

— Hurricane Katrina:
Impact on outstanding
payables to suppliers

White paper

Introduction

The true and lasting impact of Hurricanes Rita and Katrina on the Gulf Coast region of the United States will be difficult to measure for years to come. The cost of recovery is certain to be in the billions, and the timeline is unknown. Thousands of residents and businesses have been displaced, and it's uncertain when, if ever, many will return.

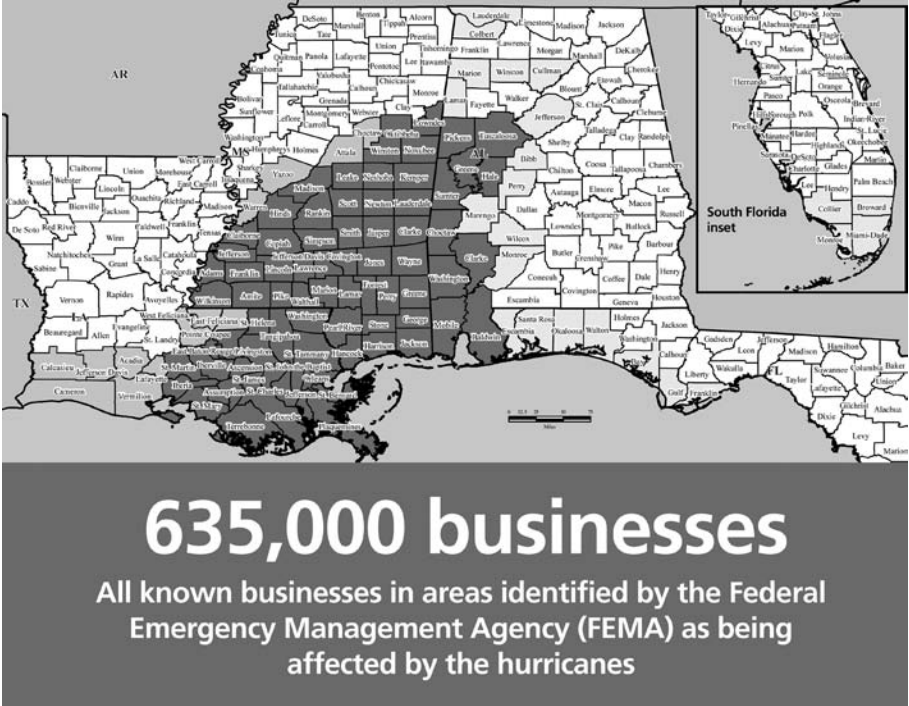
How quickly the area's economy recovers has obvious implications for the people and businesses in the region, but it also has implications for the businesses that depend on the region as a source of revenue. Businesses that have been severely damaged by the natural disaster owe a great deal of money to vendors, suppliers and service firms. If and when those creditors are repaid should be an indicator of how quickly and how far the region's economy is likely to recover.

In an effort to help Experian's clients better understand the impact of the hurricanes on their businesses, Experian® looked to its own wealth of payment data to gauge the overall magnitude of the problem, analyze the damage by industry and business size, and create a methodology for tracking the region's recovery. The initial study that follows is an attempt to set a benchmark by which future studies can track progress, identify trends and generate additional observations that may be helpful to Experian's clients seeking insight on the hurricanes' lasting impact.

In future updates to this study, Experian will investigate which and how many companies are reinitiating credit activity and will identify trends in collection activity. Experian will monitor its wealth of public record data to track events such as liens, judgments or signs of new financing that might indicate that recovery is taking hold. Future studies will show which industries are recovering more quickly than others and how larger businesses are faring compared with smaller ones. Experian will conduct and publish the results of this tracking study quarterly.

Methodology

The study is based on 635,000 businesses from Experian’s business information database, which includes information on a total of 19 million businesses. The sample represents all known businesses within each ZIP Code™ identified by the Federal Emergency Management Agency (FEMA) as being affected by the hurricanes.



Data was gathered on Aug. 30, 2005, based on Experian’s standard data collection methodology and represents an accurate snapshot of outstanding balances in the days leading up to Hurricane Katrina.

Key initial findings

- Commercial properties in the Gulf States had as much as \$40 billion in payables outstanding at the time Hurricane Katrina struck the region.
- Businesses in the counties and parishes that FEMA declared as the most impacted by the hurricane had an estimated \$7 billion in outstanding balances.
- From an industry sector standpoint, the study showed that professional and business services firms were the hardest hit by the disaster and owed the most (\$8.8 billion, or 22 percent of the total). Other industry groups significantly affected were retail trade (\$8 billion, or 20.2 percent), wholesale trade (\$5.9 billion, or 14.7 percent) and construction (\$5.7 billion, or 14.2 percent).
- The study also showed that the hurricane affected more small businesses (businesses with fewer than 50 employees) than any other business segment.
- More than 50 percent of the businesses in the area have been established for less than five years and therefore may not have the financial stability to withstand the aftermath of this disaster.
- Construction firms in the area may represent the best hope for recovery. According to Experian's research, 11 percent of the outstanding payables are owed by construction-related businesses.

Experian's National Business Database contains demographic and credit information updated monthly on more than 19 million businesses in the United States. From small, home-based businesses to Fortune 1000 companies, Experian's National Business Database contains a wealth of data that can be used to paint a picture of economic trends and to provide insight into the economic realities and challenges facing businesses in the Gulf States.

Scope of the economic problems

Based on Experian's initial analysis of the outstanding balances for the 635,000 Hurricane Katrina-affected commercial properties listed in its business information database, as much as \$40 billion in payables could have been outstanding at the time of the hurricane.



The counties and parishes that FEMA declared as the most impacted by the hurricane had an estimated \$7 billion in outstanding balances at that time (see chart below).

Parish/County	State	Percentage of outstanding balances in FEMA disaster zone
Baton Rouge	La.	13.5%
Mobile	Ala.	12.8%
Orleans	La.	9.8%
Hinds	Miss.	6.9%
St. Tammany	La.	4.9%
Baldwin	Ala.	3.9%
Iberia	La.	3.6%
Ascension	La.	3.2%
Harrison	Miss.	3.1%
Terrebonne	La.	3.0%

From an industry sector standpoint, professional and business services firms represented 22.02 percent of the outstanding payables, with health services (5.96 percent) and business services (4.23 percent) being the largest subsegments within this business segment. Also hit hard were retail trade (20.16 percent), wholesale trade (14.67 percent) and construction (14.2 percent).

Industry segment	Standard Industrial Classification code range	Outstanding balance percentage
Professional and business services	70–89	22.02%
Retail trade	52–59	20.16%
Wholesale trade	50–51	14.67%
Construction	15–17	14.20%
Manufacturing	20–39	13.81%
Transportation and public utilities	40–49	6.39%
Agriculture, forestry and fishing	01–09	3.77%
Finance, insurance and real estate	60–67	3.70%
Mining	10–14	0.72%
Public administration	91–97	0.54%

Particularly hard hit were businesses with fewer than 50 employees. Experian's trade data, which is aggregated from accounts receivable information provided by more than 5,000 contributors, showed that 72 percent of the outstanding balances were owed by this segment of businesses. This segment is most vulnerable to any business interruption, and it is likely that suppliers of these businesses will be the most impacted. Within this size of business segment, Experian shows that 31 percent of the outstanding balances were associated with the smallest segment of businesses — those with five or fewer employees.

Employee size	Outstanding balance percentage	Cumulative outstanding balance percentage
1-5	31.13%	31.13%
6-10	16.78%	47.91%
11-25	10.59%	58.49%
26-50	13.73%	72.22%
51-100	7.74%	79.96%
101-250	7.87%	87.83%
251-500	4.37%	92.21%
501-1,000	2.73%	94.94%
1,001-10,000	5.06%	100.00%

Small businesses, which tend to cater to local clientele, will be the most impacted because of the overall damage to the local economy. With millions of residents displaced and tens of thousands of businesses either in a state of suspended operations or simply never returning, the outstanding balances showing for these small businesses are most at risk.

As in the rest of the country, most businesses in this region are small, with more than 97 percent having fewer than 51 employees. A contributing factor to the risk of repayment of the outstanding balances is the age of these businesses. More than 50 percent of these businesses have been established for less than five years and therefore may not have the financial stability to weather the aftermath of this disaster. In fact, even under the best circumstances, the first five years are when a business is most vulnerable, so we anticipate that many of these businesses have a high risk of difficulty in recuperating.

Employee size	Years on file						
	< 1	< 2	< 3	< 4	< 5	< 6	6 +
1-5	13.43%	19.55%	33.15%	36.12%	39.39%	41.81%	63.76%
6-10	14.86%	23.43%	40.48%	44.28%	48.61%	51.86%	83.78%
11-25	15.19%	24.99%	43.52%	47.67%	52.45%	56.06%	92.83%
26-50	15.32%	25.36%	44.42%	48.73%	53.73%	57.52%	97.06%
51-100	15.37%	25.49%	44.73%	49.10%	54.18%	58.03%	98.60%
101-250	15.39%	25.56%	44.90%	49.32%	54.44%	58.33%	99.52%
251-500	15.39%	25.58%	44.95%	49.38%	54.52%	58.41%	99.77%
501-1,000	15.40%	25.59%	44.98%	49.41%	54.56%	58.46%	99.90%
1,001-10,000	15.40%	25.60%	45.00%	49.44%	54.59%	58.50%	100.00%

Within the small-business segment, defined by Experian as businesses with 50 or fewer employees, the industry segments with the highest outstanding balances were still professional and business services (17.30 percent) and retail trade (14.65 percent). The success of these firms in recuperating, and thus being able to meet their obligations, will be highly correlated to the ability of the local economy to recover.

Interestingly, the third-ranked segment is the small construction firm segment, with a total of 11.14 percent. Given the massive rebuilding that will need to take place, this segment should see a stronger recovery than the others. However, there is one small caveat — Are the small contractors and workers still there? This will play out over the coming months, but with the promise of a “gold rush” in the Katrina-affected areas, it would seem likely they will find their way back. Therefore, any suppliers to this segment are most likely in the best position to get paid.

The true impact will not be known for a while. It has been estimated that it will take years for the local economy in the Katrina-affected areas to recover. Additionally, with the setback from Hurricane Rita, there likely will be more of a delay in that recovery. Suppliers will have to wait for their money while their customers get back on their feet or, in many cases, be forced to take larger than normal write-offs. Of course, this will affect their cash flow.

Implications

- As with nearly all estimates associated with the hurricane, this too may be reduced as time goes by and the true impact of the hurricane is known. However, if even half of these payables turn out either to be severely delinquent or to need to be written off, there will be a significant impact on cash flow from operations for those suppliers.
- Bankruptcies will spike, but not for some time. Historically, bankruptcies peak much later than one might imagine after any natural disaster or economic shock — sometimes as long as two years following the event. There is a combination of factors that play into this trend, including the facts that creditors often extend grace periods on repayments and bankruptcy filing only occurs once the scope of forgiveness or payment lengthening has been exhausted. Experian has seen lenders and financial institutions extending grace periods and taking other steps to assist affected businesses, a process we encourage. To date, the trend has been heartening.
- The outstanding balances in the areas identified by FEMA as those most affected by hurricane damage will likely be more subjected to charge-offs than in areas less affected.

Conclusion

At Experian, we will continue to monitor credit activity of those businesses in the affected areas to determine who is back in business and who is not. From there, we expect to be able to refine these estimates to gain greater insight into the true cash flow impact of Katrina.

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475 Anton Blvd.
Costa Mesa, CA 92626
800 520 1221

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12/05

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