

NEW ZEALAND



THE REAL COST OF RENTING

'Accounting Standard Changes'-three words that would send many of us to sleep, for very understandable reasons. However, grab a cup of coffee because International Financial Reporting Standard 16, also known as IFRS16, is important enough for investors to stay awake for.

The simple aim is to improve the financial reporting of leases, yet it represents the biggest change to accounting standards in over a decade. So what exactly is IFRS16?

Previously, under the old lease accounting standard (IAS 17), leases were categorised as either financial leases or operating leases. Financial leases were included on the balance sheet whilst operating leases were not.

Operating leases were included in the notes to the financial statements with no impact whatsoever on the balance sheet. IFRS16 will now effectively bring operating leases onto the balance sheet (and will therefore be treated like finance leases) with the aim of improving the comparability between companies that borrow to buy assets (a financial lease) and those that lease assets (an operating lease).

Whilst this doesn't sound like a substantial change, it will have a significant impact on the balance sheet of those companies with large operating lease exposure such as retailers. Below we summarise the major implications from the adoption of IFRS16:

- We estimate that at least NZ\$7.8bn of debt will need to be capitalised on the balance sheet from the companies in the Forsyth Barr coverage universe, a +24% increase on current debt levels.
- We anticipate that EBITDA for the market will increase by an estimated ~+16%, although we note the range of outcomes for companies varies considerably.
- On adoption we estimate that NPAT will decrease for most companies with an average impact of ~-4%.
- A side effect is the impact on commonly used valuation multiples, with EV/EBITDA, EV/EBIT and PE all affected. We anticipate EV/EBITDA multiples will decrease by ~-0.4x and EV/EBIT and PE multiples will increase by ~+0.8x and ~1.0x respectively.
- The sector most impacted by IFRS16 is retail however building, transport, healthcare and agri sectors will also all be significantly impacted. The least impacted sectors are property, energy and aged care.

Whilst there is a change in how companies report operating leases, there is no impact on a company's commitment to pay the lease.

A ranking of companies from most impacted to least impacted is provided below using our estimated IFRS16 impact.

FIGURE 1. COMPANIES CATEGORISED BY IMPACT

MATERIAL IMPACT	SIGNIFICANT IMPACT	MODEST IMPACT	IMMATERIAL IMPACT		
1. EVO	12. MFT	20. EBO	29. CNU	40. TME	51. SUM
2. WHS	13. MPG	21. DGL	30. NZX	41. VCT	52. KPG
3. MHJ	14. FRE	22. CVT	31. TLT	42. IPL	53. NZR
4. STU	15. FBU	23. SPK	32. SPG	43. ARV	54. ATM
5. KMD	16. MVN	24. FSF	33. OCA	44. MEL	55. MET
6. NZM	17. SKT	25. GTK	34. GNE	45. APL	56. RYM
7. BGP	18. ZEL	26. SKL	35. AUG	46. POT	57. VHP
8. PGW	19. THL	27. VGL	36. TPW	47. CEN	58. PFI
9. ABA		28. SAN	37. SKC	48. MCY	59. AIA
10. RBD			38. GMT	49. ARG	60. PEB
11. AIR			39. FPH	50. PCT	

Source: Forsyth Barr analysis

It is important to note that IFRS16 is only an accounting change so theoretically it should have no impact on valuation.

IFRS16 will be effective from annual reporting periods beginning on or after 1 January 2019. That means companies with their financial year ending in December will have to adopt in FY19 and for all other year ends (March, June etc.) adoption will be in FY20. Our report Lease Liabilities Loom Large, dated 3 October 2018 should be reviewed for further information regarding IFRS16. This report includes sector-by-sector commentary on the impacts of IFRS16 – Go grab another coffee!



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