INSOLVENCY INSIGHTS

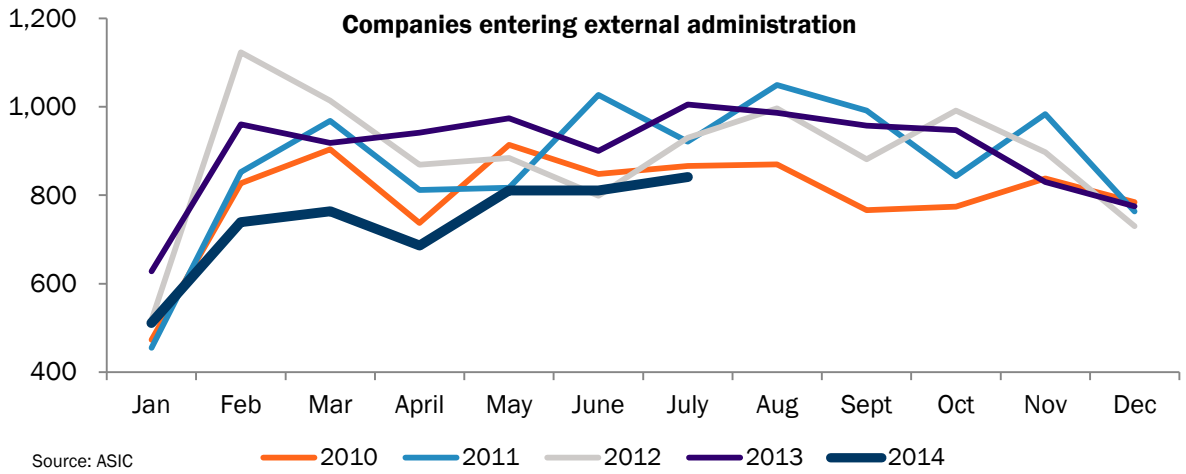
Analysis of ASIC's latest external administration appointments statistics from July 2014

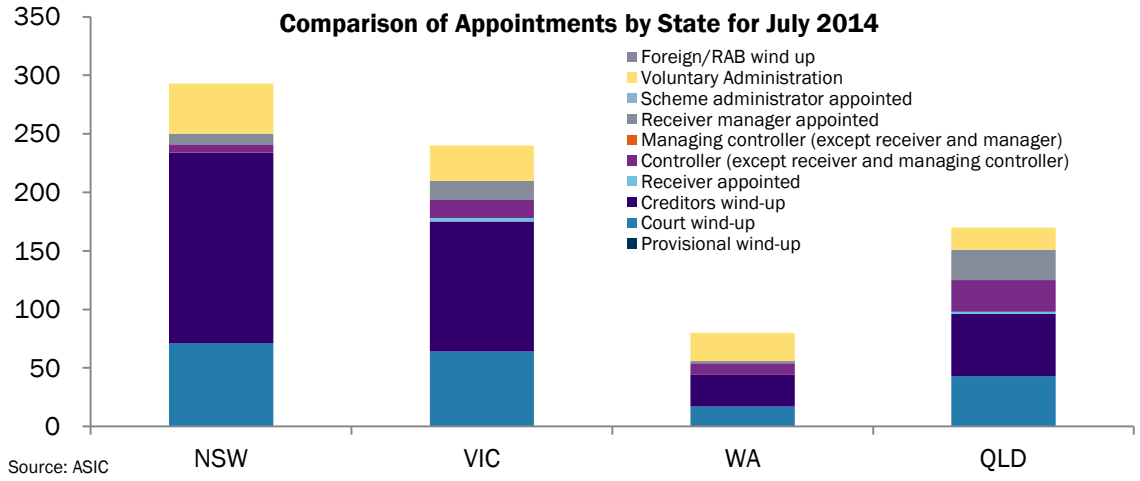
25 SEPTEMBER 2014

The Figures

What the latest figures show

- The ASIC figures show that 841 companies entered external administration in Australia during July 2014, the highest number in a month this year, yet the lowest level for the month of July since 2007.
- To date in 2014, 5,163 companies have entered external administration, well down on the 6,326 companies registered in the first seven months of 2013.
- Compared to June, external administration appointments grew the most in New South Wales, with continued increases in Victoria, Western Australia and Queensland. Western Australia recorded its highest number of insolvencies (80) for a month since November 2012.
- The biggest movements in a breakdown by types of external administration appointments for July were a 77% jump in controllers appointed and a 43% increase in receiver appointments compared to June. Meanwhile, 126 companies entered voluntary administration, the highest level for a month since August 2013.





About FTI Consulting

FTI Consulting, Inc. is a global business advisory firm dedicated to helping organisations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. FTI Consulting professionals, who are located in all major business centers throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring. More information can be found at www.fticonsulting.com.

Economic Influences

The broader market and its potential impacts on insolvency levels

- On balance, economic indicators in July were steady with signs of improvement starting to appear. The Reserve Bank of Australia said it believes the economy would grow at a below trend pace, before improvement in 2016. Growth in the global economy was continuing at a moderate pace.
- Consumer sentiment remained weak. Data from the Westpac-Melbourne Institute showed sentiment added 1.7 points, or 1.9%, to 94.9 points in July.
- Unemployment figures rose to 6.4% in July, which was a rate not seen for 12 years. ANZ job advertisements were up just 0.3%.
- Australian Industry Group (AIG) data showed the Australian PMI moved into positive territory in July, up 1.7 points to 50.7. This was the first growth recorded in the index in eight months, indicating some stabilisation in the manufacturing sector. The services index also rose, but remained in contractionary territory. The construction index continued its rise from 51.8 points in June to 52.6 points in July.
- Home building approvals spiked 2.5% in July, beating expectations after a fall of 3.8% in the previous month. The lift was attributed to a 23.1% increase in approvals in Western Australia. Economists cautioned that the overall trend still showed building approvals to be slow.
- NAB's monthly business survey showed business conditions rose in the month of July 2014 to the highest level in four years, up 6 points to +8 index points. Business conditions have been much improved on last year, but remain well below levels seen prior to the financial crisis. Business confidence also rose in the month to +10 from +8 in June.

Special Focus

Non-residential property sectors (outside mining and resources)

- The non-residential property market is currently operating on two tiers — prime and secondary. Competition for assets that are well located and supported by solid income streams is intensifying resulting in an increase in price, whereas the market for assets without these fundamentals is still quite subdued.
- In 2014, there has been a dramatic reduction in the number of commercial properties listed for sale by external administrators.
- Across all sectors, international and local purchasers are hunting for high performing prime assets, resulting in moderate yield compression across the board.

Commercial Office

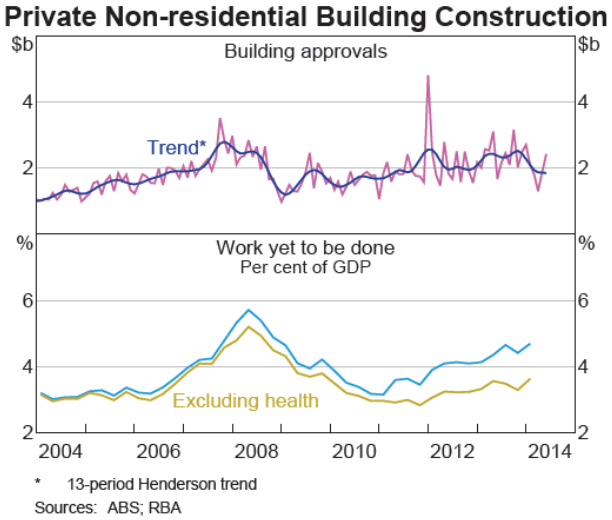
- The commercial office market in Australia remains under pressure, with current vacancy rates above their decade averages and rental yields at below historical averages.
- In Brisbane, where few new office buildings are under construction, the net absorption of office space has improved slightly. This is attributed to slightly higher business confidence and the conversion of a number of commercial buildings into residential apartments and hotels. The Sydney and Melbourne CBDs traditionally have a stronghold of company headquarters, particularly in business and financial services, and currently both CBDs have the lowest vacancy rates and the highest rental growth in Australia.

Retail

- Independent property advisory firm specialising in valuations, m3property, found: "Shopping centres nationally are expected to see mixed conditions over 2014-15, driven by residential markets and employment conditions differing across regions. Low interest rates are likely to keep purchaser demand largely positive, while structural and cyclical challenges continue to test retailers driving adjustments to strategies and business models."

Industrial

- As the retail industry grapples with structural change in the face of internet retailing, the industrial property sector will need to provide supply chain solutions (e.g. distribution centres) as manufacturing continues its structural decline. In 2013 and 2014, Sydney and Melbourne have led the country in the highest level of construction, with Brisbane also experiencing a significant increase in the level of construction activity in H1 2014. During this period, net face rents have been stable across most Australian markets and are forecast to continue in 2015. Since 2011, there has been an upward trend in the level of incentives as the competition to secure tenant commitments and fill newly constructed space increases. Incentives are currently ranging between 9% and 14% for the majority of Australian capital cities.



- There is some suggestion that the pipeline of approvals yet to be carried out will see non-residential building investment rise in coming quarters.
- The Property Council/ANZ Property Industry Confidence Index to September 2014 showed property industry confidence remained steady at 131 points compared to 132 the previous quarter.
- Concern in the industry remains about economic growth, which is expected to experience moderate and below-trend growth until 2016.

Insights Q&A

What implications/opportunities exist for property developers and construction contractors in the current market?

Combined with the diminished mining and resources investment, the muted construction approvals in the public (infrastructure) and private sector are putting additional pressure on construction companies and related services like engineering. As such, significant full-time equivalent (FTE) reductions has resulted in large tracks of surplus office space, potentially negating what little growth there is in demand. We anticipate an increase in industrial properties becoming distressed assets in regional areas servicing the mining and resources sector.

With the weight of investment into the Australian property market from offshore development companies showing no signs of dissipating in the short term, opportunities will arise for domestic operators to recycle capital by divesting existing assets. This is particularly the case for property developers that are holding well located residential development sites and/or commercial property with solid income streams.

How much are property developers, construction contractors, etc... impacting your work flow at the moment?

As a firm and as an industry we are seeing more construction and trade related appointments like Forge Group, Walton Construction, and more recently Glenzeil. The construction industry is undergoing a shift from industrial to domestic construction to capitalise on a rising residential property market.

Recent Industry Case Study

- We were appointed as Receivers and Managers over four separate properties located in Queensland, spanning 25,000m^2, which were the jointly owned assets of two individuals.
- The properties were a mixture of vacant commercial and residential land, a petrol station and commercial lots with several properties tenanted.
- During the appointment, as Receivers and Managers, we dealt with:
  - Litigation with the Director, surrounding the validity of the appointment;
  - Undertaking the Work Health and Safety (WHS) reports and instigating all required works to bring the properties into line with WHS standards; and
  - Managing all issues and difficulties with tenants, including the placement of new tenants for properties.
- All properties were sold and sale prices were achieved in excess of market values.

Is the level of workflow in this sector unusual/normal?

The type and level of work is reflective of the slightly improved economic conditions. It is now seven years since the onset of the Global Financial Crisis. The extent of the downturn was somewhat mitigated by the manner in which lenders dealt with their distressed loan books. This extended workout period has allowed most banks to cleanse their loan books to the point where the level of distressed loans, as a percentage of total assets, is well below historical levels. Despite this, the level of risk banks are now prepared to accept for commercial property exposures is still well short of pre financial crisis levels and therefore the volume of workflow for insolvency practitioners has diminished.

We have also witnessed an increased level of alternative capital solutions available to banks, such as refinancing and debt trading. FTI Consulting has a proven track record in assisting banks with alternative capital solutions and has therefore benefited from an increase in workflow in this space.

Do you expect the slowing of mining investment to continue to impact the commercial property market?

In the resources-rich states of Queensland and Western Australia, where mining and resources investment propelled a strong commercial office market, the diminished investment has resulted in rising vacancy particularly in the Brisbane fringe office markets where many mining and resources services companies are located.

Do you see increased levels of work as the property sector remains volatile?

With the current level of mining and resources investment being the new "norm" and few public infrastructure projects planned, there may be more restructure from within the construction industry. This is likely to have a knock-on impact on the property sector and we have seen recent evidence of this with the significant reduction in demand for residential and industrial property in mining areas.

Outlook

The broader market and its potential impacts on insolvency levels

- While consumer sentiment rose in August close to levels seen prior to the May budget, it fell sharply again in September, according to data from the Westpac-Melbourne Institute. Westpac Chief Economist Bill Evans said: "Most of the steady recovery we had seen in the Index over the last three months [post-budget] has been eroded."
- Australia's unemployment rate fell to 6.1% in August from the 12-year high of 6.4% recorded in July. There is an expectation the unemployment rate will stay above 6% in the short to medium term. The drop in unemployment in August was attributed to a strong increase in the seasonally adjusted estimate of employment.
- Business conditions fell in August, after a surprise spike in July, with the biggest falls in manufacturing, construction and retail. Business confidence eased a little but remains on the bullish side. NAB's latest monthly business survey showed the business confidence index dropped to +8. Business conditions also fell back, from +8 to +4.
- New car sales fell 1.3% (seasonally adjusted) month-on-month in July to 93,479. Year-on-year, total new car sales were 0.4% lower (seasonally adjusted).
- Reserve Bank of Australia Governor Glenn Stevens said continued accommodative monetary policy should provide support to improve demand and help strengthen growth, as rates were left on hold at 2.5%. The RBA said China's growth remains broadly in line with expectations and, while commodity prices remain historically high, there have been falls in the price of some commodities significant to Australian trade.
- In recent months improving market conditions, such as low interest rates and rising consumer and business confidence, were tipped to be positive drivers for the building industries within the construction sector and counter-balanced the negative trend in investment into resources related projects. However, the sharp fall in consumer and business interest in September has eroded much of that positive sentiment, particularly if muted new construction projects are postponed.
- The construction industry is highly fragmented with the top four players generating less than 10% of total revenue for the sector, indicating a low level of concentration. We therefore see insolvency levels in the construction industry set to increase, particularly for operators that have invested heavily in resources related work and those that are unable to refocus on housing construction, which is forecast to fuel growth.
- In summary we see the non-residential property sector operating on two tiers, with a "flight to quality" driving the recent capital appreciation for these assets. Despite the competiveness for primary assets we have not yet seen a significant shift in the desire for secondary assets. This may change if the current trend continues. Banks are still lending cautiously and selectively to the non-residential property sector and if this continues this will limit opportunities for operators, unless other capital solutions can be identified.

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