THE ALLEASING

EQUIPMENT DEMAND INDEX

THE RISKS AND OPPORTUNITIES TO AUSTRALIA'S GROWTH

JUNE 2017
AUSTRALIA

IS THIS THE YEAR OF TREADING WATER?

The Australian economy has been growing, however growth so far has been erratic and uneven, leaving many lacking confidence.

The latest round of the Equipment Demand Index (the Index) shows that 28.8 per cent of businesses plan to add to their asset base in the third quarter of 2017, falling from 30.6 per cent from our previous report, "2017. So Far, So Good."

It appears that growth this September quarter has been isolated to specific sectors. Construction and retail are under pressure, while the service economy and hospitality and tourism are on the rise.

Over the past few months, GDP figures from the Australian Bureau of Statistics (ABS) have shown a fluctuating economy as a result of issues at home and abroad. China mandated cuts in local coal production, which boosted Australian resources, however, Cyclone Debbie hit Queensland in March resulting in a fall in exports.

Global interest rates have been rising and even though the Reserve Bank of Australia has maintained its official rates at record lows, the Australian banks have taken their cue from the global markets where they source their funds, and their rates are creeping higher.

On a national basis, the Index showed that 53.0 per cent of businesses responded their capex budget would remain the same in FY18 as FY17, while 33.4 per cent plan to increase by an average of 10.3 per cent. A smaller 13.6 per cent plan to cut capex by an average of 6.7 per cent.

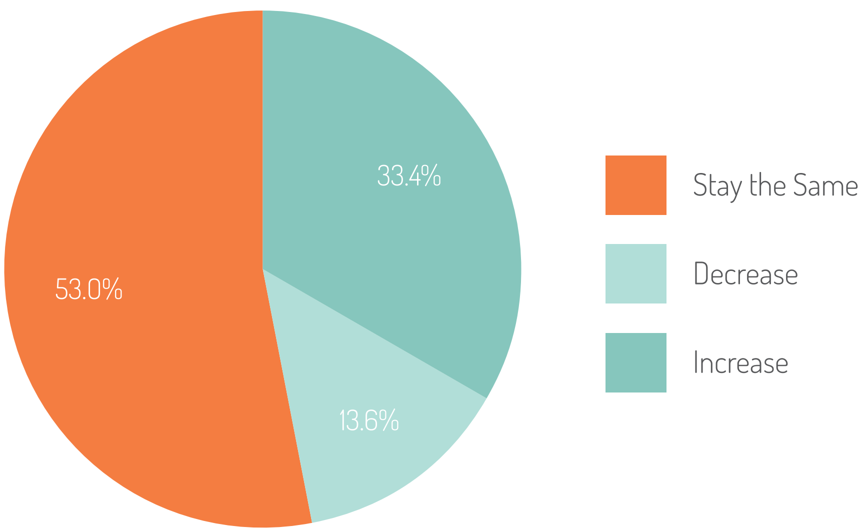
Underlining the uneven result was a significant variance in responses from industry sectors. In the services sector, which includes education and health, 38.8 per cent plan to increase their capex by a higher than average 10.8 per cent.

Compare this with the retail sector, where only 22.0 per cent of businesses said capex will increase by a lower average of 8.7 per cent.

When asked about the reasons for their capex decisions, 35.6 per cent stated they are in "expansion mode" and a further 34.8 per cent stated they are motivated by "positive confidence in the economy". On the other end of the scale, 13.0 per cent are in "contraction mode" while 15.6 per cent "lack confidence" in the economy.

On the upside, 18.0 per cent said they will "realise expansion plans" while a further 21.4 per cent said they will be looking to "improve their competitive position".

Plans for Capital Budget for 2017/18 Financial Year



CYCLONE DEBBIE LEAVES A SILVER LINING

Cyclone Debbie had a devastating impact on Queensland when it ripped through the northern coastal regions in late March this year, inflicting an estimated $1 billion in damages.

While many homes and businesses were left disrupted or in ruins, there are early signs that the reconstruction effort is underway and is likely to have a positive impact on the Queensland economy.

Queensland is the most bullish of any state, with 31.0 per cent of businesses planning to acquire assets. Most are likely to replace assets damaged in the cyclone as opposed to investing in additional equipment to drive growth.

Compared with the national average of 28.8 per cent, Queensland is significantly higher than Western Australia at 22.9 per cent. South Australia/Northern Territory posted the lowest number at 22.5 per cent.

On a national basis, businesses said that 39.8 per cent of their asset acquisition will be solely for replacement assets, whereas the percentage in Queensland is 45.9 per cent. Additionally, 25.6 per cent of businesses nationally said their acquisitions will be investment assets, compared to Queensland which stands at 16.1 per cent.

Queenslanders, however, are nothing if not resilient. The latest Sensis Business Index (Sensis) has found that despite the damage caused by the cyclone, business confidence in the state is at a seven year high. According to the Sensis report, net confidence of Queensland businesses stands at +44 points, only two points down from their previous report.

Identical results on capital expenditure were found in the current round of the Index. Where 33.4 per cent of all Australian businesses said they are planning to increase their capital expenditure in 2017/8, nearly four in ten, 39.1 per cent, of businesses in Queensland have stated that they also plan to.

When asked their reasons behind their capex decisions, the national average found that 34.8 per cent of businesses are driven by positive confidence in the economy, with 15.6 per cent citing negative confidence.

In Queensland, the divide between the two widened, with 41.4 per cent positive against a negative 11.4 per cent.

The Australian Bureau of Statistics reported that for the March Quarter of 2017, Queensland's economic growth was flat. Although this may not appear to be a positive result, the damage from the cyclone could have forced growth to decline much further, which to date, we have not seen happen.

Although Cyclone Debbie inflicted much damage and disruption, the silver lining could be an uptick in economic growth for Queensland later this year.

Businesses Inceasing Assets by State

A ROLLERCOASTER OF A RIDE FOR BUSINESS

Nearly three in ten (28.8 per cent) businesses say they plan to increase their asset base in the first quarter of the new financial year. Although the figure is still high, this is 1.8 per cent lower than our previous report.

It is possible to interpret this result in several ways. Were businesses more inclined to add assets in the lead up to June as they came to the end of the financial year?

Looking at the results since January 2017, the March quarter showed 25.6 per cent of all businesses were planning asset acquisitions, which increased to 30.6 per cent in the June quarter and now stands at 28.8 per cent. With a drop of 1.8 per cent this quarter, business sentiment seems to have peaked fairly early on in 2017.

Comparing the Index results against the ABS growth statistics demonstrates an ambiguous national economy. Australia's economy is growing but growing unevenly, and with pockets of uncertainty.

The 0.3 per cent growth figure for the first quarter of the 2017 calendar year was modest and puts annual growth at 1.7 per cent year on year, the slowest growth in around a decade. In addition, ABS data showed that of the 20 industries surveyed, 17 reported growth in March, despite a 0.7 dip in exports and a 4.4 per cent fall in housing investment dragging on the result.

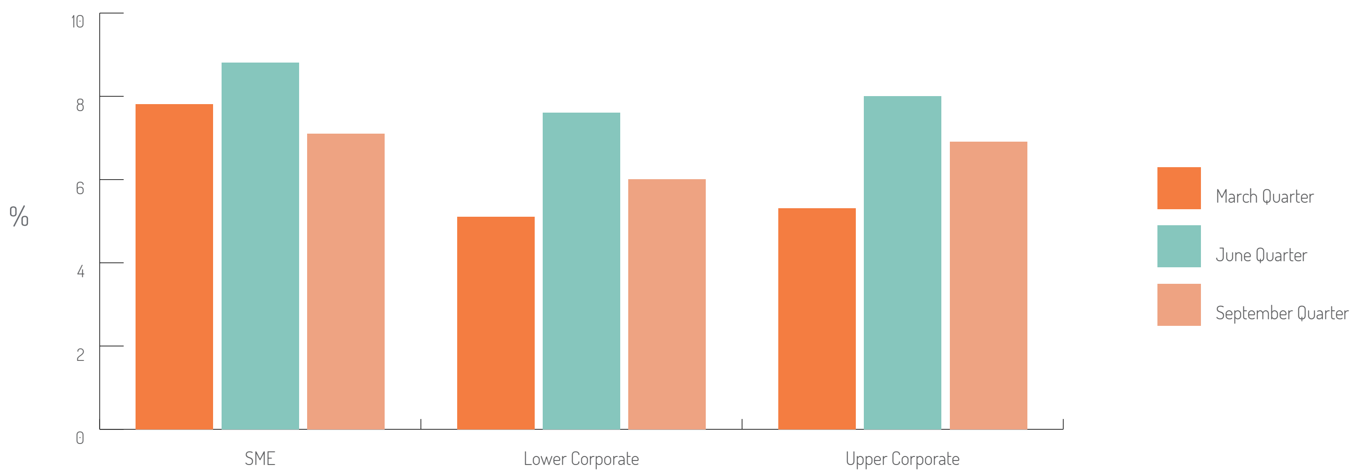
What is also uneven is the sentiment shown between larger and smaller businesses. The research in this quarter's Index continues to highlight what have now become ongoing trends. SME businesses and upper corporates continue to report acquisition intentions higher than the national average. This is shown with 30.2 per cent of SMEs and 29.7 per cent of upper corporates planning asset acquisitions, against the 28.8 per cent national average.

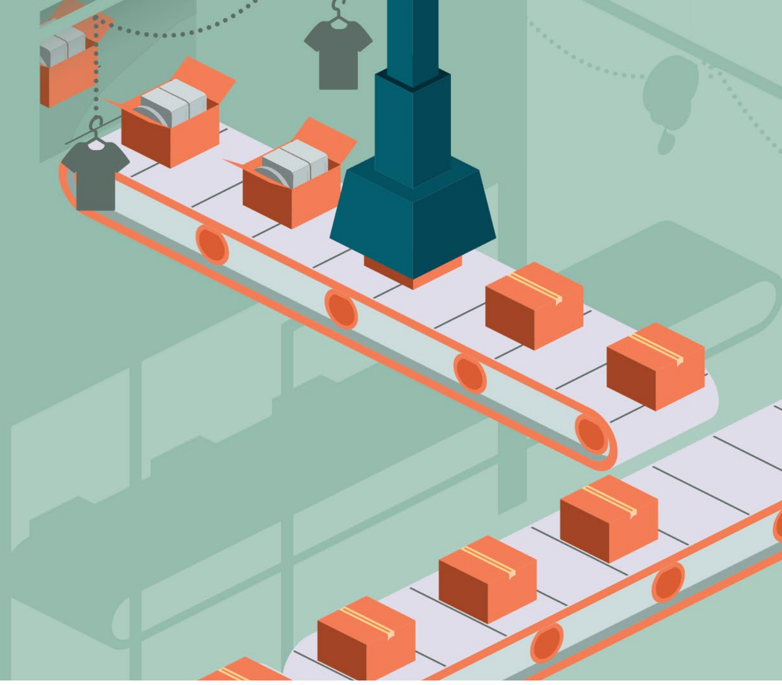
Lower corporates consistently record the lowest asset acquisition intentions of the three market segments, posting a result of 26.3 per cent this round. What's more, the number of lower corporates that state they plan to decrease their asset base is beginning to rise.

Index research has found that 16.3 per cent of lower corporates are planning a decrease, against 11.9 per cent of SMEs and 10.8 per cent of upper corporates, resulting in a national average of 13.0 per cent.

Smaller businesses would appear to be nimble and aspirational, while larger corporates have the muscle to grow more. Those in the middle appear to be in a state of flux as they face the challenges of transitioning to the next level.

Percentage Increase in Asset Base





NEW ECONOMY ON THE MOVE

The Index results continue to reflect a transformation taking place in the Australian economy. They demonstrate a shift towards acquiring newer technology in line with Industry 4.0. This type of technology includes artificial intelligence (AI), drones, automation and big data.

Some sectors are struggling with challenges of disruption, while others are using disruption to their advantage.

While retail sales jumped 1.0 per cent across the nation in April, this was buoyed by a 2.3 per cent surge in Queensland as the population recovered from Cyclone Debbie.

The long term trend has seen a decline, as shown by the 0.2 per cent fall in March, a result more typical of a retail industry which has seen a number of high profile struggles. Marcs has been forced to close a number of stores, Topshop announced they will be closing their Australian operations, and Myer's share prices continuing to plummet.

When it comes to asset acquisition intentions for the upcoming quarter, the retail sector continues to drag the national average with only 22.0 per cent of retailers planning to increase their asset base. A total which stands 6.8 per cent behind the national average of 28.8 per cent.

This compares with the 34.5 per cent result from the services sector, and 36.8 per cent from accommodation, cafes and restaurants.

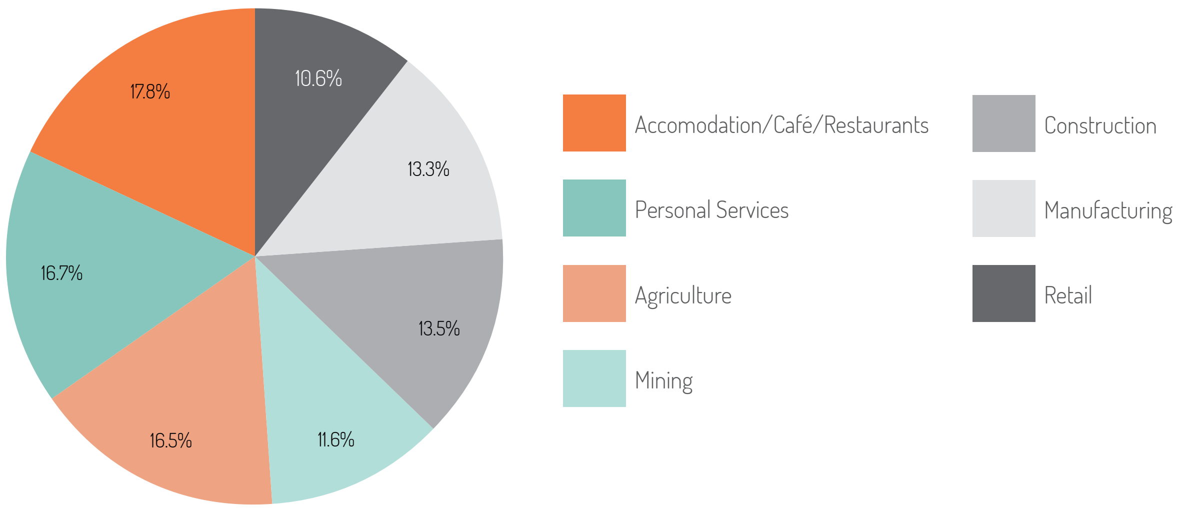
A larger percentage of retailers also plan to decrease their asset base in the coming quarter. Against a national average of 13.0 per cent, the figure for retail is 16.0 per cent.

The Index also includes data on the type of assets businesses are acquiring, and while traditional assets such as cars, trucks and manufacturing plant and equipment have remained stable or in mild decline, there is a marked interest in AI, big data and drone technology.

For example, 6.3 per cent of all businesses indicated they plan to acquire drone technology in the coming quarter, while 5.6 per cent will acquire artificial intelligence data and 20.8 per cent will invest in big data services.

This equates to 32.7 per cent of Australian businesses making acquisitions of this kind in the third quarter of this year, compared with 20.3 per cent that were planning acquisitions in this area during the March quarter.

Businesses by Industry Increasing Assets



SUMMARY

The Index shows a business sector which, on balance, is planning for growth, although there are caveats depending on geographical location, industry and market segment.

The percentage of businesses which say they are being hindered by a backlog of unproductive assets has increased from 11.7 per cent in the March quarter of 2017, to 17.2 per cent currently. Of all the business sectors, lower corporates continue to be the most challenged, with 23.1 per cent being hindered by unproductive assets.

However, rather than purchasing their infrastructure outright, more businesses want to refinance a percentage of their owned asset base. A total of 15.6 per cent of businesses now want to employ this strategy as a way to refinance 32.8 per cent of their owned assets. This has increased since the March quarter, when 11.7 per cent of businesses said they wanted to refinance 31.2 per cent of their owned assets.

Such a move would free up cash for day to day working capital to be deployed for growth opportunities, or to create a financial protective buffer should more challenging conditions arrive later this year.

There has been a subtle change in the way businesses are financing assets so far in 2017. Last quarter for example, 45.0 per cent of businesses said they would purchase assets outright, either by using equity in the business or borrowing to buy. Now, that figure is 40.9 per cent, 4.1 per cent lower than the previous report. This has been counteracted by a corresponding increase in businesses looking to use finance and operating leases in particular. A figure which now stands at a combined 25.0 per cent.

This shows that businesses are actively managing their financial risks in a more strategic way. This is a prudent deployment of capital as they face an economic environment which, at this point in the cycle, is asking more questions than providing answers.

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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