that consumers are shopping again. The consumer has yet to commit and until that happens, the economy remains in a waiting position.

The CMI shows that sales were flat in February after a major jump in January, but slight increases in new credit applications and the amount of credit extended indicate that credit remains somewhat accessible. Among the negative factors, the biggest changes took place in disputes and bankruptcies. Neither was unexpected: more companies are struggling with debt and will be maneuvering for more time, and the end of a recession is often harder on companies than the recession itself as they start to see pressure from competitors and may not have the ability to respond.

See page 5 of this report for information about the methodology and factors used to measure economic performance.

Combined Manufacturing and Service Sectors (seasonally adjusted)	Feb '09	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec '09	Jan '10	Feb '10
Sales	34.1	35.2	37.4	41.8	44.8	48.6	48.4	49.9	51.1	55.0	56.7	60.7	60.9
New credit applications	44.9	44.3	47.8	48.2	50.7	52.6	49.3	50.0	52.7	55.4	54.2	57.0	57.7
Dollar collections	47.1	48.4	48.0	48.8	51.2	50.8	50.5	53.4	54.7	55.8	58.0	61.3	61.1
Amount of credit extended	42.2	41.8	42.3	44.3	46.1	48.2	48.0	49.3	53.6	54.6	55.2	58.8	59.4
Index of favorable factors	**42.1**	**42.4**	**43.9**	**45.8**	**48.2**	**50.0**	**49.1**	**50.6**	**53.0**	**55.2**	**56.0**	**59.4**	**59.8**
Rejections of credit applications	46.7	47.8	47.4	47.4	47.9	47.5	49.0	48.4	49.0	49.3	50.1	51.4	51.0
Accounts placed for collection	37.8	37.1	38.5	40.2	40.5	44.0	43.6	45.3	47.1	49.5	50.9	50.7	50.4
Disputes	44.8	44.1	47.2	47.5	47.7	50.2	49.7	50.8	51.0	49.6	51.0	51.4	52.2
Dollar amount beyond terms	42.0	42.3	40.5	43.4	43.6	45.3	46.2	48.1	48.1	49.0	51.4	52.2	52.0
Dollar amount of customer deductions	46.2	45.5	49.8	47.5	48.9	49.2	50.6	51.8	50.5	51.3	51.3	52.5	51.2
Filings for bankruptcies	38.4	40.5	40.2	42.3	42.8	43.7	45.8	51.5	52.6	53.0	50.5	54.7	56.3
Index of unfavorable factors	**42.6**	**42.9**	**43.9**	**44.7**	**45.2**	**46.7**	**47.5**	**49.3**	**49.7**	**50.3**	**50.8**	**52.2**	**52.2**
NACM Combined CMI	**42.4**	**42.7**	**43.9**	**45.1**	**46.4**	**48.0**	**48.1**	**49.8**	**51.0**	**52.3**	**52.9**	**55.1**	**55.2**



Manufacturing Sector

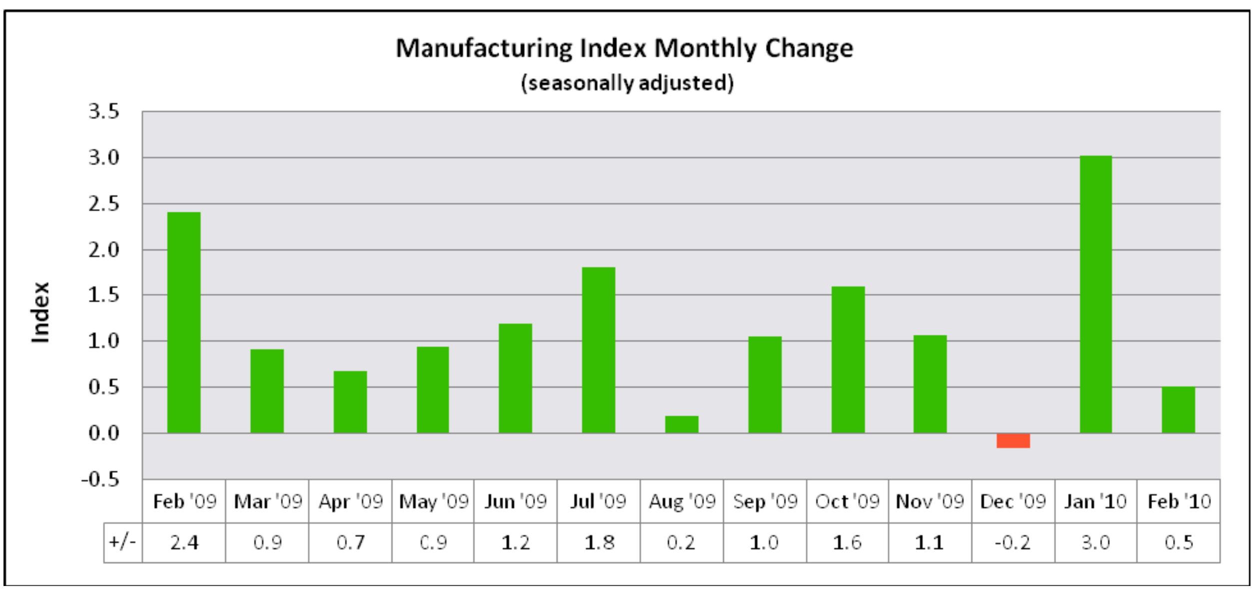
The most dramatic change in February was in the manufacturing sector where there was a gain in inventory. Decisions to boost inventory happened toward the end of 2009 and while the resulting buildup has taken about three months, there is evidence of slowdown as the suppliers wait for demand. Most of the favorable factors remained pretty solid in February with an increase in sales and a pretty substantial surge in new credit applications. “Unfortunately, dollar collections were down, likely reflecting the fact that many manufacturers are now stretching to get in position for the expected recovery and that has affected their ability to pay,” said Kuehl.

The big shifts in the sector took place in the non-favorable items. There were more disputes, dollars beyond terms and bankruptcies. There seem to be different factors at work with each. The bankruptcy situation tends to worsen at this stage in a recovery. “During the depths of a recession, the pressure on business is entirely from the economy itself and almost everybody is in the same situation—just hunkering down to survive and waiting for the economy to rebound,” said Kuehl. “Once the economy starts to move, competition within industries becomes a factor—especially for those businesses better prepared for the downturn. Just enough pressure is applied on the weaker competitor that it becomes too much and they are forced to capitulate.”

The disputes and the dollars beyond terms seem to stem from some companies getting over-stretched again. They are trying to get in shape to meet expected demand and competitive threats to their market share, but are still struggling with cash flow. Acknowledged tightness in the lending sector is also reducing the options these companies have that would enable them to float further until the demand hits.

The slowdown experienced in manufacturing in February may extend into March unless demand starts to materialize, which appears to be a 50-50 proposition at best at this point.

Manufacturing Sector (seasonally adjusted)	Feb '09	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec '09	Jan '10	Feb '10
Sales	34.7	36.7	39.6	40.7	45.4	48.7	48.4	48.7	52.0	56.3	55.8	61.8	62.5
New credit applications	45.2	44.6	50.7	49.3	51.1	55.3	48.6	50.5	52.9	56.8	55.2	54.0	57.8
Dollar collections	48.3	49.5	48.0	47.5	51.6	51.7	51.3	52.1	55.7	53.1	56.0	61.5	59.6
Amount of credit extended	40.5	41.8	44.1	44.2	45.8	49.3	48.9	48.8	53.5	53.4	55.2	59.2	60.7
Index of favorable factors	**42.2**	**43.1**	**45.6**	**45.4**	**48.5**	**51.3**	**49.3**	**50.0**	**53.5**	**54.9**	**55.6**	**59.1**	**60.2**
Rejections of credit applications	46.5	48.1	47.2	47.4	47.8	47.5	50.6	48.9	49.6	49.5	49.5	52.4	51.4
Accounts placed for collection	38.1	37.7	38.6	41.8	41.2	44.1	43.3	46.3	47.1	49.5	51.0	51.3	51.0
Disputes	44.4	44.4	45.8	47.6	46.1	49.3	48.2	49.5	50.9	48.0	50.1	50.7	51.9
Dollar amount beyond terms	46.5	48.1	42.8	44.5	45.3	46.3	48.1	48.3	47.9	50.0	51.4	52.5	53.3
Dollar amount of customer deductions	44.5	45.6	47.6	46.6	47.6	47.8	50.4	50.8	49.9	50.3	49.8	52.2	51.3
Filings for bankruptcies	39.2	40.6	39.6	43.6	43.2	43.1	47.3	51.7	52.1	55.4	46.6	55.4	56.5
Index of unfavorable factors	**43.2**	**44.1**	**43.6**	**45.2**	**45.2**	**46.4**	**48.0**	**49.2**	**49.6**	**50.4**	**49.7**	**52.4**	**52.6**
NACM Manufacturing CMI	**42.8**	**43.7**	**44.4**	**45.3**	**46.5**	**48.3**	**48.5**	**49.6**	**51.2**	**52.2**	**52.1**	**55.1**	**55.6**



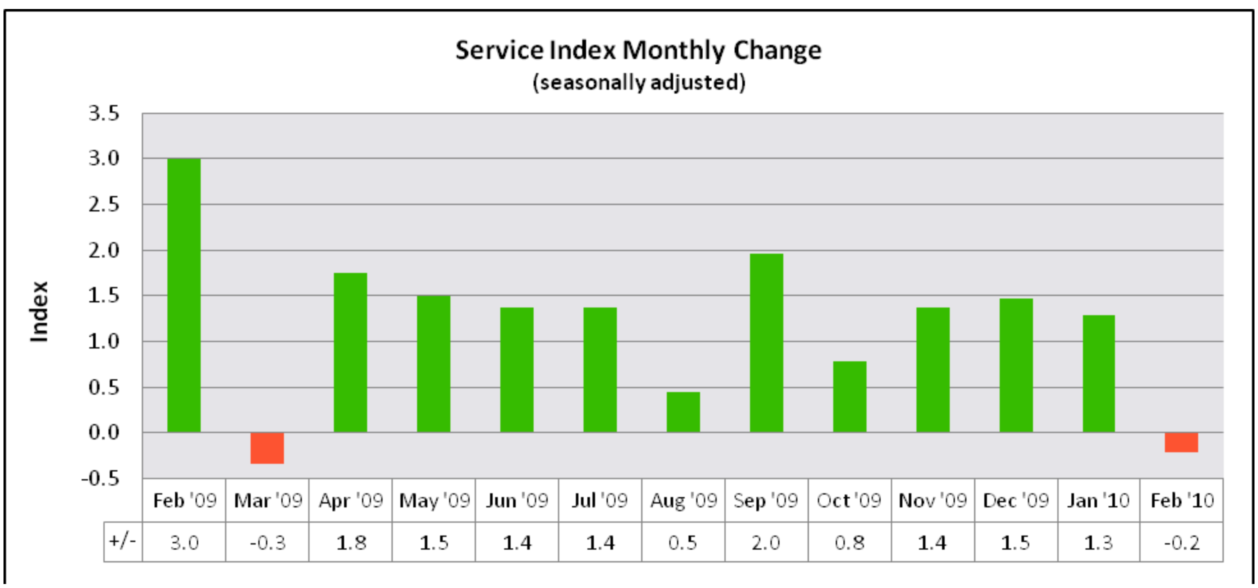
Service Sector

There was a drop in the service sector this month from 55.0 to 54.8 and January was more anemic than for manufacturing. The service sector is now feeling the effects of a greater number of layoffs. The manufacturing sector, led by construction, has already taken its lumps. There were portions of the service sector that also got hit early—most notably financial services—but retail rebounded in the holiday season.

The biggest drops occurred in sales and new credit applications. “Some of this is expected as consumer spending is generally slow this time of year. This is being exacerbated by more caution in consumer confidence than in past years as reflected in Conference Board data,” said Kuehl. “But business expansion in retailers like The Home Depot, Lowe’s, Target and Walmart somewhat contradicts these findings.”

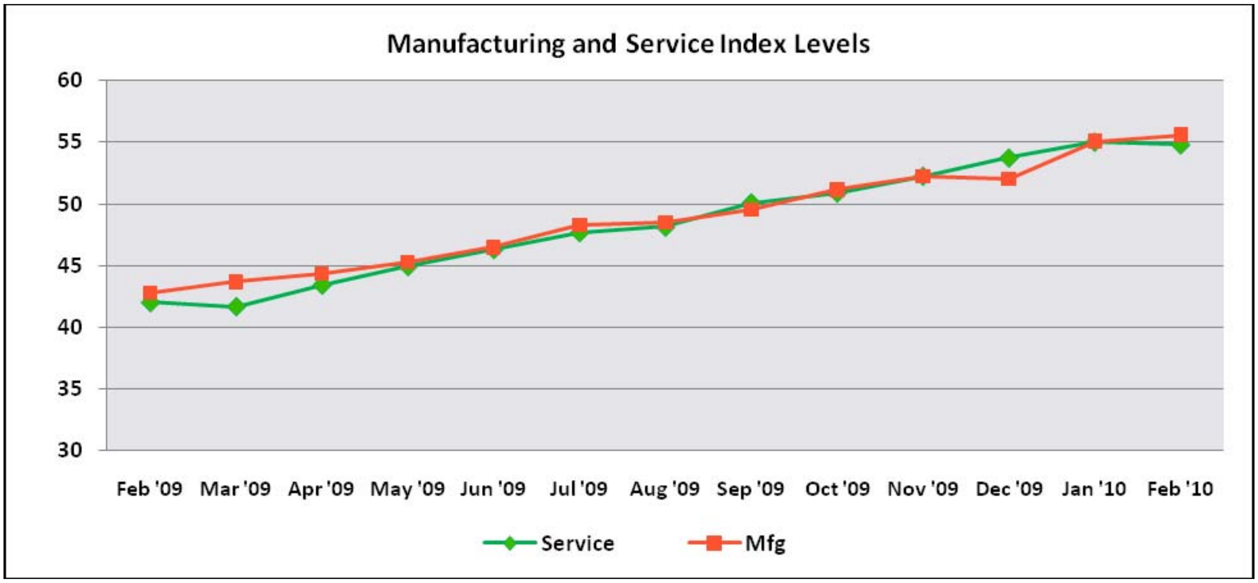
There were some declines in the unfavorable factors as well, but better news was sprinkled in. The number of accounts placed for collection increased, but filings for bankruptcy improved to the best number seen in over two years. “The good news here is that there are normally a lot of retailers facing bankruptcy after the holiday season. If they were limping into the end of 2009 needing a truly dazzling year to survive, they probably did not get it,” said Kuehl. “It seems the purge in retail took place last year and most of the sector has survived to fight for a place in the 2010 sweepstakes.”

Service Sector (seasonally adjusted)	Feb '09	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec '09	Jan '10	Feb '10
Sales	33.5	33.7	35.2	42.9	44.1	48.4	46.5	51.0	50.3	53.7	57.5	59.6	59.3
New credit applications	44.6	44.0	44.9	47.2	50.3	49.9	49.5	49.5	52.4	54.1	53.2	60.1	57.6
Dollar collections	45.9	47.4	48.0	50.0	50.8	49.8	50.5	54.8	53.7	58.6	59.9	61.2	62.7
Amount of credit extended	43.9	41.8	40.6	44.3	46.4	47.1	46.3	49.8	53.8	55.7	55.2	58.3	58.2
Index of favorable factors	**41.9**	**41.7**	**42.2**	**46.1**	**47.9**	**48.8**	**48.2**	**51.2**	**52.5**	**55.5**	**56.5**	**59.8**	**59.4**
Rejections of credit applications	46.9	47.5	47.7	47.4	48.1	47.4	48.5	47.9	48.5	49.2	50.6	50.4	50.6
Accounts placed for collection	37.5	36.5	38.5	38.7	39.8	43.9	43.7	44.3	47.1	49.4	50.7	50.1	49.9
Disputes	45.2	43.9	48.6	47.3	49.4	51.2	49.0	52.1	51.0	51.2	51.9	52.1	52.5
Dollar amount beyond terms	37.4	36.6	38.3	42.3	41.9	44.3	49.5	47.9	48.3	48.0	51.4	51.9	50.6
Dollar amount of customer deductions	48.0	45.4	52.0	48.4	50.2	50.7	51.1	52.7	51.1	52.3	52.7	52.9	51.1
Filings for bankruptcies	37.7	40.4	40.8	41.0	42.3	44.4	47.0	51.3	53.0	50.7	54.3	53.9	56.0
Index of unfavorable factors	**42.1**	**41.7**	**44.3**	**44.2**	**45.3**	**47.0**	**48.1**	**49.4**	**49.8**	**50.1**	**52.0**	**51.9**	**51.8**
NACM Service CMI	**42.0**	**41.7**	**43.5**	**45.0**	**46.3**	**47.7**	**48.2**	**50.1**	**50.9**	**52.3**	**53.8**	**55.0**	**54.8**



February 2010 vs. February 2009

The dramatic improvement from year to year is still pretty obvious. February of last year was clearly a period in the middle of the recession, but as the chart shows, this is when conditions started to improve. From this point forward, the gap will narrow. “The index was still well below the 50 mark until September 2009, but that means that within five months, all reflected chart numbers will be above above 50 unless there is an unexpected crash on the horizon,” said Kuehl.



Methodology Appendix

CMI data has been collected and tabulated monthly since February 2002. The index, published since January 2003, is based on a survey of approximately 1000 trade credit managers during the last 10 days of the month, with about equal representation between the manufacturing and service sectors. The survey asks respondents to comment on whether they are seeing improvement, deterioration or no change for various favorable or unfavorable factors. There is representation from all states, except some of the less populated such as Vermont and Idaho.

The computation of seasonality is based on the formula used by the U.S. Census Bureau and most of the federal government’s statistical gathering apparatus, making it possible to compare the CMI diffusion index with comparable indices—such as those from the Purchasing Managers, the Supply Chain Managers and others.

Factors Making Up the Diffusion Index

As shown in the table below, 10 equally weighted items determine the index. These items are classified into two categories: favorable factors and unfavorable factors. A diffusion index is calculated for each item with the overall CMI being a simple average of the 10 items. Survey responses for each item capture the change—higher, lower or the same—in the current month compared to the previous month.

For positive indicators, the calculation is:

$$\frac{\text{Number of “higher” responses} + \frac{1}{2} \times \text{number of “same” responses}}{\text{Total number of responses}}$$

For negative indicators, the calculation is:

$$\frac{\text{Number of “lower” responses} + \frac{1}{2} \times \text{number of “same” responses}}{\text{Total number of responses}}$$

A resulting CMI number of more than 50 indicates an economy in expansion; less than 50 indicates contraction.

Favorable Factors	Why Favorable
Sales	Higher sales are considered more favorable than lower sales.
New credit applications	An increase in credit applications says that demand is greater this month, which represents increased business if credit is extended.
Dollar collections	Higher dollar collections represent improved cash flow for the selling firm and the ability of buying firms to pay.
Amount of credit extended	An increase for this item means business activity is expanding with greater sales via trade credit.
Unfavorable Factors*	**Why Unfavorable**
Rejections of credit applications	Increased rejections of credit applications means more marginal creditworthy customers are seeking trade credit and being denied.
Accounts placed for collection	As this item increases, the selling firm is having trouble collecting accounts, or conversely, there is an increase in buyers not paying.
Disputes	Higher dispute activity often is associated with cash flow problems of customers. They dispute the invoice to defer payment until later.
Dollar amount of receivables beyond terms	As this item becomes higher, it means customers are taking longer to pay.
Dollar amount of customer deductions	Higher deductions often are associated with cash flow problems of customers.
Filings for bankruptcies	Higher bankruptcy filings mean cash flow difficulties of customers are increasing.

**Note: When survey respondents report increases in unfavorable factors, the index numbers drop, reflecting worsening conditions.*

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About the National Association of Credit Management

The National Association of Credit Management (NACM), headquartered in Columbia, Maryland, supports approximately 18,000 business credit and financial professionals worldwide with premier industry services, tools and information. NACM and its network of Affiliated Associations are the leading resource for credit and financial management information and education, delivering products and services, which improve the management of business credit and accounts receivable. NACM's collective voice has influenced legislative results concerning commercial business and trade credit to our nation's policy makers for more than 100 years, and continues to play an active part in legislative issues pertaining to business credit and corporate bankruptcy.

This report and the CMI archives may be viewed at http://web.nacm.org/cmi/cmi.asp.

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