HERE WE GO, AGAIN BOOM/BUST?

Prue Younger, **CEO Message**

It has come to pass that the forest sector has been working away quietly on the back end of high market prices but that seems to have shown a few cracks in the last few months, albeit infrastructure pressure points and ports for many reasons being an indicator with fleets of ships anchored off shore around the country. So what is happening out there? The best place I have found to get on the ground information is the accountants that day in, day out are at the coal face of the industry, so I called on our Business Partner Blackburne to say it as it is currently. Thanks in advance Mark Blackburne for your honest words of just how it is...

After a good run for most in the industry post lockdown the pendulum, as always happens, is now swinging strongly into downturn. How long no one knows, but this is already negatively impacting many contractors. As an industry we have all been here before, it hurts, and will shake out some weaker contractors. There are a well-established range of planning measures to assist survival. These are usefully summarised on the FICA website under 'COVID-19 Support Documents' in the 'news' section. **https://www.fica.org.nz/industry-reports**

My even briefer summary is, be honest and realistic with yourself about the prospects and act quickly. Experience shows that contractors are generally optimists which in many ways is a great characteristic, but the "she'll be right" doesn't cut it at these times. So if things aren't working for you at the moment be honest with yourself as to what you can do to change - going with the flow, downhill, is not a survival strategy. The accepted definition of insanity "continuing to do the same thing while expecting a different result" always applies.

Of course contractors are often frustrated in that much of what significantly impacts them is outside their control. As well as the obvious availability of work, a significant factor always affecting contractor viability is uplift. This has been a significant feature in recent times with increasing supply chain pressures now combining with formal restrictions on targets. Our experience is that ongoing 80-90% of production for any contractor is hard, but may be able to be managed over the short term, but for weaker contractors, especially those with high debt levels, will quickly create dire outcomes.

The meaning of the title above is to highlight that not only are we now facing the 'normal' downturn and associated issues, on top of this is a sustained across-the-board level of input cost increases that we have not faced since the high inflation times of the 1980s, so will be unknown to many.

We are having daily discussions with suppliers/contractors on these issues e.g. just this week we saw, a 13.8% increase from one oil supplier, 25% increase in steel prices, insurance assessor advising repair costs over the last 12 months up 35% per claim. Plus regular increases in machine costs (that's when you can obtain and don't have to wait 6-12 months!). And so it goes on.

Of course the obvious are wage costs. This not only reflects government-imposed statutory increases (minimum wage/sick leave/public holidays, and other lesser-known 'add-ons'), but, combined with the shortage of skilled labour in the industry means that wage rates have escalated well in excess of normal 'inflation'. All of these increases reduce margin. We are seeing increasing examples where contractors performing at or near target levels are finding cash surplus required to meet finance and other commitments is diminishing. While decreases in targets are clear and obvious, cumulative cost increases are more subtle and can lead to "a death by a thousand cuts" scenario sneaking up on contractors.

Our regular costing work undertaken for contractors is highlighting that much work priced on historical rates is well under-costed and not reflecting real inputs now required. Both contractors and forest owners have an historic comfort level around what a rate is expected to be and in many cases this is now not reflecting reality.

So this current downturn (hopefully temporary) has a potential double whammy in that, on top of the normal reduction in volumes, the industry is also having to manage a level of real cost increases not seen for many years.

Regrettably there are no easy answers, market cycles are what they are. The purpose of these comments is to highlight the need to take prompt action, both in terms of reviewing rates and also looking at the toolbox of planning measures referred to at the start of this article. And sooner rather than later - head in the sand does not work at these times.

Mark Blackburne
Blackburne Group – Chartered Accountants
Phone: (07) 376 0092 Ext 821
www.blackburnegroup.co.nz

I will end with the overview of the project in a break out box:

National Forestry Contract Model Project

For many years, supply chain factors have consistently been recognised as a critical, but hard to influence factor in forestry workplace wellbeing, health and safety.

We appreciate that while the dynamics are often different between the Corporate and smaller scale operations, one fact remains... the relationship between Forest Owner/Managers and Contractors is critical to industry success and a strong culture between these partners is essential. While FICA produced Summary Contract Guidelines in 2019 to highlight key areas for improvement for contractors and their arrangements with forest growers, the opportunity for a model contract or template to be developed was recognised as a means of directly influencing health and safety outcomes and industry partnerships. As a result, several industry stakeholders have come together to advance the development of a model contract/template to improve business performance and work conditions. WorkSafe has agreed with this thinking and provided funding to support the design of a model contract. It is an exciting time ahead for the industry and this project will create meaningful and transformational change and advancement in professionalism. We are looking forward to keeping you posted across this project over the coming months. Prue