


FICA SEMINAR

UNDERSTANDING YOUR FIXED AND VARIABLE COSTS

UDC
New Zealand's Finance Company

INTRODUCTION

What I want to cover off today:

- UDC overview and update.
- Where we see the forest industry today and in the next 12 months.
- Understanding and managing your fixed and variable costs.
- Managing your cashflow in Lumpy times.
- Questions ?

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LONG HISTORY AND STRONG OWNERSHIP

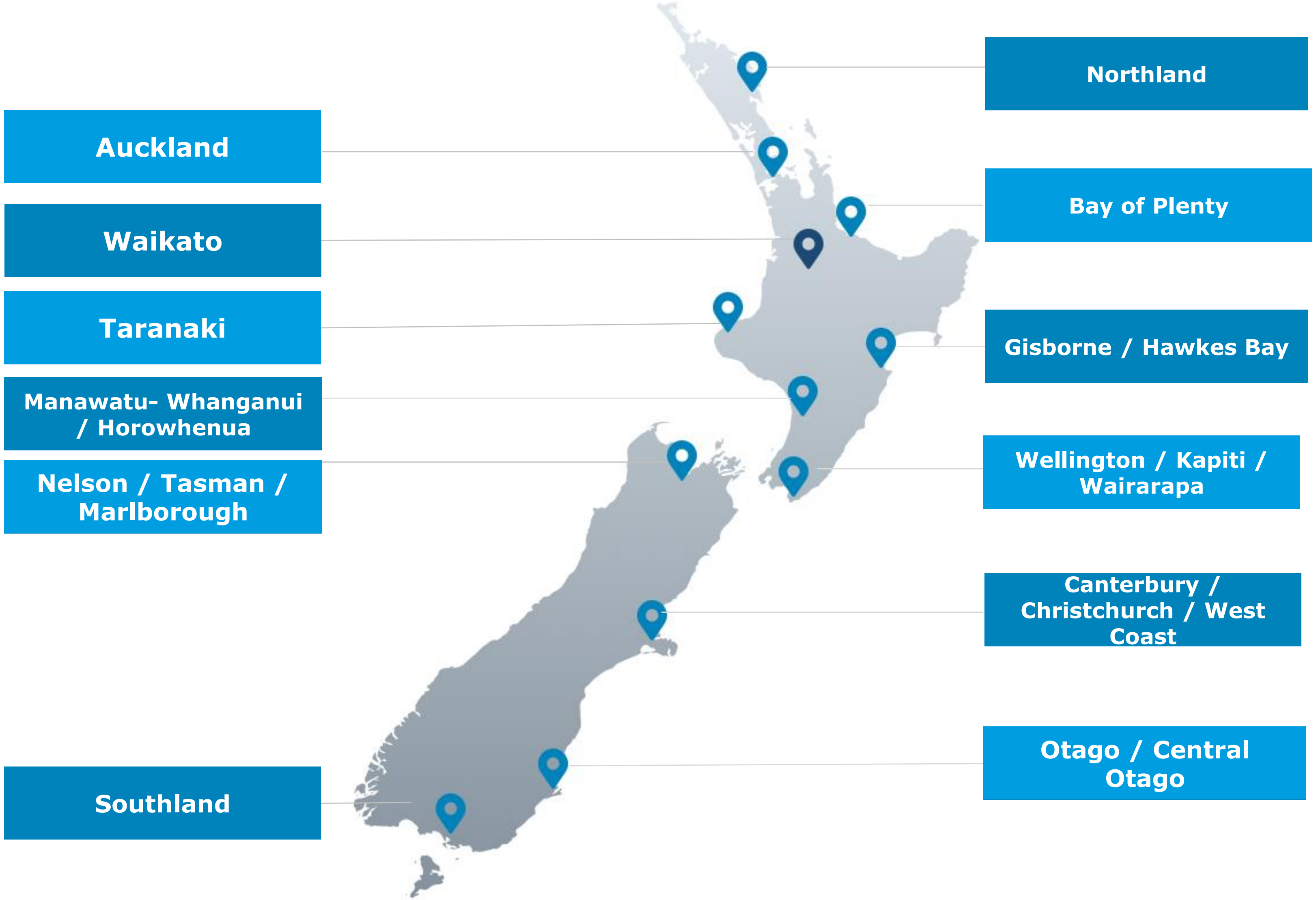
- **Over 85 years of operations in New Zealand**
- **In 2020 we were acquired by Shinsei Bank from Japan.**
- **Over 240 staff, with regional sales teams and national office in Auckland to provide centralised support.**
- **Our business focus is the financing of plant and equipment for New Zealand's primary industries.**
- **Our commercial finance loan book exceeds $1.6 billion with over 30% of this book to the forest harvesting and transport sectors.**
- **We have a vested interest in and understand New Zealand's forestry industry.**

UDC History

1930s – 1950s	1960s	1965	1980	2000s	2020 - Today
• UDC was established in 1937 as Financial Services Limited (**FSL**) • In 1951 FSL was acquired by London-based United Dominions Trust, and was renamed United Dominions Corporation (**UDC**)	• In the early 1960s Traders Finance Limited, Hawke's Bay Investment and Finance Company Limited, New Plymouth Finance Company Limited and Dunedin's United Finance Corporation Limited all became part of UDC • The combined entity had a ~30% market share	• UDC began its relationship with ANZ in 1965, selling 20% of its shares to the ANZ Banking Group (New Zealand) Limited (**ANZ**)	• UDC became a wholly-owned subsidiary of ANZ in 1980. It maintained management autonomy and continued to support itself financially	• The business grew substantially, and was seen as a reliable and reputable home for investors and as an efficient and competitive operator in asset financing • UDC's loan portfolio grew to more than $1b	• In September 2020 Shinsei Bank, Limited of Japan acquired 100% of UDC from ANZ • UDC continues to operate as a strong, independent finance lender in the New Zealand economy with the expertise, strength and long-term support of Shinsei Bank

NATIONAL COVERAGE

- National General Manager
- 3 Regional Managers
- 12 Local Offices
- Commercial Team of 34
- Head Office support for lending, operations and support services
- We have on the ground staff located between Whangarei and Invercargill.



FORESTRY is a key industry for UDC

- **Forestry has been and remains a key industry for UDC.**
- **Our regional teams have significant experience lending to forestry harvesting and transport contractors.**
- **Supporting our field staff is our credit team of 25 + staff.**
- **We understand the forestry industry. An example of this we will match the finance terms to the economic and mechanical life of the assets.**
- **We also react quickly to support our clients in tough times.**

WHERE WE SEE THE NZ FORESTRY INDUSTRY TODAY?

The past four years have been very unstable for the forest industry primarily around the impact of Covid.

It really has been a perfect storm in the past four years, it started in mid 2019 with China slowing down and then Covid said hello in 2020 and continues to be an issue as China focuses on a Covid elimination strategy.

There has been a flow on effect to the forestry industry:

- Increased shipping costs and the availability of ships
- Increased steel costs are being passed on by transport and harvesting equipment suppliers
- Availability of labour leading to increased labour costs
- Increased fuel costs
- Increased interest rates

WHERE WE SEE THE NZ FORESTRY INDUSTRY TODAY?

- Costs across all aspects of the forestry industry are increasing, both for the contractors and the forest companies.
- Inflation has been with us for some time and isn't going away in a hurry.
- Then as we were getting used to the flow on effects of Covid and Inflation we are now facing the significant impact of the Ukraine war.
- We are in for another tough 12 months. Recently I recall a commentator referring to the year ahead as being 'Lumpy'.
- Our clients are already experiencing these Lumpy conditions with the impacts ranging from harvesting quota to complete shut downs.
- Given where we've been in the past four years I believe we need to plan for Lumpy being the new norm.

LUMPY IS THE NEW NORM SO WHAT CAN WE DO?

With FICAs monthly Forestry Market Report it finishes with the sentence:

'We are about changing the behaviour, providing better information and acknowledging risks ahead to better inform'.

This presentation seeks to highlight an area where we believe New Zealand's forestry harvesting and transport contractors can acknowledge the inherent risks and position their businesses to survive the tough times and prosper in the better times.

Much of this presentation focuses on how we see our forestry customers managing their cash flow.

LUMPY IS THE NEW NORM SO WHAT CAN WE DO?

UDC Finance has a large number and range of harvesting and transport contractors. Our experience is that the more successful contractors are those who fully understand their cash flow position and actively manage it.

As a harvesting or transport contractor there is little you can do to influence the revenue side of our businesses. The market (and mainly China) dictates this !

What we can influence is a focus on our costs. Both fixed and variable.

UNDERSTANDING YOUR FIXED & VARIABLE COSTS

All businesses have fixed and variable costs and we believe that by understanding the difference between fixed costs and variable costs you will be in a better position to understand how you need to act for the good of your business.

- **Fixed - costs that will continue no matter what, but with better planning we have seen that fixed costs can be managed.**

- **Variable - costs that will vary dependant upon the hours worked / tonnes harvested**

The key focus needs to be retaining as much cash in the system as possible.

Cashflow is about your bank account.

CASHFLOW BUDGETING

This presentation is about managing the cashflow aspects of your business, as opposed to your profit and loss account. The two are linked but there is a subtle difference.

As mentioned earlier UDC has a large range of forestry contractors, and it is our experience that the more successful contractors manage their cash flow budget on a daily / weekly / monthly basis.

They are fully aware of their fixed and variable costs and if there is any pending revenue or cost changes they immediately amend their cashflow budget.

They then know what their cashflow position will be and they make changes quickly.

So that raises the question as to what changes they can make ?

As pointed our earlier we find that there are few levers to pull in terms of Revenue but by having a solid understanding of their costs they have the opportunity to better manage their cashflow.

FIXED COSTS

Some examples of fixed costs and possible solutions to reduce these costs are:

- **Wages and Salaries**. In the past wage costs have always been variable with the likes of reduced hours and / or layoffs. But in today's tight labour market retaining your highly trained operators and drivers is critical to the ongoing success of the business. We are now finding that these costs are fixed.

- **Loan Repayments**. Loan repayments on plant and equipment are made up of Principal and Interest. At UDC we will always consider reducing or temporarily stopping principal repayments. I believe that most lenders will also do the same. The key here is reaching out to your lenders as soon as the cashflow is about to change. Be proactive and support your request with your updated cashflow.

- **Rent.** We find rent can be paid to an external landlord or as is often the case an entity linked to the owners. With an external landlord look for some rent relief and with an owner linked rental maybe simply stop the payments or if they are linked to a mortgage repayment look to have the mortgage terms amended.

VARIABLE COSTS

- **Repairs and Maintenance.** This is a critical expense for harvesting and transport contractors and often one of their top five costs. What we often find is that many contractors will use down time to get stuck into their R + M. We are told … ‘It keeps the men busy’ … ‘why not do the work when the gear isn’t working’. There is no right or wrong answer here but again the key is managing and preserving your cashflow.

- **Fue**l is very topical at present particularly with the rapidly increasing fuel costs. Our experience is good operators fully understand the impact on their business costs and with have FAF clauses in their contracts. The key has been to move fast with passing on these increases.

- **MPI Data** on Diesel costs. 12 months ago Diesel was $1.06 per litre, at the start of this year it was $1.27 per litre and earlier this month it was $1.90 per litre.

- That’s an increase of 79% in 12 months. This year alone we’ve seen an increase of 50%.

LOAN REPAYMENTS

Loan Repayments.

Dependant upon your facility terms and conditions these can be fixed or variable costs.

At UDC we do give favourable consideration to principal payment relief … this can be in full or part principal relief.

We find experienced operators who understand their cashflow are quickly in touch with us presenting their revised cashflow budgets.

Revisit your cashflow budget and then get in touch with your lenders.

SHAREHOLDER DRAWINGS

ARE THESE FIXED COSTS OR VARIABLE?

For some this cashflow cost is fixed due to commitments entered into by the owners of the company, but for others it can be flexible.

- **Mortgage repayments** – generally these are locked in but you can talk to your mortgage lender about principal payment relief and / or extending the term of the mortgage.

- **Toys** – yes we all love our toys … boats, jet skis, the Harley, plus what ever else can fit into the shed. Certainly, in tough times the expenditure on these needs to stop and perhaps can be sold to put cash back into your business.

SUMMARY

As mentioned earlier we see the lumpy revenue past few years continuing in 2022 / 23 with the added pressure of significantly rising costs due to the inflationary pressures all businesses are now facing.

What we have seen work with a number of UDC's customers is their ability to manage and understand their cash flow position.

This understanding of their cash flow allows them to react quickly to lumpy times.

Questions/comments?

THANK YOU

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