How has financial reporting been affected by COVID-19?

Analysis of the impact on July to December 2020 NZX50 reporters

Following our publications last year looking at the impact of COVID-19 on financial reporting for NZX50 March to June 2020 reporters, we have analysed the effect on NZX50 companies reporting from July to, and including, December.

These reporters experienced the full impact of the Alert Level 4 and 3 lockdowns. Businesses that reported later in the year also experienced the largely COVID-free months that New Zealand was fortunate to experience in the later part of 2020.

So, how significant was COVID-19 on these reporters?

Number of audits completed by each firm:	
Deloitte	**2**
KPMG	**4**
EY	**2**
PwC	**4**

Source: NZX50 February 2021

Reporters by balance date	
July	**3**
September	**3**
December	**6**

Source: NZX50 February 2021

Reporting the impact of COVID-19

Z Energy set a precedent early in 2020 of including a detailed note considering the impacts of COVID-19 on key financial statement line items in its 31 March 2020 financial reporting. We have continued to see this, even though the impacts on this group of reporters were mostly not as significant. Generally, although there were pronounced operational impacts, many of the companies in this reporting period experienced a turnaround in results after the April/May lockdowns ended.

Key findings:

12 businesses
on the NZX50 with July to December year ends have now completed their financial reporting

6 reporters
included a detailed COVID-19 related note in the financial statements with others including references to COVID-19 impacts in specific areas of notes to the financial statements

3 businesses
claimed the wage subsidy amounting to a total of $54.6m

3 businesses
received the wage subsidy but subsequently repaid it

Few material uncertainty clauses were included by registered valuers in investment property valuations. There is still caution but not material uncertainty

5 businesses
did not declare a dividend as a result of COVID-19 uncertainty

All 12 reporters
had 'clean' audit reports

Many new KAMs were included in audit reports – some as a result of COVID-19, others due to the new leasing standard or acquisitions

The story of the wage subsidy return

Of the 12 reporters in this group, six originally claimed the wage subsidy but three had returned the amounts received prior to their year end. Of the three that did not return the subsidy, approximately $54.6m was claimed (this does include a small amount received from offshore governments). Only one of these three reporters realised a net loss for the year.

It is likely that the other businesses who claimed the subsidy would have reduced their employee numbers quickly if it hadn't been available and therefore the subsidy most likely supported the ongoing employment of staff and the stability of the business.

As we reported previously, there was no consistency in how the wage subsidy was disclosed in financial statements. The accounting standards permit a company to either report the subsidy as other income (government grant) or as a reduction of expenses. Often a narrative explanation was included detailing how the subsidy had been treated.

Impact on retail and entertainment sectors

In April 2020 it became obvious the retail and entertainment sectors would be hit hard by the Level 4 lockdown in New Zealand and in other countries if they had international operations. For example, Vista Group International Limited (Vista) reported that by the end of March 2020 98% of cinemas around the world had closed. Kathmandu Holdings Limited (Kathmandu) and Restaurant Brands New Zealand Limited (Restaurant Brands) had all New Zealand stores closed during the Level 4 lockdown. During Alert Level 3 they only had online or click and collect services operating. All three claimed and retained the wage subsidy. Restaurant Brands also obtained a $11.3m paycheck protection programme loan in Hawaii from the US Federal Government.

The impact of COVID-19 has been most significant for Vista. The Vista Board moved swiftly with a capital raise of $65.1m in April 2020 and were able to negotiate a loosening in banking covenants. At the end of the year, revenue was down 39% to $87.5m, with impairments of $28.4m including a $13.7 write down of the investment in Vista China and a goodwill writedown of $11.6m. In addition, a further $19.4m (an increase of $18.2m) in accrued revenues and trade receivable provisions were raised. Overall provisioning of 36.3% is held against accrued revenue and trade receivables. All of this contributed to a net loss of $56.7m against a net profit of $12.8m in 2019.

Despite Restaurant Brands and Kathmandu having an extended period of store closures, both achieved a positive net profit after tax. Kathmandu $8.9m (down from $55m in the prior year) and Restaurant Brands $30.9m (aligned to the prior year ($30.1m) although that was for a 44 week financial period).

Kathmandu has estimated COVID-19 reduced their revenue by $135m. The balance sheet was shored up with a $207m capital raise in April 2020. Dividends were suspended and a plan put in place to reduce costs and accelerate synergies from the recent acquisition of RipCurl. Kathmandu was also able to obtain a waiver from measurement of bank covenants until 31 July 2021.

From Restaurant Brands results it would appear individuals around the world have relished being able to enjoy fast food after lockdowns. Restaurant Brands have noted that they lost sales of circa $40m as a result of the Level 4 lockdown in New Zealand alone. However, they were able to make up that lost margin with the strong performance of their US operations. This included the acquisition in September 2020 of Great American Chicken Corp (for $119m cash consideration) which has 69 KFC and Taco Bell stores.

Material uncertainty in the valuation of properties largely absent

As previously reported, valuers for 31 March 2020 reporters had included a material uncertainty clause in their property valuations. This clause highlighted that less certainty, and consequently a higher degree of caution, should be attached to valuations as a result of COVID-19. It was due primarily to the lack of commercial property transaction activity on which to establish a willing buyer, willing seller price or fair value.

Valuers have acknowledged that although caution remains, there is not material uncertainty with transactional activity resuming. Some valuers are still including the material valuation uncertainty clause but it is property specific and only a few were noted in the latest round of reporters.

Dividends – to pay or not to pay?

More July to December reporters declared a dividend than the June reporters. Only five did not. Some announced a final dividend but had previously cancelled interim dividends. Apart from Vista and Kathmandu, this group of reporters has not been as significantly impacted in revenues or cashflows by COVID-19 as the June reporters.

NZX benefits from market uncertainty and balance sheet rebuilding activity

The NZX recorded a net profit after tax of $17.6m up 20.1% on 2019. It has benefitted from a record level of market activity – particularly during the March/April 2020 lockdowns. We have noted that in those months many businesses rushed to strengthen their balance sheets with equity raises. The NZX experienced a 149% increase in volumes traded in this period. More than $5b in capital was raised on the secondary market in the 90 days from the beginning of April. Overall $17.6b of equity has been raised – 50% higher than the NZX's expectation.

In the later part of 2020, IPO activity resumed following a cessation. More recently, Air New Zealand has announced it is seeking to raise additional capital in the coming months.

Fonterra

Fonterra had a strong year with debt levels reduced by over $1.1b in the year. While some of its businesses were impacted by COVID-19, other parts performed strongly with the cooperative benefiting overall from its portfolio. Fonterra was able to leverage their global supply chain when COVID-19 impacted traditional supply lines. Net profit after tax was $659m from a loss of $610m in the prior year. The 2019 strategy review, which saw an impairment charge of $483m taken against their results in 2019, resulted in a $480m benefit to results in the current year. A $963m overall positive impact year on year.

Other notable mentions from financial reports

- Synlait Milk Limited (Synlait) has increased its holdings of finished goods inventory (canned and bulk infant nutritional products) by $60m to ensure demand can be met with the increased COVID-19 supply chain risk.
- ANZ's New Zealand segment recorded a $345m higher impairment charge related to lending (secured and unsecured) in line with other retail banks.
- Napier Port Holdings Limited, in its first reporting since listing on the NZX, performed well and is pushing ahead with its $119m capital expenditure programme – the 6 wharf expansion project.
- Sanford Limited (Sanford) secured an additional $40m of bank facilities in May 2020. Net profit after tax was down 46% on the prior year with lower prices for wildcatch and revenue from a lower value product mix. In line with Synlait, primary producers are seeing increases in finished good inventory holdings. Sanford has increased inventories of salmon, mussels and hoki by $37m or 92% on its prior year inventory holding.
- For Summerset Group Holdings Limited, the priority was keeping their residents safe. An additional $9.2m was spent on preventative measures to keep residents protected from COVID-19.

What was the impact on audit reports?

Last year, we used the analogy of traffic lights to indicate areas of concern and where readers of audit reports should focus their attention. The table below illustrates the outcome for July to December reporters:

Audit report type		
Clean (the audit report does not include any areas of concern)	**12**	A number of new KAMs were included by auditors
Clean but with a warning (the audit report includes some areas of concern for users of financial reports to be aware of)	**0**	None of the companies had what is called a "material uncertainty with respect to going concern" emphasis in the audit report
Qualified (a report where the auditor has not had all the necessary information needed)	**0**	

What do the 'green' traffic light audit reports reveal?

All listed company audit reports are required to include key audit matters (KAMs). The auditor uses KAMs to tell the story of their audit, especially where significant effort was needed.

Generally we saw an increase in the number of KAMs reported by auditors.

New KAMs included:

- NZ IFRS 16 Leases – the impact of the adoption of this new standard was seen as significant by the auditors of two companies.
- Impairment of assets – goodwill, intangibles and receivables was a significant area of focus in many audit reports and was a new area, not identified by the auditor previously, in four companies.
- The auditors of three companies included new KAMs in respect of acquisitions which required significant audit effort.
- One auditor included a KAM in respect of seafood inventory net realisable value.
- A significant capital expenditure programme was included as a KAM in one company's audit report.

Was the 2020 reporting season unprecedented?

The impacts on financial reporting from COVID-19 have been significant. Generally, we have seen improved transparency in financial reports. Disclosures have been more detailed, particularly in explaining the impact of COVID-19, outlining how impairment has been considered and providing more information for users to understand the greater number of difficult judgements, and estimates, and how they were made. We hope this level of transparency and of 'telling the story' continues.

Auditors have added many new KAMs in their audit reports highlighting areas where significant effort was required. We continue to encourage savvy investors to use audit reports to help them frame questions for Directors at Annual Shareholders meetings and, in doing so, bring greater transparency to financial reporting.

This overview follows our three earlier papers looking into the likely impact of COVID-19 on audit reports published in April 2020, and the effect of the pandemic on March to May NZX50 reporters as well as those in June. If you have any questions or would like to know more, please get in touch.

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