COVID-19
LOOKING BEYOND THE SUBSIDIES

SECTOR MODELLING FOR SEPTEMBER-DECEMBER 2020

Prepared by ANZ Client Insights

CONTENTS

INTRODUCTION

The COVID-19 pandemic has had a dramatic impact on New Zealand. This report discusses what COVID-19 means for the business sector and outlines the potential earnings profiles of some of New Zealand's key industries as we move into September-December 2020.

BACKGROUND

The impact of COVID-19 has drastically heightened the need to conduct business activity with greater efficiency. Many have already completely re-set operating models, slashed cost structures and introduced new offerings to help return to a position of sustainable earnings.

While government and other relief has provided a buffer in the short term, the impact of COVID-19 will be significant and there will continue to be a period of financial difficulty for many businesses as they navigate through the challenge. Ongoing support will be needed and businesses will need to find new ways of working which make every dollar count.

To support the ongoing discussion around managing the impacts of the COVID-19 pandemic, we discuss some of the key market developments and model the potential earnings implications for businesses as we move beyond the period of government wage subsidies and business loan support. This is based off the Reserve Bank of New Zealand, Treasury and ANZ Economics New Zealand Gross Domestic Product ("GDP") forecasts.

From previous economic shocks we have identified that the ability to adjust and gain support from customers, suppliers, banks and other stakeholders has benefitted from a clearly articulated business plan. These plans often adjust as markets become clearer, but they ensure that all parties understand their role in supporting the recovery of the business. At ANZ, we remain committed to supporting our customers through these challenges and playing our part in supporting New Zealand's economic recovery.

Mark Hiddleston
Managing Director, Commercial & Agri
ANZ

1. THE CONSUMER IMPACT

New Zealand entered Alert Level 2 at 11.59pm on 13 May 2020. The impact saw spending rise by 5% year-on-year (YoY). However, we believe that economic activity is better reflected by transaction volumes at this point in time, down 12% (YoY).

CONSUMER SPENDING IS RECOVERING

Spending via ANZ merchant facilities[1] during Level 4 lockdown was down 55%, versus the same period in 2019, illustrating the dramatic impact that lockdown had on the New Zealand economy. This was driven by lower transaction volumes, down 71%, while the average transaction size increased from $48 to $73 as consumers shopped less often, but spent more per visit.

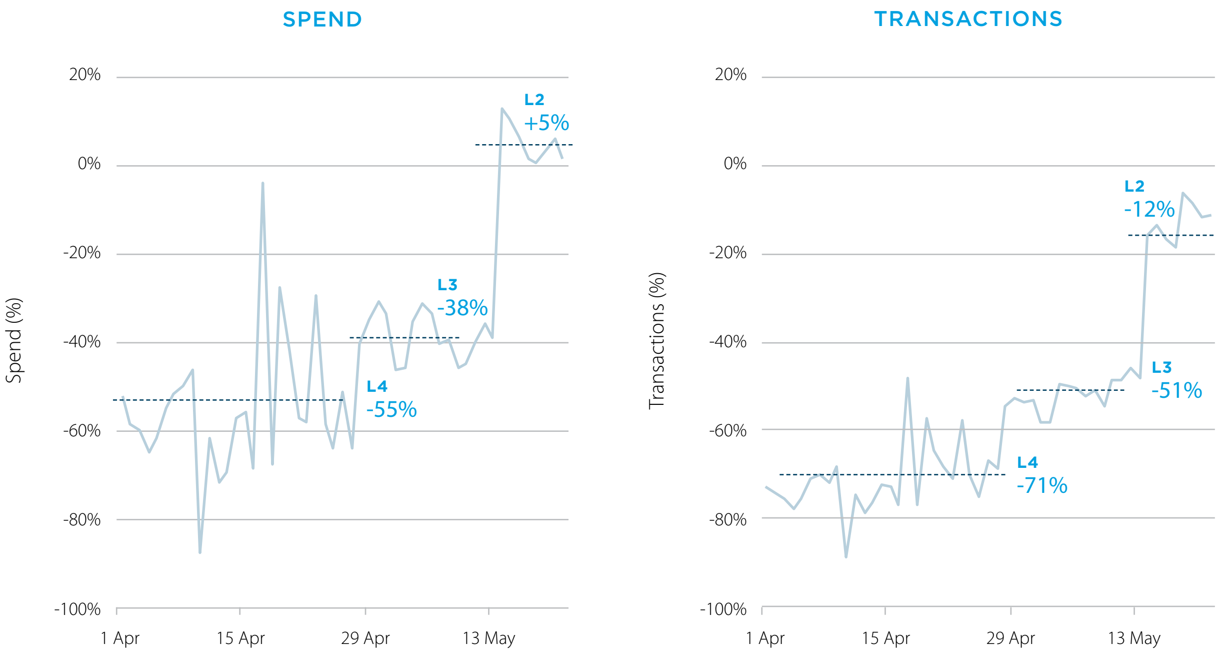
Coinciding with the move to Alert Level 3 spending picked up at the end of April 2020 and has since further improved to be up 5% under Level 2 (versus 2019).

On the surface this appears to be a good sign for the economy. However, these figures importantly include the impact of cash transactions moving to card and virtual card based payments and also reflect some pent-up demand from Level 3 and 4 trading conditions. As such, we believe that transaction volumes provide a better barometer for underlying economic activity at present.

ANZ Economics forecast New Zealand GDP of -21.6% YoY for the June 2020 quarter and -10.1% YoY for the September 2020 quarter.

Consumer Spending (2020 vs 2019)

Source: ANZ Consumer Finance



(1) Cards and Virtual Cards

2. IMPACT ON BUSINESS

The impact on businesses has been softened in the short-term through government wage subsidies, rental concessions from landlords, extended short-term debt facilities, business loans (including a $6.25 billion government Business Finance Guarantee scheme) and some changes to business tax. These have all helped to provide additional liquidity which has reduced pressure on cash flow and given some breathing space for now – but businesses cannot afford to be complacent.

GOVERNMENT WAGE SUBSIDY

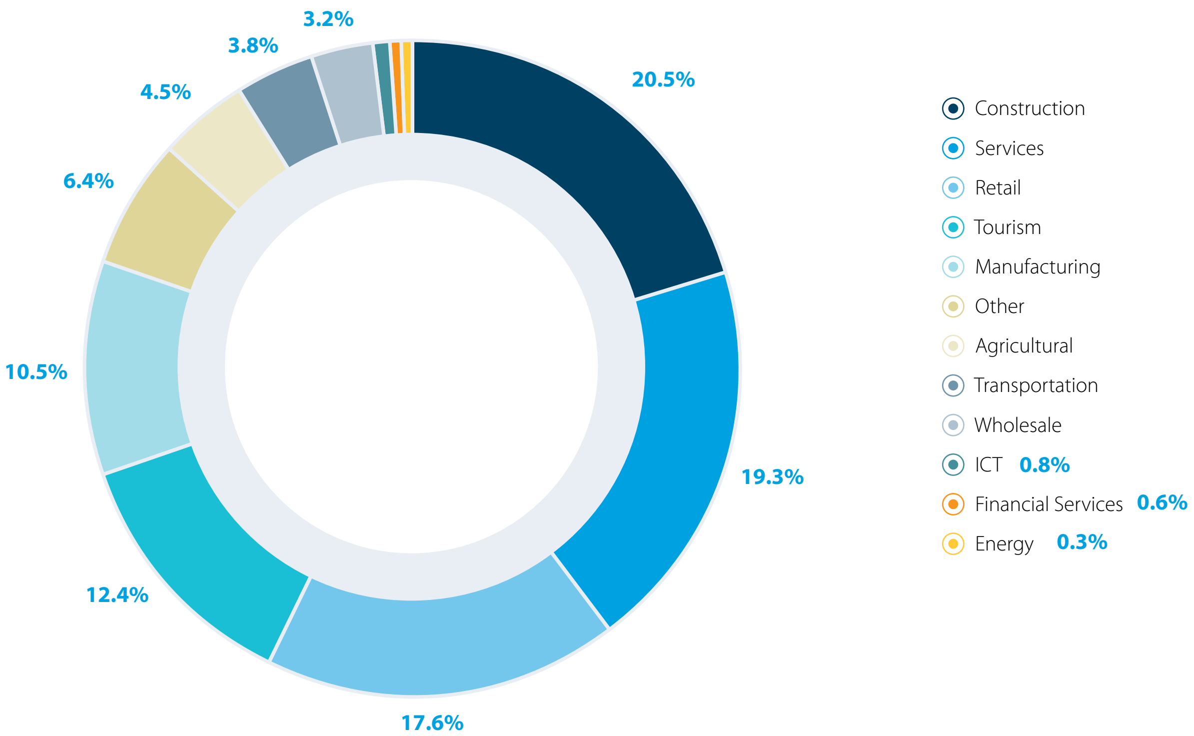
Ministry of Social Development data shows that the government had paid out $10.9b in COVID-19 wage subsidies up to 22nd May 2020.

These advance payments, covering an initial 12 week period, helped to boost cash balances across New Zealand businesses (see page 7). This has helped provide much needed cash to help keep workers employed in the short term. The extension of the wage subsidy until 1 September 2020, announced in the Budget, will continue to provide support for employers wanting to retain staff (albeit with a higher threshold for eligibility).

The chart below uses ANZ data[(2)] to show the approximate breakdown by way of wage subsidy payments received by industry from March – May 2020.

Government Wage Subsidy – Approximate % of Sector Payments

Source: ANZ Analysis



(2) COVID-19 wage subsidy payments received by ANZSIC code

COMMERCIAL PROPERTY RENT CONCESSIONS

Landlords have also granted tenants considerable flexibility as a result of COVID-19, as demonstrated by ANZ transactional data which shows commercial property income down during April, May and June 2020 respectively. This was driven by a large number of businesses being unable to access premises during Level 4 and Level 3 conditions, resulting in the temporary re-negotiation of payment arrangements.

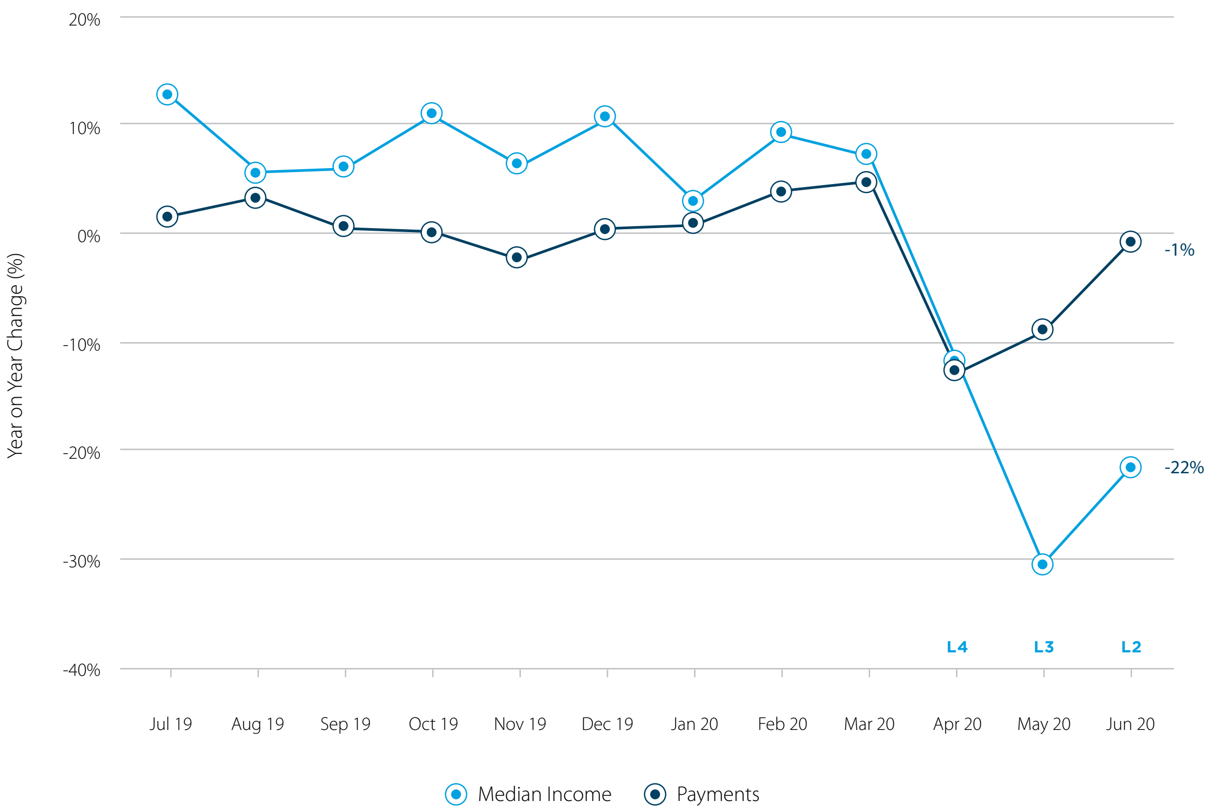
Data for the first business day in June 2020[3] shows two key developments:

- An improvement in transaction volumes to -1%, from -9% in May 2020. This suggests that many tenants have moved back to a normal payment frequency.
- A recovery in the median payment amount to -22%, from -31% in May 2020. This suggests an improvement in the rental amount that tenants have paid with business conditions improving.

The impact on landlords has been well publicised and we expect the sector will continue to work with tenants, particularly those exposed to tourism and the retail economy.

ANZSIC 7716 Commercial Property – Year on Year Income Analysis (1st Business Day of Month)

Source: ANZ Analysis



(3) ANZ transactional data

MANY BUSINESSES HAVE SOME TEMPORARY WORKING CAPITAL 'HEADROOM' – BUT IT WON'T LAST FOREVER

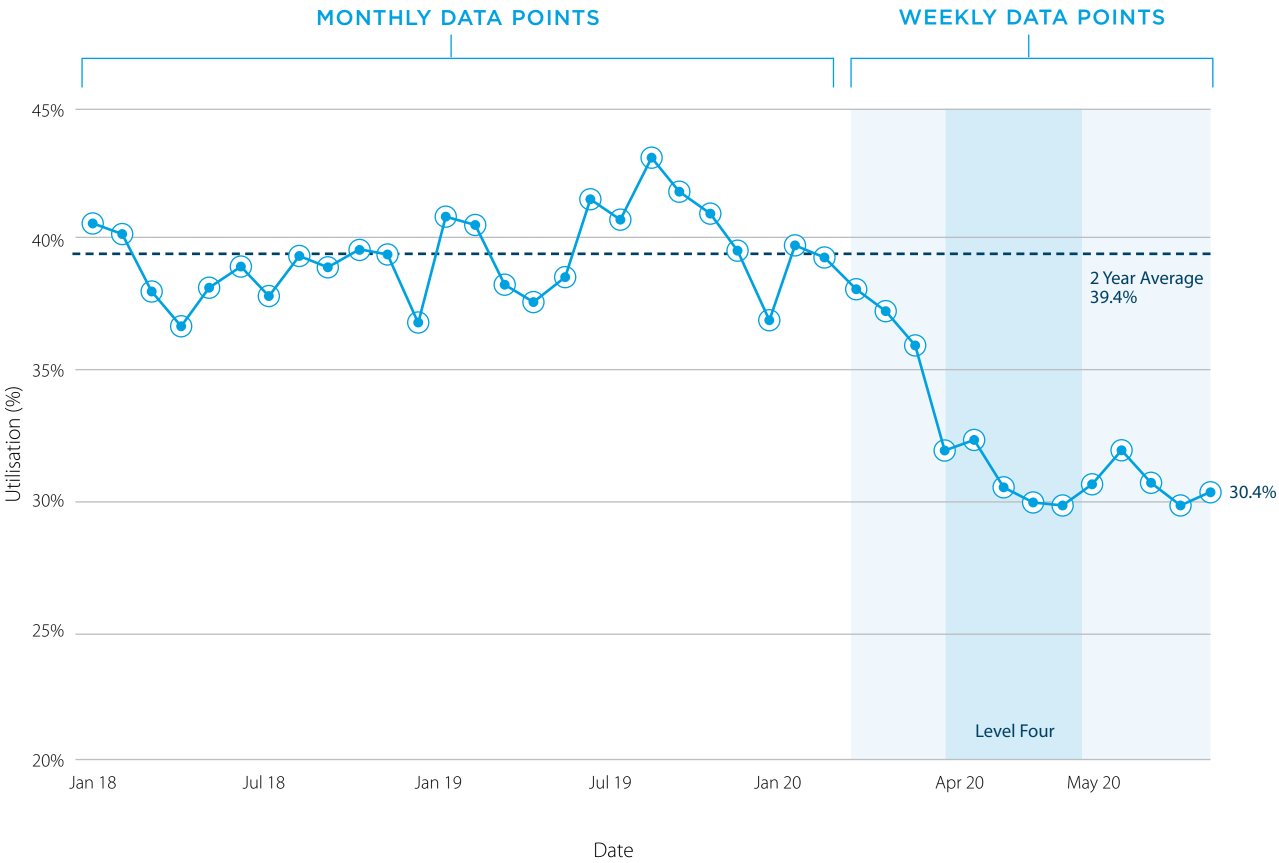
Given the impact of COVID-19 on future cash flow and profitability, many businesses took the opportunity to extend limits on short term debt facilities during March, April and May 2020.

Combined with advance payments under the government's wage subsidy scheme and rental concessions, this saw the average utilisation of short term debt facilities by ANZ business customers reduce from 39.9% at the start of March 2020 to a low of 29.8% during April 2020. This has provided additional 'headroom' which will be critical in managing through difficult trading conditions in the near future, as businesses transition to new levels of economic activity, staffing, operating models and capital structures.

To manage the challenges ahead businesses will need to focus on making every dollar stretch as far as possible in an environment where earnings are under pressure. This means that cash flow, liquidity and working capital management will become even more critical in providing the support needed to return businesses back to a point of financial sustainability.

Utilisation (%) of Overdraft and Flexible Loan Facilities (ANZ Commercial & Agri/Business Banking customers)

Source: ANZ Analysis



3. MODELLING EARNINGS FOR SEPTEMBER-DECEMBER 2020

The key challenge for businesses in the near future will be supporting staff expenses and ongoing fixed cost obligations off a lower sales revenue base.

WHAT COULD THE FUTURE LOOK LIKE?

To understand the potential implications for businesses, we have modelled what earnings might look across different sectors of the New Zealand economy after the government's wage subsidy support is forecast to end, and with Level 1 restrictions applying.

We compare the modelled performance for September - December 2020 against the financial results for each sector in 2019. We use the following broad adjustments to the 2019 financial results to model the future period:

- Sales revenues – have been adjusted down in consideration of the Reserve Bank of New Zealand, Treasury and ANZ's GDP forecasts provided in Appendix 1.
- Wages and salaries – we have assumed that labour is fully flexible with demand (i.e. we have adjusted wages and salaries down proportionately with sales revenues, in percentage terms). This includes director salaries and fees, and superannuation payments.
- Fixed costs – operating lease and expenses and general expenses and admin remain unchanged from 2019 levels.
- Other costs – other costs (including sales and marketing expenses and other operating expenses) are also scaled down proportionately with sales revenues.
- Gross profit margins – no change in gross profit margins.[4]
- Government policy changes – we do not take into account potential future announcements on new spending packages, tax relief or other initiatives, post the release date of this paper.

For more information on the model and underlying assumptions, see Appendix 1.

IMPORTANT: Sector performance will vary from our results depending on the future path of the economy. Our modelling represents a snapshot of a point in time (i.e. three months) only, and demand dynamics will change throughout the recovery. Sectors which may be under pressure currently may recover strongly in future periods, and vice versa. Please also refer to the disclaimer on page 2 of this paper.

(4) Changes in market pricing and margins fall outside the scope of this analysis.

EARNINGS PERFORMANCE – RAIN CLOUDS ON THE HORIZON

The table below shows the percentage change in headline EBITDA between the 2019 financial results and our modelled September – December 2020 quarter. This points to a difficult period ahead in many sectors.

Those that are aligned to tourism with high fixed overheads are at particular risk, and that risk increases the longer the tourism sector is essentially closed. While areas such as building and construction may benefit from completion of in-progress and committed work, they may face headwinds in later quarters with changes in market confidence potentially impacting on new projects going ahead.

Sectors such as aged care, veterinarians and legal services which primarily service the domestic economy, appear to be less impacted. But, while these businesses are less exposed to the impacts of reduced tourism and social distancing, their prospects will nonetheless be influenced by the broader economic cycle.

Meeting funding arrangements in the short term off a lower headline EBITDA figure will require changes in capital structures for a number of businesses. Securing short term facilities to support liquidity and working capital has been important to date, and we expect this to continue as businesses look to rapidly transition to new operating models.

Forecast % Change in Headline EBITDA (September - December 2020 Annualised vs FY-2019)

Source: ANZ Analysis

Industry	Lower 25%	Median	Upper 25%
Aged Care	-5%	0%	5%
Veterinarians	-5%	0%	5%
Legal Services	-8%	-4%	0%
Food Manufacturing	-9%	-5%	0%
Civil	-10%	-6%	-2%
Road Freight	-12%	-9%	-7%
Plastics Manufacturing	-15%	-10%	-8%
Pharmacy Retail	-17%	-12%	-9%
Building Supplies	-18%	-14%	-12%
Non Residential Construction (Excludes Civil)	-18%	-15%	-13%
Residential Construction	-22%	-15%	-13%
Dentists	-17%	-15%	-13%
Timber Processing	-25%	-18%	-14%
Fabricated Metal Manufacturing	-23%	-19%	-16%
Cafes, Bars and Restaurants	-50%	-21%	-15%
Early Childcare Education	-36%	-23%	-15%
Sports and Outdoor Retail	-32%	-25%	-20%
Car Retail	-35%	-26%	-15%
Apparel and Textile Retail	-62%	-36%	-25%
Accommodation and Motels	-160%	-75%	-44%

Lower 25% = Bottom Quartile of Sector; **Median** = Middle result of Sector; **Upper 25%** = Top Quartile of Sector

EARNINGS MARGINS – FLEXING COST STRUCTURES WILL BE CRITICAL

Our modelling shows that many sectors (particularly those with low fixed overhead costs) may be able to maintain broadly similar EBITDA margins prior to COVID-19. However, this insight mainly reflects our key assumptions that a) wages and salary expenses and other costs can be adjusted proportionately lower with sales revenues and b) gross profit margins are able to be maintained.[5]

The analysis also highlights which sectors are more exposed to fixed cost structures in a declining sales revenue environment. This is based on our model assumption that fixed costs are unable to be changed in line with reduced consumer demand.

We acknowledge that scenarios outside of our model settings will occur as all businesses have different dynamics at play (e.g. pricing policy, maintaining quality staff, contractual agreements and view of market recovery). As such, this insight aims to provide context into where each sector could broadly be in relation to earnings margins for the latter part of 2020 and to support ongoing dialogue around potential business impacts and planning.

Forecast EBITDA Margin % for September – December 2020 compared to FY-2019

Source: ANZ Analysis

	FY-2019			Sept – Dec 2020		
Industry	Lower 25%	Median	Upper 25%	Lower 25%	Median	Upper 25%
Legal Services	23%	37%	48%	22%	35%	46%
Accommodation and Motels	12%	25%	53%	-10%	13%	50%
Road Freight	10%	15%	21%	9%	14%	21%
Dentists	9%	15%	20%	7%	11%	18%
Civil	8%	13%	22%	7%	13%	22%
Plastics Manufacturing	8%	13%	18%	7%	11%	16%
Veterinarians	6%	12%	16%	5%	12%	15%
Timber Processing	5%	11%	15%	5%	10%	14%
Fabricated Metal Manufacturing	5%	10%	18%	4%	9%	17%
Early Childcare Education	5%	10%	17%	3%	9%	15%
Aged Care	2%	9%	17%	2%	9%	17%
Building Supplies	5%	8%	13%	4%	7%	13%
Pharmacy Retail	4%	8%	12%	3%	7%	12%
Food Manufacturing	4%	8%	16%	3%	8%	16%
Non Residential Construction (Excludes Civil)	4%	7%	12%	4%	7%	12%
Sports and Outdoor Retail	5%	7%	10%	4%	6%	9%
Cafes, Bars and Restaurants	2%	5%	10%	1%	4%	10%
Apparel and Textile Retail	3%	5%	12%	1%	3%	9%
Residential Construction	1%	4%	7%	1%	4%	7%
Car Retail	2%	3%	4%	2%	3%	4%

Lower 25% = Bottom Quartile of Sector; **Median** = Middle result of Sector; **Upper 25%** = Top Quartile of Sector

(5) Changes to prices and margins fall outside the scope of this analysis.

WHAT DOES THIS MEAN FOR BUSINESSES?

Wage subsidies, rental relief and other factors have provided a buffer against some of the immediate impacts of COVID-19. However, that buffer is limited. Businesses should be planning for life after the support packages end, including the consideration that New Zealand may still move up and down Alert Levels.

Rapidly transitioning to new operating models and securing additional sources of working capital will be important factors that businesses will need to focus on. We believe that tight control of costs and prioritisation of resources will be key to reaching a position of sustainable earnings and achieving that position will be a key milestone for many businesses as they move forward.

Some businesses may not be in a position to survive a COVID-19 recession. However, for others, we think it offers an opportunity to accelerate innovation, find efficiencies and change business models. The next few months will be challenging, but change can bring opportunities for those in a position to take advantage of them.

At ANZ, we remain committed to helping our customers manage through the impact of COVID-19. If you are an ANZ customer and feel your business may need additional financial support from ANZ, please contact your Relationship Manager. They can help you determine what is available and the most suitable offering to meet your needs.

For further information on how ANZ is helping our customers visit :

anz.co.nz/heretohelp

news.anz.com/new-zealand/business

APPENDIX

APPENDIX – MODEL ASSUMPTIONS

The RBNZ and Treasury recently modelled impacts to New Zealand's GDP under Level 1-4 restrictions. These figures are represented as a percentage of GDP prior to COVID-19.

The RBNZ has also provided a industry breakdown for GDP under Level 3 and Level 4 scenarios, which we have used to base our September - December 2020 assumptions on.

ANZ Economics GDP forecasts are also shown below.

ANZ GDP Forecasts

Source: ANZ Economics

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
GDP (% QoQ)	0.5%	-2.5%	-20.6%	15.5%	2.0%	1.0%	1.0%	1.0%	1.0%
GDP (% YoY)	1.8%	-1.2%	-21.6%	-10.1%	-8.8%	-5.5%	20.2%	5.1%	4.1%

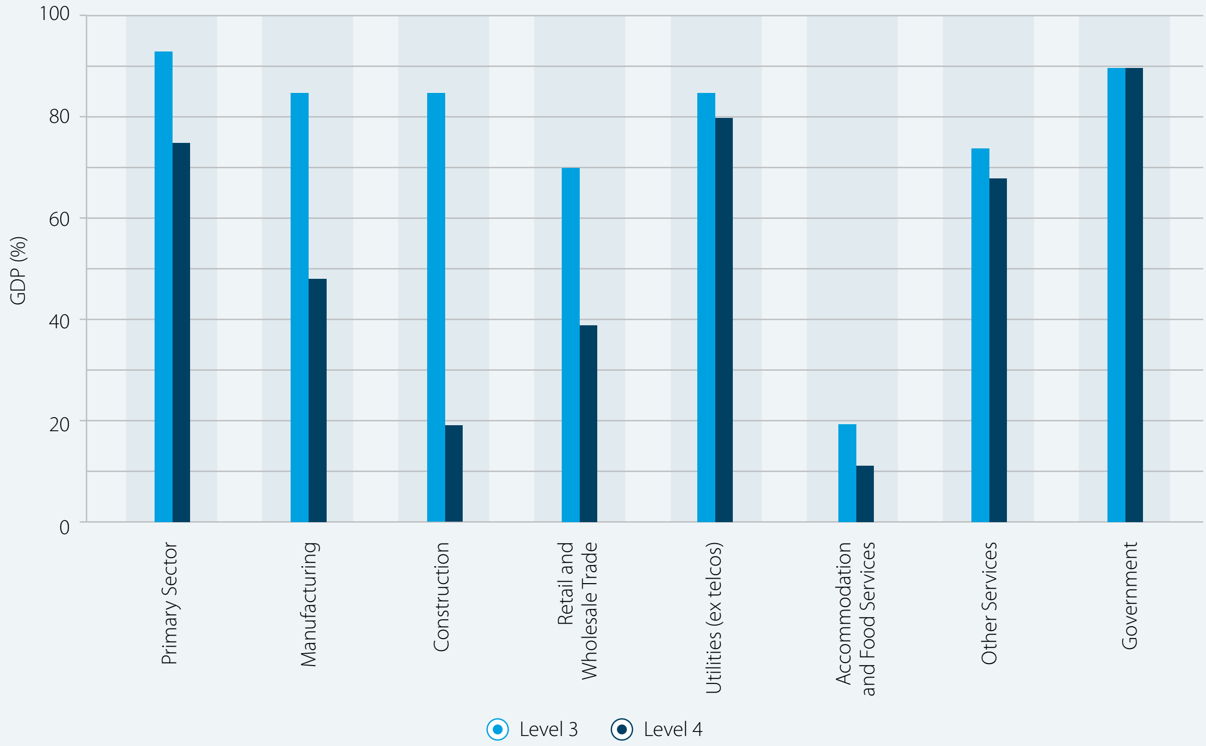
Percentage of normal time GDP produced at each Alert Level

Source: RBNZ, Treasury

	RBNZ (6 May 2020)	Treasury (14 April 2020)
Level 1	96.2%	90%-95%
Level 2	91.2%	85%-90%
Level 3	81%	75%
Level 4	63%	60%

GDP by Industry During Level 3 and 4 (as a % of Pre-Coronavirus GDP)

Source: RBNZ



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