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## The pivot point to a better future (p2)

Kiwi businesses must stop living 'pay cheque to pay cheque' (p4)

**PLUS**

How can Not for Profit organisations build resilience in times of acute disruption? (p6)

Can the Primary Healthcare sector leverage opportunities created by COVID-19? (p9)

Opportunity and sacrifice: How do we pay for NZ's recovery? (p11)

# The pivot point to a better future

When we look back at this time in our lives, it will be a significant milestone of change across the world.

For each New Zealander, it might be the fork in the road where you decided to spend more time with your family. Or when your business pivoted in a new direction. It could be the point at which you lost your job and had to retrain in a new industry. Hopefully it won't be the time you faced financial disaster, but unfortunately that will be the reality for some Kiwi households.

## Accelerating existing trends – and wreaking havoc

Some current changes are already accelerating: online shopping is booming, for instance. The lockdown removed people's choices, and first-time online shoppers have realised that the fears they had about putting their credit card details online were unfounded. The products they ordered turned up, as promised. Many will be converted. Traditional brick-and-mortar retail will now be more about creating an experience – otherwise why bother going shopping when we can get everything online?

Other industries aren't seeing existing trends speeding up; instead their activity levels have been severely dented in ways they couldn't possibly have anticipated. Our tertiary education sector relies heavily on income from international students, a market segment which has evaporated. Those students also occupy a large number of inner-city apartments in our major cities; this is one reason we'll see apartment prices fall much faster than values for standalone suburban homes. The CBDs themselves may be less densely-populated – will people want to avoid the city centres? Will working from home become far more common and lead to a lower density of workers in the CBDs? If that happens, commercial property prices and yields may be permanently affected. For residential property, we may see the reverse: working from home may mean we are prepared to pay more for an extra room. Many of the unanticipated outcomes of this crisis will be negative, but hopefully there will be some surprising upsides too.

## Where we have made gains, let's not lose them

This is an opportunity for New Zealand to be more productive; I've already seen some impressive pivots. One of my clients supplies food to the hospitality sector and their business has been decimated over the past few months – but they've pivoted hard into a meal kit delivery service that was doing only modest traffic prior to coronavirus. That's taken off and helped keep staff employed over this time.

The lockdown has been bad for almost all Kiwi business owners, but many will be looking at this as a chance to review their operations and make positive changes. Under normal circumstances, people resist change, but with the world in upheaval we can take big strides and people are more likely to embrace – or maybe just accept – these changes. Hopefully during the down-time business owners have been planning, evaluating and strategising while putting measures in place to be more cost-effective and efficient. Let's not lose these gains, because they could be the foundation of a more productive economy.

## Redeploying our skilled workers

A period of enforced time at home has afforded employees some more time to reflect. For those people who have now lost their jobs, it's going to be tough. In certain industries it may be a long time before jobs reappear – too long for people to wait it out. Those in the tourism, retail, hospitality and the media sectors may have to find new directions.

One of the most brilliant factors of the modern global economy is the way that technology can match up demand with supply. That's what Uber and Airbnb do so well. Now we need to harness that power to match newly unemployed New Zealanders with gaps in the labour market.

The Ministry of Social Development recently announced the launch of a website that connects jobseekers to employers – honestly, the mind-blowing part about that announcement was that the site didn't exist in the first place. It also provides some training, but it's mainly designed to improve basic employability: interviewing well, writing your CV, what to wear. Newly unemployed workers are going to need training in hard skills tailored to specific industries where there is a need for them. Once again, technology can deliver training at home, and on demand, so we need to make the most of it.

Pilots, for instance have skills like leadership, decision-making and technical aptitude that other industries were seeking before the lockdown. Can they be redeployed into a fast-growing sector like logistics or IT? Crown infrastructure projects will also need a steady supply of people – can we upskill people to fit into some of these roles? Could the Government partner up with tertiary training institutes for some quick wins? There's a lot of work to do on this, but the potential is there for this to be a powerful and permanent way to match jobseekers with industries in the future.

## The smart money is already looking ahead

We've taken a body blow. But it's not fatal. We're on the road to recovery; optimists and opportunists are already hunting out the silver linings. One of my clients, whose business has been savaged by the lockdown, delivers service food to the Pacific Islands. After news that we might have a travel bubble with Australia and potentially the Pacific Islands, he was approached by a buyer for his business. Was that buyer just trying to get a cheeky deal? Maybe, but clearly the buyer believes in the future potential of the operation. It certainly gave my client a little extra confidence after all that's happened.

This crisis has been bad and some of its outcomes are undoubtedly dire. But it's also a pivot point, personally and in our economy, to allow us to move to better ways of working, deploying people and using technology. Let's try to keep the positive differences, improve our productivity and be as adaptable and creative as we know New Zealand can be.

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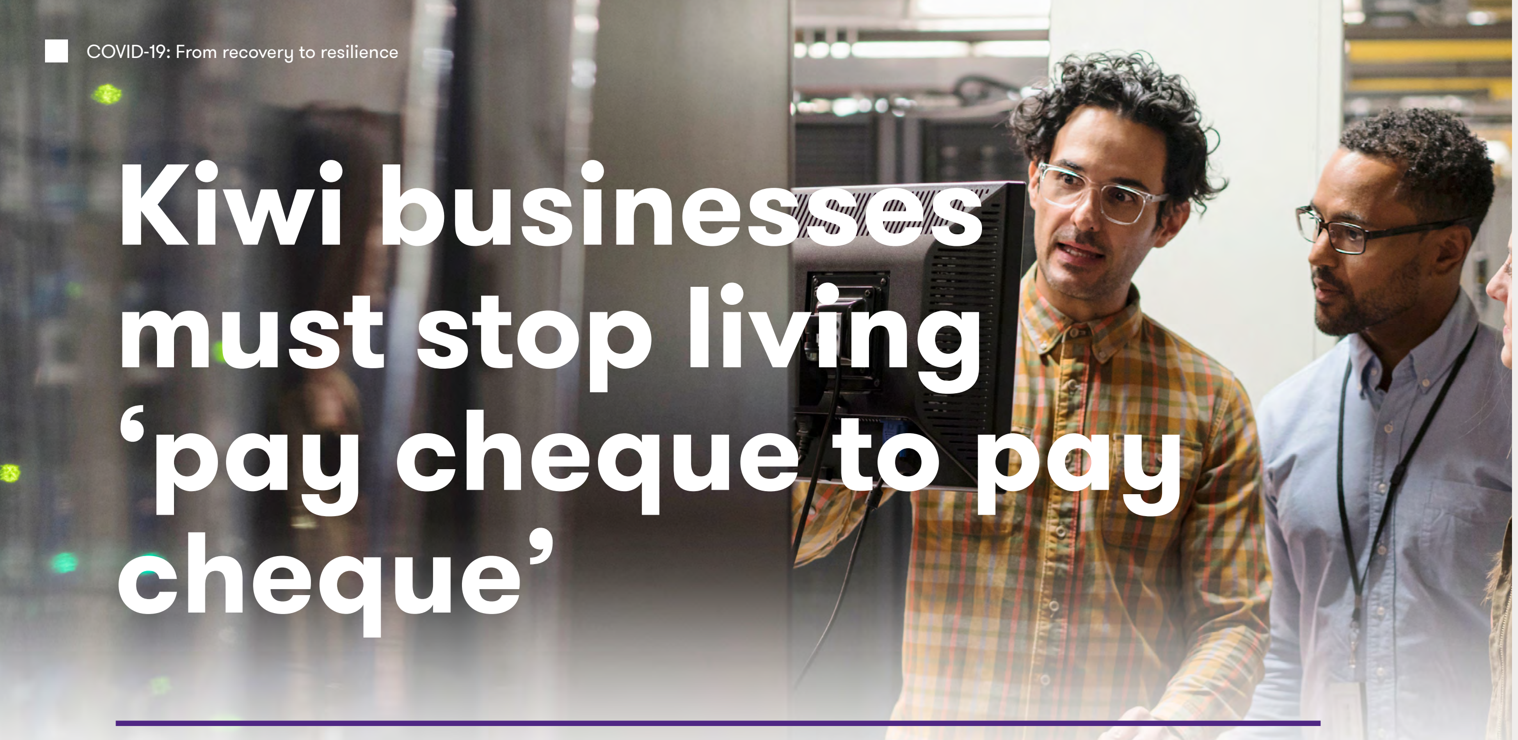
**Contents**



# Kiwi businesses must stop living ‘pay cheque to pay cheque’

Resilience is about being ready for the tough times, and COVID-19 is revealing Kiwi businesses’ weak spots – particularly the way that many are operating project by project, hoping for the best and unprepared for the worst.

Now, faced with a crisis, our business owners are having to make some extremely tough decisions: Do I have the confidence and the cashflow to keep my staff on? Do I make some people redundant or reduce everyone’s wages? Who will need to go when the wage subsidy runs out?

## Service industries: Eat what you kill

New Zealand has moved away from manufacturing, a sector which has a level of built-in resilience due to its cashflow demands and long international lead times. We’ve shifted instead towards service industries, which are rarely set up with strong cash reserves and continuity plans.

It’s an ‘eat what you kill’ mentality, where the profits made by our SMEs are cleared out by the owners, rather than being retained for investment and strengthening.

Effectively, these small and medium-sized service businesses have been living pay cheque to pay cheque in a thriving economy which left them floundering during the strictest lockdown levels. The wage subsidies have helped, and provided we don’t go back into lockdown, they will save many jobs. In other industries, even extended wage subsidies are not enough to protect workers. In tourism for example, some businesses were announcing redundancies at the same time that wage subsidy extensions were made available.

Staff thought maybe it would give them a lifeline; it wasn’t even close. Tourism has been decimated and only the most resilient companies in the sector will survive – the ones that were only just getting by last year are unlikely to make it.

## Your business isn’t an ATM

Many Kiwi businesses have grown by accident, rather than by design, and they aren’t prepared for a serious shock. Typically, we’d see this exemplified by a small company that began as a mum-and-dad operation before expanding to take on extra people. As the business grew, though, the mum-and-dad mindset never changed. Cashflow and staffing fluctuate from project to project; no serious structural improvements have been implemented; profits are taken out of the business and maybe invested in a beach house. That model leaves our small business owners – and especially their employees – high and dry in a crisis.

A business isn’t a personal ATM. It needs cash reserves, investment in future technology and strategies for surviving in a downturn. If your business scrapes through this crisis thanks to the wage subsidy, you can be grateful. But don’t mistake survival for resilience. Resilient businesses will be the ones that recover quickest, whose owners are under the least stress, who lose the fewest jobs and those who will be able to capitalise on opportunities in the post-COVID-19 environment.

> A business isn’t a personal ATM. It needs cash reserves, investment in future technology and strategies for surviving in a downturn.

## Moving from survival to resilience

If your business is going to survive, that’s an excellent start. But surviving isn’t enough – you need to build a better, more resilient organisation. Change is always a tough sell for our businesses. As business advisors, we always encourage our clients to build resilience into their strategies and operating models by investing in better efficiency, slicker online trading or new distribution channels, for example.

However, they tend to fret about upfront costs and find it hard to visualise tough-to-quantify future gains. The response is often, “I don’t want to distract the team from their core business.”

Unfortunately, when that core business dies, business owners and their remaining staff spend their time frantically attempting to set up new distribution channels, supply chains and market strategies. All of which could have already been in place, at two-thirds the cost and a quarter of the stress, possibly without job losses, if they’d started earlier.

With change forced on us, now is the time when New Zealand can hopefully take a huge leap forward in technology and efficiency. This crisis has been the catalyst for a shock in many traditional industries – when the firefighting phase is over, can our businesses respond with permanent positive changes? Can we have a more productive economy? It’s possible, but not if we merely do the bare minimum to survive and maintain our old ways. This should be the wake-up call for survivors to create more resilient businesses, and to keep trying to maintain a high level of resilience through investment and planning.

## Are you ready for the next crisis?

Get it right, and when the next crisis hits, your business can be better prepared. After the Christchurch earthquakes, many business couldn’t access their PCs or paper-based files or reach all of their clients and team members. During that period, our advice to affected clients was to get rid of landlines, switch everyone to laptops, implement direct virtual customer distribution channels and upgrade to secure cloud file storage systems. There was no way we could have predicted the COVID-19 lockdown, yet when it came, businesses that had those systems were in place never needed to stop working even though it might have been at reduced capacity. That’s in stark contrast to companies who had to shut their doors for seven weeks and make people redundant because they still relied heavily on outdated means of business operations and methods of communication.

Right now, your business focus will be cash management. But as the economy sparks back to life, you should be working with your stakeholders, finance advisors, directors and staff to plan for a stronger organisation. Look for the weak spots in your business: which areas are most likely to fail? How can we shore up those weak spots? We have tools and advice in the COVID-19 hub on our website that can provide a good starting point for this process. We don’t know when the next crisis will come, or what it will look like, but a more resilient business is a win for its owners, its staff and the New Zealand economy.

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# How can Not for Profit organisations build resilience in times of acute disruption?

In this brave new world, Not for Profits, like most Kiwi organisations, are struggling to deal with the urgencies of today while building resilience for tomorrow.

The impact that disruption has on NFPs is profound given that this sector traditionally has to do more with less in standard economic conditions.

Now, NFP industry leaders are charged with the mission-critical task of identifying not only the short-term, but the long-term issues impacting their industry, and to define the actions needed to navigate and mitigate unprecedented uncertainty.

## The top 8 immediate impacts

The instant impacts we are seeing in the short term are wide ranging and include:

1. Immediate loss across a variety of revenue streams including membership/services and earned revenue
2. Additional expense and operational complexity to continue service delivery, deploy a remote workforce, and to operate across local, regional, national and international jurisdictions. Contractual third-party relationships may also be strained
3. A reduction and/or changes to the way mission related services are delivered to communities and constituents
4. The wellbeing and subsequent disenfranchisement and dilution of the workforce
5. Volatility in the investment portfolio returns of many funders/private donors
6. Compromises to financial, operational and technology controls
7. Difficulties in meeting regulatory obligations and deadlines
8. Risk of non-compliance with stakeholder reporting requirements and engagement

There are some levers that NFPs can pull to stem the tide of immediate negative impacts on their organisations. Currently, cashflows and other forecasting models need to be revised and redeveloped. Leaders need to consider if any non-critical assets can be used to fund cash shortfalls and look at work force strategies that not only ease pressure on cash flow but will still deliver on the organisation's purpose. These strategies also need to be balanced with the safety and wellbeing of team members, volunteers, communities and constituents. The Government has set up a COVID-19 Community Awareness and Preparedness Fund Grant, and injected an additional $27m into the sector for select social services.

Communication is also key; crisis communication plans for both donors and team members need to be executed. You team members also need to be across polices about remote work arrangements, and any potential operational, financial and technology control gaps need to be assessed against a remote working environment.

An immediate focus also needs to remain on stakeholder access to quality programmes and services.

## Building resilience in the long term: 3 critical impact areas

Resiliency starts with a commitment to identifying and mitigating risk factors that can further disrupt an organisation. For example, as COVID-19 moves with rippling effects to every aspect of society, it will cause potential longer-term implications that need to be addressed; here's three impact areas that we see as critical.

### 1. Liquidity and cashflow management

#### The impact

Many Not for Profits will discover that their 'new normal' has increased operational complexity along with a cost structure that is no longer fit for purpose. Uncertainty around the type and amount of revenues going forward will also contribute to this challenge, and current financial and operational models that no longer reflect reality will limit the effective management of the organisation on an ongoing basis. Working capital is also likely to be constrained along with the capability of any investment portfolios that provide operational support. And course, these factors lead to the inability to demonstrate financial health to external parties to meet debt covenants.

#### The opportunities

Not for Profits can build resilience in this area by:

- Preserving and managing cashflow, and revisiting lending terms
- Assessing the composition and performance of any investment portfolios and evaluating reserve levels and funding strategies
- Revisiting the organisation's strategy by considering strategic revenue enhancement and cost reduction opportunities

**2. Supply and demand**

**The impact**

Changes in the way programmes and services are delivered can put a strain on tools and technology. The labour, materials and infrastructure needed to deliver on an organisation's purpose in times of disruption will also cause a lack of alignment between services, programmes and capacity.

**The opportunities**

Identifying areas in the market where there is duplication of effort is often overlooked as a cost saving strategy for Not for Profits. Building strategic alliances with like-minded organisations with a similar mission and purpose can enable pooling of resources, sharing of costs and even some bargaining power when negotiating contracts with suppliers.

> Investing in workforce optimisation and transformation is a highly effective way of building resilience within an organisation, regardless of industry.

**3. People**

**The impact**

NFPs' workforce expectations and culture will evolve along with the pandemic, which means people strategies will need to change as well; this often starts with managing team members' expectations while making any necessary updates to their compensation, benefits and contracts. Managing a changing internal culture will also require increased stakeholder communication along with extra support for mental and physical health and wellbeing.

**The opportunities**

Investing in workforce optimisation and transformation is a highly effective way of building resilience within an organisation, regardless of industry. In the meantime, regular and transparent communication with team members needs to be a priority; good communication strategies help nurture great cultures. Part of this will involve ensuring that particular policies are up to date, clearly communicated and accessible for all staff. A good place to start is the organisation's formal working from home policy which should include provisions for future organisational, structural and delivery scenarios. And don't forget that there are organisations out there who want to support the NFP sector so that the great work charitable organisations are doing for our communities can continue.

Microsoft is offering Office 365 E1 free for 6 months to volunteers; this package includes Teams as well as email, file storage and more. Teams will be particularly useful for maintaining a healthy culture and level of communication; its video conferencing facility and other collaboration tools can make "business as unusual" feel a lot more like business as usual. CommunityNet Aotearoa have published a fantastic range of resources about working from home as well.

## Communicate. Collaborate. Innovate.

Above all during this time of uncertainty, now is as good a time as ever for not for profits to create open channels of communication with each other and other stakeholder groups. Innovative solutions for different ways of working and delivering services will require strong, collaborative relationships - both old and new.

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# Can the Primary Healthcare sector leverage opportunities created by COVID-19?

It's been a rough ride for primary health care providers in New Zealand over the past few months to say the very least. At the beginning of lockdown in late March, they had just two days to transform their practices. Most went from delivering nearly 100% of their consultations in person, to delivering around 75% of these online during the peak of the crisis.

## A new way of operating that works for everyone?

Some silver linings have emerged from this crisis.

Every practitioner I've spoken with has said that during the very first week of conducting online consultations, they quickly realised that they should have made these changes years ago, and that they envisaged that the way they will work in the future will change for the better.

Primary care practitioners, like other professionals, now have a prime opportunity to reduce operating costs and increase margins by minimising the level of investment they currently make in infrastructure – a significant outgoing for most practices. Traditional brick-and-mortar surgeries can be consolidated into shared premises for practitioners that can deliver a mix of in person appointments and online consultations. Consolidated practices will also increase the number of registered patients per practice.

With lower total costs, funding might go further.

The biggest difference will be in the ongoing acceptance and availability of online consults. We know that this will be taken up readily by many Kiwis – there's a huge convenience factor. By staying home, seeing the doctor online and potentially having a contactless prescription delivered, we could help to reduce the spread of colds, flu, and of course the Coronavirus.

Some offshore labour could potentially be utilised, for instance in triaging, to bring down the cost of labour.

New and innovative ways of operating could also be a positive change for future practice owners. At present, we have an ageing demographic of practitioners and a shortage of people willing to buy their

practices so they can retire. A new model of working may attract young doctors into practice ownership.

## Missed opportunities by Government

Budget 2020 woefully lacked support for the primary healthcare sector; the Government failed to take advantage of the rapid progress practitioners made in terms of digital telehealth and didn't appear to provide any incentives to enhance the gains already made in this area.

Without more support, some primary healthcare practices will be forced to close; many are just weeks away from completely running out of cash. A survey of 50 general practices throughout the Auckland region conducted by ProCare reveals that 48 are trading at a loss. The survey was carried out during lockdown level 4 and the results prompted General Practice New Zealand Chair Jeff Lowe to ask Health Minister David Clark for urgent additional funding.

We know from experience that when a GP practice closes, it rarely reopens. That service is lost to the local community and health tends to suffer as a result, contributing to the kind of healthcare inequality that we all want to avoid.

Now that we have entered alert level 1, GPs are almost certainly going to experience a massive influx of patients – a tsunami is the word some commentators have used.

Pent-up demand for medical treatment is not the same as the demand we have for other products and services. There is no bake-your-own bread equivalent for health diagnostics. For instance, it's estimated that every month in New Zealand over 1,000 cancers are detected in routine screening tests. You can defer the testing, but the cancer will still be there. And that's only one example; anyone who has been avoiding the doctor may have had their condition worsen during lockdown and all those people will now be converging on their local GP practice.

These patients will undoubtedly cause a bottleneck in the public health system along with those who have to cancel their health insurance after a job loss or business downturn.

All this after locums have had their hours reduced, or in many cases they've had their allocated sessions cancelled entirely. Those who have found work in other sectors will not be available if an upsurge in patients occurs. We may have lost them from the sector for good.

## Supporting the sector that's on the front line

The primary health care sector could see positive changes in the long run, but practices need immediate treatment for their cashflow shortages. While there are lots of opportunities for practitioners to consider, COVID-19 still ripped the band-aid off the financial challenges they have always faced.

We locked down the nation to save lives and ease the burden on our public health system, now it's time to lock in some serious cash for a sector that's on the front lines of this crisis.

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# Opportunity and sacrifice: How do we pay for NZ's recovery?

This year, the Government borrowed a hefty $60 billion to account for greater uncertainty in the wake of COVID-19. Massive spending is an essential way to protect New Zealand – our people and our economy – from the worst effects of the pandemic. But it does raise one important question: Who's going to pay for all this?

To improve New Zealand's financial position, we have to do exactly what any individual household does when it takes on a big mortgage – cut our expenses, find a way to earn more money, or both.

## Can we let economic growth alone fund the recovery?

We're all hopeful that by the end of 2020 the worst of the COVID-19 recession will be behind us and the economy experiences strong growth. It's possible that the economy will grow enough to generate higher tax revenue, slowly repaying the debt that we're currently racking up without making any other sacrifices. Helen Clark has indicated she prefers this longer-term repayment strategy; it has the advantage of leaving all our current spending intact.
We may also be able to grow foreign investment with incentives to make New Zealand more attractive to big businesses, capitalising on the reputational boost New Zealand's had from our crisis response. Once border restrictions are eased, changes to our immigration laws could attract highly skilled new residents to help with current and future projects, also boosting our economy and tax pool. That would be a good win.

But considering the hit we've taken to our GDP, and the fact that slow repayment leaves us more vulnerable to another crisis, it seems likely the Government will want to do more than just wait it out and hope for the best.

## Cutting superannuation spending

Assuming we can't just wait for more taxes to help pay off our debt, how do we cut our spending? There are two obvious areas which can make an enormous difference: superannuation and taxes.

Superannuation for everyone over 65 is eye-wateringly expensive and has been a looming problem for a long time. As our population ages, the burden of paying this long-lasting benefit to an increasingly healthy (and often wealthy) group falls to a proportionately declining percentage of tax-paying New Zealanders. Even before we were hit with coronavirus, the superannuation equation was looking dangerously imbalanced.

Raising the superannuation age to 67, then gradually to 70, would accurately reflect how our quality of life has improved. The age for superannuation between World War II and the 1990s was 60, then it increased to 65 between 1992 and 2001. There's no reason that couldn't be repeated. The saving to the Government would be vast and with so much upheaval now, it might be a time when Kiwis will accept that a change like this is needed.

Superannuation could also be made available only to those who need it – the independently wealthy could be excluded by creating a wealth or income cap. In Australia, the majority self-fund their retirement, with only a few receiving government superannuation.

To help New Zealanders achieve more retirement savings in their personal accounts, the way KiwiSaver is taxed could be changed to make it far more attractive to invest. Over time compulsory contributions by savers and employers could increase in small affordable percentage steps, just like Australia has done for almost 30 years. More money in KiwiSaver is a win for everyone because it means more funds for first-home buyers and it provides a pool of investment capital for local projects and business.

## Tax changes to boost our income

This crisis is also a chance to think of the big picture and introduce tax changes that could help reduce inequality and spread the burden across society. These include:

- **Stamp duty or land tax.** Australia, the UK and Singapore are examples of nations that collect a stamp duty on property purchases. Potentially we could limit this to purchases by foreign investors; although that would be only a small increase in revenue, it would be more palatable from a political perspective
- **Capital gains tax.** It has been considered and abandoned many times, but finding a way to tax capital is essential to reducing inequality
- **Estate tax, wealth taxes, or both.** The bar can be set high, as it is in the USA, so this has only a modest impact on small estates but takes a bigger bite out of the wealthiest ones. This could be an alternative to CGT
- **Changing our tax brackets.** Leaving the lowest tax brackets as they are, decreasing the tax rate in the middle, and then raising it for incomes above $300,000 for instance. The 33% tax paid on income over $70,000 is relatively high when compared to similar nations, so that could be reduced, but income over $300,000 or $400,000 could be taxed at 45% or even 50% which seems extreme but would not be outside the rates of some of our larger trading partners
- **Taxing income vs capital.** Our tax system already places a disproportionate tax burden on those with incomes rather than those with capital. A fair balance will be hard to perfect politically. Those at the very top of the income scale have options, and those with offshore capital will wave goodbye to the New Zealand tax system altogether. The increase to 39% back in April 2000 is a classic example of these groups voting with their feet

There's no easy answer here, but without taxing wealth we are missing out on a big piece of the income puzzle which most successful nations have deeply integrated into their systems.

## And don't forget the deferred maintenance

As we strive to cut our spending and increase our incomes, this giant piece of property on which we've taken out a huge loan also needs a lot of work. Think of New Zealand as a large house filled with people, where a lot of the basic maintenance work has been deferred for many years. Ask any homeowner and they'll tell you that the roof won't wait to leak until you've saved up enough money to pay for it. While we pay back our debt, we need to strengthen and maintain our infrastructure: roading, schools, water supplies, rail, and national parks. Our health system also needs so be future proofed for potential future virus outbreaks. All at an immense cost.

## A chance for change – but not without sacrifices

Households all over New Zealand are cutting their spending, looking for ways to increase their incomes, meet their debt obligations and still fix that leaky roof. The Government is facing all the same challenges and choices, on a national scale.

This Government has the opportunity to be bold and take strides towards improving the future of the country. But no matter what decisions are made, every opportunity comes with sacrifices and costs.

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# How COVID-19 changes M&A due diligence

## Diligence with 20/20 vision

Nothing in recent history has changed the business landscape as drastically or as quickly as the COVID-19 pandemic, and resulting predicted recession, which presents a real challenge for mergers and acquisitions. Market multiples, past cash flow generation, and other measures based on performance formed the foundation of due diligence. But what good are historical measurements when the future may no longer reflect history?

Like the rest of the world, transactions in New Zealand have slowed down dramatically. Borders are closed, international travel is restricted, and though the immediate health risk appears to have been thwarted, our way of life, and our way of doing business, has changed. Management is consumed with weathering the immediate crisis while trillions of committed capital wait for the dust to settle. But deals will resume. In fact, the pandemic may create a wave of new deals as troubled companies look for exit strategies and investors look for a market correction. In some industries, companies may exit the pandemic healthier, attracting a new round of interested sellers. Given these M&A opportunities, how can buyers and sellers accurately gauge value and risk going forward?

Navigating this new terrain, buyers will be more diligent in their approach, while sellers will need to prepare for increased scrutiny. Historical business information may be less useful and will be carefully dissected as an accurate predictor of future performance. There will also be increased focus on forward-looking information, including, forecasts, budgets, backlogs, and pipelines, along with qualitative factors regarding changes in business practices.

## Due diligence for the COVID-19 era

In a post-pandemic world, buyers must understand not only the direct impact of COVID-19 on the target but also management's response to the crisis and the pandemic's effects on near- and long-term operations. These steps will provide increased visibility to achieve maximum returns on investment. Below are five areas of supplemental due diligence that buyers and sellers should consider.

### Expanded EBITDA benchmarks

Consider a pro forma adjustment to reflect 2020 financials under normal operations. The months directly affected by the pandemic are likely not representative of historical financial performance nor indicative of future results. While COVID-19 will adversely impact most companies, some businesses may experience a temporary or permanent benefit, so consider the specific facts. There is no one size fits all approach. The key focus here is to understand the "new normal" of the company. Following are some methods for quantifying the pro forma impact:

- Compare EBITDA trends for the quarter before COVID-19 (on a seasonally adjusted basis) to impacted months and management's near-term forecasts
- If momentum for financial performance appears to be stabilising for a series of months, the annualisation of EBITDA for the most recent quarter(s), adjusted for seasonality, may help determine the impact of COVID-19. Shorter reference periods will likely be less reliable than a quarter or half-year approach
- Benchmark EBITDA trends of the company relative to industry peers
- Benchmark performance against growth rates from prior years and future year projections.
- With uncertainty clouding the immediate future, understanding operating leverage and breakeven points become more important to model how a change in revenue or costs impacts EBITDA and a time horizon to achieve stability

### Top-line impact

In addition to looking at profitability metrics (e.g., EBITDA margin), it is important to understand the short- and long-term COVID-19 revenue impact.

- Analyse sales trends before, during, and after the pandemic by customer, product, end-market, and channel. This will provide a structure for assessing which key market trends will most impact the top-line performance. Further, it will help identify risks in sectors expected to have extended recovery periods
- Consider the company's position in the value chain and potential for lagged pandemic impacts. While businesses with global supply chains were affected early on, certain verticals and sectors may experience lagged effects not yet reflected in historical financials
- Focus on forecasts in addition to historical results and carefully review budgets, backlogs, and pipelines. Consider historical win rates, budget vs. actual performance, and post COVID cancellation rates
- Some companies may alter standard practices with increased acceptance of returns and discounting in response to changes in aggregate demand. Other companies may find limited supply provides opportunities to increase pricing

### Vendors and supply chains

Understand the timing and resulting changes in the company's supply chain recovery. Consider the company's suppliers and key sourced materials (particularly for sole-sourced materials). Determine if there will be permanent changes resulting from the adaptation process.

Does the company have reliable sources for the timely delivery of the quality materials, and will those relationships survive the pandemic?

- What will be the ongoing impact on vendors and product pricing?
- Does the company have vendor agreements with purchase commitments? With supply chain disruption and changing purchase volumes, consider whether purchase commitments can be met, and penalties for not meeting these obligations
- Is the company considering diversifying supply risk to multiple vendors or alternative countries? If so, what are the impacts on margin, order fulfilment and quality?

### Employees and contractors

Payroll is commonly a company's most significant expense. Many businesses have been forced to make difficult personnel-related decisions, including reducing working hours and making cuts to the workforce. Understand any financial or operational ramifications of the company's personnel decisions.

- Pay attention to headcount fluctuations during the crisis. Will the company be able to rehire the workers needed to resume operations as the crisis recedes—

especially skilled and experienced team members?
- Did the target receive the Government's wage subsidy? If so, do current employee expenses need to be normalised?
- Understand whether the target temporarily deferred compensation to employees or reduced employee salaries. Further, has the company delayed pay out of severance, deferred salaries, payroll taxes or bonuses? Consider whether funds should be left behind at close for settling these deferred obligations

## Working capital and additional debt-like items

Given the upheaval of COVID-19, historical accounting methodologies may not reflect all risks on the balance sheet. Additionally, historical working capital may not accurately reflect working capital needs going forward. With the disruption affecting all levels of business, a fresh look at accounting methodology is warranted.

- Consider the trends and potential deterioration of the target's accounts receivable portfolio. Has the company updated its allowance for bad debts to reflect the risk of these assets and to offset inflated AR levels?
- Has a drop in demand resulted in extended aging of inventories? Consider the need for additional inventory reserves for spoilage, slow-moving, excess and obsolete inventory. This consideration will avoid inflated inventory balances from skewing net working capital
- How is the company accounting for any wage subsidy or government support? Is the company accruing for deferred payroll taxes?
- Analyse accounts payable trends of your target and whether extended payables should be considered indebtedness in closing agreements
- Look for rent concessions granted and consider treatment as debt in closing agreements

COVID-19 is also adding significant complexity to how sale and purchase agreements are negotiated and drafted – look out for our other article on five areas to consider when negotiating a deal right now.

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