Badges of Success in today's changing world

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The impact of global events on today's business environment is unmatched over the last seventy years.

From the Covid-19 pandemic to the Russian invasion of Ukraine, major flood events, rising geopolitical tensions and a Federal Election, businesses are feeling the deteriorating effects of this unprecedented chain of events – and the practical impacts can be crippling.

Our clients and peers have cited skyrocketing coal and energy costs, delays on imports and a lack of transport availability, as just a few of the challenges threatening the survival of their business.

So what do we do about it?

Historically, the obvious answers have been:

- Pass input price increases onto your customers;
- Seek alternate inputs; and / or
- Hedge your input costs.

However, given the speed and volatility of the changes, some of our clients have simply not been able to achieve one or any of these historical solutions.

What else can we do – what are the badges of success, or failure?

We suggest the following:

- Variabilise your cost base wherever possible. This will require difficult and uncomfortable converations with employees, unions, lessors and suppliers. You need to ensure you can flex up or down as required, because it is likely cost spikes or supply disruptions will make BAU trading a loss making proposition. The counter factual for the stakeholders is simply sustainable continuation for your business – you will not survive if you don't make changes.
- Talk to your customers – we understand that even some of the traditionally steadfast retail operators are currently genuninely considering accepting and passing on price increases. Obvioulsy any altruistic motive is unlikely and the practical reality is you may well be the only, or a non-replaceable, supplier.
- Be opportunistic in both input volume and pricing. Where opportunities present in the market to take product at 'acceptable' pricing (as distinct to historically normal pricing), seize the moment as the mantra for now is survival as opposed to profit: live to fight another day.
- Working capital – aggressively manage your working capital and explore non-traditional lending options. Cash is king – this will never change as a business rule.
- Don't overreact – whilst this message may appear at odds with the above, you are managing 'lumpy' conditions as opposed to fundamentally changing your long term business model.
- Communicate – to all of your stakeholders as everyone is in the same boat.

We have seen a number of clients utilise a mix of these strategies to manage through these uncertain times. For example – fleet owners negotiating utilisation based lease charges for their fleet and ensuring new customer contracts not only include a rise and fall for fuel, but also shortened payment terms. Some retailers are now acknowledging or accepting stock outs as an unavoidable consequence of the current situation – which historically has been seen as a fatal flaw. The alternate of being left with excess, out of season stock is not acceptable from a cashflow perspective.

The TMA

The Turnaround Management Association (TMA) encourages boards of directors and management teams of financially stressed businesses to engage early with turnaround professionals. Our aim is to guide companies from uncertainty to stability.

Our experts have the tools to help your business navigate through uncertain times. Search our member directory to find experts in business recovery, corporate turnaround and restructuring.

A more in-depth look

Why are we feeling these impacts?

In Australia, the following all continue to play a major part in our daily business lives:

- COVID 19: the pandemic has impacted:
    - supply chains – internationally with freight delays and costs, availability of inputs, and domestic freight - cost and availability;
    - people – physical and mental health, hard lockdowns and flow on isolation impacts on availability of employees on site;
    - travel – inability to move domestically and internationally – the impact on inbound migration / tourism has materially impacted tourism, health and higher education (amongst others); and
    - cost of funds – central bankers worldwide have pumped emergency liquidity into markets, including through continuing highly accommodative monetary policy – as growth and activity have returned, the interest rate pendulum has started to trend up;
    - certainty – there is a natural reluctance to invest in the face of uncertainty (acknowledging the pace of M&A transactions until the last month has been ferocious and is only just beginning to plateau and delay the timing of completion of transactions);
- Russian invasion of Ukraine – the impact on the global supply of oil and gas is materially impacting availability and pricing of power (electricity and gas) and fossil fuels around the world;
- Queensland / Northern NSW floods;
- Geopolitical tensions; and
- Federal Election – potential change in future government the uncertainty around future policy.

What are businesses reporting as the biggest challenges?

Some examples from our clients and peers include:

- Input costs – Diesel up c. 53% since 30 May 2021[1], Electricity up 67% in Q1 2022 on Q4 2021[2] and Gas up 64% in Q1 2022 on Q1 2021[3]. Some states have experienced markedly greater variability in input costs (i.e. electricity in

[1] Australian Institute of Petroleum – 15 May 2022 (Melbourne) https://aip.com.au/pricing/Diesel/VIC/Melbourne

[2] Australian Energy Market Operator Limited – April 2022 (National Energy Market wholesale spot price average) https://aemo.com.au/-/media/files/major-publications/qed/2022/qed-q1-report.pdf?la=en

[3] Australian Energy Market Operator Limited – April 2022 (East Coast National Energy Market wholesale spot price average) https://aemo.com.au/-/media/files/major-publications/qed/2022/qed-q1-report.pdf?la=en

Queensland during Q1 2022) and importantly these prices are materially higher (i.e. 50%) than the ten year average (after allowing for inflation);

- Newcastle Coal (Metallurgical Coal used for coke production in steel making) up c. 75% in four months 20 May 2022[4];
- Cost of assets with immediately available yellow goods for example often costing more than new kit;
- Complete lack of transport availability in addition to pricing increases, for example: freight cost for a container historically costing $900 now costing in excess of $8,000;
- Demurrage free days being strictly enforced at 3 days, exacerbated by inability to contract road transport from port (previously ports typically provided up to 10 days before applying demurrage); and
- Delays on imports – cars are the simple and publicly understood example but additionally and for example, solar inverters expected to be delivered in September 2021 are currently expected to reach Australian docks in July 2022, with no guarantees!

Across the board, CPI ran at 2.1% for the March 2022 quarter and therefore 5.1% for the twelve months to the March 2022 quarter, with further rises expected for the June 2022 quarter. Interest rates are also rising with the first interest rate increase in eleven years occurring in early May 2022 lifting the rates from 0.1% to 0.35% with future rises expected.

As such, input costs have increased and will continue to do so and the variability in input costs is enormous, almost entirely unpredictable and unlikely to abate in the short term.

[4] Investing.com Newcastle Coal Futures Chart - Investing.com