PPB ADVISORY

Submission by PPB Advisory

Productivity Commission's inquiry into Australia's Automotive Manufacturing Industry

PPB Advisory is a corporate advisory firm which undertakes restructuring, advisory engagements and formal insolvency appointments within the automotive supply chain. We understand the Productivity Commission will receive a number of submissions in response to this inquiry so this submission will focus on:

1. If government funding of automotive original equipment manufacturers (**OEMs**) is continued, the government should also consider providing a restructuring fund for component manufacturers to 'right size' their workforce and re-scale costs down to operate profitably at current OEM volumes
2. If the government withdraws, or materially reduces, funding support to OEMs the government will be exposed to fund employee entitlements across the industry which, from our experience, may average c$64k per employee.

1. Government support for component manufacturer restructuring

By providing a restructuring fund, the government will be investing in component manufacturers to reshape, retrain and diversify to help ensure the automotive industry survives to at least 2022.

We have found many component manufacturers:

- are labour intensive with direct labour costs representing a significant portion of their fixed overhead structure, which have not decreased with declining Australian OEM production volumes
- need to reduce headcount by 20% to 30% (on average)
- do not have cash or funding available to restructure their businesses
- do not have a shareholder or parent entity willing and able to fund restructuring initiatives
- need a one-time cash injection to fund the costs involved in restructuring to a maintainable size.

Funding restructuring initiatives would give automotive participants:

- the ability to continue trading and become sustainable
- the opportunity to better compete for international contracts, using reduced overhead costs and better streamlined operations
- improved balance sheet strength helping to diversify into new markets and pursue new commercial opportunities
- time to reskill and retrain their workforce.

After a government funded industry restructure it is possible that the period to 2022 will see OEM volumes vary or fall and the occasional component manufacturer fail for various reasons.

However, even with normal business fluctuations the potential exposure to the government, in terms of funding employee entitlements, will not exceed its current exposure in an industry shut down.

Providing restructuring funding now allows the government to help support an automotive industry restructure, paying a smaller portion of redundancy costs now, with the chance of preventing an automotive industry collapse.

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For example, we were appointed Receivers and Managers of APV Automotive Components Pty Ltd (**APV**) because it was operating at a loss and was unable to fund redundancy costs necessary to right size the business. APV identified its workforce needed to be reduced by 20% to operate at breakeven on current OEM volumes however, did not have the funds to pay the c$2m redundancy costs.

As no funding was available APV was placed into liquidation, resulting in the:

- closure of the business and redundancy of the entire 127 person workforce compared to the initial restructuring need of 20 to 30 staff to right size the business
- the government exposure to the full redundancy payments of c$9.3m compared to the initial funding need of c$2m to restructure and keep the business in operation.

If APV had been able to secure the c$2m funding it needed to implement its planned solvent restructure, there is a good chance the company would have continued to operate today and 90+ staff would have kept their jobs.

See Appendix A for further background on the APV appointment.

2. Redundancy costs in the automotive industry

If a withdrawal or material reduction of government funding resulted in the collapse of the automotive industry the government may be exposed to funding employee entitlements via the Fair Entitlements Guarantee (**FEG**)[1].

Using a sample of automotive files we have worked on we have found that average employee entitlements in a closure of an automotive component manufacturer is c$64k (see Appendix B for further details of this calculation).

Automotive redundancy costs are typically higher than other industries as:

- **contract or EBA redundancy entitlements are higher than may occur in other industries**
  Often 4 weeks per year of service, and often these amounts are uncapped or capped only at very high levels (e.g. 100 weeks entitlement).
- **employees generally have a longer period of service than in other industries**
  Resulting in a higher redundancy liability
- **sick leave may be vesting**
  Resulting in an increased payout figure when an employee is made redundant.

These average entitlements and potential redundancy cost per employee in the industry should be considered when evaluating whether to provide further government funding to the automotive industry.

Should the Productivity Commission wish to discuss any elements of this submission, or any other automotive considerations, we welcome the opportunity to assist in any way we can.

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[1] Further information on the FEG can be found at:
http://employment.gov.au/fair-entitlements-guarantee-feg

Appendix A - Case Study – APV Automotive Components Pty Ltd ('APV')

Summary

- APV was a Tier 1 supplier to Toyota, Holden and Ford.
- APV needed c$2m of funding to reduce its workforce of 127 down to 100, to put the company in a break-even trading position
- Unable to restructure, the business eventually ceased trading and all 127 employees were made redundant
- APV had insufficient assets to cover outstanding employee entitlements (which totalled c$9.3m) and the government (via the FEG) eventually funded this[2].

Details

APV was a Tier 1 supplier of components for fuel systems and other safety equipment to Toyota, Holden and Ford.

We were appointed receivers and managers of APV in April 2012 following the break-down in negotiations between APV, one of the manufacturers and its unionised workforce.

APV needed c$2m of funding to downsize its workforce and make the business viable in terms of cash flow and generating a break-even profit position. APV could fund $1m through related company facilities but was seeking a further $1m funding or for the workforce to accept voluntary redundancy at 50% of the compulsory redundancy rate. Unfortunately, APV was not successful in obtaining the $1m and the workforce voted against accepting a reduced redundancy rate.

Consequently, we were appointed as receivers and managers and traded the business for 5 months after negotiating comprehensive funding and working capital arrangements with the customers. During this time we reduced the workforce by 30% to more appropriate levels given production volumes, re-engaged the remaining staff and optimised the supply chain. These initiatives allowed the business to trade at slightly better than break even during the receivership.

The business eventually ceased trading as it was always the long term intention of the customers to migrate to new suppliers once APV was placed into formal insolvency, thus making the business unsaleable. This resulted in all additional 90 remaining staff being made redundant.

The end result was that there were insufficient assets to cover the employee entitlements due (totalling c$9.3m). The government (via the FEG) eventually funded the redundancies and 127 employees were made redundant[2].

If APV had been able to secure funding for the full $2m it needed to implement its planned solvent restructure, there is a good chance the company would have continued to operate today and 90+ staff would have kept their jobs.

As federal funding for employee entitlements is only available to entities in liquidation the:

- potential $1-2m in government funding to restructure and keep the business in operation ended up costing the government c$9.3m in redundancy payments (less reimbursement from some asset realisations).
- entire workforce of 127 staff was made redundant instead of the initial 30 staff to right size the business.

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[2] In this scenario we were able to sell certain assets to return some funds to DEEWR, however as discussed above in section 3, our assumption is that there will be no available assets from which future DEEWR funding could be repaid.

Appendix B – Employee entitlement calculations

The below table provides details of employee entitlements of automotive component manufacturers PPB Advisory has restructured over the past 6 years:

Employee entitlements summary

	# of employees	Unpaid wages and RDO's	Annual leave and loading	Long service leave	Redundancy (inc. PILN)	Sick Leave	Super	Total	Avg. per employee
Entity 1	354	354,252	1,835,292	2,990,336	12,511,460	2,302,629	-	19,993,969	56,480
Entity 2	127	91,211	533,967	1,128,226	6,704,615	786,362	67,570	9,311,951	73,322
Entity 3	224	201,441	568,878	2,172,925	11,562,856	1,267,849	-	15,773,949	70,419
Entity 4	190	115,751	1,201,735	1,586,614	8,144,104	940,571	-	11,988,775	63,099
TOTAL	**895**	**762,655**	**4,139,872**	**7,878,100**	**38,923,035**	**5,297,412**	**67,570**	**57,068,644**	**63,764**

Redundancy entitlements (including payment in lieu of notice) equate to 68% of total employee entitlements. These are liabilities that are not currently provided for or actively monitored by automotive industry employers, but will represent a significant portion of total automotive industry entitlements if the industry was to collapse.

It is this high redundancy cost that prevents automotive industry participants from undertaking their own restructuring initiatives.