THE ALLEASING

EQUIPMENT DEMAND INDEX

2017. SO FAR, SO GOOD

APRIL 2017
AUSTRALIA

IT'S ABOUT THE DOMESTIC ECONOMY

When businesses decide to make an asset acquisition or not, what are the dominant factors in their thinking? Are they thinking of existing and future competitors, their own cost structure, or are they adhering to a strong business strategy which sets out a plan for growth?

Each of these may be factors, but it seems that decision makers are focused on the big picture, which is the national domestic economy.

Of the businesses surveyed, 59.2 per cent stated that the most common negative factors impacting their plans for asset acquisition were driven by their confidence in the domestic economy.

Smaller businesses were more likely to feel undermined by negative domestic conditions. Where an above average 63.7 per cent of SMEs were impacted by the domestic economy, the results for lower and upper corporates were 58.5 and 53.8 per cent respectively.

The second most common response was currency volatility and the Australian dollar, which was selected by 48.0 per cent. When it came to analysing this result by market segment, the response was inverted with larger businesses more sensitive to the currency.

Of upper corporates, 55.8 per cent cited currency volatility, with 51.2 per cent of lower corporates and 39.3 per cent of SMEs.

Clearly, there is a strong relationship between the domestic economy and the Australian dollar, with the value of the currency a major factor in the cost structures of tens of thousands of businesses, many of which also source their assets from offshore.

According to the Australian Bureau of Statistics (ABS), more than 50,000 Australian businesses are exporters, while Australian businesses import AUD$30 billion in goods and services each month.

Sectors such as tourism and manufacturing, which represent around 3.0 per cent of national GDP, are highly sensitive to currency volatility, both for exporters and companies which use offshore supply chains in their production.

Overall, this round of the Index shows that around 30.6 per cent of businesses are planning to acquire assets this quarter, a 4.4 per cent increase from the previous report.

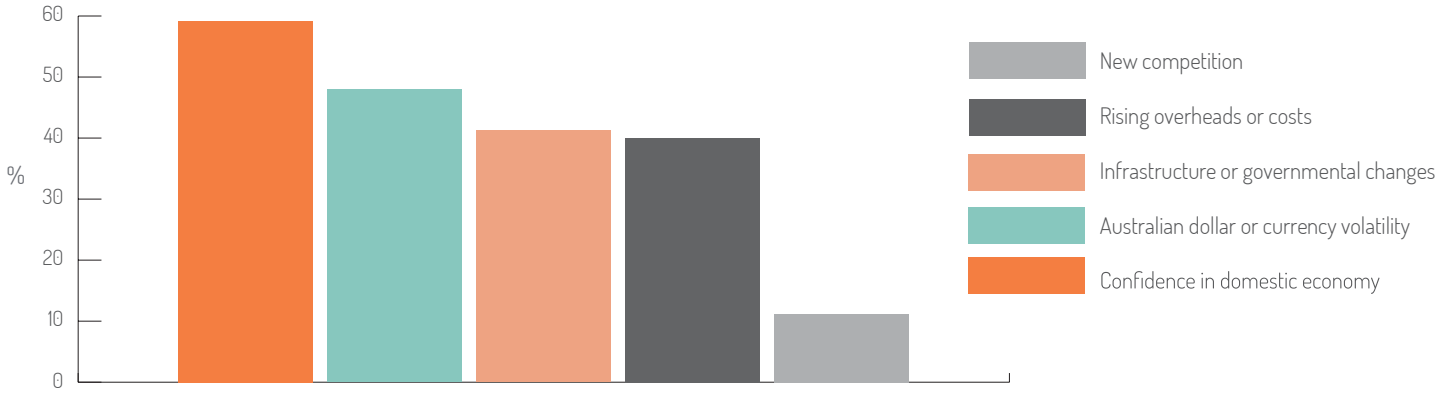
This would suggest a strong level of confidence in the domestic economy, a key component of which is currency stability.

After the unprecedented period of US dollar parity around 2010, the Australian dollar has traded in a tighter range between 71 US cents and 78 US cents in the last twelve months.

While the Reserve Bank of Australia has sought to use interest rate policy to force the dollar lower, the current range offers a good balance for the competitiveness of both importing and exporting businesses.

Having had a period of currency stability with the Australian dollar, this has enabled businesses to plan growth and asset acquisitions with some confidence that volatility is not going to interfere with their cost structures and forecasts.

Factors Impacting Asset Acquisition Intentions



BUYING VS LEASING. TIME TO UNLOCK CASHFLOW?

In the financial year ending June 30 this year, the Australian Bureau of Statistics (ABS) has forecast businesses will spend around $52 billion buying plant and equipment.

In this round of the Index, businesses reported that 25.0 per cent of their asset base is currently leased or otherwise financed.

Using this 25.0 per cent figure from the Index and overlaying it with the ABS projections, this suggests that of the $52 billion to be spent on plant and equipment, $40 billion will be purchased outright while $12 billion will be leased or financed.

This bias towards buying outright is supported by other Index data, which shows that four in ten businesses are using their own equity to fund their asset purchases, which they will buy outright.

So do businesses make the decision to buy, as opposed to lease, because of access to capital and financing or because it is seen as a better solution?

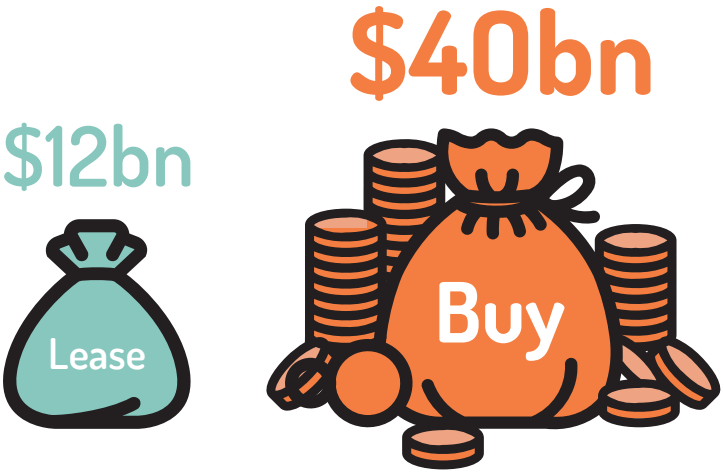
Four in ten businesses buying their assets outright say that their main driver is price, but is this a false economy?

For those businesses which choose to lease or finance, four in ten cite improved cash flow as the main reason for their decision. By leasing assets, businesses are able to free up cash to ensure the smooth running of the business and drive growth.

Instead of paying a lump sum for an asset, the annual outgoings to acquire and use it are significantly less than a one off payment to purchase outright. Particularly if maintenance and upgrades are included in the agreement.

Not all of the AUD$40 billion businesses will spend on buying assets this year could be leased or financed, but if more businesses were to explore alternative avenues to acquire assets, such as leasing, this would potentially free up billions in the economy.

Achieving this requires not only a change in thinking from businesses, but a greater availability of finance and innovative capital solutions from providers.



MONEY USED FOR LEASING ASSETS VS BUYING

$52 Billion

BUSINESSES ADDING ASSETS

Australian businesses are embracing the second quarter of 2017 with new positivity, a result that tallies with recent national accounts which marked a welcome return to growth. After the September quarter results demonstrated a slip into negative territory, with the economy contracting 0.5 per cent and raising the spectre of recession, national growth in the December quarter was 1.1 per cent.

The result was encouraging in itself, but a major rebound in the mining industry was one of the standout results as 15 out of 20 industries showed strong signs of growth. Higher prices for coal and iron ore prompted a 9.1 per cent improvement in trade.

The latest round of the Alleasing Equipment Demand Index conforms with official results from the Australian Bureau of Statistics (ABS), and suggests that the mining industry slump, which has plagued Western Australia for the last few years, may have turned a corner.

Compared to the 25.6 per cent of businesses which forecast an increase in assets in the previous round of the Index, which looked at intentions for the March 2017 quarter. This quarter, the average was an 8.8 per cent increase in assets, up from 6.5 per cent from the previous round.

According to the ABS, Western Australia snapped five quarters of negative growth in March 2017 quarter, with the state economy growing 0.4 per cent, and the Alleasing Index results confirm this more positive theme.

More than one quarter (26.4 per cent) of Index respondents in the mining and mining services industry signalled their intent to increase their asset base during the June 2017 quarter, up significantly from 17.6 per cent in the previous report.

In terms of state-based analysis, Western Australia went from 14.0 per cent of businesses planning an increase in the March quarter, to 25.9 per cent in the June quarter.

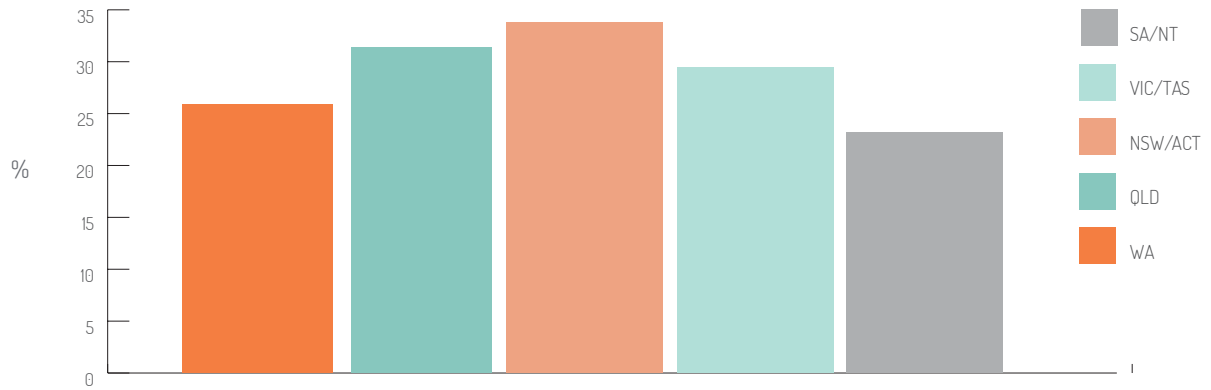
Businesses in New South Wales and the Australian Capital Territory continued to deliver the most positive responses, with 33.8 per cent planning an increase in assets, while Queensland businesses were also bullish, with a result of 31.4 per cent.

In South Australia, the story is very different, where the ongoing energy supply crisis may have sapped the positivity out of business sentiment.

Only 23.2 per cent of South Australian businesses said they would increase assets this quarter. This is up marginally from 22.2 per cent in the previous Index, but is significantly below the increased national average.

Of the other states, a lower 29.4 per cent of businesses in Victoria and Tasmania plan asset acquisitions, down from 31.3 per cent in the previous round.

Businesses by State Looking to Increase Their Asset Base



COST OF CAPITAL. THE BIG BRAKE ON BUSINESS

As part of their latest report on Australian investment, the University of Melbourne's Grattan Institute recently coined the term "Stagnation Nation", to describe the country's current state.

While mining investment has shown a rise in the last six months as commodity prices have improved, the long term trend has been for mining investment to fall, but this has not been replaced by the expected gains from service industries.

The Grattan Institute study, 'Stagnation nation? Australian investment in a low-growth world,' shows that non-mining investment has fallen from 12.0 per cent to 9.0 per cent in the last five years, lower than at any point in the past 50 years.

The report makes the point that low interest rates have not delivered expected growth and calls instead for lower corporate tax rates to stimulate business investment.

Low interest rates have not solved the issue of access to capital for Australian businesses, or had much impact on its cost.

This has also been an issue globally and was identified in the Organisation for Economic Co-Operation and Development's (OECD) statement last year, showing that low interest rates across developed economies have not reduced the cost of capital.

Instead, they have encouraged "short termism" from investors who have little incentive to invest in industries which foster innovation over the longer term.

In an economy such as Australia, which lacks a developed retail bond market and where larger corporates are forced offshore for capital, the cost of capital continues to be a drag on business, a sentiment expressed by 54.4 per cent of businesses in Alleasing's latest survey.

Further analysis of this data shows a disparity between small and large businesses. While 60.2 per cent of SMEs nominated the cost of capital as an issue, the results for lower and upper corporates were 50.3 and 43.5 per cent respectively.

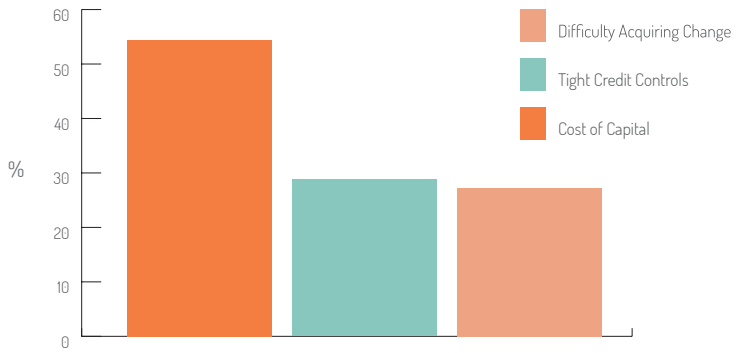
The state in which a business operates would also appear to have an impact on perceptions of the cost of capital. Numbers were below average in New South Wales / Australian Capital Territory and Victoria/ Tasmania at 48.7 per cent and 52.1 per cent respectively. The numbers were much higher in Queensland (59.5 per cent), Western Australia (62.9 per cent) and South Australia /Northern Territory at 65.1 per cent.

Exacerbating the Western Australia result was the response from the mining sector, where 58.4 per cent of respondents cited cost of capital issues. This compared with lower results from sectors such as Transport (48.6 per cent) and Manufacturing (53.4 per cent).

These responses around the cost of capital were significantly ahead of the second most cited constraint, tight credit controls for 28.8 per cent of all businesses, and difficulty in acquiring capital at 27.2 per cent nationally.

On a more positive note, when asked about technology, many businesses viewed upgrading their technology to have a significant benefit on their cost priorities, with 41.2 per cent citing this as technology's biggest advantage. This was followed by 38.8 per cent citing business growth as another main advantage of upgraded technology. Businesses revealed that cost cutting is a continuous exercise, and takes precedence over the ability to grow even in an environment in which official interest rates have been at historic lows.

Most Common Business Constraints



IN SUMMARY

Despite the geo-political turbulence of 2016, the Australian economy has managed to stay on course for growth.

Fallout from the Brexit vote, the Trump Presidency and, perhaps of more immediate concern, the impact of lower growth in China have all weighed on global economic sentiment.

Along with almost daily forecasts of a collapse in the housing market, the media is full of bearish forecasts for the direction of the world economy, and how that would impact on Australia.

In the face of this, the domestic economy has so far proved to be reassuringly resilient. On the upside, media claims of a "second resources boom" would also seem overdone, but at the same time, the Index shows a renewed confidence in the mining sector, which is recalibrating its asset acquisition intentions.

The steady increase in the number of businesses indicating they plan to acquire assets is a vote of confidence in the economy in 2017, helped along by currency stability.

Even so, the Index reveals ongoing impediments to growth. Record low interest rates have still not translated into a lower cost of capital for Australian businesses, which still struggle with the tight credit policies of providers.

This pushes businesses to rely more on their own funds, and opt for outright purchases when, in another environment, innovative capital solutions could both secure them the assets they need and free up cash for other uses.

Growth remains elusive, and focussing on it is a secondary priority after the ongoing battle to control cost and access to capital.

Australia's economy has started well enough in 2017, barring any surprise global event, it would appear GDP growth will be positive this year.

The potential for the economy, however, would be much greater if negative factors identified in the Index, such as the cost of capital and the credit policies of providers, could be addressed and improved further.

ABOUT

The Alleasing Equipment Demand Index (the Index) is a quarterly index, which examines the current asset inventory of Australian businesses, as well as expectations for future investment. The inaugural Index was run during July and August 2014.

This edition of the Index includes 'Upper Corporate' businesses turning over between $101 million and $250 million each year. The Index comprises research from three segments: SME's turning over $5-$20M, Lower Corporates ($20-$100M), and Upper Corporates ($100-$250M).

This round of the index was created from interviews with 500 Australian businesses in March 2017.

The Index is executed by Collins Communications on behalf of Alleasing.

Alleasing is a leading, independent provider of asset finance and leasing solutions. Established more than 25 years ago, we have financed billions of dollars' of assets across a range of sectors, and business sizes.

Our focus is on supporting businesses to achieve greater productivity and growth through effective management of their assets, and we are prepared to invest in helping you do this via a residual position in the assets.

Our team is driven to deliver solutions that meet your business needs and which provide operational flexibility. This includes the ability to acquire, change or expand your asset base as the need arises.

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