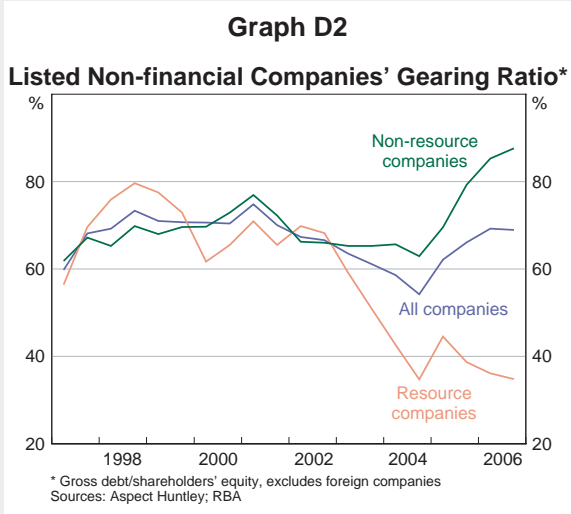
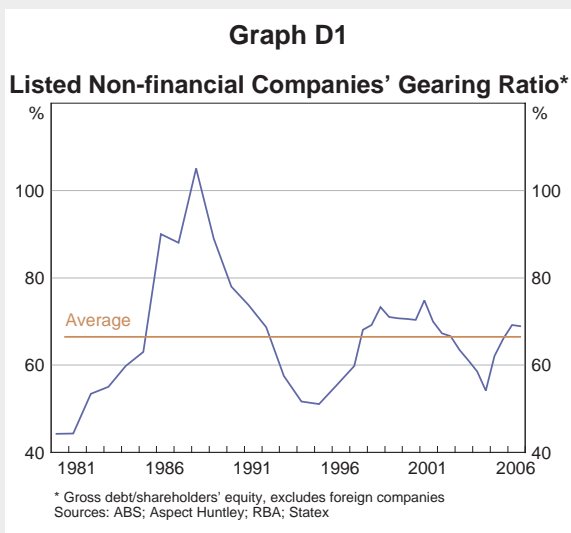


Box D: Recent Developments in Corporate Gearing in Australia

The gearing ratio – the ratio of the book value of debt to equity – of listed non-financial companies has risen by 15 percentage points in the two years to December 2006 to stand at 69 per cent (Graph D1). This is close to its post-1980 average of 67 per cent, but well below its level in the late 1980s when it exceeded 100 per cent. It suggests that corporate balance sheets remain in a sound condition on average.

The aggregate movement, however, masks quite a range of behaviour by individual firms. All of the recent increase in leverage is due to non-resource companies (Graph D2). Their gearing has increased by 25 percentage points since December 2004, to 88 per cent, reflecting faster growth in debt than equity. In contrast, the gearing ratio of resource companies – at 35 per cent in December 2006 – was broadly the same as two years ago, and almost 40 percentage points below its level earlier in the decade. For resource companies, strong profitability and a fall in their dividend payout ratio has meant they can finance investment out of current cash flows. As a consequence, the value of their outstanding debt has fallen over the past five years and is around the same level as in the late 1990s.

Within the non-resource sector, much of the rise in debt and gearing was accounted for by a small number of companies. These were mostly utility companies, many of whom were newly listed over this period, and industrial companies which have been active in acquiring other



companies and assets. Of the \$70 billion increase in debt holdings of listed companies over the two years to December 2006, 10 companies raised over \$40 billion of this.

More generally, about one-third of the 15 percentage point increase in aggregate gearing owes to delistings of less-leveraged companies and new listings of more highly leveraged companies. At end 2006, the gearing ratio of companies that listed on the ASX in the preceding two years averaged 120 per cent, almost double the gearing ratio of companies that were listed for the 2004 to 2006 period, while the gearing ratio of companies that delisted was around 40 per cent.

The remaining 10 percentage point increase in aggregate gearing primarily reflected an increase in leverage of companies that initially had low gearing ratios (of up to 25 per cent) (Graph D3). The gearing ratios of more highly leveraged companies (>50 per cent) actually

fell, with particularly sharp declines recorded by resource companies. In terms of company size, smaller listed companies (market capitalisation of up to \$5 billion) have tended to increase their gearing over the past two years, with average gearing ratios rising by about 6 percentage points over this period. This has been partly offset by a moderate fall in leverage of large companies (market capitalisation above \$5 billion).

Finally, while the book value of equity provides one basis for assessing corporate gearing, the market value of equity can also be used, as it incorporates expectations about future profits which can be

used to service corporate debt. While the book-value gearing ratio of all non-financial companies has increased in recent years, it has remained broadly unchanged when measured on a market-value basis. This is because strong increases in share prices have largely offset rising debt levels. On this measure, gearing has remained at around 25 per cent, though it can move sharply given the underlying volatility of equity markets. ↗

