Grant Thornton
An instinct for growth™

NORTON ROSE FULBRIGHT
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Bankers' Boot Camp 2019

Facing down economic & regulatory headwinds

The impact of culture on high performance
An increasing focus on transparency and independence
Keeping pace with the accelerated rate of change

Now more than ever, banks are expected to operate with much greater transparency, accountability and responsibility within an increasingly competitive lending landscape.

This includes navigating the regulatory pressures and community expectations on the back of the Banking Royal Commission, meeting new codes of practice, dealing with changing accounting and reporting standards, and generally operating in volatile markets and industries, while also providing customers with the financing they need to grow.

Our Bankers' Boot Camp series is designed to help our banking clients navigate these challenges and identify opportunities, seeking to explore the key issues and insights impacting our clients, as discussed with our technical, industry, and economic experts.

Here we wrap up the highlights from our 2019 series, where we hosted more than 500 senior bankers from the major financial institutions in Brisbane, Sydney, Melbourne and Perth.

Enjoy our wrap-up and please don't hesitate to reach out if you or your teams would like further information on any of the areas covered.

Matt Byrnes
Partner, Financial Advisory
Grant Thornton Australia

For full access to program materials and insights, you can download our materials here.

What you said

We took a pulse across all the major cities to hear where the banking sector sees the opportunities and risks.

Which industry has the best prospects for lending growth?

Health & Aged Care remains #1

37%

2018
35%

City breakdown:

Brisbane
34% Health & aged care
23% Energy & resources
11% Food & agribusiness

Melbourne
41% Health & aged care
16% Food & agribusiness
10% Professional services

Perth
40% Health & aged care
23% Energy & resources
17% Food & agribusiness

Sydney
31% Health & aged care
16% Energy & resources
14% Professional services

An aged care provider's perspective

Read our 'Future of Ageing and Aged Services' report to understand the opportunities and challenges identified by 121 CEOs and executives from the sector.

https://www.grantthornton.com.au/en/insights/reports/the-future-of-ageing/

For the third year in a row Health & Aged Care was a clear leader in terms of having the best prospects for lending growth. This is notable in the context of two Royal Commissions, namely the current Royal Commission into Aged Care Quality and Safety, and the impending Royal Commission into Disability Services.

Government investment in primary health, aged care and disability services is struggling to meet the demands of a growing and ageing population, with the private sector filling the gap for required and specialist services.

Despite a willingness from Government to support the sector, and positive lending growth sentiment from our bankers, it is interesting to note that our Health & Aged Care industry team estimate that almost 50 per cent of providers are struggling to remain profitable, indicating that there is more to do to ensure this important sector can meet the needs of our next generation.

Which industry do you think presents the greatest risk?

Retail & consumer products remains #1

56%

2018
46%

City breakdown:

Brisbane
54% Retail & consumer products
25% Property & construction
8% Food & agribusiness

Melbourne
61% Retail & consumer products
25% Property & construction
5% Energy & resources

Perth
67% Retail & consumer products
25% Property & construction
4% Professional services

Sydney
43% Retail & consumer products
38% Property & construction
8% Health & aged care

CBRE revealed statistics supporting the high volume of retailers – particularly mid-market apparel retailers – exiting the market, with the key factors driving this being the sluggish Australian and global economic climate for consumer spending, as well as a significant shift towards online shopping.

However, it was noted that the flow on impact to property has been mitigated to an extent as the footprint left behind by struggling retailers is being filled by services, co-working spaces and online retailers requiring a base for operations.

Property & Construction was also highlighted as a key risk sector in all major markets and this was examined further by our expert panel in our industry lens session (see page 7).

What poses the greatest risk of disruption to your organisation?

Regulatory & compliance pressures remains #1

63%

2018
45%

The options:

- Increasing competition from fintech companies
- Regulatory & compliance pressures
- Ability to achieve internal efficiencies
- Managing customer expectations and related impact on brand
- Drive to increase margins and profits

City breakdown:

Brisbane
50% Regulatory & compliance pressures
26% Internal efficiencies
11% Increasing competition from fintech companies

Melbourne
70% Regulatory & compliance pressures
12% Internal efficiencies
9% Managing customer expectations

Perth
81% Regulatory & compliance pressures
8% Increasing competition from fintech companies
6% Internal efficiencies

Sydney
50% Regulatory & compliance pressures
23% Increasing competition from fintech companies
15% Drive to increase margins and profits

Regulatory and compliance pressures continue to dominate as recommendations from the Royal Commission into the Financial Services sector are being rolled out and the new Banking Code of Practice is implemented and enforced.

Our expectation is that, as these changes become embedded throughout 2020, the focus will shift towards other trends. We are particularly interested to see how the banks will respond to increasing competition from fintech and neo-banks as more lenders enter the Australian market.

Ideas to improve the banking environment

We asked our attendees to suggest different ways they could improve the banking sector. While there were a wide range of ideas – some clear themes emerged.

If you had the power to change or introduce one law that would have the biggest positive impact on banking, what would it be?

1. Further clarity on what responsible lending means for bankers
2. Training and awareness for bank customers, namely directors and key management, to improve financial knowledge and enhance customer and lender engagement
3. Co-operation between lenders and portability of bank accounts and loan documentation between institutions to facilitate a smoother transition when a customer chooses to change lenders
4. Structured programs within banks aimed at better understanding their customer's business, in order to be seen as a partner in the customers growth journey

How does this compare to last year?

1. Reducing 'red tape' by finding a better balance between the increasinwg burden of compliance and regulation, and the space needed to innovate in order to grow.
2. Banks investing in better education and awareness of their own people to ensure improved quality of lending.
3. Building relationships with advisors and partners who can support bankers in presenting a future bank-customer relationship built on insights and a deeper understanding of the customers' business.

Customer tales

We heard fascinating growth stories from a number of bank customers, covering a range of industries, as they shared their experiences about how they have grown their businesses, and the important role financiers and advisors have played in their success.

Daniel Foggo from Ratesetter (Sydney)

A real disruptor in financial circles, Ratesetter is a peer-to-peer lending business with an emphasis on consumer choice. Still a young business, **Daniel Foggo**, CEO, shared some great insights on the core of their success: building trust and transparency with customers and investors is pivotal. Importantly, Ratesetter doesn't shy away from the compliance requirements.

To Daniel, it's about taking the same ownership as any other responsible lender and simplifying the front-end experience for customers. A great success story and a brilliant example of how the banking and lending market is evolving.

Lina Calabria from Bellroy (Melbourne)

Founded in 2010, Bellroy is a high-growth Australian retail and manufacturing brand that is focused on solving the problem of carry. Beginning with the design and distribution of a wallet in Bells Beach, and now with another office in Fitzroy, Bellroy creates long-lasting modern classics: from wallets, pouches and mobile phone cases, to key covers, folios and bags.

Lina Calabria, co-founder and COO of Bellroy, shared their fascinating growth journey, from early global successes online, right through to their recent private equity investment process. Lina discussed the importance they place on corporate social responsibility and environmental sustainability (they are Certified B Corp), and the culture and qualities they look for in their people.

Linton Burns from LogiCamms (Brisbane)

LogiCamms is a multidisciplinary engineering business providing services to a range of industries. Their Transition Director **Linton Burns** shared his account of the reverse public takeover of LogiCamms.

Linton took the audience through his unique experiences from the transaction, including lessons learnt through transitioning debt providers.

Russell Baskerville from Empired (Perth)

Originally formed in Western Australia, Empired is a national IT services provider with a reputation for delivering enterprise-class IT service and solutions. **Russell Baskerville**, Managing Director of Empired, described the company's growth journey: from 'four people in a loft' to now employing more than 1000 people and reporting an annual revenue of around $180m.

Russell talked about the importance of building and evolving leadership capability relative to where you are on the journey, being clear on your vision (and staying the course), and instilling trust and alignment across your leadership teams.

Rebecca Morrow, Head of Marketing and Brand speaks with Russell Baskerville, Managing Director of Empired.

Technical issues & hot topics

As always, each year brings a new list of codes, standards and regulations that bankers must navigate as part of their roles. Of the many hot issues for bankers, we selected two. Around the country, we brought together accounting and legal experts to discuss the impact of recent changes.

A snapshot

IFRS 16 Leases

In 2016, the International Accounting Standards Board (IASB) issued IFRS 16 Leases which represents the first major overhaul in lease accounting for over 30 years. This will become mandatory for all entities in December, and our attendees heard about the impact of the changes on reporting to banks from their customers. The new standard changes the nature and format of information presented by customers to banks with the biggest impact being on how covenants such as EBITDA and other important ratios are presented, as well as the banks' risk rating models which directly impact pricing and other terms for customers.

What is AASB 16 *Leases?*

A fundamental change to key data points

Income Statement		Cash Flows	
Operating Leases	↓	Operating Cash Flows	↑
EBIT/EBITDA	↑	Financing Cash Flows	↓
Depreciation	↑	Net Cash Flows	-
Interest	↑		
Profit	-		

Balance Sheet		Ratios	
Current Assets	-	EBITDA %	↑
Total Assets	↑	Working Capital	↓
Current Liabilities	↑	Return on Assets	↓
Total Liabilities	↑	Leverage	↑
Equity	-	Free Cash Flow	↑

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Banking Code of Practice

We were joined by our sponsors, Norton Rose, who took our audiences through the important new Banking Code of Practice (BCOP). Our legal specialists in this area shared how AFCA differs in their approach to disputes compared to the Financial Ombudsman Service, some recent trends in regulatory activity, as well as what bankers need to be mindful of in the case of vulnerable customers, and what these changes mean for the risk profile of customers generally.

Thanks to our Norton Rose speakers:

Mark Schneider (Brisbane)
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Chris McLeod (Perth)
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The impact of culture on performance

Matt Croxford, Partner & National Head of Human Capital at Grant Thornton, shared his insights for creating a culture by design – and not default – and how businesses can better tap into their most valuable asset: their people.

Creating a workplace culture that supports people to invest more energy into their work not only creates an environment where people feel valued and can thrive, it has a positive tangible commercial impact on organisations: recruitment savings; staff retention; efficiencies; and a resultant growth in profit and equity value.

Time v energy

Many organisations are largely structured around paying people through the lens of time-based value – full time, part time and so on. Time is fixed and finite, it's perishable and we all have the same amount. Energy, on the other hand, is variable and discretionary. The energy our people put into what they do is so much more valuable. The greater the energy and enthusiasm for the task at hand, the more productive that person is and the greater the value they create for the organisation.

The formula – Give. Be. Do

There are three basic principles that influence the amount of energy that individuals are willing to give each day: give your best; do your best; be your best. Get the mix right and you will see your culture transform with exponential benefit to your people, your clients and customers, and your business.

The checklist

Assess if you are realising untapped potential by asking your team these questions.

Motivation: At work, to what extent do you feel...?

- [ ] You have a voice in decisions that impact you?
- [ ] You are growing personally and / or professionally?
- [ ] Your work is meaningful?
- [ ] You are supported by those around you?
- [ ] You enjoy what you do?
- [ ] Encouraged to go above and beyond?

Execution: On the job, to what extent do you believe...?

- [ ] You have the tools required to get the job done?
- [ ] The organisation is structured to get the best out of you?
- [ ] Supporting systems are optimised for your success?
- [ ] You can count on your leaders to make decisions when needed?
- [ ] Colleagues in other departments will help you to achieve your goals?

Authenticity: To what extent do you feel...?

- [ ] You are clear on what matters around here?
- [ ] Leaders focus their attention on what matters?
- [ ] The right things are measured?
- [ ] Difference is encouraged?
- [ ] You can be yourself whilst at work?
- [ ] You can speak your mind with your leaders?

Industry lens: What's happening in Real Estate & Construction

A slow-down in pre-sales, falling prices in the major cities, and regulation around consumer lending over the last 18 months has put pressure on developers to be more creative in their marketing and incentives.

The failure of developers such as Ralan Group highlighted the risk of unconventional funding methods being adopted by desperate developers.

Pressure on developers has been compounded by calls for increased regulation of the industry following the emergence of quality concerns with combustible cladding and structural integrity (Mascot/Opal Towers).

The issues

Stricter credit assessment processes	Land Tax and Stamp Duty reforms targeting foreign investors	Banks withdrawing from high-rise apartment developments
Retailers exiting the market	Rise of the non-bank lenders	Downturn exposing builders to increased risk of failure
Rising levels of delayed and failed settlements	Proposed Vacant Land Tax changes in Parliament	Cladding and quality concerns impacting re-sale

Our expert panel discussed the key issues at play: funding for new developments, the appetite of foreign investors, statutory reforms regarding land tax and stamp duty and GST, and the increased regulatory lens on the treatment of sub-contractors.

Here are some highlights:

- Lenders need to keep abreast of trends in the sector to better understand inconsistencies and predict potential risks. Lenders need to remain 'positive skeptics'.
- Lessons learned from the Ralan Group administration suggest that whilst there is a focus on the feasibility of a project during the due diligence phase, lenders and advisers should ensure they are monitoring the financial accounts of the special purpose vehicle (SPV) entities linked to the development as well as obtain source documents in relation to funds held in trust accounts to ensure there is not irregular activity and to in turn manage credit risk.
- Inconsistency in regulation and legislation in each state is a challenge. Whilst most states have enacted legislation to deal with combustable cladding and chain of responsibility for construction materials, some have responded to the concerns of sub-contractors enacting compulsory annual financial monitoring and Project Bank Accounts (Queensland 2018). As the Mascot/Opal Towers concerns continue to evolve, the NSW Government appears likely to adopt at least some of the Shergold-Weir report recommendations. A National Building Ministers Forum focused on harmonising regulation of the building industry is monitoring these reforms.
- As revenue declines, keys drivers of builder performance are:
  - flexibility in costs (ability to right size labour/overheads)
  - being recognised for quality/sticking to areas of expertise
  - reliable ERP systems to supporting budgeting/tendering
  - robust contract administration and credit risk management (including insurance)
  - innovative design to manage and streamline upfront work in the planning stages, and minimising risks in the construction phase

Market update from CBRE

Our sponsors CBRE shared their thoughts on current and future issues in each local market.

At the start of the year, the Australian economy was forecast to grow in the order of 2.9% during 2019. That now looks more like 1.8%. This would be just the second time the Australian economy has grown below 2% in the past 28 years.

Economic growth in 2019

3.5% → 2.9%

2.7% in 2020

2.8% → 1.8%

2.5% in 2020

We have seen the impact of this reflected in our local property sector, with the tail end of 2018 and early 2019 being particularly soft for both residential and commercial property.

Where is the funding coming from?

Interestingly the major domestic banks have pulled back – with close to a 10% per annum drop in exposure to land developments and subdivisions over the past three years, according to CBRE. There was slight growth in other residential, however this masks a drop in exposure to apartment developments.

This is mirrored by a pull back from foreign banks as well – with a 17.5% per annum drop in exposure to land development and subdivisions. To make sense of these numbers, we need to acknowledge that foreign-owned banks have accounted for almost 90% of the net increase in actual exposure to commercial real estate in the last three years – most of this growth from Asian banks.

The national highlights

Residential: We are past the worst.

Based on ABS data, the past few months have seen the first early signs of a turnaround in national residential lending figures. In terms of pricing, the June quarter saw the smallest median price decline since the start of 2018 and better auction clearance rates in Sydney and Melbourne are another positive sign.

Retail: Pressure builds.

The closure of a number of bricks and mortar retailers has gained pace since 2014, with almost half of those being retailers of mid-range apparel. In 2018, 22 major retailers either exited the Australian market or entered voluntary administration, up 38% on 2017. These exits, however, have occurred in conjunction with pure-play online retailers moving into physical stores, supporting the notion that an online-offline model could define the future success of retailers.

Office: Flight to quality continuing.

In any market with high vacancy there has been a flight to quality: Brisbane CBD, Canberra and Perth. This means conditions will continue to be challenging in secondary office stock. Co-working has been a large driver of demand for office space.

Logistics: Where everyone wants to be.

There is requirement for 350,000sqm p.a. nationally to help move product, much of this driven by online sales and e-commerce. 120,000sqm of this is required in NSW. There is an estimated $4bn in additional sales from e-com in the three years to 2021. Every additional $1bn in e-com = 85,000sqm

Client insights

In an increasingly challenging and competitive market, one confronted by lenders and advisers alike, the team at Grant Thornton are always looking for ways to create insights and bring value to our clients.

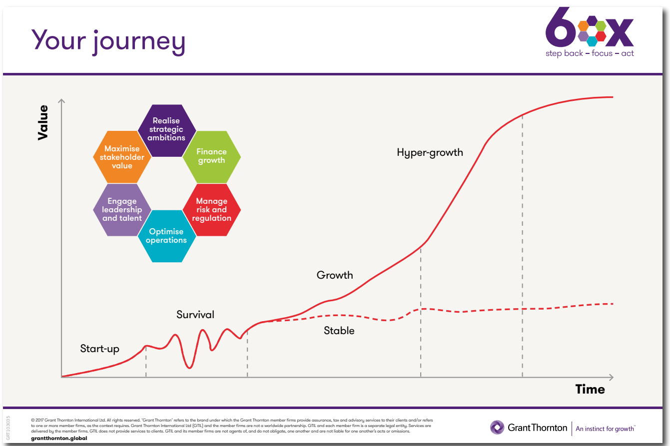
Grant Thornton has developed a range of innovative tools and frameworks for our clients that aim to differentiate our offering.

6-Box

6-Box is a conversation framework that focuses attention on the critical success factors for business survival and growth: strategy, financing, risk, operations, stakeholders and people. This unique framework, developed by Grant Thornton's global centre of excellence, and based on over 20,000 client conversations globally, enables a robust conversation about the things that matter most to our clients' success.

What is the value?

- Robust conversation about the business
- Minimum three partners from at least two service lines
- Minimum two hours
- Challenge the client constructively
- Test and validate their plan
- Focus on listening
- Uses informed questioning and visual aids
- Provides clarity on vision and alignment with the leadership team



Benchmarking

Our industry Benchmarking reports provide a unique comparison to assist our clients in understanding how their business is tracking against their industry peers across a number of data points, highlighting risks, avenues for improvement and opportunities to pursue. Our data and tailored reports for each client capture a large sample of both private and public information in the relevant sector to ensure sufficient scale to draw meaningful conclusions in relation to industry averages and emerging trends.

Risk assessment and mitigation tool

Organisations should proactively monitor the financial viability of stakeholders. Being able to identify issues early and manage counterparty risk in a proactive manner is a key for sustainable success.

Our risk assessment and mitigation tool is a bespoke platform and approach that enables organisations to undertake a financial viability assessment, on a portfolio or industry wide basis, of key providers (current and prospective) utilising a traffic light risk alert system, to assist banks, government departments, or industry leaders to manage risk in the dealings with providers in that portfolio or sector.

Dealtracker

Drawing from almost 10 years' of data – our Dealtracker report pulls together Australian M&A, private equity and IPO transactions, providing a unique insight into the M&A trends in the domestic market.

Originally designed to assist private owners to assess the value of their business, the data provides reliable EBITDA multiples by industry, business size, and domestic and international investments. Our client data is complemented by other sources, including S&P Capital IQ, the Australian Securities Exchange, Mergermarket, IBISWorld, transaction surveys, company announcements and other publicly available information, providing clients, their lenders and advisors, with the most comprehensive insight into recent Australian deal activity.

The overlooked opportunity in Australia's mid-sized businesses

Now is the time to look at different ways of incentivising Australian businesses – especially mid-sized businesses. Our national economy is sluggish. With the right incentives and tax policies in place, they can grow in size, scale and reach. They can employ more people, collaborate with other Australian businesses, and better contribute to Australia's bottom line. We've had two successive quarters of negative growth per capita. Consumer spending is down. The housing market is trending down. The economy needs a kick-start.

Would a boost to mid-sized business have an impact?

To find out, we asked Economist, Neville Norman, from the University of Melbourne and Cambridge University to look at how a 10% increase in revenue would articulate itself in one and five years in terms of profit and tax revenue, particularly in lieu of the corporate tax cuts that failed to pass last year.

The short answer is yes – for our simulated mid-size company with revenue of $100m – a 10% boost would result in an increase of 35% in company cash flow over five full years, with $26.7m (an increase of 25%) in company tax payable over the same period.

Read our full report

Keynote speaker

We were fortunate to have Stephen Koukoulas as our keynote speaker who shared his insights and observations.

Stephen Koukoulas

Market Economics

Stephen Koukoulas is one of Australia's leading economic commentators and thought leaders. He's a regular contributor to newspapers and TV, as well as discussions and debates on housing, consumer spending, investment strategies, interest rates and budget policy. Stephen has a reputation for providing reliable, accurate and informed economic forecasting at both local and international levels, drawing from his unique experience: including Chief Economist of Citibank, heading global research for TD Securities in London, as well as Senior Economic Advisor to the Australian Prime Minister.

Stephen shared his insights on the Australian and global economy, and his predictions for what's in store for 2020.

You can view Stephen's presentation here.

Access our program materials

For full access to program materials and insights, you can download our materials here.

Our sponsors

NORTON ROSE FULBRIGHT

Norton Rose Fulbright is a global law firm. We provide the world's preeminent corporations and financial institutions with a full business law service.

With more than 600 lawyers in five offices – Brisbane, Canberra, Melbourne, Perth and Sydney – we are one of the largest Australian law firms operating on an international level. Our international reach and, in particular, our significant presence in the Asia Pacific region, sets us apart from our competitors. Our recent combination with leading Australian law firm Henry Davis York in 2017 strengthened our presence in key industry sectors, particularly financial institutions and government and infrastructure, as well as giving us depth in the risk advisory and regulatory space. Our other key industry strengths include mining, agriculture, healthcare, energy, utilities and services.

CBRE

CBRE is the world's largest commercial real estate services and investment firm, with 2017 revenues of $14.2 billion and more than 80,000 employees (excluding affiliate offices). CBRE has been included in the Fortune 500 since 2008, ranking #214 in 2017. It also has been voted the industry's top brand by the Lipsey Company for 17 consecutive years, and has been named one of Fortune's "Most Admired Companies" in the real estate sector for six years in a row.

CBRE offers a broad range of integrated services, including facilities, transaction and project management; property management; investment management; appraisal and valuation; property leasing; strategic consulting; property sales; mortgage services and development services.

DominionGroup

Dominion Group is one of the largest providers of plant and equipment valuation and auction services in Australia, with clients spanning major banks, finance companies, the insolvency industry, government departments and the health and insurance sectors. The company offers a wide range of services pertaining to, asset valuations, asset management, asset auctions and sales.

The company mission is to deliver the most effective asset valuation, management and realisation solutions for each of the clients by developing a competent and professional team of independent valuers and auctioneers who will work diligently to deliver the best financial outcome for clients.

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