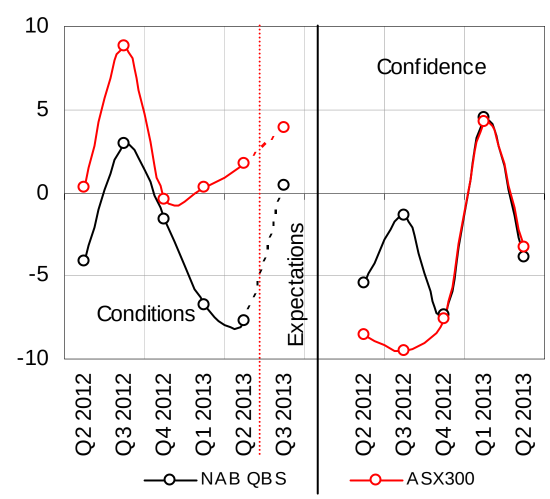
**National Australia Bank**

# Quarterly ASX 300 Business Survey June 2013

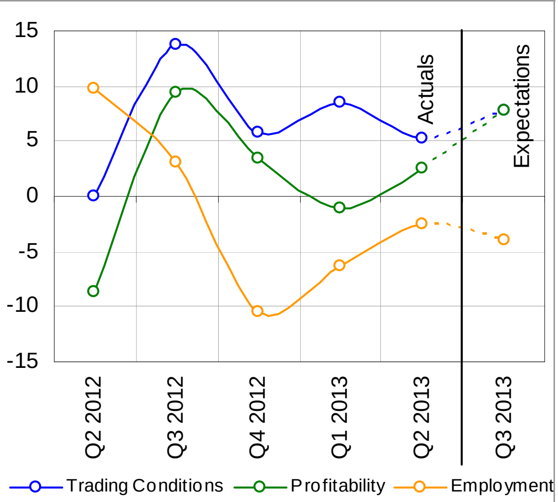
## Stronger conditions for ASX 300 in Q2 – widening the gap to the economy – but confidence fell sharply. Mining conditions fell, now the weakest among ASX 300 firms. Discounting among ASX 300 may be evident. Stocks & orders point to weakness in domestic economy

- ASX 300 firms recorded a slight improvement in business conditions in June, up to +2 points, while trends in NAB's Quarterly Business Survey (QBS) deteriorated a little further – down to -2 points. The improvement in conditions for the ASX 300 was driven by gains in the Transport, Utilities & Communications sector and Manufacturing. There was a decline in conditions for Mining – which recorded the weakest conditions overall, highlighting the transition in the sector over recent quarters.
- Counter to the trends for conditions, business confidence weakened across the economy – with ASX 300 confidence trending in line with the broader economy over the past three quarters. Mining, Finance, Business & Property Services and Construction contributed to this decline.
- The relative softness in the domestic economy remains evident in the measures of sales margins, forward orders and stocks – with each of these measures deteriorating further in the ASX 300 survey than the QBS.
- Cost trends generally worsened for the ASX 300 in the June quarter – with stronger growth in labour costs, and both purchase costs and overheads increasing, while final product prices deteriorated further.
- Capacity utilisation was up for the ASX 300 in Q2, but investment fell sharply – with the capital expenditure measure weaker than that of the broader economy. Manufacturing, the Finance, Business & Property Services sector and Mining contributed most to this decline.
- Cashflows for the ASX 300 were considerably stronger than the broader economy – remaining at +18 points, while conditions in the QBS deteriorated, down to +4 points from +7 points in March.
- While demand was seen as the main constraint for profitability among ASX 300 firms, it was seen as less of an issue for output. These divergent trends may be consistent with further discounting among these firms.

**Business conditions & confidence (net balance, nsa)**




**Business conditions components (net balance, nsa)**




## Key quarterly business statistics**

| Q2 2013 | ASX300 | NAB QBS | | ASX300 | NAB QBS |
|---|---|---|---|---|---|
| | Net balance | | | Net balance | |
| Business confidence | -3 | -4 | Trading | 5 | -7 |
| Business conditions | | | Profitability | 3 | -10 |
| - Current | 2 | -8 | Employment | -3 | -7 |
| - Next 3 months | 4 | 0 | Forward orders | -14 | -8 |
| - Next 12 months | 21 | 13 | Stocks | -13 | -4 |
| Capex plans (next 12 months) | 19 | 15 | Export sales | -1 | -3 |
| | % change | | | % change | |
| Labour costs | 0.39 | 0.27 | Retail prices | 0.08 | -0.04 |
| Purchase costs | 0.27 | 0.36 | | Per cent | |
| Final product prices | -0.26 | -0.11 | Capacity utilisation rate | 84.6 | 79.1 |

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** All data non-seasonally adjusted. Cost and prices data are percentage changes expressed at a quarterly rate. All other data are net balance indexes, except capacity utilisation, which is an average rate, expressed as a percentage. Fieldwork for this Survey was conducted from 27 May to 13 June 2013.

# Analysis

Larger firms in Australia recorded slightly stronger **business conditions** in the June quarter, in stark contrast to weakening conditions for the broader economy.

Respondents to our ASX 300 survey recorded a net balance of +2 points (compared with 0 points in Q1).

Trends remain divergent at an individual industry level. The slight strengthening in aggregate business conditions was driven by a strong improvement for Manufacturing (from steeply negative conditions in Q1) and Transport, Utilities and Communications (see page 6).

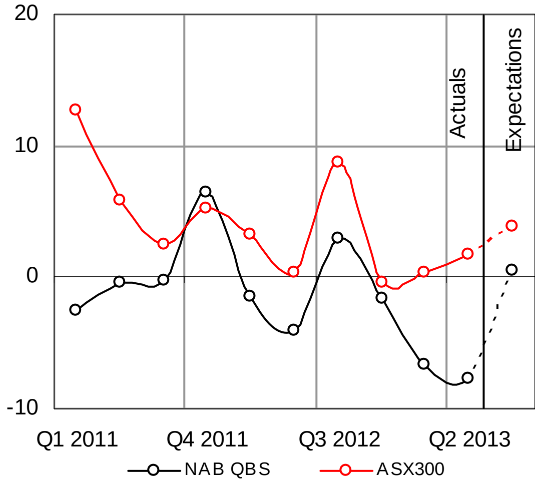
In contrast, business conditions in NAB's Quarterly Business Survey (QBS) deteriorated a little further in Q2, down to -8 points (on a non-seasonally adjusted basis), from -7 points previously.

Short term expectations are marginally stronger for the ASX 300, recording a net balance of +4 points for Q3 2013. The gap between the ASX 300 and the broader economy is tipped to narrow, with a strong recovery anticipated in the QBS, back up to 0 points.

The key driver of the expected improvement in ASX 300 conditions next quarter is Retail, while Mining, Manufacturing and Finance, Business & Property Services also exhibit stronger trends. In contrast, Transport, Utilities and Communications is tipped to soften.

### *Modest gains for ASX 300 widens the gap to the economy in Q2*

**Business conditions (net balance, nsa)**




| net balance | Conditions – current | Conditions – next 3 months | Conditions – next 12 months | Confidence – next 3 months |
|---|---|---|---|---|
| ASX 300 | 2 | 4 | 21 | -3 |
| NAB QBS | -8 | 0 | 13 | -4 |

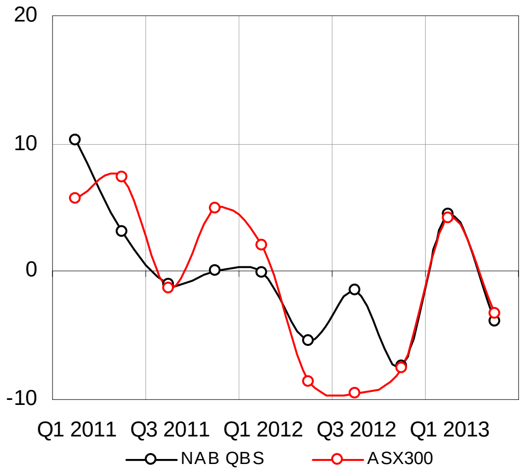
Despite the improved conditions for the ASX 300, **business confidence** weakened across the economy in Q2 2013, continuing the trend of close correlation between the two surveys.

Firms in the ASX 300 recorded a net balance of -3 points in our latest survey (compared with +4 points previously), while confidence in the QBS fell to -4 points (from +4 points in March).

For the ASX 300, the decrease in confidence was driven primarily by the Mining and the Finance, Business & Property Services sector, while confidence in Wholesale improved (see page 6).

### *ASX 300 confidence continues to trend in line with the economy*

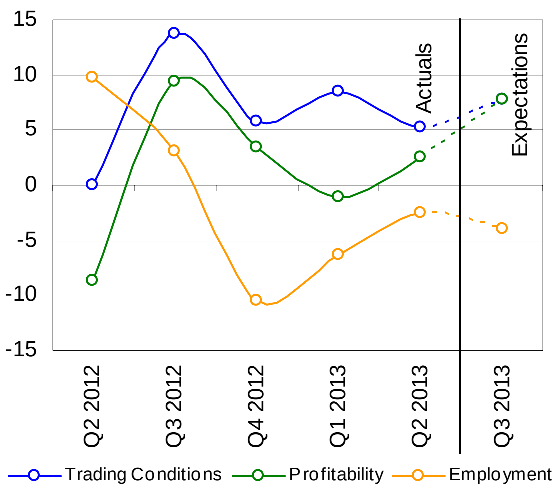
**Business confidence (net balance, nsa)**




| net balance | Trading Conditions | Profitability | Employment | Sales margins | Forward orders | Stocks |
|---|---|---|---|---|---|---|
| ASX 300 | 5 | 3 | -3 | -22 | -14 | -13 |
| NAB QBS | -7 | -10 | -7 | -20 | -8 | -4 |

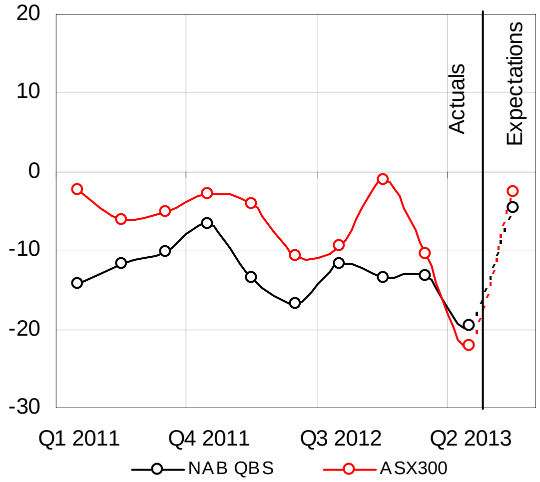
## Profits and employment push ASX 300 conditions a little higher

**Business conditions components (net balance, nsa)**




## Sales margins fall sharply in June quarter for ASX 300

**Sales Margins (net balance, nsa)**

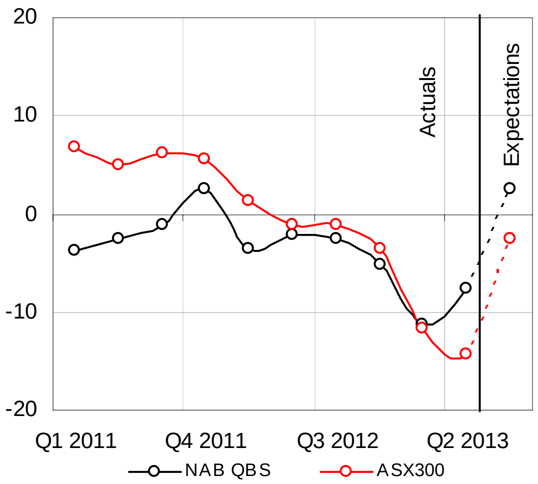



Improving trends for employment and profitability drove the increase in aggregate business conditions. Employment levels remain negative – at -3 points (but improved from -6 points in Q2), while profitability was +3 points, from -1 point previously. In contrast, trading conditions eased back to +5 points (from +8 points in March). Profitability is the key component driving the increase in expected conditions in Q3, with gains in trading conditions offset by a softening in trends for employment.

The improved trends for profitability were somewhat at odds with weakening trends in sales margins. ASX 300 firms recorded at net balance of -22 points in the June quarter, down from -11 points in our previous survey. Margins also declined in the QBS, though less significantly – down to -20 points from -13 points previously. The decline in margins may indicate a further signs of discounting among ASX 300 firms.

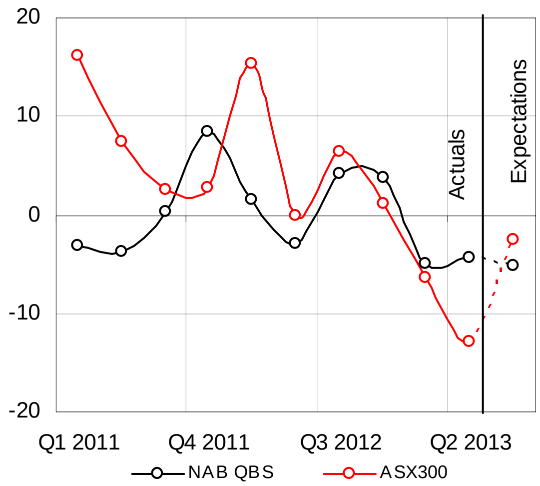
## Forward order trends worsened for ASX 300, slight uptick for QBS

**Forward Orders (net balance, nsa)**




## ASX 300 stocks fall further in June, counter to stabilising trend in QBS

**Stock levels (net balance, nsa)**



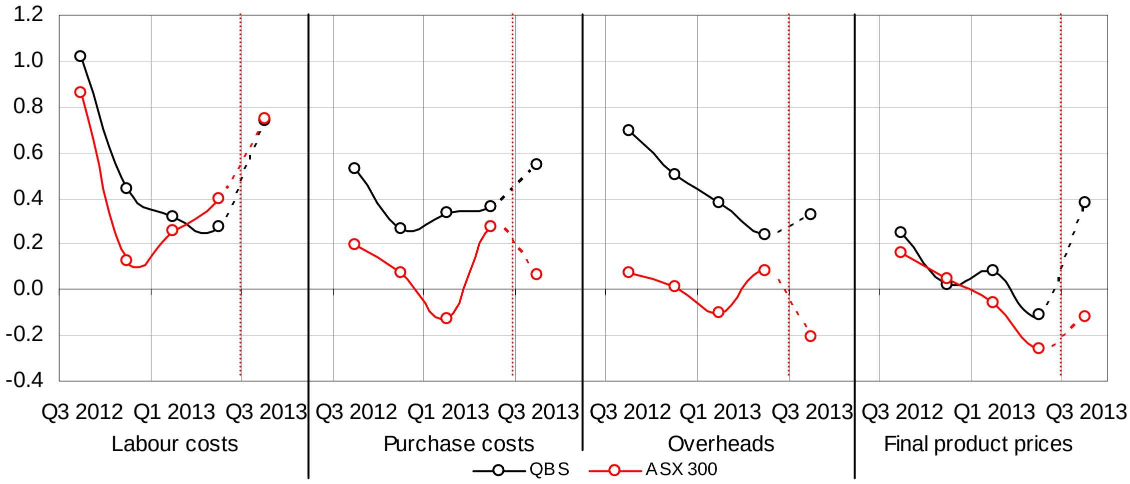

Forward orders have continued to deteriorate for the ASX 300– with the measure at -14 points in June, down from -12 points previously. In contrast, forward order trends improved for the broader economy, albeit remaining negative at -8 points (from -12 points in the March quarter). Short term expectations are also stronger in the QBS, at +3 points, compared with -3 points for ASX 300 firms.

Stock levels  for the ASX 300 also declined further in the June quarter, down to -13 points (from -6 points in Q1), while the measure was unchanged for the QBS at -4 points. ASX 300 firms tip a rebound – albeit to still negative levels of -3 points in Q3, while stocks are expected to ease to -5 points for the QBS.

The current levels for both forward orders and stocks are indicative of softness in the economy at the present time.

## ASX 300 firms faced rising costs in the June quarter, as final prices weakened further

**Costs & Product Prices (qoq %, nsa)**



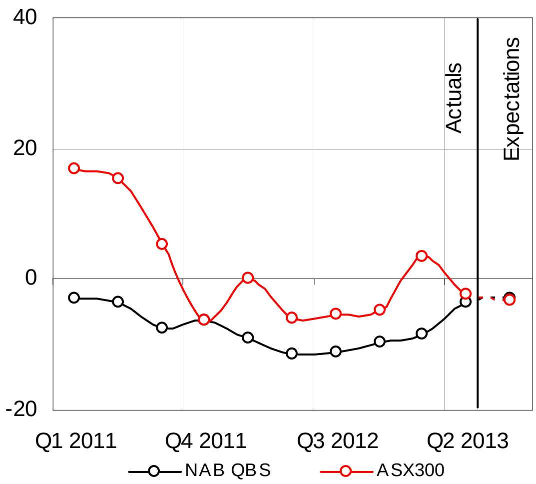

Cost trends generally worsened for the ASX 300 in the June quarter – with stronger growth in labour costs, and both purchase costs and overheads increasing (after recording declines in Q1). Labour costs increased by +0.4% in Q2, compared with +0.3% in the QBS. Purchase costs and overheads for the ASX 300 increased by +0.3% and +0.1% respectively (compared with declines of -0.1% for both measures last quarter).

As cost pressures increased during the quarter, final product prices deteriorated further – in line with weaker sales margins. ASX 300 prices fell by -0.3% in June, compared with -0.1% in the QBS.

The expectations for Q3 are highly mixed among the ASX 300. Labour costs are tipped to increase significantly – back up to +0.7% (in line with expectations for the broader economy), while trends for both purchase costs and overheads are expected to soften. ASX 300 respondents anticipate further falls in final product prices at -0.1%, in contrast to strong expectations in the QBS.

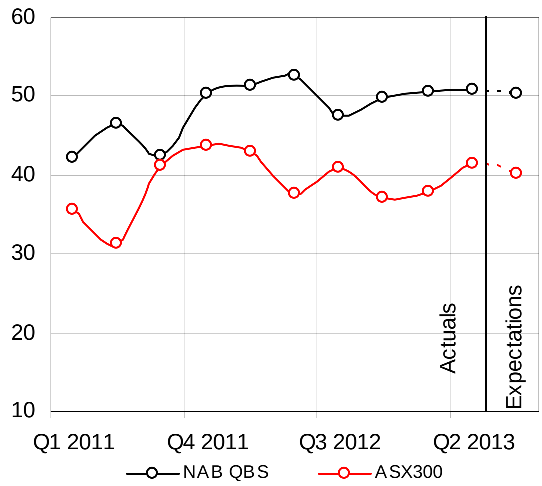
## Borrowing conditions back to negative for the ASX 300 in Q2

**Ease of obtaining borrowings (net balance, nsa)**




## A larger share of ASX 300 report no borrowing requirements

**No borrowings required (%, nsa)**

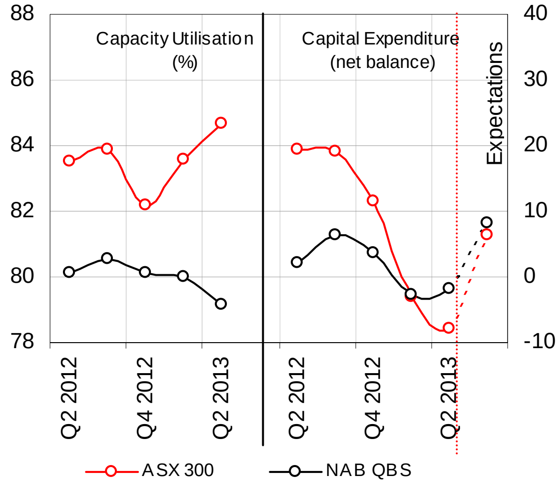



Borrowing conditions softened in Q2 for the ASX 300 – with ease of obtaining borrowings falling to -2 points (from +3 points in the March quarter) – in line with the broader economy. Short term expectations are essentially flat – with both surveys recording a net balance of -3 points for Q3 2013.

A slightly larger share of firms in the ASX 300 reported no borrowing requirements in Q2 – at 42% (compared with 38% in March), while the share in the QBS was flat at 51%. For ASX 300 firms, only a modest decline in this share is expected in the third quarter, down to 40%.

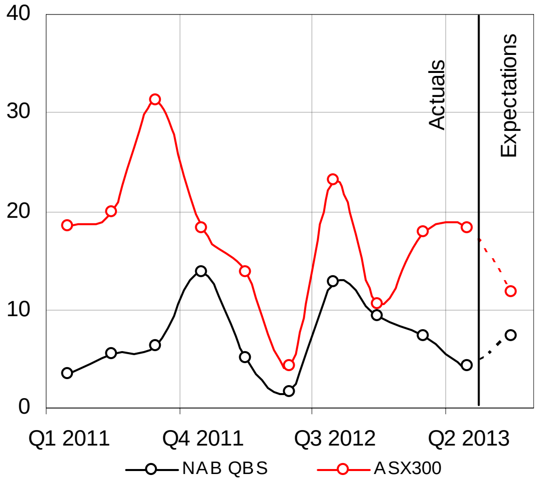
## CapU rises for the ASX 300, but capex has fallen significantly

**Capacity Utilisation and Capital Expenditure**




## Cashflow trends remain divergent, with ASX 300 outperforming

**Cashflow (net balance, nsa)**



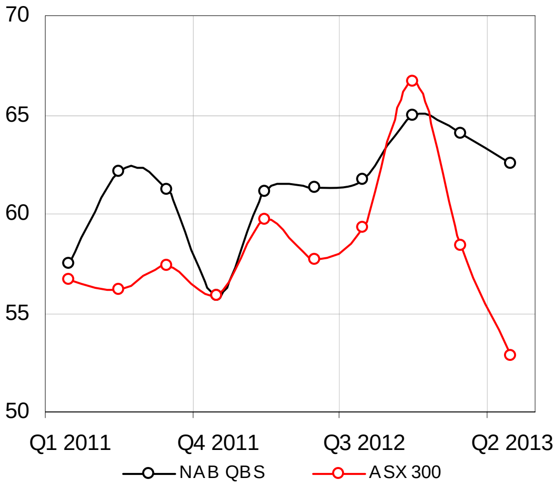

Trends for capacity utilisation diverged between the two surveys – with ASX 300 firms reporting stronger utilisation, at 85% (compared with 84% in March), while utilisation fell to 79% in the QBS (from 80% previously).

Capital expenditure trends have continued to deteriorate over recent quarters – with ASX 300 capital expenditure at -8 points in Q2 (compared with -2 points in the QBS). Capex for the ASX 300 has fallen sharply over the past year – in Q2 2012, it was +20 points. Manufacturing, Finance, Business & Property Services (FBP) and Mining contributed most to the decline this quarter (see page 7).

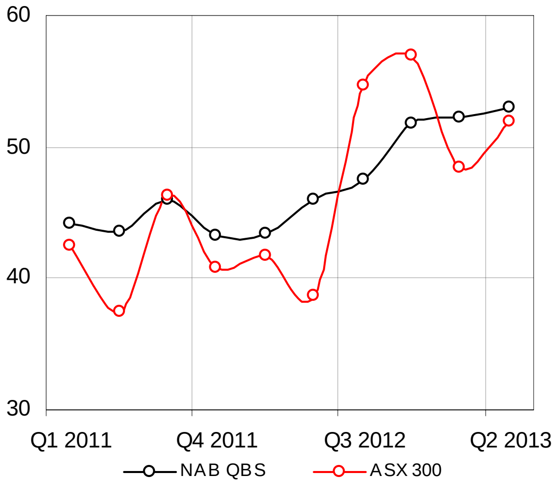
Firms in the ASX 300 report considerably stronger cashflow trends than the broader economy. ASX 300 firms recorded a net balance of +18 points, unchanged from the level in Q1, while cashflow for the QBS declined to +4 points (from +7 points previously). The main contributors to the decline were Mining, Manufacturing and FBP. Short term expectations are for cashflow trends to converge – with a pickup in the QBS and declines anticipated in the ASX 300 survey.

## Demand is less of a constraint on ASX 300 output, but still impacts profits – discounting may have been a characteristic of larger firms in Q2

**Constraints on output (% of firms) – Sales & Orders**




**Main constraint on profitability (% of firms) - Demand**




There was a notable decline in the number of ASX 300 firms noting Demand (Sales & Orders) as a constraint on their output – with the share falling from 58% of firms in Q1 to 53% in June. Firms in the QBS continued to cite sales & orders as a key constraint – at 63% in our latest survey (down from 64%).

In contrast, demand remains the main constraint on profitability in both surveys – at 52% for ASX 300 firms and 53% for the QBS. The divergent trends in these measures for the ASX 300 may be consistent with further discounting among these firms.

# Industry analysis

## *Business conditions: Transport and Manufacturing push overall conditions higher, but Mining continues to soften – now the weakest sector*

There remain some highlight divergent trends in **business conditions** by industry. Only two sectors recorded significant improvements in Q2 – **Transport, Utilities & Communications** (TUC) – the strongest sector at +50 points (from +12 points previously) – and **Manufacturing**, which moved up from -20 points to +3 points.

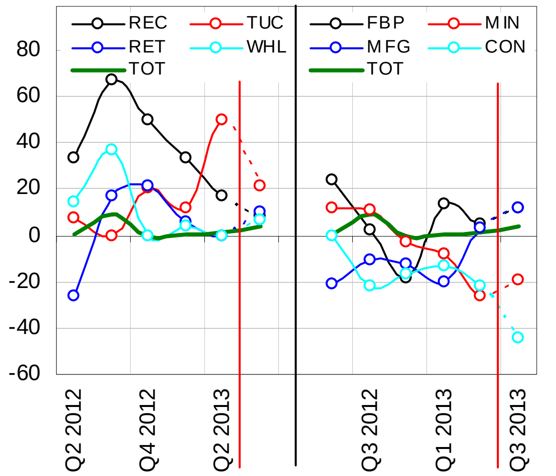
These positive trends were countered by a decline in the **Mining** sector, with conditions falling to -26 points (from -8 points previously) – the weakest level overall, highlighting the transition that has occurred in the sector over recent quarters.

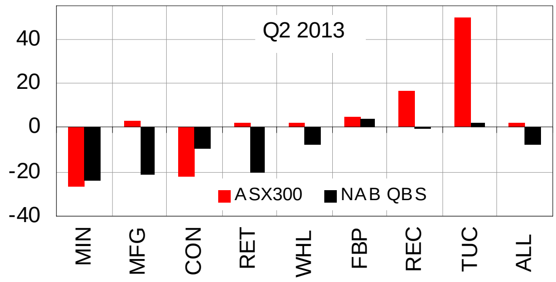
There was also a large decline for the **Recreational & Personal Services** (REC) sector, although this had a lower impact on the overall level of conditions due to a limited sample size.

In terms of expectations, the modest improvement expected in business conditions is driven by stronger trends in **Retail**, **Mining**, **Manufacturing** and **Finance, Business & Property Services** (FBP), but tempered by negative trends in **TUC** and **Construction**.

Compared with trends in the QBS, ASX 300 firms recorded stronger business conditions in **TUC**, **Manufacturing**, **Retail** and **REC**, but weaker conditions in **Construction** and **Mining**.

**Business conditions (net balance, nsa)**




## *Business confidence: Lower levels for confidence led by Mining, Finance, Business & Property and Construction, while Wholesale was stronger*

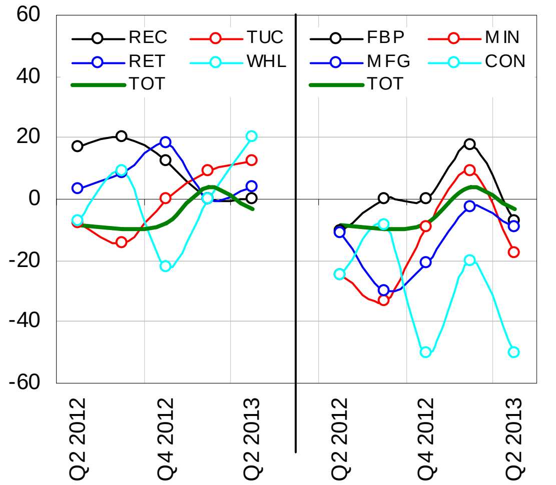
After narrowing considerably in Q1, the range of **business confidence** by industry widened again the June quarter.

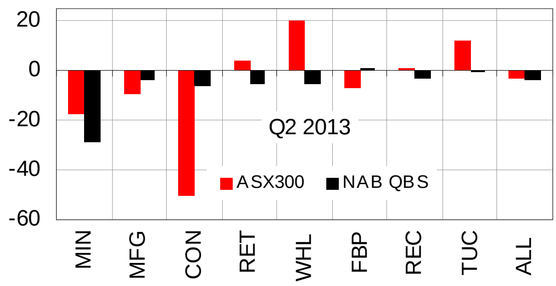
The overall decrease in confidence was driven by falls in confidence for **Mining** (down to -18 points from +9 points in Q1) and **Finance, Business & Property Services** (FBP), which fell to -7 points (from +18 points previously). **Construction** also fell sharply, down to -50 points from -20 points in March.

In contrast, there was a considerable improvement in **Wholesale** confidence, rising up to +20 points from 0 points in our previous survey – making this sector the strongest overall.

Business confidence has tracked closely between the ASX 300 and QBS in recent quarters – however trends are quite different at an industry level. Confidence levels were considerably stronger for ASX 300 firms in the **Wholesale**, **Transport, Utilities & Communications** (TUC) and **Mining** sectors (despite the Mining sector recording the second weakest level of confidence overall), while **Construction** and **FBP** recorded weaker levels of confidence among ASX 300 firms than the broader economy.

**Business confidence (net balance, nsa)**



## Forward orders: Retail and FBP drive lower level for orders in Q2, but Retail expectations are positive for Q3

Trends for **forward orders** by industry were quite divergent in the June quarter. The overall decline was driven by falls in **Retail** and **Finance, Business & Property Services** (FBP).

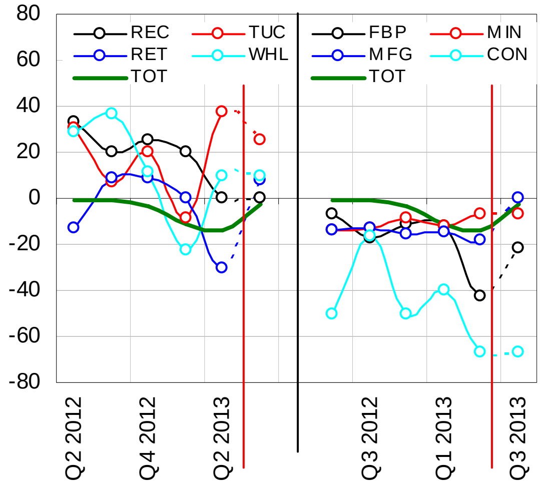
Forward orders for **Retail** fell to -31 points (from 0 points previously). **FBP** orders declined to -43 points (from -12 points in March). There was also a considerable decrease in **Recreational & Personal Services** (REC), down to 0 points from +20 points previously.

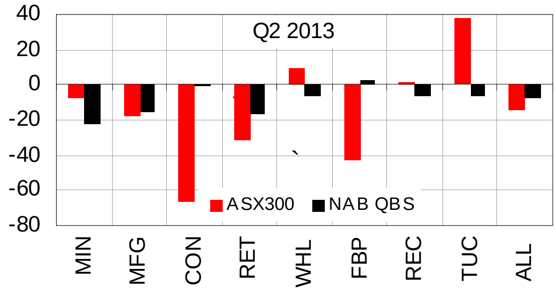
In contrast, trends for forward orders improved for **Transport, Utilities & Communications** (TUC) (at +38 points in Q2 from -9 points previously) and **Wholesale** (+10 points compared with -22 points in Q1).

The less negative expectations for Q3 2013 are driven primarily by **Retail** – with the sector recording a net balance of +8 points. Expected orders are also less negative for **FBP**.

The range of forward orders by industry was considerably wider for the ASX 300 in Q2 than in the QBS. Orders were considerably stronger for **TUC**, **Wholesale** and **Mining**, and considerably weaker for **Construction**, **FBP** and **Retail**.

**Forward orders (net balance, nsa)**




## Capital expenditure: Declines in capex driven by Manufacturing, FBP and Mining in Q2, while they drive an uptick in expectations for Q3

The deterioration in **capital expenditure** in Q2 was driven by declines in just three sectors.

**Manufacturing** recorded the most significant decrease – down to -67 points (from -15 points in the March quarter).

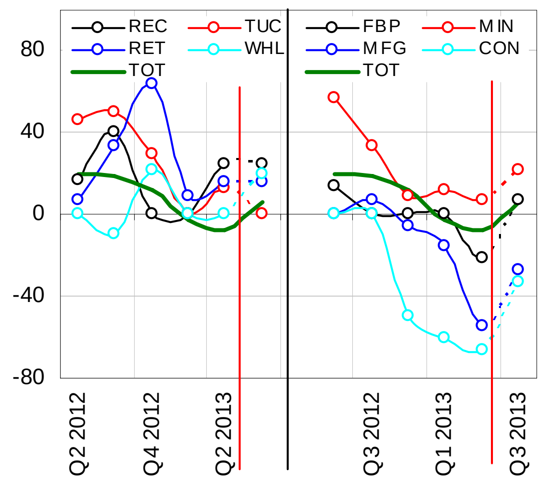
The **FBP** sector also saw a steep fall, down to -21 points from 0 points previously.

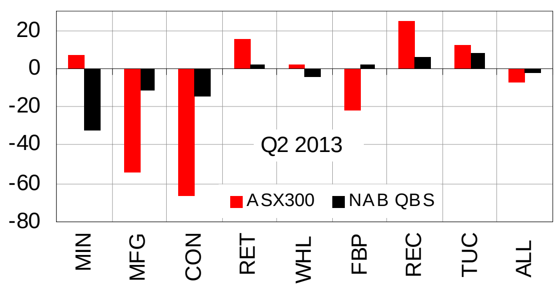
The decrease in **Mining** was less significant – although the sector has deteriorated considerably over the past year – down to +7 points in Q2, from +12 points in our previous survey.

ASX 300 firms anticipate an improving trend for capital expenditure in Q3 2013 – excluding **REC** (which is unchanged) and **TUC**, which is tipped to decline to 0 points. The improvement is driven by improving trends in both **FBP** and **Manufacturing**.

On average, ASX 300 firms recorded weaker trends for capital expenditure than the broader economy. This was driven by the **Construction**, **Manufacturing** and **FBP** sectors, while **Mining**, **REC** and **Retail** recorded stronger conditions than the levels in the QBS.

**Capital expenditure (net balance, nsa)**



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