Auto Postcard

Ferrier Hodgson

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AUSTRALIAN AUTO MANUFACTURING – RIP

Toyota's earlier-than-expected decision to follow the lead of Holden and Ford has confirmed what most had expected and many had called for – the death of car manufacturing in Australia.

While a decision from Toyota was anticipated some time before June, the recommendations contained in the Productivity Commission's Interim Report clearly brought Toyota's decision-making process to a head.

The Commission's report was definitive in recommending that Toyota's long-term future in Australia should be without this government's endorsement and financial support. Toyota also identified the expected impact of future free trade agreements as a major concern – an issue which manufacturers generally should be wary of.

While Ford has indicated that it intends to cease its operations by 2016 with Holden and Toyota to follow suit the year after, the expected rapid decline in sales of Australian made cars is likely to lead to accelerated exit dates.

Lower sales volumes will place even further pressure on the already distressed component supplier base, with business casualties expected in the short term, further impacting OEM production and sales as the supply of critical parts becomes riskier. Given the OEMs' broader strategy, it is difficult to imagine now that they will be keen to bail out suppliers to preserve production.

While the OEMs and many of the large foreign-owned suppliers are expected to have the necessary resources and expertise to implement a solvent wind down and exit of operations, the same cannot be said for the locally-owned tier-one and downstream component manufacturers.

Despite the rhetoric of diversification, in reality, this has been very difficult to implement. The automotive sector is built around volumes and efficiencies and there are simply very few high-volume customers in Australia. Any Australian suppliers cost-competitive enough to fully export are likely to be in the low-volume niche markets which may be insufficient to sustain the businesses in any event.

Diversification is more likely to come from developing new capabilities that open up new markets. Developing such opportunities takes time and capital, two attributes which local component suppliers are short of. For those that have been able to diversify into new markets, this may only represent a small amount of the total turnover, and again it may not be sufficient to sustain the business over the longer term.

The unfortunate reality is that component suppliers that are heavily reliant upon revenue from the OEMs will struggle to survive, given the significant restructuring required to offset reductions in revenue. In particular, the cost of streamlining labour will be overly onerous given the scarcity of available funds and the typical long-serving tenure / high redundancy costs of staff employed in the industry.

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Major suppliers to Ford may have already run out of time, with Ford announcing that in response to continuing poor sales they will be further reducing production from 130 cars to 80 cars per day (40 per cent reduction). Based on our discussions with those within the industry, their expectation was that anywhere between 10 to 20 component suppliers may struggle to see out the next 12 months – and that was before Toyota's announcement.

The timing of refinancing of banking facilities must also be considered, as lenders are unlikely to extend facilities where the ability to service and repay debt is at risk.

Unfortunately for many component suppliers, the only option may be to continue to run their business for as long as it remains solvent, and default into insolvency in due course, with the government to fund staff redundancies through the Fair Entitlements Guarantee scheme which applies in liquidations. The terminal effect of Toyota's announcement means that business sales are unlikely to be an option.

The confirmed exit of the OEMs should, however, clear the path for the Federal Government to redirect some of the funding allocated to the Automotive Transformation Scheme through to 2020 and implement a financial support plan for the transition out of the automotive sector.

In particular, funding should be made available for component suppliers to assist with pursuing opportunities which may ensure their business survives and / or exiting the industry and redeployment of staff to other sectors. A portion of any funding provided needs to be directed into one-on-one programs to mentor and assist individual suppliers, ensuring there is a hands-on approach to the assistance.

It is a nervous time for those in the automotive sector. Directors and businesses in the sector need to consider their futures, their personal obligations and seek professional advice.

Ferrier Hodgson has a team of professionals who understand the industry and have the operational and restructuring expertise to assist.

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Ferrier Hodgson's automotive specialist Jim Sarantinos regularly sends an *Auto Postcard* detailing the latest news and trends in the sector. If you have any comments or suggestions, please contact Jim directly at jim.sarantinos@fh.com.au. If you know of others you think would be interested to receive the *Auto Postcard*, please send us their details.

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