Ia Ara Aotearoa Transporting NEW ZEALAND | **Advisory**

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Transporting New Zealand's economic advisor, Cameron Bagrie, has prepared the following commentary specifically for road transport operators to consider in relation to their businesses

The economic cycle is turning, overlaid with Omicron challenges and global / Ukrainian uncertainty. Disruption is widespread, whether that be the forementioned labour availability (reliability), or government policy swings and roundabouts.

There are bright spots. Go talk to any dairy farmer! An overheating economy, as the Organisation for Economic Co-operation and Development (OECD) described New Zealand, is a good problem. Night follows day just as day follows night. The economy experiences cycles that need to be navigated.

Inflation is rampant, like we have not seen in 30 years. We have a brutal combination of a supply shock (Covid supply chain disruption), an energy / commodity shock (Ukraine), constrained supply amidst an overheated economy and structural factors forcing inflation higher, such as a redistribution-based government policy agenda. Taming inflation is not growth or asset price friendly. Getting inflation down means turning the housing and construction cycle. House prices month-on-month are now falling.

People are talking about stagflation; a combination of stagnant growth and inflation. I prefer the term slugflation. Firms being slugged on all sides and rapidly rising costs.

Many in the workforce have not seen the destructive impact of inflation. Inflation is a thief that erodes purchasing power. Rising costs siphon business margins if not passed on, and add a layer of uncertainty to business planning and pricing.

Productivity can help escape the clutches of inflation but only so much cost can be absorbed. In an environment where inflation expectations have risen a lot, passing on costs can be easier to achieve.

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Inflation expectations in New Zealand normally sit around 2%. At present the Reserve Bank's two year ahead measure is 3.3%. The one year ahead measure is 4.4%. ANZ's Business Outlook Survey has one year ahead inflation expectations at 5.3%.

Amongst all the inflation concerns, here are some other things to think about.

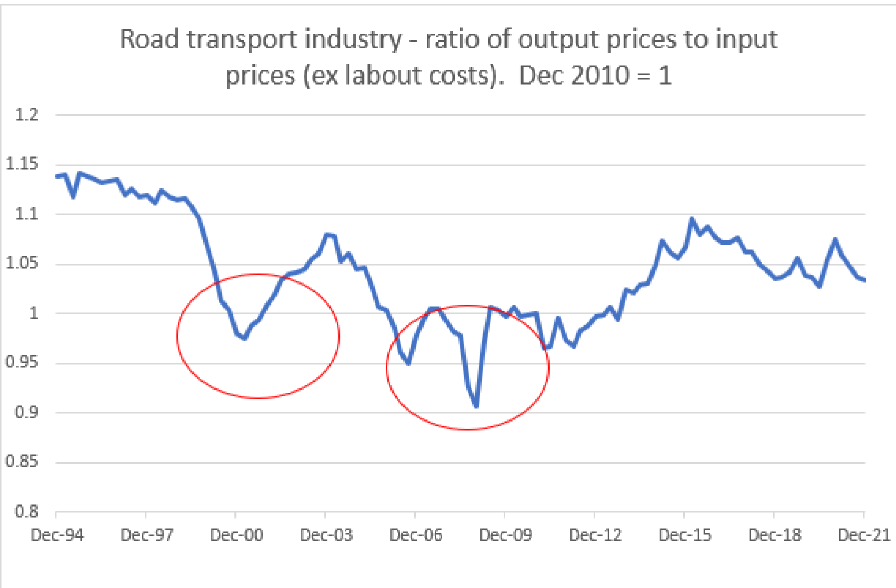
Cash is king and will be particularly important over the coming months as Omicron restrains capacity (revenue), whilst costs continue to be incurred as a part of any business and are rising.

Maintaining sufficient working capital means making the cashflow cycle as short as possible; aka high inventory turnover and collecting debtors fast. Remove unnecessary costs and make sure staff are contributing to the bottom line. Make sure the debt structure matches the business asset profile and cashflows appropriately.

Covid is a supply shock with enduring consequences which means many businesses need to reset cost lines and not just tinker. Four million international tourists are not going to magically reappear when borders open.

Margins are everything, to state the obvious. Within the road transport industry, the ratio of output prices to input prices (excluding labour) can be thrown around by diesel and fuels costs from quarter to quarter, but more broadly suffered badly in the Asian crisis induced recession and around the global financial crisis (refer chart below). The potential for such margin swings reinforces the importance of having a strategy to manage cost increases.

Wage inflation is rising at four percent in the road transport industry, and many would say the real number is a lot higher. Staff retention is becoming more challenging as is workforce reliability.



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The term “the great resignation” is being thrown around as people job-hop. That is what happens when you have the strongest labour market in 30 years.

But what if there is more to the great resignation? The population is aging, constraining working availability. Maybe New Zealand got too reliant on imported labour and didn’t investment sufficiently in training people locally. Maybe it is about time bad employment practices and employers were exposed and good employers get some kudos and become more preferred in the employment stakes.

Stakeholder capitalism is usurping shareholder capitalism. The former is the long-game and latter is being dictated by the short-term profit motive. Look after staff because they look after the customer is what I was taught when I joined the National Bank. Money drops out of that equation over the long-run.

Of concern is rising welfare dependency with 40,000 more people on a benefit than prior to Covid, amidst a record low unemployment rate. The workforce of tomorrow is in the school system of today. School achievement and attendance does not bode well. If you are selling products, make sure they are contributing to the bottom line and prune ones that are not.

There are always some who get into trouble as the cycle turns. Under my company, Chaperon – helping businesses navigate banking, we see a tendency to hold off too long, before it ends up being too late. Be on top of emerging problems; risks can easily materialise into issues. Know how to identify and manage risks.

Go early to your funder if you see a pending problem.

Never present a problem – always present the solution:

- This is the issue
- This is what caused the issue
- This is what we are doing about it – plan A, and B
- This is what we need from the bank and
- This is how you will be repaid

Understand your sales, profitability drivers, gross margins, labour productivity and overheads so you can forecast your breakeven position and the negative cash impact of downside performance.

Understand where your cash is absorbed in your balance sheet and be able to explain the length of your operating cashflow cycle and the steps you take to minimise it.

A turn in the cycle will offer opportunities and challenges.

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Some of the challenges are obvious and have been noted.

There are opportunities too. The strong, resilient and flexible will find those as economic circumstances pick off the most vulnerable first.

Cameron Bagrie
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