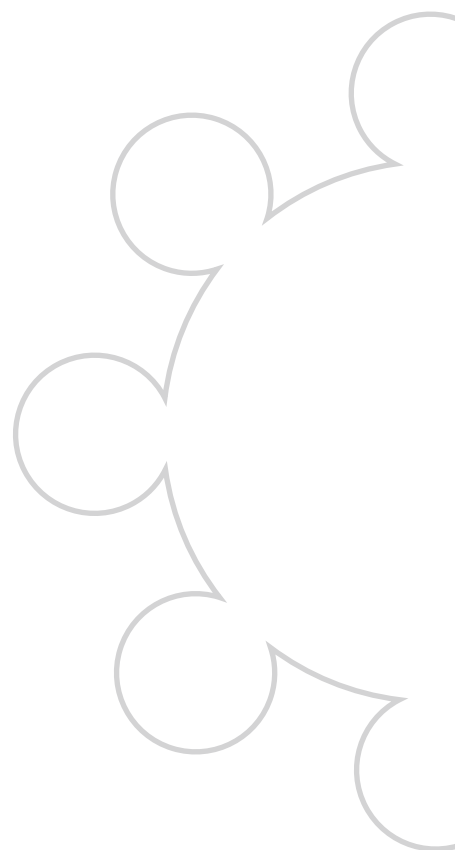


Utilities



Like all parts of the global economy, the energy and utilities sector has been impacted to varying degrees by the COVID-19 pandemic. Oil demand has reduced significantly which has negatively impacted prices and production, and accelerated the continued drop of gas prices globally. Europe has also seen record collapses in electricity prices due to falling demand.

New Zealand's experience has been more positive. Our utilities have proven themselves to be remarkably resilient, and services have been uninterrupted throughout the lockdown period. Robust business continuity plans were implemented prior to lockdown, and teams have been working effectively on site and remotely. Strong balance sheets have provided financial resilience.



With New Zealand facing into the post-COVID-19 recession, we're seeing utilities take a more cautious approach to their capital expenditure programmes. Major investment is likely to be deferred by anywhere from 6 months to 2 years. The ability to bring in specialised offshore resources necessary to deliver major capital projects will likely be curtailed for an extended period.

The increased focus on health and safety brings increased costs as utilities implement additional measures to ensure the health, safety and well-being of field staff. This will result in additional staff, maintenance and supplies costs which cannot easily be passed onto consumers and businesses. Cashflow management will be critical to minimise the impact.

Regular maintenance activities may be restricted or re-prioritised which could in the long term increase the risk of security of supply. While the current supplies of tools, essential spare parts and equipment may be sufficient for urgent repairs and remedial maintenance, the ability to ensure network reliability and staff safety will become less certain as the global crisis continues.

The lockdown and associated restriction of movements around the country may also have highlighted key person risks and the lack of qualified and trained key staff in some areas or regions.



Consolidation of small to mid-size players within the sector.

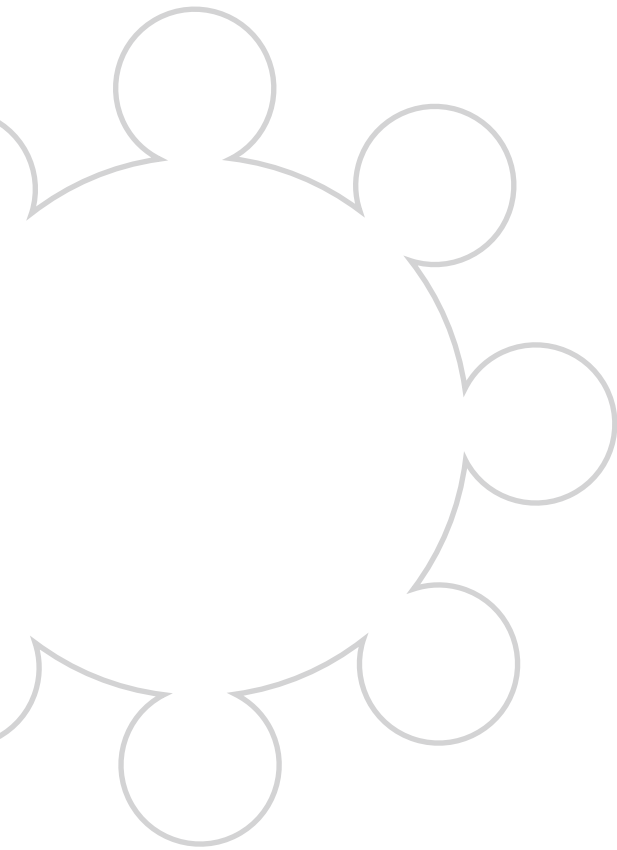
New Zealand has a large number of electricity line distribution (ELDs) businesses and one could argue the case for consolidation in a country of our size.

Whilst the Electricity Price Review concluded no restructure was required to the electricity distribution structure, the profitability of many ELDs will likely be marginal post-COVID-19.

Population growth varies across the regions, but remains strong in Auckland as does the demand for electricity. This will highlight the significant disparity in profitability between the smaller ELDs and those in the larger centres, and will be further emphasised by the post-COVID-19 recession.

From an operational standpoint, each ELD duplicates the management effort required for a stand-alone business; this is inefficient from a NZ-Inc perspective and ultimately, the consumer pays for this. There will be an increasing need for more efficient spend, and our view is this will drive consolidation of ELDs.

Equity consolidation won't be possible, but there could be significant value in consolidating operational activities such as IT systems, Control Room, maintenance and capital spend programmes) for neighbouring ELDs in the regions.



The energy, utility service and technology poverty gap widens.

In the climate of economic uncertainty created by the COVID-19 pandemic, providers of energy, utility and technology services will need to ensure that these essential services remain reliable, affordable and accessible by businesses and consumers. Pricing strategies will be critical to this.

The government initiative to deploy 17,000 devices and access for low decile school students/households may become an increasingly common approach for other utility services. To avoid significant volumes of disconnections, payment defaults (delaying payment has also been encouraged by governments/regulators in some countries) and an increasing debt financing issue or at worst regulatory intervention, proactive pricing schemes and tariffs that demonstrate a social conscience will need to be considered.

This must also be an integral part of infrastructure planning to avoid situations where higher infrastructure costs cannot be passed onto businesses and consumers. Coordination of infrastructure capital projects will reduce costs i.e. integrated civil works

A large number of construction projects have been delayed due to the national lockdown, and others that were in the pipeline might not go ahead as utilities face resourcing and capital challenges. We see a real opportunity for collaboration between services providers to effectively deliver capital projects.

This will be more evident in those regions that have greater needs and have scale, and in particular Auckland. This could be achieved by these businesses pooling certain engineering expertise (a Servco model) or acquisition. While this brings back memories of the old Ministry of Works department, this could be of significant benefit. For example, entities such as Watercare (AKL water utility) and Vector (AKL electricity distribution and telecommunications) could pool resources to deliver programmes more effectively and with less disruption in the community. It would also provide opportunities for training and redeployment of people, which would help build additional organisational resilience and social wellbeing in terms of skills development and job security.

Providers will also need to ensure efficient service delivery models such as leveraging shared services models (technology and staff) for aspects of the service so that baseline costs are optimised.

Our view is that a more collaborative industry and government approach is fundamental for New Zealand's prosperity. The short-term focus on individual organisational outcomes should shift to one where the long-term benefits for the country guide strategic decision making.

FADES analysis

Short term horizon Infrastructure planning:

Asset Management Plans are typically based on five year horizon but the enormous disruption created by COVID-19 means the demand forecasts may no longer be relevant or accurate.

Capital planning may become more focused on the short-term given the level of uncertainty. We see two potential outcomes: major capital projects could be ceased or suspended, or the lolly scramble for funding as part of the Governments initiative to fast track shovel ready projects may result in projects being progressed that may not have necessarily been priorities in the near term.

It is critical that the requirements and business case for these projects are thoroughly reviewed and confirmed to still be valid in a post-COVID-19 environment rather than being used simply as an alternate funding mechanism; money needs to be spent on the projects that will most benefit the future of New Zealand.

Cities, businesses and consumers may operate in completely different ways in the future and it is important to avoid projects that may become white elephants. Energy sector renewables initiatives may also be directly impacted by supply chain issues related to COVID-19. With China being a primary producer of clean energy technologies and components for solar panels, wind turbines and batteries, delivery delays and subsequently increased demand due to the coronavirus lockdown could impact planned project deadlines. Regardless, New Zealand remains committed to meeting our emissions reductions targets under the Paris Accord and our own Zero Carbon Act; as lifeline utilities, our service providers need to keep this front of mind and ensure this is taken into account for all infrastructure planning.

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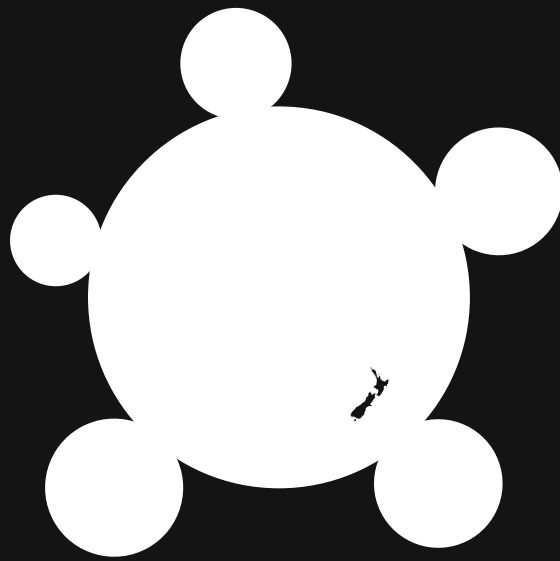
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