

Equity Strategy

Coronavirus — Impacts and Consequences

The coronavirus outbreak continues to gain momentum with the number of new cases growing daily. It is nigh impossible to predict (1) the length of time it will take to contain the spread of the virus, and (2) future containment measures. Therefore, it also very difficult to forecast the ultimate financial impact on companies with direct or secondary exposure to it. Near term earnings risk exist for a wide variety of companies across the travel, tourism, freight, export and manufacturing industries. However, the coronavirus is unlikely to have a lasting impact on trade and consumer mobility, and therefore we see limited impact on long term intrinsic value of the companies exposed.

Coronavirus in numbers

There are now almost 25,000 confirmed cases of coronavirus globally according to available data, the majority of which are in China. At this stage, the outbreak appears to be contained beyond China's borders, albeit the number of cases has been growing but remains at very low levels. The death rate is 2%–3%, which is low compared to SARS (~9.6%), but high enough to warrant the dramatic containment initiatives now in place. The path from here is uncertain, given the evolving situation.

Cities in lockdown; disruption will have an impact on supply chains

There are currently 13 Chinese cities in lockdown with a combined population of >50m people. A further 10 cities (combined population of >90m) have closed council controlled services. These containment measures could be widened geographically and prolonged while the virus growth rate increases. A large number of factories across the country remain closed after an extended Chinese New Year holiday.

Global markets react, but modest at this stage

Since the coronavirus started making global headlines on 20 January 2020, the S&P 500 has fallen just -2% and the MSCI All Index has fallen -1%. Locally, the S&P/NZX 50 is down -2% over the same period. However, companies in the travel, tourism and freight industries have fallen more markedly. The SARS episode in 2003 suggests that stocks and markets will recover lost ground once the daily number of new cases peak.

Stock implications

Tourism Holdings (THL) is the only company thus far to downgrade near term earnings as a result of the coronavirus (as well as several other issues). However, other companies are exposed and may see some impact on their near term outlooks. These include Auckland Airport (AIA), Air New Zealand (AIR), Comvita (CVT), Fonterra (FSF), Mainfreight (MFT), Napier Port (NPH), Port of Tauranga (POT), Sanford (SAN), Scales (SCL), Skellerup (SKL), Skycity (SKC), Synlait (SML), and The a2 Milk Company (ATM).

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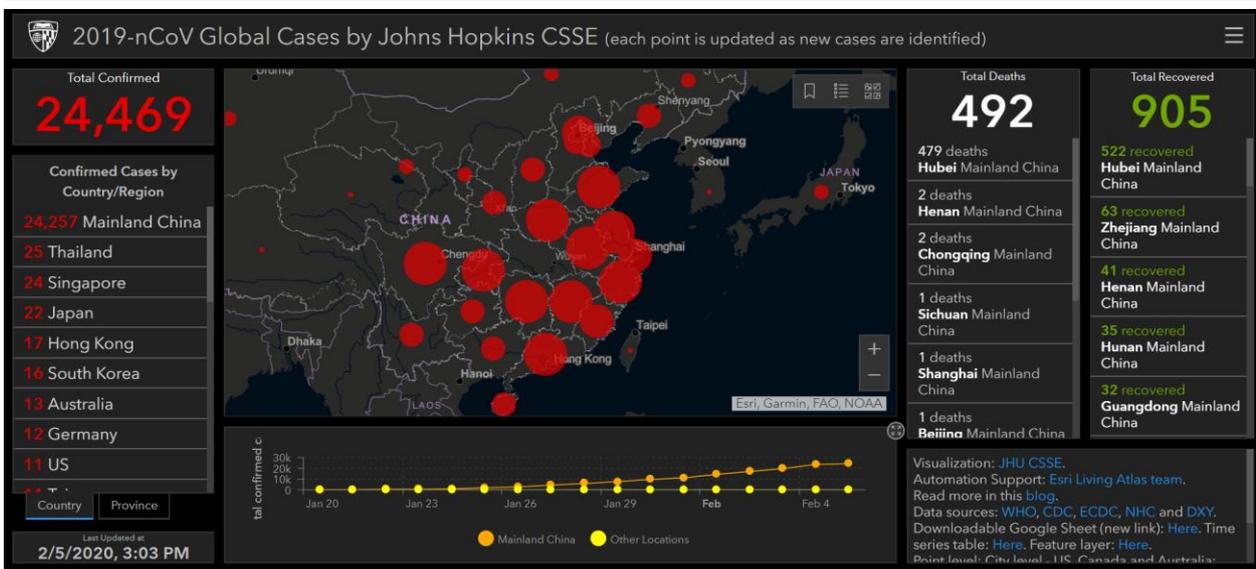
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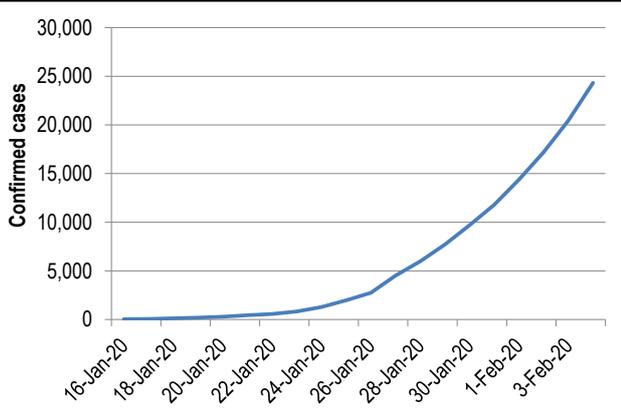
Coronavirus in pictures

Figure 1. Coronavirus map



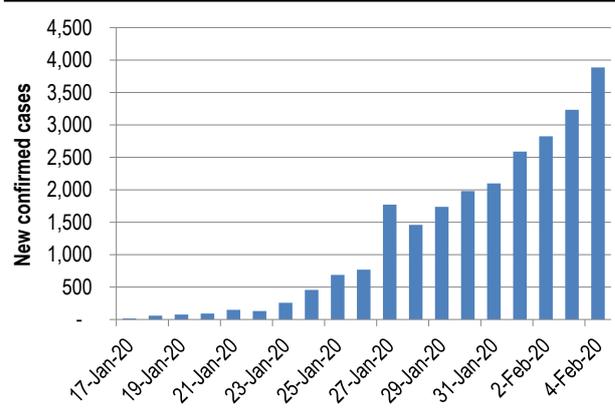
Source: John Hopkins University, Forsyth Barr analysis

Figure 2. Confirmed cases in China



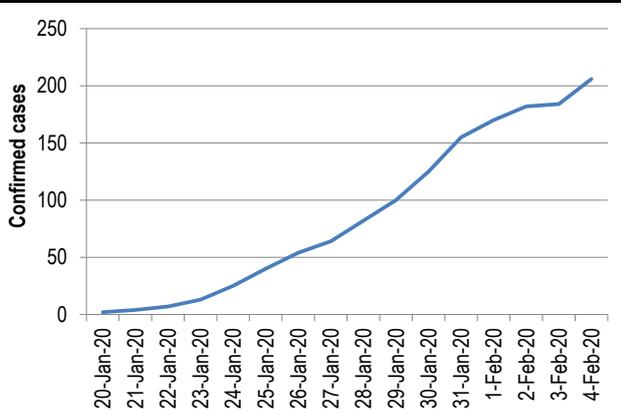
Source: Chinese National Health Commission, Forsyth Barr analysis

Figure 3. New confirmed cases in China by day



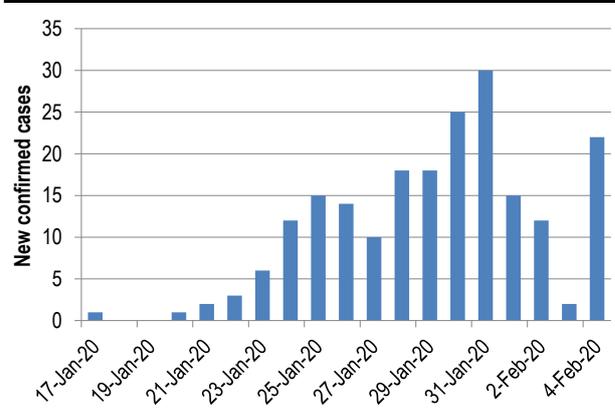
Source: Chinese National Health Commission, Forsyth Barr analysis

Figure 4. Confirmed cases outside of China



Source: Forsyth Barr analysis

Figure 5. New confirmed cases outside of China by day



Source: Forsyth Barr analysis

Company by company implications

Figure 6. NZX companies under our coverage with a direct exposure to coronavirus

Company	Potential issues	Potential P&L impact
Air New Zealand	Suspended Shanghai services for February/March. This could be extended if the outbreak is prolonged. Risk to other routes including Hong Kong and Singapore	Shanghai capacity represents ~5% of total international. The suspension will impact overall capacity growth through 2H20. Demand impact on other routes could also be a feature. Lower oil prices will assist spot buying in FY20 and hedged rates for FY21
Auckland Airport	Entry restrictions on Chinese visitors and reduced air capacity to/from China. Contagion risk to other Asian countries and further-a-field	Chinese pax represent ~7% of total international and spend ~2.5x more than average in duty free retail
Briscoe Group	Product sourced from China; disruption to date but faces risk from wider factory shutdowns	Immaterial
Comvita	Exposed through Chinese consumer purchasing habits and supply chain (inventory movements)	China makes up ~30% of group revenue
Delegat Group	Sales to China negligible; some secondary impact possible from wine build up in other markets	Immaterial
Fisher & Paykel Healthcare	Any lift in respiratory illness is beneficial to FPH's hospital product sales (both consumables and hardware). China uses predominantly reusables	Immaterial in the context of FPH's global business at this point (annual patient numbers of ~3m for Optiflow consumables, ~1.5m for non-invasive ventilation and ~5m for its Invasive Ventilation products). We estimate group revenue exposure to China is c. 5%
Fonterra	Exposed through Chinese consumer purchasing habits, pricing and supply chain (inventory movements)	China made up ~21% of group revenue in FY19. FSF is also exposed via inventory movements and any price implications for dairy products
Kathmandu	Product sourced from China; disruption to date but faces risk from wider factory shutdowns	Based on tier one supplier employee numbers, ~40% are in China
Mainfreight	Blocked supply chains may result in lower cargo volumes, albeit likely shift from sea to air (because of blockages) may benefit margins	Asia represents ~2% of reported revenue, but understated given trade flow will be higher proportion of total. Very difficult to quantify at this stage
Napier Port	Log export market temporarily closed for China. Horticulture and dairy exports exposed and likely impacted to some extent	Log and other forestry exports represent close to 50% of NPH's revenue. Material profit impact if export channels close for an extended period
New Zealand King Salmon	Relatively small exposure to China. Fresh exports to China impacted, however, product likely diverted to other markets	China represents <2% of sales
Port of Tauranga	Log export market temporary closed for China. Horticulture and dairy exports exposed and likely impacted to some extent	More than 75% of POT's export logs typically go to China. Logs represent ~15% of port revenue and generate a very high 90%+ EBITDA margin
Sanford	Fresh exports to China impacted; frozen seen disruption to date, however, expect demand to fall in the short term	Asia (ex Japan) ~15% of revenue, could be higher when accounting for secondary markets
Scales Corporation	China is SCL's largest market but apples currently out of season limiting impact to date. Harvest begins early March	Asia represents ~30% of revenue
Skellerup Holdings	Manufactures vacuum pumps and footwear in China	Products manufactured in China ~15% of revenue
SKYCITY Entertainment Group	Reduced air travel from China through the key Chinese New Year period	Key exposure is VIP which is ~13% of EBITDA. We also estimate main gaming floor exposure to tourists is c. 5–10% (of which a majority are likely Chinese) and there is likely some exposure for hotels (~10% EBITDA)
Synlait Milk	Directly exposed through supply chain, indirectly through key customer a2 Milk (see below)	We estimate ~65% of SML's gross profit is from key customer, a2 Milk (~70% of ATM's revenue is exposed to Chinese consumers)
The a2 Milk Company	Staple product. Supply chain disruption is the key risk in our view, both into China and around China. It is difficult to know how this plays out but ATM does have product on the ground (we estimate ~2–3 months at the warehouse and then some in the channel) which should help should there be any material disruption or extension of customs clearance timing	Revenue exposure to China ~30%, although we estimate this lifts to c. 70% including daigou
The Warehouse Group	Product sourced from China; disruption to date but faces risk from wider factory shutdowns	Based on tier one supplier employee numbers, ~30% are in China
Tourism Holdings	Entry restrictions on Chinese visitors and reduced air capacity to/from China. Contagion risk to other Asian countries and further-a-field	Chinese tourists represent a small share (~2%) of RV rentals, but ~15% of Waitomo visitors

Source: Forsyth Barr analysis

Figure 7. NZX companies under our coverage with a potential secondary impact from coronavirus

Company	Potential issues	Potential P&L impact
Fletcher Building	A minor inconvenience; minimal Chinese sourcing but alternative arrangements will mitigate	Immaterial
Michael Hill International	Minimal impact on supply chain; could see some demand impact from lower Chinese tourism	Immaterial
PGG Wrightson	Impact for New Zealand produce could have secondary impacts on PGW's rural supplies business	Immaterial
Steel & Tube	An inconvenience; some Chinese sourcing but alternative arrangements will mitigate	Immaterial
Ebos Group	Has some exposure to the daigou channel	Consumer products ~1% of group, some exposure in Community Pharmacy (~57% of group) for the more discretionary categories. Difficult to quantify but likely immaterial
Freightways	Closure of some Chinese factories mean potential product sourcing issue for inbound parcels	Very difficult to quantify but likely immaterial
Gentrack	Extended impact on airports may have impact on IT resourcing decisions	Airports represent ~25% of GTK's revenue, albeit P&L impact likely immaterial
Refining NZ	Reduced fuel demand will probably negatively impact on margins	Very hard to quantify — but probably immaterial
Z Energy	Falling oil prices typically helps margin, minor negative impact from lower jet fuel sales	Minor and transitory in nature

Source: Forsyth Barr analysis

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