National Australia Bank

Quarterly SME Survey — June quarter 2013

SME confidence & conditions improve significantly with activity of smaller firms outperforming larger firms for the first time in almost four years. SME conditions strengthened across most industries – especially in the service based sectors – suggesting lower interest rates and a lower AUD may be helping. Forward indicators still subdued overall, implying limited near-term improvement in demand.

- SME business confidence improved significantly in the June quarter, edging higher than larger firms (NAB Quarterly Business Survey) and rising a touch above the series average. SMEs optimism may have gained from a lower AUD and easier monetary policy settings. This quarters' confidence reading represents the first time in three years that SMEs have been more optimistic than their larger counterparts. By industry, confidence lifted significantly in property services and construction, possibly due to improving expectations in response to lower borrowing costs, although confidence was relatively unchanged for finance services. Confidence improved strongly in Queensland, SA and Victoria & is now similar across states
- SME business conditions also improved markedly in the June quarter, with activity of smaller firms outperforming their larger counterparts but remaining relatively subdued compared to the series average. Smaller firms generally performed better than larger businesses, in particular, those in finance and business services. Business conditions varied significantly across industry groups by a range of 38 points, with manufacturing firms remaining heavily depressed. The large variance between industry groups highlight that the multi-speed economy is persisting for SMEs. Business conditions strengthened across every state, with particularly solid improvements in Queensland and South Australia, but net balances for all states were negative except for Victoria.
- Improvements in forward orders, employment conditions and investment suggest an improving outlook for SMEs; these indicators have edged higher than levels reported by larger firms.
- The improvement in business confidence in the June quarter was broadly based across all SME business sizes.
- Responses to a special question suggest that in the past twelve months, almost two-thirds of SMEs developed or improved their websites to improve competitiveness, while one-third of respondents reduced their prices.

Key quarterly business statistics**

	2012q2	2013q1	**2013q2**		2012q2	2013q1	**2013q2**
		Net balance				*Net balance*	
SME business confidence	-11	**-5**	**2**	SME trading conditions	-4	**-6**	**3**
Low	-7	**-7**	**2**	Low	-9	**-12**	**-6**
Mid	-13	**-6**	**0**	Mid	-4	**-10**	**5**
High	-13	**-4**	**3**	High	-2	**0**	**6**
SME business conditions	-8	**-7**	**-2**	SME profitability	-12	**-11**	**-5**
Low	-12	**-10**	**-7**	Low	-15	**-11**	**-9**
Mid	-6	**-10**	**-2**	Mid	-11	**-14**	**-3**
High	-8	**-4**	**0**	High	-12	**-8**	**-4**
SME cash flows (n.s.a.)	-13	**-6**	**-3**	SME employment	-8	**-5**	**-3**
Low	-20	**-13**	**-7**	Low	-13	**-7**	**-5**
Mid	-9	**-9**	**-8**	Mid	-3	**-6**	**-5**
High	-13	**-1**	**3**	High	-10	**-4**	**-3**

Low: $2-3m p.a. Mid: $3-5m p.a. High: $5-10m p.a.

** Data are seasonally adjusted by NAB, except SME cash flow (insufficient time series available). All data are net balance indexes. Fieldwork for this Survey was conducted from 27 May to 13 Jun 2013 covering almost 700 SME firms across the non-farm business sector.

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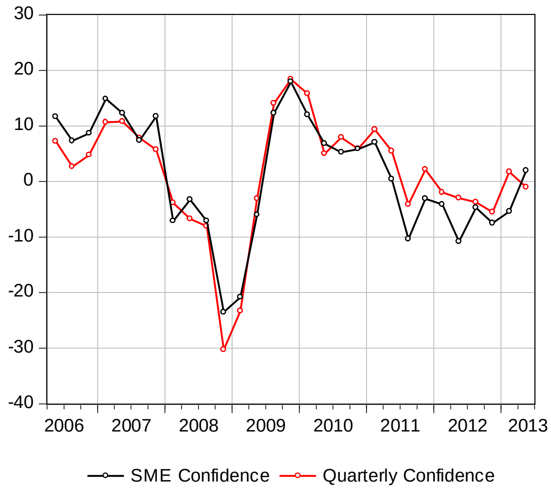
Next release:
13 August 2013 (July Monthly)

Analysis

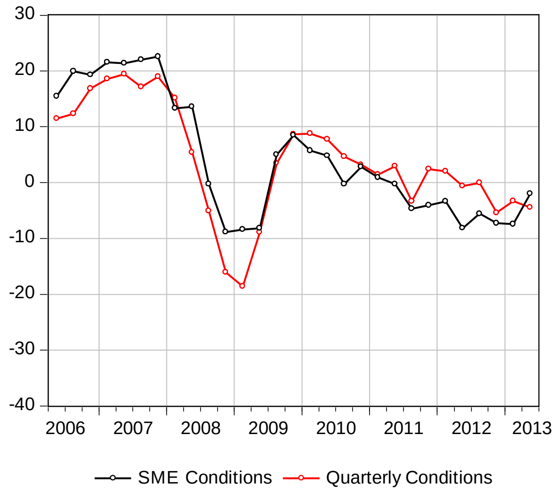
Confidence improved sharply, edging above larger firms

Business confidence (net bal., s.a.), SME & quarterly



Conditions pick up, slightly better than larger firms

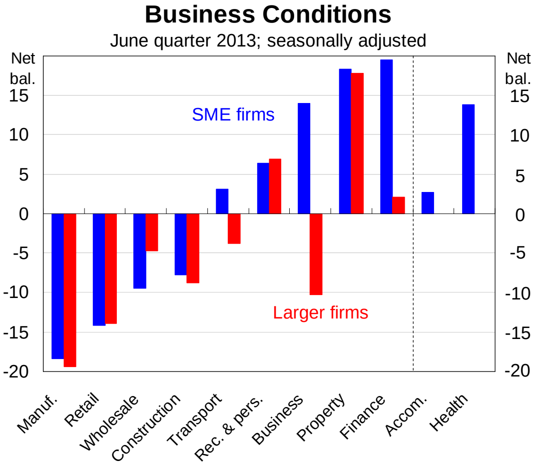
Business conditions (net bal., s.a.), SME & quarterly



SME business confidence improved significantly in the June quarter – up 7 points to +2 points – with the index rising to the highest level in two years, to be a touch above the series average (of +1 point since mid-2006). While smaller firms have tended to be less optimistic than larger firms in recent years, SME confidence readings surpassed their larger counterparts in the June quarter for the first time in three years. The relatively better sentiment reading for smaller firms may be related to the improvement in business conditions than external economic developments which were generally mixed (lower domestic interest rates and AUD, but financial market jitters. Low-tier firms became notably more confident in the quarter, while confidence picked up in mid-tier and high-tier firms.

SME business conditions improved solidly in the June quarter – up +5 to -2 index points – but remained well below the series average (of +4 points since mid-2006). Almost all industries reported a strengthening in business conditions in the June quarter suggesting the economy may be benefiting from the lower interest rate and exchange rate environment. Nonetheless, sub-par business conditions suggest that either lower interest rates need more time, or more momentum needs to build in the economy. Business conditions of larger firms deteriorated slightly, to be a touch weaker than their SME counterparts.

SME firms performing better than their larger counter parts.

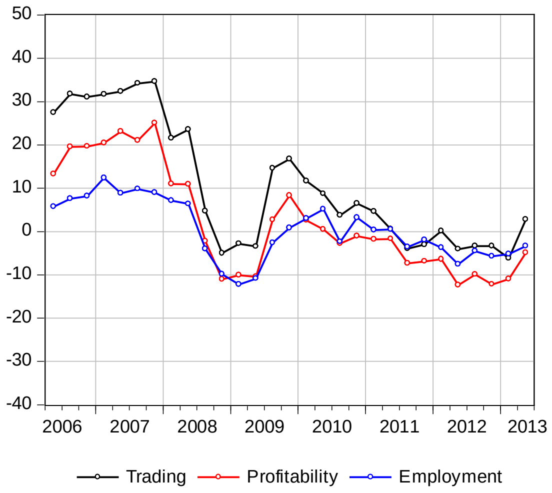


A comparison of industry conditions for SMEs and larger sized firms (taken from NAB's Quarterly Business Survey) suggests that there was only marginal variation between conditions of the very poor performing consumer and trade dependent industries across firm sizes, but variations between the service based industries were quite marked. Both smaller and larger property services firms performed strongly in the quarter, while finance and business services significantly outperformed their larger counterparts. Conditions of SME health services firms strengthened considerably in the June quarter.

Analysis (cont.)

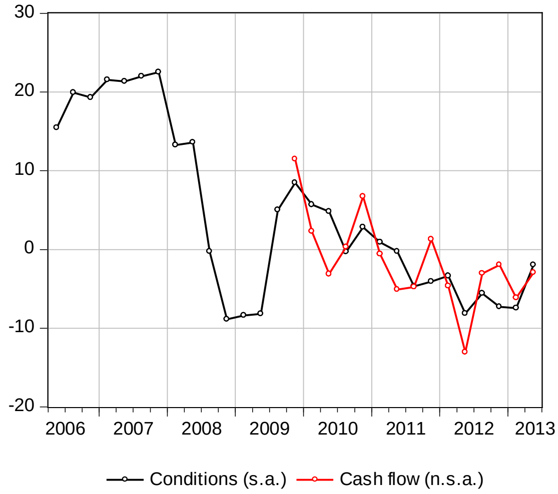
Profits, employment & trading conditions strengthen

SME business conditions components (net bal., s.a.)



Cash flows improve

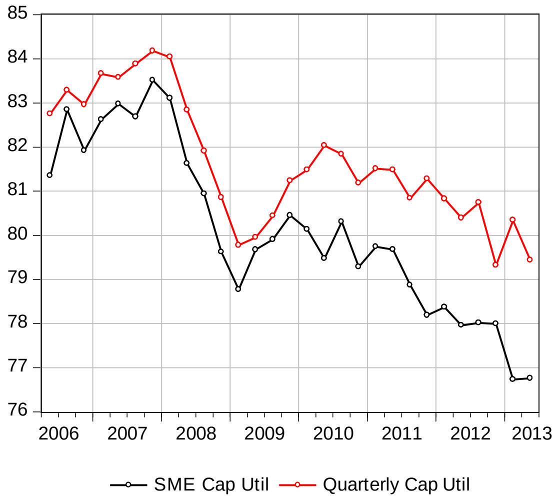
SME business conditions & cash flow (net bal.)



The lift in SME business conditions reflected solid improvements in profitability and trading conditions and a slight up tick in employment conditions. SME cash flows (not seasonally adjusted) improved in the June quarter, unwinding a fall in the March quarter.

Utilised capacity remains broadly unchanged

Capacity utilisation (per cent, s.a.), SME & quarterly



Orders trending upwards, edging higher than larger firms

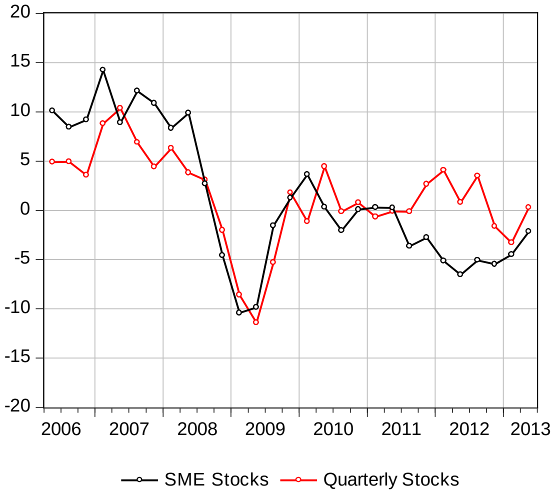
Forward orders (net bal., s.a.), SME & quarterly

Capacity utilisation was broadly unchanged at 76.8% in the June quarter. This outcome is well below the series average of 80.1%, and significantly below the level of utilised capacity experienced by larger firms. In the quarter, a modest increase in utilised capacity of mid-tier firms (up 1.0 ppt to 70.2%) was largely offset by a fall in capacity utilised by low-tier firms (down 1.1 ppts to a new low of 74.8%); utilised capacity of high-tier firms was little unchanged at a relatively higher level (77.8%). Across industries, capacity utilisation was very low in manufacturing (70.2%) and accommodation, cafes & restaurants (72.6%), while it was highest in property services (83.6%) and health services (83.1%). Forward orders of SMEs improved in the quarter, rising from -9 to -4 points, surpassing their larger counterparts. Forward orders strengthened across all industries, with the exception of manufacturing, where they fell modestly and remained very subdued (-18). The most notable improvements in orders were in construction (up 20 to +5 points) and accommodation, cafes & restaurants (up 13 to +7 points). The pick up in forward orders across all firm sizes implies less weakness in near-term domestic demand.

Analysis (cont.)

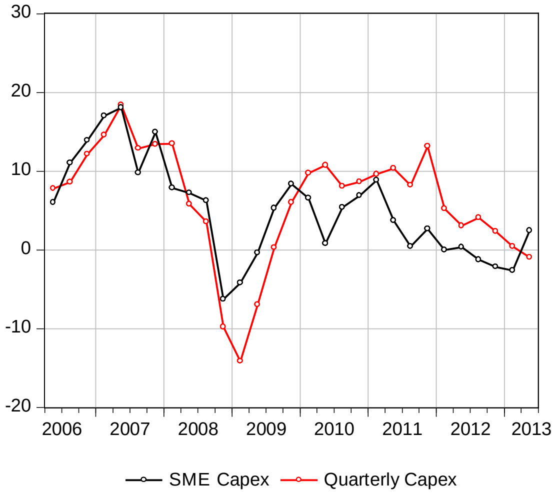
De-stocking continues but at a slower pace

Stocks (net bal., s.a.), SME & quarterly



Investment activity increases

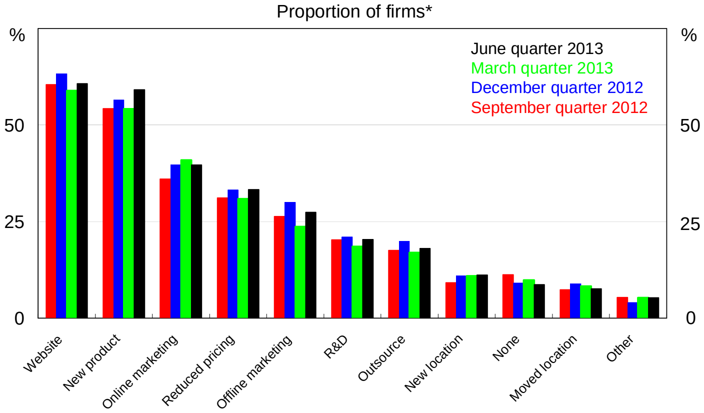
Capital expenditure (net bal., s.a.), SME & quarterly



The SME stocks index continued to trend upwards in the June quarter – mirrored by a sharp increase in the index for larger firms. While the SME stocks index has risen in recent quarters, it remains in negative territory, implying a reduction in inventories in the quarter; this is consistent with increased trading activity. The capital expenditure index picked up sharply in the quarter, outpacing larger firms for the first time since December quarter 2009.

A majority of firms continue to increase their online presence to boost their competitiveness in the market

Strategies employed over past 12 months to improve competitiveness
Proportion of firms*



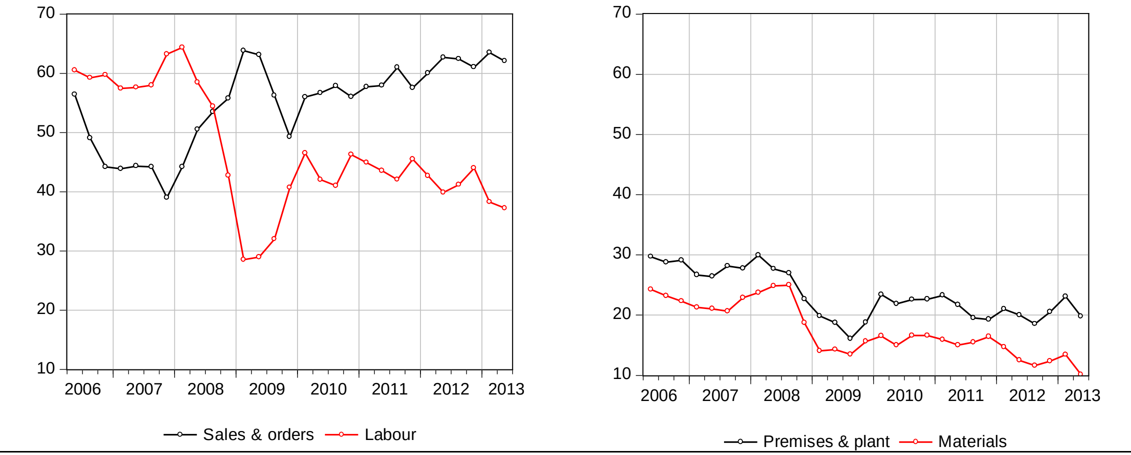
* Multiple responses allowed; will not sum to 100%
Source: NAB Quarterly SME Survey

In the June quarter SME Survey, we again asked firms whether they had employed any new strategies over the past 12 months in an attempt to improve competitiveness in the market. The results show that almost two thirds of all respondents developed or improved their websites, while more than half of firms launched new products to try to strengthen their position among their competitors (see Graph). Firms are increasingly reducing their prices in an effort to improve competitiveness. Only a small proportion of respondents either moved or opened new locations to try to improve competitiveness.

Analysis (cont.)

Sales and orders increasingly constraining output

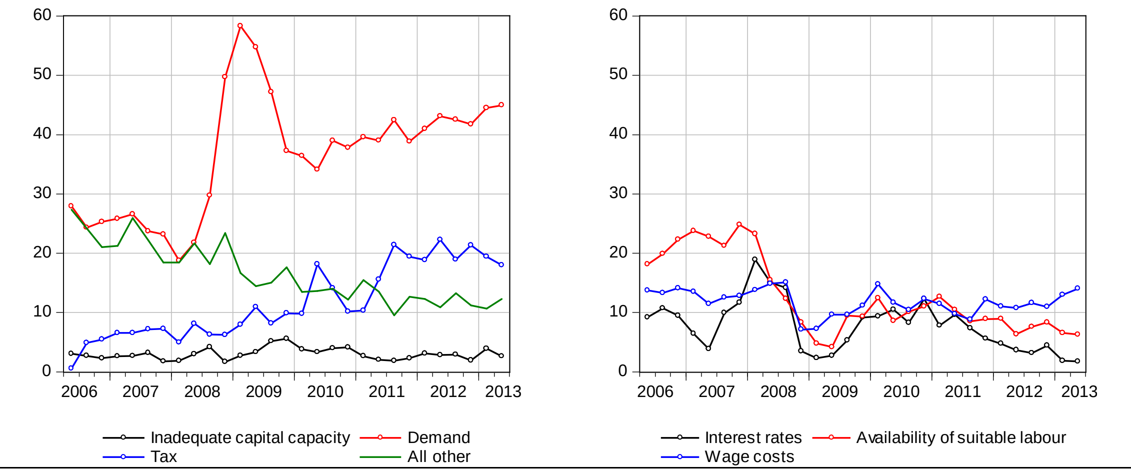
Constraints on current output (% of firms)



Sales & orders remained the most constraining factor for SMEs in the June quarter, although a slightly smaller proportion of firms reported it as a constraint than in the March quarter. This outcome is consistent with a solid improvement in trading conditions. While still relatively constraining, the availability of suitable labour became less of a constraint on output in the quarter – possibly reflecting a reduced need for new labour in the current soft business environment. Labour availability appears to be more of an issue for SMEs than for their larger counterparts. The labour market remains in a soft patch at present and the difficulty of obtaining suitable labour appears fairly benign for all firms sizes compared to pre-GFC levels. The importance of premises & plant and materials as constraints fell, and remained relatively unimportant, broadly similar to larger firms.

Lack of demand expected to increasingly constrain profitability; interest rates and lack of capacity less important

Main constraint on profitability in next 12 months (% of firms)

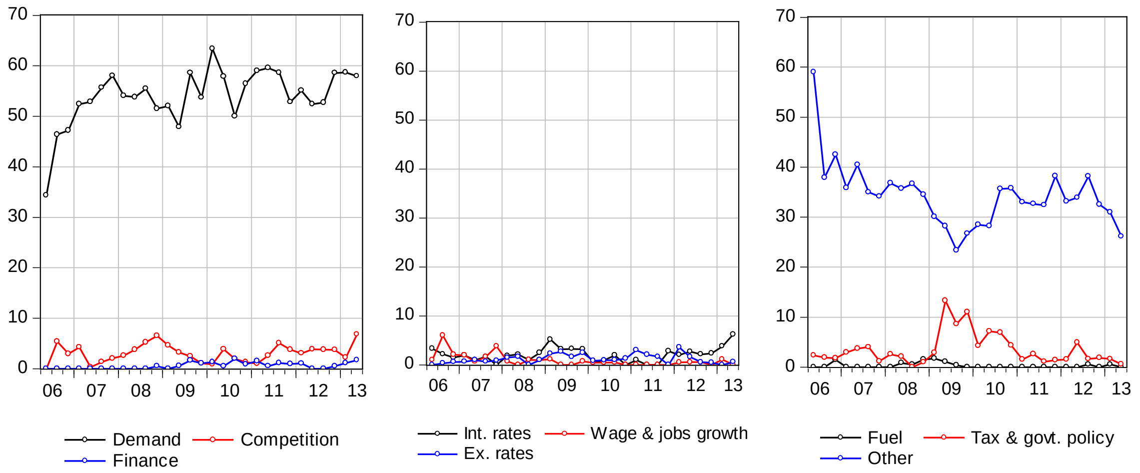


In the June quarter, lack of demand remained the number one factor expected to constrain profitability over the next 12 months – there has been a clear upwards trend in the proportion of firms indicating lack of demand as a constraint over the past three years, consistent with a general deterioration in trading activity over this time. The proportion of firms concerned about the impact of changes to tax policy on future profitability has remained at a relatively elevated level over the past two years. Only a very small proportion of firms are concerned about the impact of interest rates on future profitability, with this factor declining in line with the fall in borrowing costs. The availability of suitable labour and wage costs also appeared of little concern to SMEs.

Analysis (cont.)

Demand still driving improvements in trading performance – lower interest rates and improved competitiveness also helping

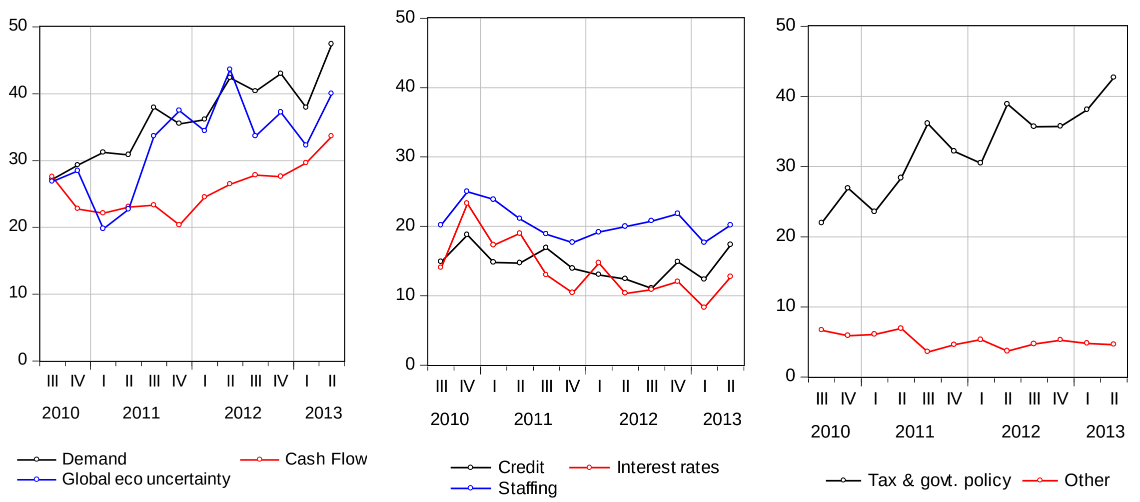
Main reason for improvement in trading performance (net balance)



Trading performance improved in the June quarter, mainly supported by demand, with a significant proportion of firms noting this as a key driver. “Other” reasons as a contributing factor to improved trading continued to ease further in the quarter though remained relatively significant overall; this largely reflects seasonal and company specific factors. Tax & government policy appears to have provided very little support to trading performance in the quarter.

SMEs most constrained by a lack of demand and tax & government policy

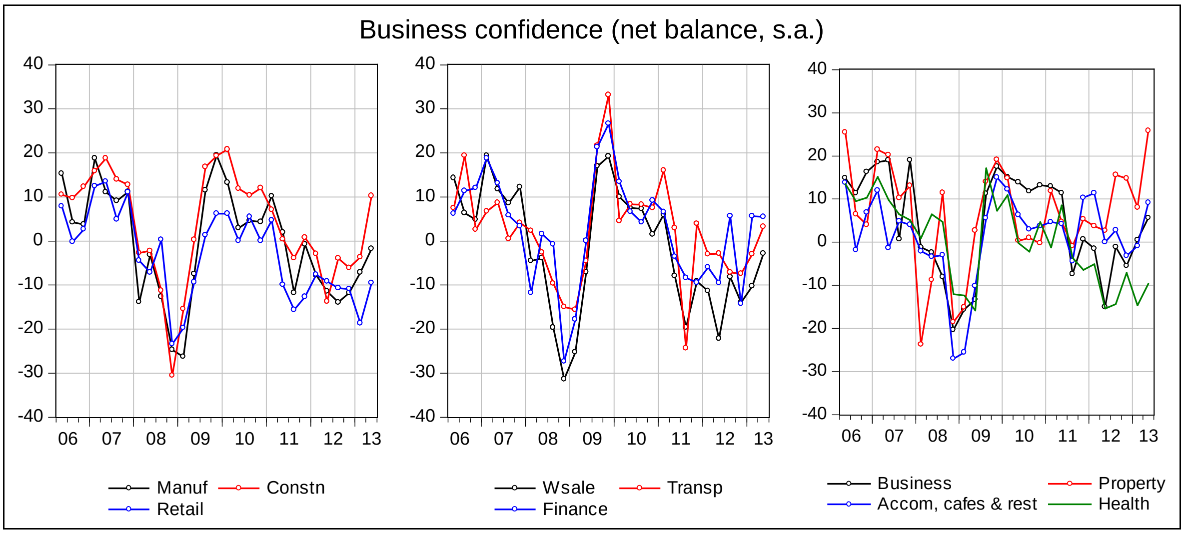
Most significant constraining factors for SMEs (per cent, multiple response)



The ability of SMEs to make longer term decisions became increasingly constrained by demand, tax & government policy, global economic uncertainty and cash flow with these factors increasing in significance in the quarter. Firms appear to be increasingly concerned about credit, even though borrowing costs have eased after the RBA lowered the cash rate in May. Concerns over tax & government policy have picked up moderately in the lead up to a Federal election.

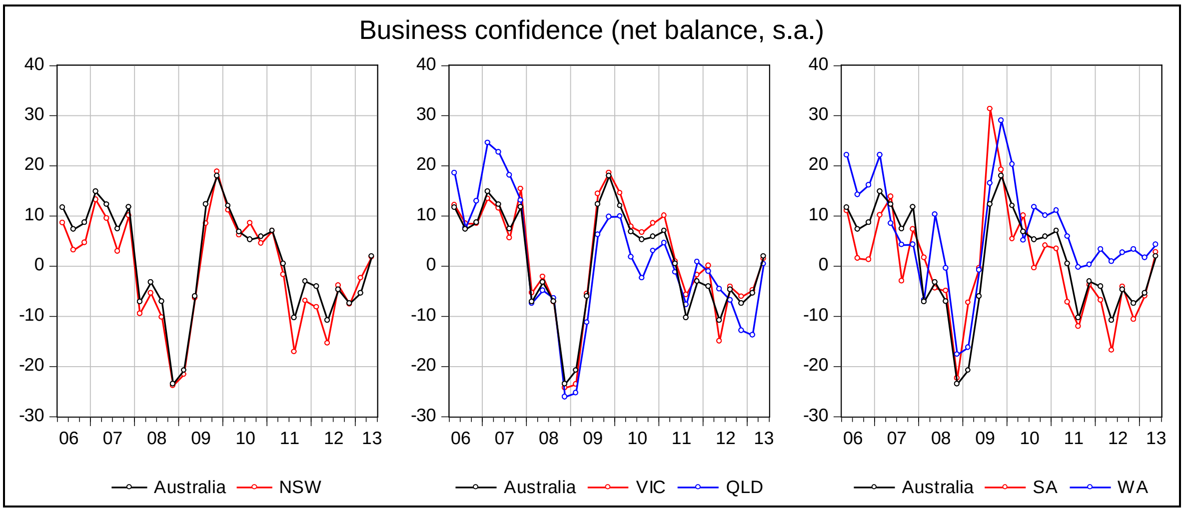
Industry and State analysis

Property services & construction most optimistic; retailers & health services very pessimistic



Business confidence lifted across a majority of industries in the June quarter, with a particularly sharp rise reported in property services (up 18 to +26 points) and construction (up 14 to +10). Confidence is skewed towards residential construction optimism. Finance services was the only industry to report a deterioration in confidence (down 1 to +5 points). Confidence was strongest in property services and by far the lowest in retail and health services (both -10).

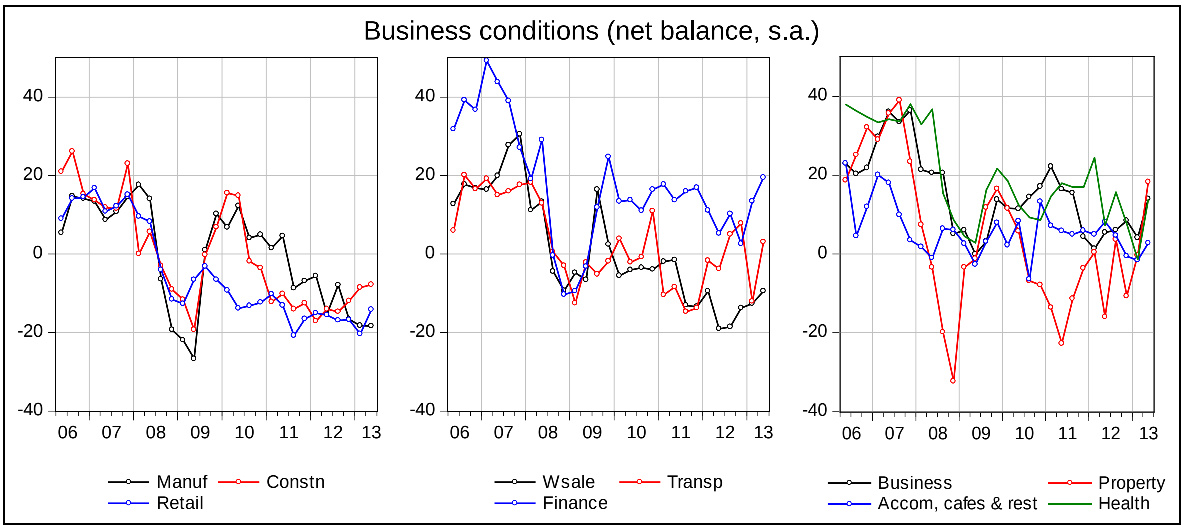
Business confidence up across all states; particularly pronounced in Queensland



Business confidence improved in all states. Marked improvements were reported in Queensland (up 14 to zero), SA (up 9 to +3) and VIC (up 6 to +1). Confidence lifted modestly in NSW and WA. Overall business confidence in Australia lifted by 7 points to a net balance of +2 points in the June quarter.

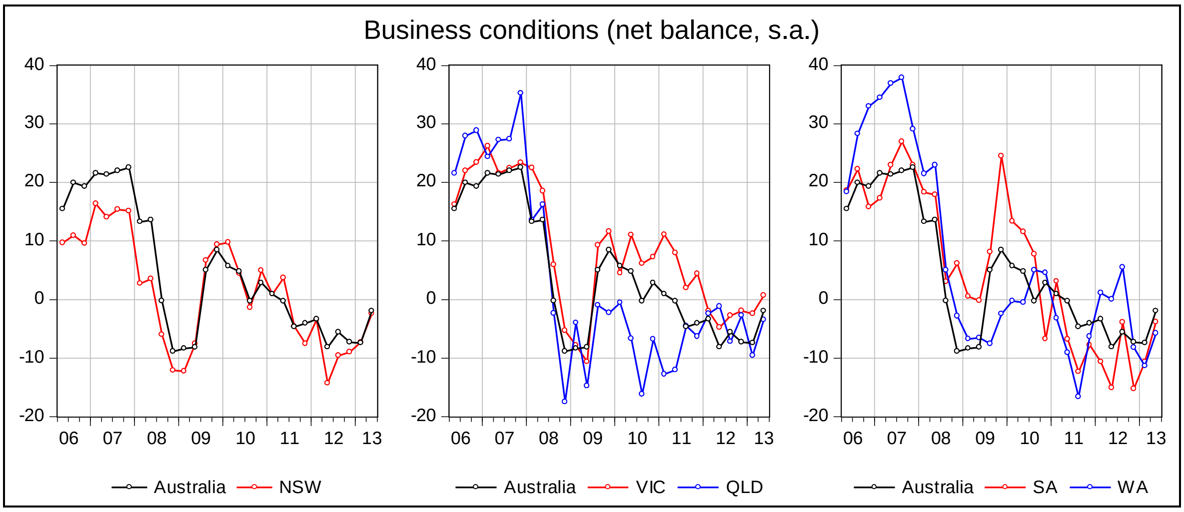
Industry and State analysis (cont.)

Conditions improve sharply in property services, health and transport



Business conditions improved solidly in property services, health services and transport; while activity was a little better in construction and wholesale, and unchanged (at a very low level) in manufacturing. SME conditions were strongest in finance (+20), property services (+18), health services and business services (both +14). In contrast conditions were weakest in manufacturing (-18), retail (-14), wholesale (-9) and construction (-8). Although business conditions have improved on last quarter, overall conditions still remain negative (-2) and below the series average of +4 points since mid-2006. Business conditions of larger firms were slightly weaker, at -4 points in the quarter.

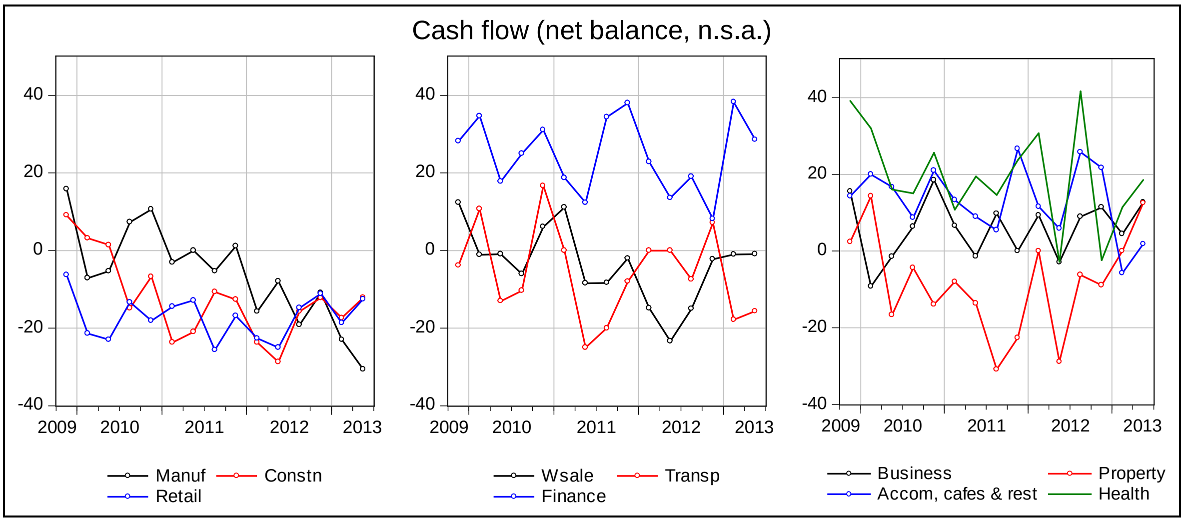
Conditions strengthen, notably in SA, WA & QLD, while Victoria & NSW still performing better overall



Business conditions strengthened across all states in the June quarter, most strongly in SA and at a more subdued pace in Victoria. Overall, SME conditions were strongest in Victoria (+1), while they were most subdued in WA (-6), SA (-4) and Queensland (-3).

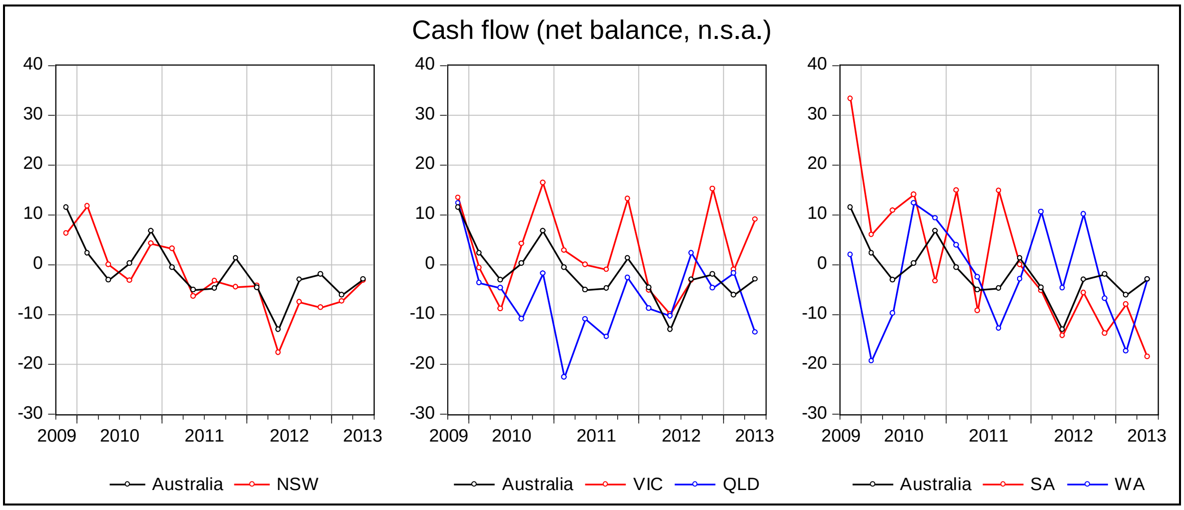
Industry and State analysis (cont.)

Cash flows very strong in finance; very weak in manufacturing, retail, construction and transport



Cash flows (not seasonally adjusted) improved across all industries, with the exception of manufacturing (consistent with poor trading activity) and finance, while cash flows were broadly unchanged in wholesale. Cash flow improved most significantly in property services, business services and accommodation, cafes & restaurants. Cash flows were strongest in finance services (+29), health services (+19), business and property services (both +13), while they were very poor in manufacturing (-31) and transport (-16).

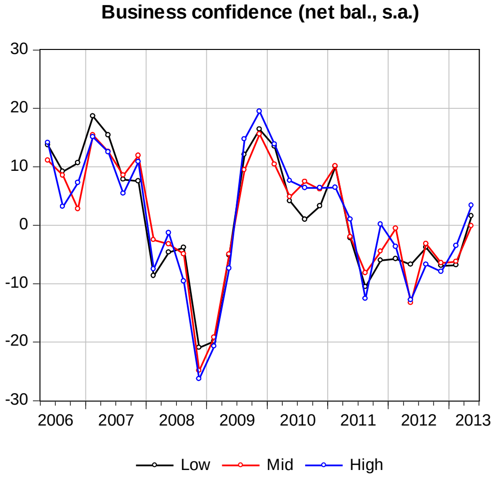
Cash flows strongest in Victoria, weakest in South Australia

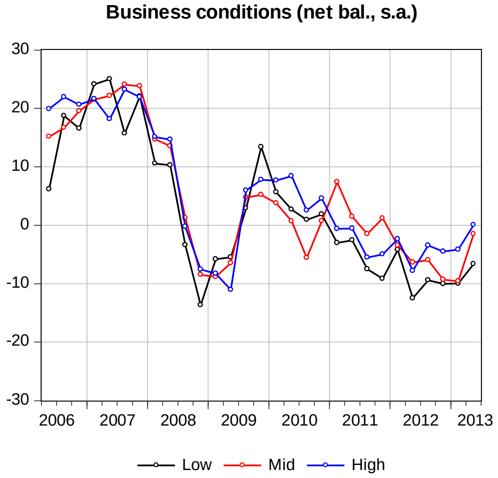


The modest improvement in overall cash flows (not seasonally adjusted) in the June quarter was largely a result of strong outcomes in Victoria and WA. Cash flows in WA seem to have been supported by strong improvements in profitability and trading conditions. In contrast, cash flows fell sharply in Queensland & South Australia. In levels terms, cash flows were strongest for Victoria, WA and NSW, while they were weakest for South Australia and Queensland.

Firm size analysis

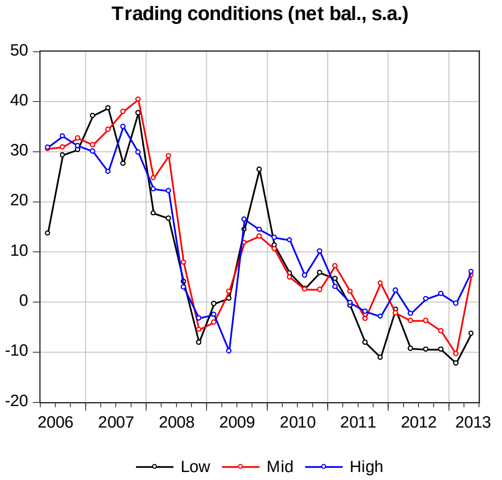
Confidence and conditions relatively stronger for high-tier SMEs

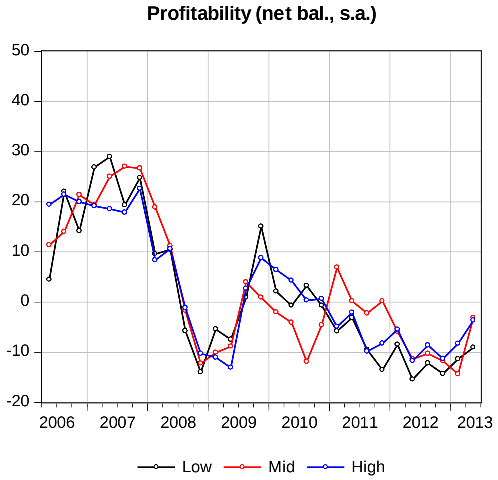




The improvement in business confidence was broadly based across all SME firm sizes in the June quarter. Confidence improved most significantly for low-tier firms ($2-3m p.a.), while high-tier ($5-10m p.a.) and mid-tier firms ($3-5m p.a.) recorded a solid improvement in confidence. Overall confidence across SME firm sizes remained relatively similar, ranging from zero points for mid-tier SMEs, to +3 points for high-tier SMEs. Conditions improved most notably for mid-tier firms (up +8 to -2 points), while they improved modestly for high-tier (up +4 to zero points) and low-tier firms (up +3 to -7 points).

Trading conditions & profitability strengthen across all SMEs; mid-tier firms' conditions improve significantly

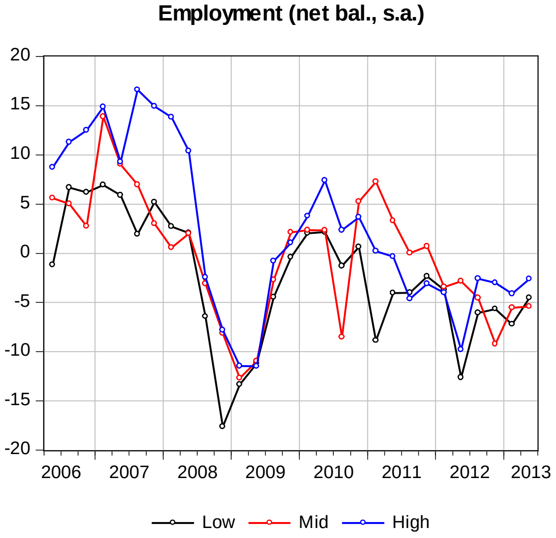


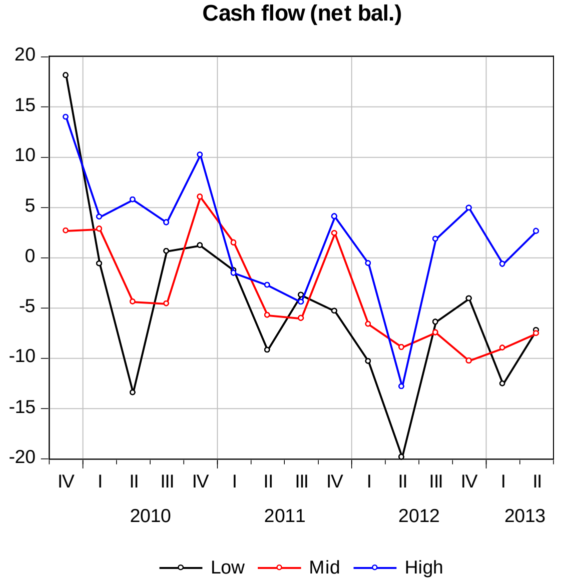


Trading conditions improved significantly across all SME sizes in the June quarter. A particularly solid improvement was reported for mid-tier firms (up 15 to +5 points). Trading also improved for high-tier-firms (up 6 to +6 points) and low-tier firms (up 6 to -6 points). SME profitability also strengthened and was the most pronounced for mid-tier firms (up 11 to -3 points). Profitability of high-tier firms improved strongly (up 4 to -4 points), while it marginally better for low-tier firms (up 2 to -9 points). The improvement in profitability for SMEs is consistent with better margins. Although labour costs increased modestly in the quarter, they remain relatively subdued compared with the series seven-year average.

Firm size analysis (cont.)

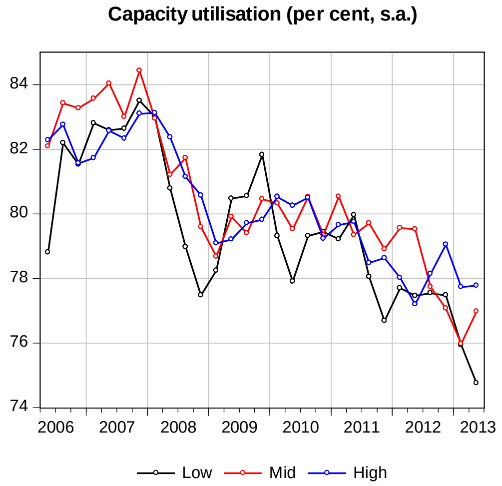
Employment conditions & cash flows improve across all SMEs

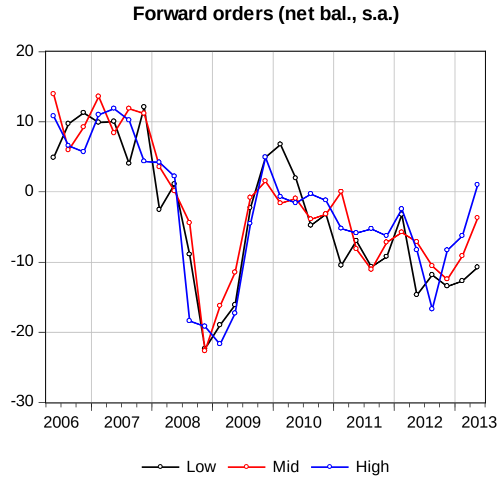




SME employment conditions improved slightly in the June quarter. Employment conditions improved modestly for low-tier firms (up 2 to -5 points) and it was a touch higher for mid-tier (up 1 to -5 points) and high-tier firms (up 1 to -3 points), entirely unwinding the fall in employment conditions in the March quarter. Overall employment conditions were not too dissimilar across firm sizes, varying by 2 points. Cash flows improved modestly in the June quarter. In levels terms, cash flows remained highest for high-tier firms (+3 points), while cash flows for mid-tier (-8 points) and low-tier (-7 points) SMEs remained relatively subdued. Stronger cash flow outcomes are reflected in better trading conditions for SMEs.

Capacity utilisation slumps for low-tier firms; despite improvement in forward orders





Capacity utilisation for all SMEs was broadly unchanged at 76.8%. However, there were some marked variations in movements across firm sizes. In the quarter, a modest increase in utilised capacity of mid-tier firms (up 1.0 ppt to 77.0%) was largely offset by a fall in capacity utilised by low-tier firms (down 1.1 ppts to a new low of 74.8%); utilised capacity of high-tier firms was little changed at a relatively higher level (77.8%). The level of SME forward orders improved significantly – with levels now ranging between -11 points for low-tier firms and +1 point for high-tier firms – but remained very weak overall, implying little improvement in near-term demand.

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