Report for June 2014

Issued June 30, 2014

National Association of Credit Management

Combined Sectors

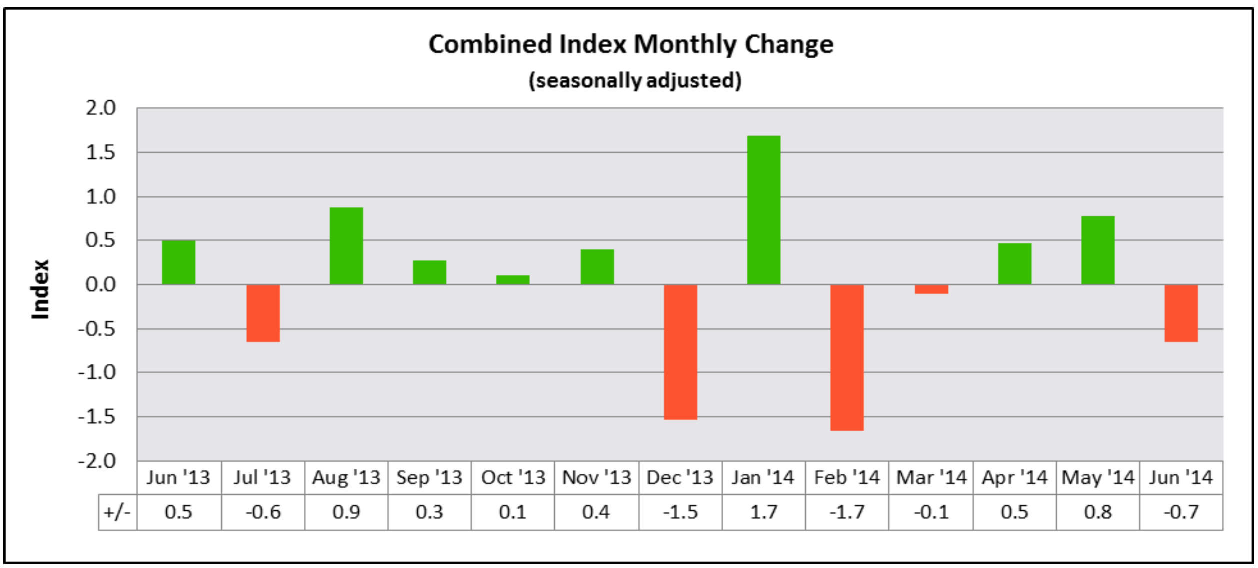
This month's Credit Managers' Index (CMI) reading from the National Association of Credit Management (NACM) was 56.1—barely higher than it was in April, but falling well below May's 56.8. The readings had been closing in on 60 (57.1 in November and 57.3 in January) and are still firmly in positive territory, but are now just not trending in the preferred direction. The services sector took the brunt of the impact, and the manufacturing sector did not budge, for the second month in a row.

After the readings last month, it was thought that the CMI would show continued progress, but the manufacturing sector was flat and the service sector experienced a very sharp decline—enough to drag the index down. "The drop was unexpected, which has suddenly become a common refrain as some other data releases are starting to show similar trends," said NACM Economist Chris Kuehl, PhD. The economy is clearly not out of the woods just yet, and the latest revision of first quarter GDP came as a shock. "It now appears that the economy contracted by far more than originally reported," Kuehl said. "Add to this the latest data on durable goods and there is something amiss. Consumer confidence numbers have recovered to levels not seen since the start of the recession, but that renewed level of enthusiasm has not been enough to pull the economy forward, or so it would seem."

The damage was greater in the unfavorable categories although the favorable factors saw some decline as well. The combined index of favorable factors deteriorated slightly from 62.7 to 62.4, but that is still firmly in the 60 range. The biggest drop was in sales, which went from a several years' high of 65.6 to 63.9. That is still a reading higher than at any point since November of last year, but after the surge last month, it was hoped the trend would accelerate. Dollar collections dropped out of the 60s, from 61.2 to 59.3 and amount of credit extended also slipped, from 65 to 64.8, but stayed very close to the record highs of late. New credit applications improved and that could be good or bad news. It is now over 60 for the first time since the recession, sitting at 61.5 after 58.9 last month. "The problem is that there were more rejections of credit applications as well," Kuehl said. "When there are more applicants and more rejections, it is a signal that more companies in financial distress are seeking credit in the hopes that somebody will help them survive."

The real shifts seem to be taking place in the unfavorable factors, suggesting a certain amount of economic and financial distress. The unfavorable factor index slipped by almost a full point, from 52.8 to 52, but the bigger news was the change in some of the individual factors. Rejections of credit applications shifted from 52.7 to 52, suggesting the existence of more desperate applicants. Accounts placed for collection also shifted a little, from 53.8 to 52.5—a sign that more creditors are falling too far behind to ignore, sparking more collection activity. Disputes slipped under 50 again to 49.5 after being at 50.2 in May. "This is an area of worry for a few months now and is another signal of some financial distress as companies try to change the terms of their arrangements using whatever leverage they can," Kuehl said. There was also a major dip in dollar amount beyond terms as it slipped below 50 for the first time since December. It is now at 49.6 after being at 51.5 last month. Dollar amount of customer deductions also slipped under 50 for the first time in over two years to 49.4, a full point down from May. Filings for bankruptcies actually improved and is as robust as it has been in some time. The reading this month is 58.9 compared to 58.4 last month. "It will be interesting to see if this reading gets worse in future months as these other categories are now trending badly," Kuehl said.

Combined Manufacturing and Service Sectors (seasonally adjusted)	Jun '13	Jul '13	Aug '13	Sep '13	Oct '13	Nov '13	Dec '13	Jan '14	Feb '14	Mar '14	Apr '14	May '14	Jun '14
Sales	62.3	61.4	63.1	62.7	62.5	63.4	58.7	61.5	59.4	59.1	61.8	65.6	63.9
New credit applications	58.8	58.0	58.7	57.4	58.5	59.2	57.2	58.2	58.1	57.3	59.3	58.9	61.5
Dollar collections	59.3	57.5	60.4	60.6	61.4	59.7	58.7	60.9	58.8	56.4	58.1	61.2	59.3
Amount of credit extended	62.8	62.4	63.3	62.9	63.8	63.2	62.6	65.4	61.4	63.1	63.8	65.0	64.8
Index of favorable factors	**60.8**	**59.8**	**61.4**	**60.9**	**61.5**	**61.3**	**59.3**	**61.5**	**59.4**	**59.0**	**60.7**	**62.7**	**62.4**
Rejections of credit applications	52.5	53.2	52.7	53.0	52.1	53.3	54.5	54.6	52.3	52.4	52.3	52.7	52.0
Accounts placed for collection	53.9	53.6	52.5	54.3	53.3	55.0	53.4	55.2	54.6	54.1	51.7	53.8	52.5
Disputes	51.9	51.0	51.6	51.7	51.8	51.9	50.7	52.2	51.9	50.9	54.7	50.2	49.5
Dollar amount beyond terms	50.5	48.5	51.1	52.2	52.7	54.7	49.7	52.8	51.1	52.4	50.0	51.5	49.6
Dollar amount of customer deductions	52.5	51.0	51.4	51.7	51.8	52.4	51.5	51.6	50.4	51.2	50.3	50.4	49.4
Filings for bankruptcies	56.8	58.2	58.7	59.8	59.6	59.0	59.0	60.5	58.5	58.4	58.1	58.4	58.9
Index of unfavorable factors	**53.0**	**52.6**	**53.0**	**53.8**	**53.6**	**54.3**	**53.1**	**54.5**	**53.1**	**53.2**	**52.8**	**52.8**	**52.0**
NACM Combined CMI	**56.1**	**55.5**	**56.4**	**56.6**	**56.7**	**57.1**	**55.6**	**57.3**	**55.6**	**55.5**	**56.0**	**56.8**	**56.1**



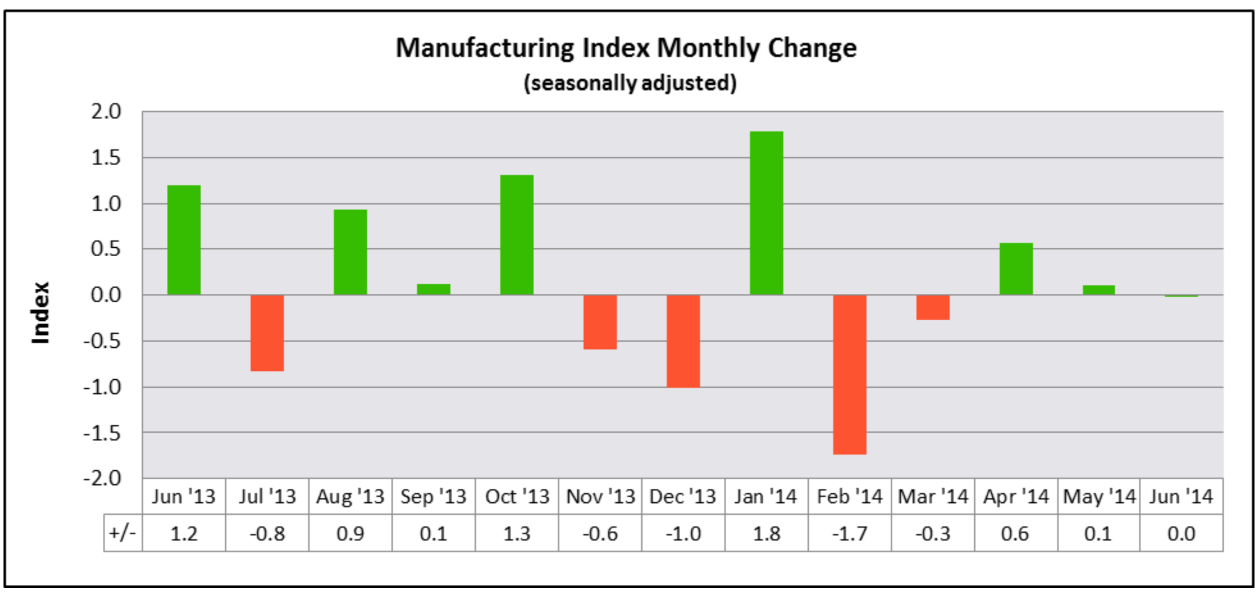
Manufacturing Sector

"The manufacturing sector, at 56.1, is about as stable as it can get," said Kuehl. "For the last three months, there has been almost no change at all in the index. The sense is that manufacturing has settled down after the brutal first quarter numbers." The index of favorable factors improved slightly from 62 to 62.8 and remains in the 60s, but the index of unfavorable factors headed in a direction that no one wants, declining from 52.2 to 51.7.

Sales increased from 64.5 to 65.7, which is a very promising sign for the future given the recent reduction in durable goods numbers, as did amount of credit extended, from 64.4 to 65.2, a good sign as far as future expansion is concerned. New credit applications also jumped from 57.2 to 61.7, its first time over 60 since the recession began. "But there's a caveat here," Kuehl said. "As mentioned above, the rise in the level of credit applications can be undone by an increase in rejections of those applications and as we will see below, this is what has happened." Dollar collections was the only factor to decline, from 62 to 58.5. There are far more slow pays than had been the case last year and even at the start of this year.

“The unfavorable factors pose more of a concern,” Kuehl said. “As referenced above, rejections of credit applications trended down and that reduced the impact of the increased rate of credit application. Too many of those seeking credit are not in a position to receive it.” Disputes slid deeper into the 40s, from 49.6 to 48.5, and is one of the more distressing readings as it signals that some of the better creditors are challenging those they have credit with, Kuehl noted. “Those that are not considered decent credit risks do not get to dispute much. They just become subject to collection. The arguments take place when there is some mutual leverage,” he said. Dollar amount beyond terms also slid, from 52.5 to 50.2—very close to sliding under 50 and into contraction territory. Dollar amount of customer deductions remained under 50 by falling from 48.3 to 47.9. On the positive side, accounts placed for collection held steady, improving just slightly from 53.3 to 53.5, and filings for bankruptcies improved from 57.1 to 58.7. “There is still some worry that bankruptcy rates will increase if all these other negatives keep getting worse, but as far the reading goes, it is currently very healthy,” Kuehl said.

Manufacturing Sector (seasonally adjusted)	Jun '13	Jul '13	Aug '13	Sep '13	Oct '13	Nov '13	Dec '13	Jan '14	Feb '14	Mar '14	Apr '14	May '14	Jun '14
Sales	61.0	60.3	62.3	61.6	64.3	63.4	61.7	59.6	57.9	58.5	61.6	64.5	65.7
New credit applications	58.6	57.5	58.4	55.6	58.9	59.2	57.7	59.5	57.7	56.1	58.8	57.2	61.7
Dollar collections	59.4	57.9	61.0	60.5	61.4	58.7	59.5	62.7	56.4	57.4	59.1	62.0	58.5
Amount of credit extended	61.2	61.4	62.1	62.4	64.8	61.8	61.5	66.4	60.4	61.7	64.5	64.4	65.2
Index of favorable factors	**60.0**	**59.3**	**61.0**	**60.0**	**62.4**	**60.8**	**60.1**	**62.0**	**58.1**	**58.4**	**61.0**	**62.0**	**62.8**
Rejections of credit applications	52.7	52.9	52.3	52.4	52.0	52.9	55.5	54.4	52.8	52.6	52.6	52.6	51.4
Accounts placed for collection	53.6	53.6	53.0	53.7	54.0	55.7	53.3	55.7	59.9	56.1	51.5	53.3	53.5
Disputes	50.8	49.5	49.8	50.8	52.1	51	50.2	51.0	51.6	50.6	57.2	49.6	48.5
Dollar amount beyond terms	50.8	48.3	52.5	52.9	54.6	54.8	50.0	53.2	51.7	52.8	49.5	52.5	50.2
Dollar amount of customer deductions	52.5	49.8	49.3	50.7	51.9	51.4	49.7	51.8	50.4	50.4	48.5	48.3	47.9
Filings for bankruptcies	57.1	58.1	57.9	59.4	59.0	58.5	57.7	60.4	58.6	58.5	57.0	57.1	58.7
Index of unfavorable factors	**52.9**	**52.0**	**52.5**	**53.3**	**53.9**	**54**	**52.7**	**54.4**	**54.1**	**53.5**	**52.7**	**52.2**	**51.7**
NACM Manufacturing CMI	**55.8**	**54.9**	**55.9**	**56.0**	**57.3**	**56.7**	**55.7**	**57.5**	**55.7**	**55.5**	**56.0**	**56.1**	**56.1**



Service Sector

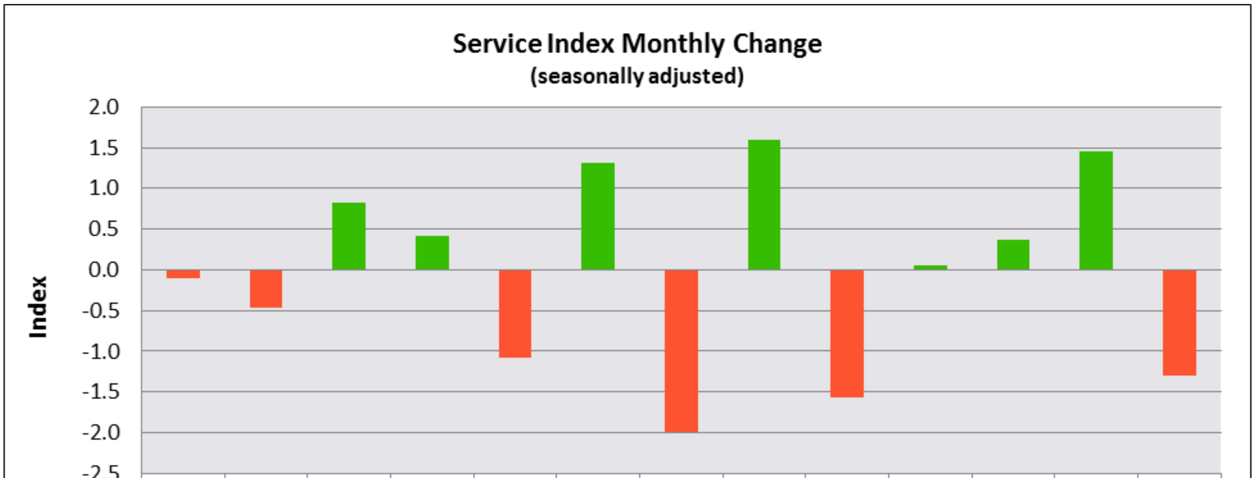
"The service sector caused the most damage to the combined CMI score this month with its fall from 57.4 to 56.1 and that has many scratching their heads," Kuehl said. "It was so good last month, hitting levels not seen since the end of the recession and leading the CMI to impressive new levels. Now it is bringing the index down. There decline was sharp in the favorable factors index's fall from 63.4 to 61.9. The good news is it remains in the 60s for the third month in a row. The index of unfavorable factors showed some real distress, however, sliding from 53.4 to 52.2 and getting too close to the break point for comfort."

Sales cooled drastically this month, from 66.6 to 62.1. While this was a big drop, it is still comfortably in the 60s where it has been for well over a year and was still more robust in June than any point since January. Amount of credit extended also saw a significant shift, dropping from 65.7 to 64.3, but the other factor to fall, dollar collections, did so just slightly from 60.5 to 60.1. As it did in the manufacturing sector, new credit applications rose, from 60.7 to 61.3. The same caveat applies though as the rate of rejections rose a little as well—again, a signal that some of the applicants are far from qualified to seek that extra credit. "The most important point illustrated by these numbers is that despite some shrinkage, all the indicators are in the 60s, a pretty healthy performance and better than it has been in recent months," said Kuehl. "The growth in the service sector has slowed, but it is still robust compared to last year and even earlier this year."

The data in the unfavorable factor index is more worrisome. Rejections of credit applications dipped a little, but the shrinkage from 52.8 to 52.6 was far less dramatic than it was within manufacturing. Accounts placed for collection also suffered with its fall from 54.4 to 51.4. Disputes was not nearly as volatile as it was with manufacturing, moving only very slightly from 50.8 to 50.4. "The real issue here is that this category is inching ever closer to 50, the point that separates contraction from expansion," Kuehl said. Dollar amount beyond terms slipped into the 40s, from 50.4 to 48.9, and that is far from a good sign. Dollar amount of customer deductions has shrunk as well from 52.4 to 51.0. Filings for bankruptcies also retracted, falling from 59.8 to 59, but this is still very close to 60 and better than expected.

"The majority of the distress in the service sector seems to be coming from the retail community as the spring recovery has not been as robust as hoped," Kuehl said. "There have been lingering problems in the construction business as well, mostly stemming from the lack of funding for public projects."

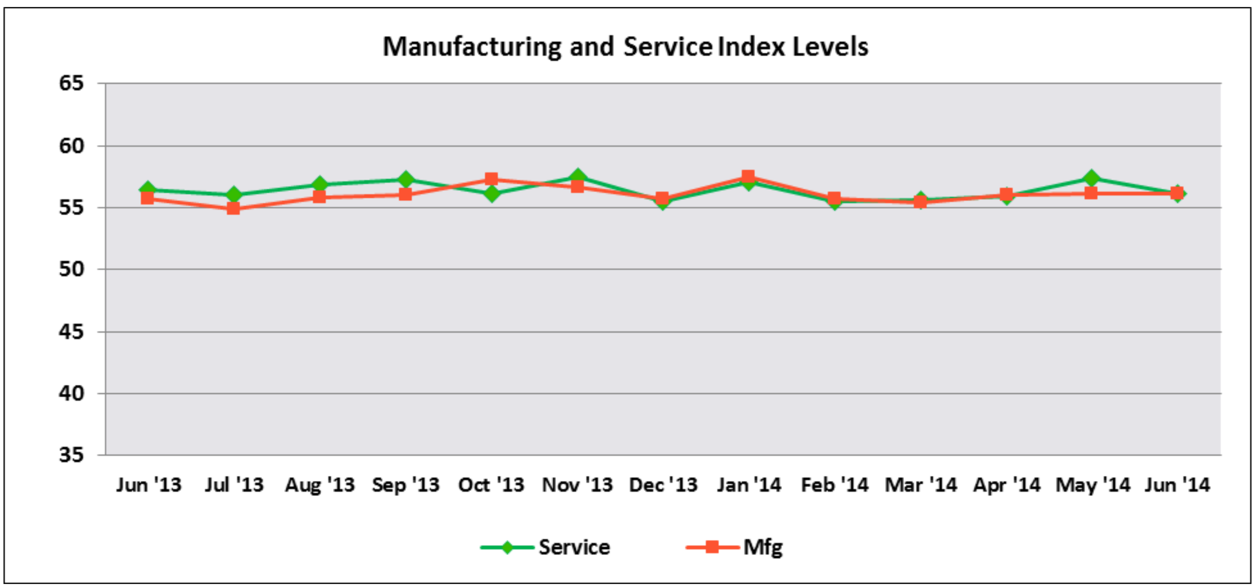
Service Sector (seasonally adjusted)	**Jun '13**	**Jul '13**	**Aug '13**	**Sep '13**	**Oct '13**	**Nov '13**	**Dec '13**	**Jan '14**	**Feb '14**	**Mar '14**	**Apr '14**	**May '14**	**Jun '14**
Sales	63.6	62.5	63.9	63.8	60.6	63.4	55.7	63.4	60.9	59.6	61.9	66.6	62.1
New credit applications	59.1	58.4	59.1	59.2	58.1	59.1	56.7	57.0	58.5	58.5	59.8	60.7	61.3
Dollar collections	59.3	57.1	59.8	60.7	61.3	60.6	57.8	59.2	61.1	55.4	57.1	60.5	60.1
Amount of credit extended	64.3	63.3	64.5	63.4	62.8	64.5	63.6	64.4	62.3	64.5	63.1	65.7	64.3
Index of favorable factors	**61.6**	**60.3**	**61.8**	**61.8**	**60.7**	**61.9**	**58.4**	**61.0**	**60.7**	**59.5**	**60.5**	**63.4**	**61.9**
Rejections of credit applications	52.4	53.5	53.2	53.7	52.2	53.6	53.5	54.8	51.8	52.2	51.9	52.8	52.6
Accounts placed for collection	54.1	53.6	52.0	55.0	52.7	54.2	53.5	54.8	49.3	52.2	51.8	54.4	51.4
Disputes	53.0	52.6	53.3	52.6	51.4	52.8	51.3	53.3	52.2	51.2	52.1	50.8	50.4
Dollar amount beyond terms	50.3	48.7	49.7	51.5	50.9	54.5	49.3	52.3	50.6	52.0	50.5	50.4	48.9
Dollar amount of customer deductions	52.5	52.2	53.5	52.8	51.8	53.3	53.3	51.4	50.4	51.9	52.1	52.4	51.0
Filings for bankruptcies	56.5	58.2	59.6	60.1	60.3	59.4	60.4	60.5	58.4	58.4	59.2	59.8	59.0
Index of unfavorable factors	**53.1**	**53.1**	**53.6**	**54.3**	**53.2**	**54.6**	**53.6**	**54.5**	**52.1**	**53.0**	**53.0**	**53.4**	**52.2**
NACM Service CMI	**56.5**	**56.0**	**56.9**	**57.3**	**56.2**	**57.5**	**55.5**	**57.1**	**55.5**	**55.6**	**56.0**	**57.4**	**56.1**



	Jun '13	Jul '13	Aug '13	Sep '13	Oct '13	Nov '13	Dec '13	Jan '14	Feb '14	Mar '14	Apr '14	May '14	Jun '14
+/-	-0.1	-0.5	0.8	0.4	-1.1	1.3	-2.0	1.6	-1.6	0.1	0.4	1.5	-1.3

June 2014 versus June 2013

The June 2014 CMI is exactly where it was in June 2013, at 56.1. This is an economy going nowhere fast. “The most troubling sign is that companies seem to be getting into more distress again and that might affect future performance,” Kuehl said.



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 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 the PMI and other manufacturing and service sector indices.

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

NACM, headquartered in Columbia, Maryland, supports more than 15,000 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, education, products and services designed to improve the management of business credit and accounts receivable. NACM's collective voice has influenced our nation's policy makers on federal legislation concerning commercial business and trade credit for more than 100 years, and continues to play an active role in legislative issues that pertain to business credit and corporate bankruptcy. Its annual Credit Congress is the largest gathering of credit professionals in the world.

NACM has a wealth of member experts in the fields of business-to-business credit and law. Consider using NACM as a resource in the development of your next credit or finance story.

View CMI archives at http://web.nacm.org/cmi/cmi.asp.

Source: National Association of Credit Management

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