Report for February 2011

Issued February 28, 2011

National Association of Credit Management

Combined Sectors

This month's Credit Managers' Index (CMI) from the National Association of Credit Management (NACM) reveals a tale of two economies and two strategies. There is continued good news in the index with sales and credit availability, but there is some very bad news as far as the toll this economy has had on business thus far. An impressive growth in sales pushed the number well into the 60s with a reading of 66.3—the highest since the recession started in 2008. Credit applications experienced the same growth, rising to 60.3 after having slipped to 58.6 in January. This number is also the highest since 2008, suggesting that companies still expect growth and are taking steps to get ready. The good news continued with dollars collected, which improved from 60.9 to 63.4. And, finally, there was good progress in the level of credit extended—an increase from 64.8 to 66.5.

The sum total of all this positive trending is an improvement from 62 to 64.1 in the favorable factor index. "What then is the problem?" asked Chris Kuehl, PhD, managing director of Armada Corporate Intelligence and NACM economic advisor. "Why is overall growth in the CMI non-existent? The 56.4 reading this month is the same as last month despite the good numbers."

This is the vexing part of a transition economy, said Kuehl. This is the time that companies move aggressively to capture market share due to the sense that the consumer is starting to engage—an assumption reinforced by overall economic numbers. The retail sector finished 2010 stronger than expected and the last set of data from the Purchasing Managers Index (PMI) show substantial gains in both the manufacturing and service sectors. Consumer confidence is up as well. These are the signs everyone has been waiting for, but they are not the signs of a fully recovered economy.

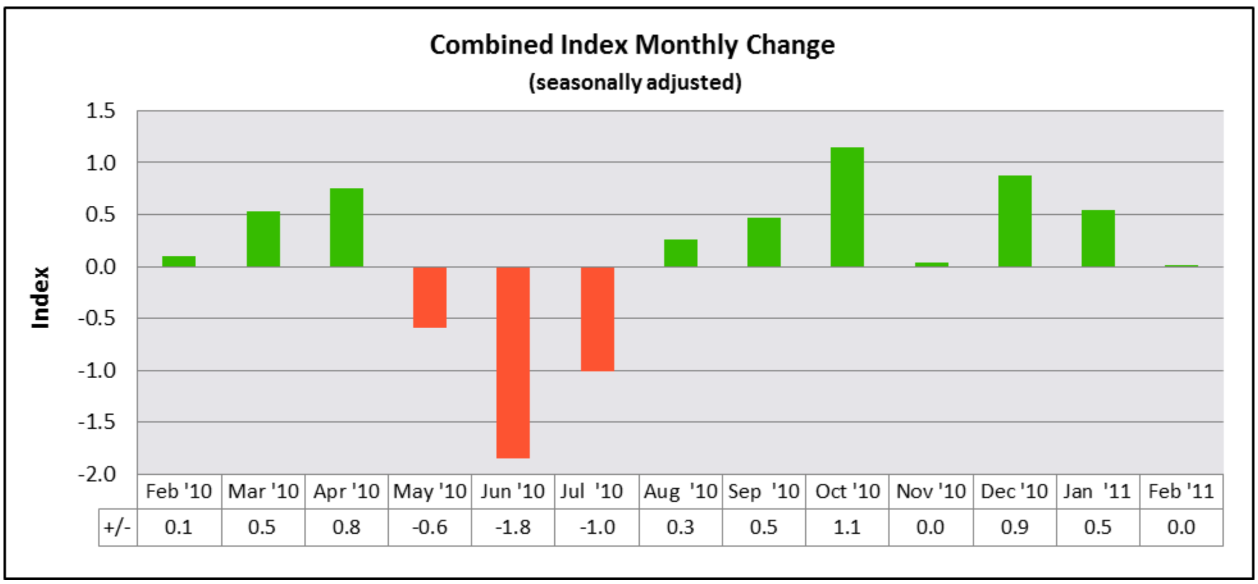
This situation creates the same pattern every time. The strongest competitor in a given market, the market leader, starts responding to anticipated demand with more capital investment, some hiring and additional marketing. That provokes the market challengers in that sector to respond in kind to maintain their edge. Right behind them are the market followers that also have to react to the moves of those in the dominant position. It is a chain reaction driven by the need to hang on to market share—a race that some companies are better positioned to enter. They are the ones that can wait for the recovery. Those that are not sitting on enough cash have no choice but to make investments and hope that the timing is right.

One of two things will happen to these companies. If the timing is right, the investment will pay off. The anticipated demand will manifest itself, and the cash flow will be there to handle the investment and credit requests. If the timing is off or if the company is forced to respond to the competition sooner than preferred, the debt soon becomes brutal and business failures ramp up. This is the signal sent by this month's index. The two negative factors showing the biggest increase were bankruptcies (falling from 59.1 to 56) and accounts placed for collection (moving from 52.5 to 49.9). Other indicators deteriorated as well. In the end, the declines in the unfavorable factors dragged down the combined index and left the CMI flat for the month.

This part of the transition out of a recession can be the most brutal. Companies barely hanging on could survive if there is little additional pressure. Now with the competition starting to heat up, these struggling companies are left with poor options. They either just accept the loss of their market or they gamble on their ability to hang on. If they guess wrong, they get into trouble soon. It is now a matter of how patient creditors can be and the point where credit managers must really show their skill at reading businesses. If they restrict an account to reduce exposure, they strain the relationship and may lose that customer should it rebound. If they give too much and the company goes under anyway, they have lost a lot of money and could put their own company in some peril.

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 '10	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec '10	Jan '11	Feb '11
Sales	60.9	65.0	65.7	64.5	59.0	57.2	57.6	58.6	60.8	61.9	65.9	63.5	66.3
New credit applications	57.7	57.5	57.4	58.6	57.4	54.1	54.6	54.8	56.8	58.2	60.1	58.6	60.3
Dollar collections	61.1	61.9	62.1	59.7	59.4	56.3	57.7	60.0	61.9	58.6	60.7	60.9	63.4
Amount of credit extended	59.4	61.3	61.3	60.2	55.9	56.0	57.1	58.7	59.8	61.2	61.7	64.8	66.5
Index of favorable factors	**59.8**	**61.4**	**61.6**	**60.7**	**57.9**	**55.9**	**56.7**	**58.0**	**59.8**	**60.0**	**62.1**	**62.0**	**64.1**
Rejections of credit applications	51.0	50.1	50.9	50.7	51.0	52.0	50.7	49.1	51.4	51.0	50.8	51.2	51.4
Accounts placed for collection	50.4	51.1	50.6	54.5	51.4	49.3	51.1	50.4	51.7	52.5	51.5	52.5	49.9
Disputes	52.2	52.2	51.7	51.3	50.4	50.6	50.9	50.8	49.9	50.8	49.2	51.0	49.2
Dollar amount beyond terms	52.0	51.5	51.9	50.2	49.1	49.4	47.0	49.1	50.9	48.9	53.4	51.5	50.6
Dollar amount of customer deductions	51.2	51.7	55.7	51.8	50.3	50.5	49.6	50.6	48.9	50.2	49.6	50.6	50.1
Filings for bankruptcies	56.3	55.3	57.6	57.6	56.6	55.0	56.9	55.7	57.0	56.3	55.4	59.1	56.0
Index of unfavorable factors	**52.2**	**52.0**	**53.1**	**52.7**	**51.5**	**51.1**	**51.0**	**50.9**	**51.6**	**51.6**	**51.7**	**52.6**	**51.2**
NACM Combined CMI	**55.2**	**55.7**	**56.5**	**55.9**	**54.1**	**53.0**	**53.3**	**53.8**	**54.9**	**55.0**	**55.8**	**56.4**	**56.4**



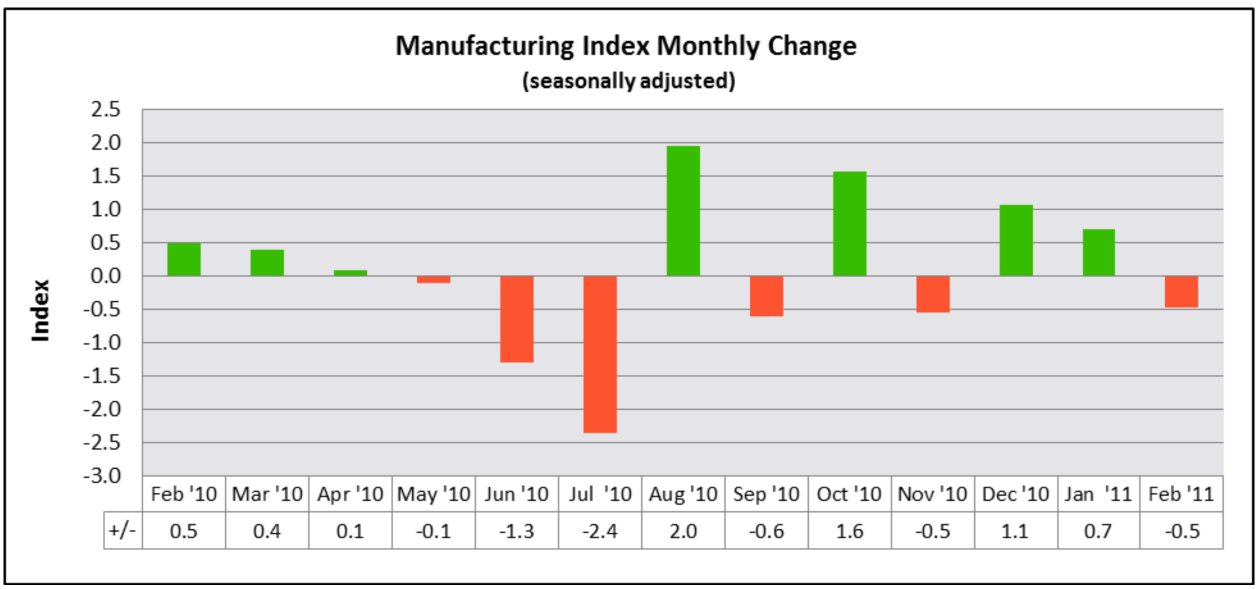
Manufacturing Sector

Manufacturing manifested the most pain. The manufacturers of yesterday may have been able to invest and spend money by adding staff and getting the edge needed when the decision is made to try to compete with the market leaders. That is not the way it works today. Now the competitive edge is provided by machines and technology. The requirement to spend before being able to truly compete can be deadly. The problem is lead time. It takes at least nine months for a company to fully realize the investment. Machinery and technology have to be installed and learned, workers trained and the system adapted to go after the business. It takes time and during that period they are not earning anything to offset the investment.

On top of this issue is the threat of inflation. The Federal Reserve may not be ready to declare that inflation is an issue, but those buying steel, copper, aluminum and other commodities have been seeing the sharpest price hikes in more than two years. They have to buy these items in anticipation of demand, but more importantly they are convinced that these prices are only heading up, which provides temptation to stockpile at levels they have avoided for the past several years. This is all a major strain on the budget and has been a contributing factor to business failure.

Despite the fact that favorable factors improved in the last month—from 62.2 to 63.4—there was a drastic reduction in the index of unfavorable factors. These collectively moved from 52.7 to 51.1, marking the lowest point since September 2010. The total index therefore fell from 56.5 to 56, leaving it at a level higher than most of last year but it still sends a message that some companies are having a hard time holding their own. Bankruptcies are up substantially and so are disputes as well as accounts placed for collection. These are all signs that some companies are hard pressed to handle the competitive environment right now.

Manufacturing Sector (seasonally adjusted)	Feb '10	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec '10	Jan '11	Feb '11
Sales	62.5	66.9	65.2	66.0	59.1	56.1	59.4	57.9	59.3	62.2	66.6	64.7	65.1
New credit applications	57.8	57.9	57.1	58.9	58.9	53.7	54.3	54.4	54.9	57.8	59.1	57.7	59.6
Dollar collections	59.6	61.4	60.9	59.7	59.0	53.0	60.1	61.1	61.0	57.9	60.5	60.3	61.5
Amount of credit extended	60.7	62.0	62.1	58.9	58.2	55.8	56.0	57.3	59.9	61.2	61.6	66.2	67.6
Index of favorable factors	**60.2**	**62.1**	**61.3**	**60.9**	**58.8**	**54.6**	**57.5**	**57.7**	**58.8**	**59.8**	**61.9**	**62.2**	**63.4**
Rejections of credit applications	51.4	50.9	52.3	51.6	51.8	52.0	52.6	49.6	53.2	52.1	51.3	52.0	51.9
Accounts placed for collection	51.0	51.9	52.0	54.3	54.3	48.5	52.8	51.9	53.6	52.7	51.1	53.0	51.2
Disputes	51.9	51.5	51.8	50.0	50.6	50.8	51.3	50.0	49.5	48.6	48.1	49.8	48.2
Dollar amount beyond terms	53.3	51.3	52.2	50.1	50.3	50.4	51.0	49.6	55.2	49.4	53.9	52.1	51.3
Dollar amount of customer deductions	51.3	51.6	50.8	51.0	49.2	49.9	48.4	49.4	48.5	48.8	49.4	49.1	50.1
Filings for bankruptcies	56.5	54.8	56.6	59.5	55.6	53.4	57.1	55.8	57.7	56.7	56.5	60.2	53.9
Index of unfavorable factors	**52.6**	**52.0**	**52.6**	**52.7**	**52.0**	**50.8**	**52.2**	**51.1**	**52.9**	**51.4**	**51.7**	**52.7**	**51.1**
NACM Manufacturing CMI	**55.6**	**56.0**	**56.1**	**56.0**	**54.7**	**52.4**	**54.3**	**53.7**	**55.3**	**54.7**	**55.8**	**56.5**	**56.0**



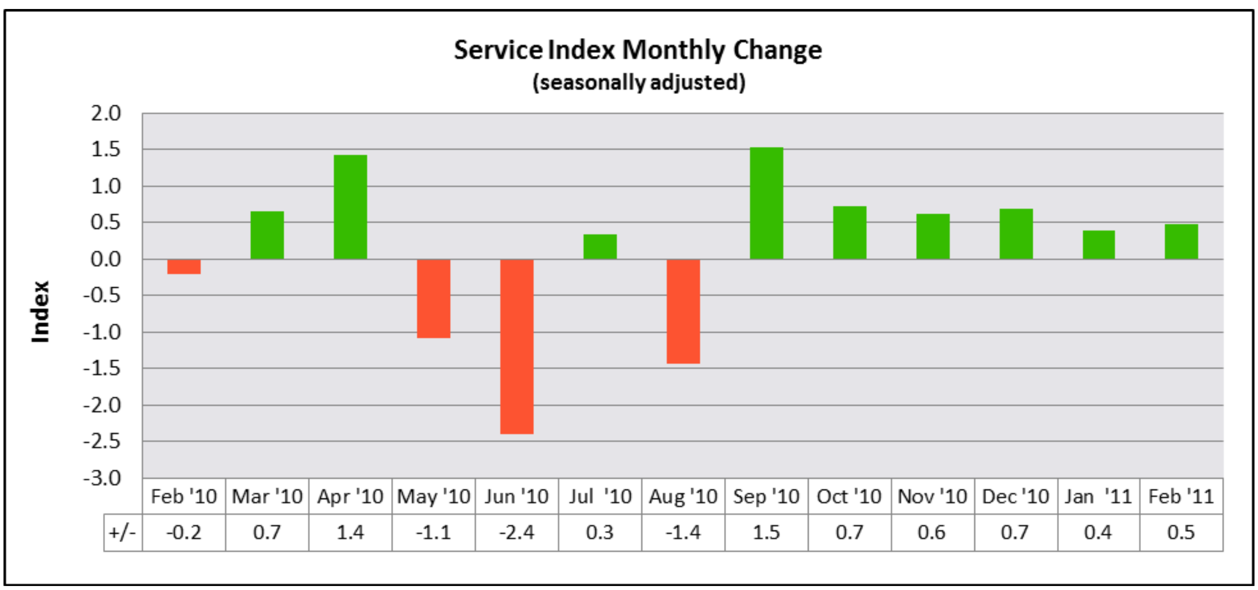
Service Sector

The situation in the service sector is much less threatening than in manufacturing. There was a solid increase in everything on the favorable side of the equation: sales are up as well as applications for credit and dollar collections. The rise in the whole category was impressive—moving from 61.7 to 64.8.

There was not the same joy in the unfavorable category, but neither was there the carnage that took place in manufacturing. While the decline was significant and took the sector back to levels set a few months ago, there was still growth.

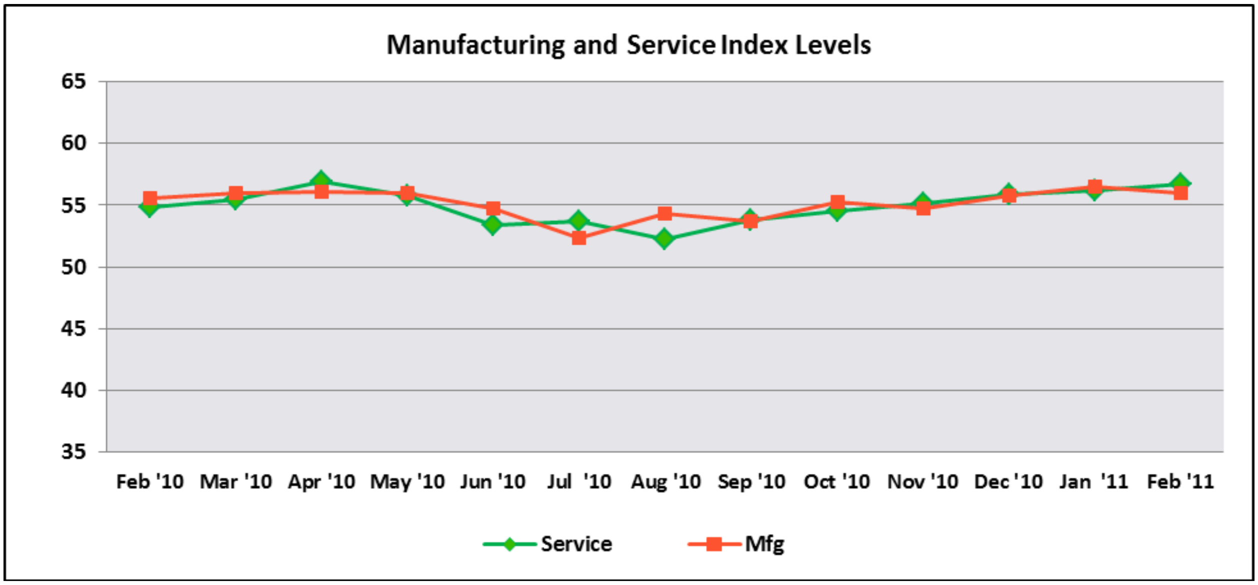
The good news is that there was not a hike in the level of bankruptcies and there was not a decline in the number of credit applications approved. The damage was done in terms of dollar exposure (moving from 51 to 49.9) and accounts placed for collection (52.1 to 48.6). The evidence is that much of the problem with accounts was in the retail space as many of these outlets are finding it hard to capture consumer attention in regions slow to bounce back.

Service Sector (seasonally adjusted)	Feb '10	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec '10	Jan '11	Feb '11
Sales	59.3	63.0	66.3	63.0	58.8	58.2	55.7	59.3	62.2	61.6	65.1	62.3	67.5
New credit applications	57.6	57.1	57.7	58.2	55.9	54.5	54.8	55.1	58.7	58.6	61.1	59.4	61.0
Dollar collections	62.7	62.4	63.2	59.7	59.7	59.7	55.2	59.0	62.9	59.2	60.9	61.6	65.2
Amount of credit extended	58.2	60.5	60.5	61.5	53.7	56.3	58.1	60.0	59.6	61.2	61.8	63.4	65.4
Index of favorable factors	**59.4**	**60.8**	**62.0**	**60.6**	**57.0**	**57.2**	**56.0**	**58.4**	**60.9**	**60.2**	**62.2**	**61.7**	**64.8**
Rejections of credit applications	50.6	49.4	49.6	49.7	50.3	51.9	48.7	48.7	49.6	49.8	50.3	50.4	51.0
Accounts placed for collection	49.9	50.2	49.2	54.8	48.5	50.1	49.4	48.9	49.9	52.4	52.0	52.1	48.6
Disputes	52.5	52.9	51.6	52.7	50.3	50.5	50.5	51.5	50.3	52.9	50.3	52.1	50.1
Dollar amount beyond terms	50.6	51.6	51.7	50.3	47.9	48.4	43.1	48.5	46.6	48.5	52.9	51.0	49.9
Dollar amount of customer deductions	51.1	51.8	60.5	52.6	51.4	51.0	50.8	51.7	49.4	51.6	49.9	52.1	50.1
Filings for bankruptcies	56.0	55.8	58.6	55.7	57.6	56.6	56.6	55.5	56.3	55.9	54.3	57.9	58.2
Index of unfavorable factors	**51.8**	**52.0**	**53.5**	**52.6**	**51.0**	**51.4**	**49.8**	**50.8**	**50.4**	**51.8**	**51.6**	**52.6**	**51.3**
NACM Service CMI	**54.8**	**55.5**	**56.9**	**55.8**	**53.4**	**53.7**	**52.3**	**53.8**	**54.6**	**55.2**	**55.8**	**56.2**	**56.7**



February 2011 vs. February 2010

The year-over-year numbers are nothing to stimulate celebration, but there is likewise no real room to panic. The pattern has been set over the course of the last year and there is not yet a breakout in evidence, although it has been pointed out that the month ended with some dramatic commodity price moves and there is hope that March will be less erratic.



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 1,000 trade credit managers in the second half of each 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 and 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:

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

For negative indicators, the calculation is:

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

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.*

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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