



INDUSTRY UPDATE

Victorian Manufacturing Industry A Changing Landscape

Australia's Industrial Heartland

With over 30% of total domestic manufacturing capacity, the Victorian manufacturing sector is the largest of any state in Australia.

The industry focuses on components and assembled goods manufacture, with a strong presence in the automotive, electronics, metal fabrication, aerospace, and precision engineering areas. 57% of Australian automotive production is in Victoria.

Manufacturing contributes more than \$26 billion to the Victorian economy, accounting for 60% of Victoria's total exports. Not surprisingly, the sector directly or indirectly provides 40% of Victorian jobs.

Whilst many large multi national manufacturers exist in Victoria, the industry comprises numerous small to medium, often privately owned businesses.

Manufacturing represents a large share of total output for many Victorian metropolitan and regional areas, with manufacturing exceeding 40%, and some greater than 50%, of total output in a number of municipalities.

Manufacturing has strong upstream and downstream linkages with other industry sectors and the general economy. Considerable flow on effects can therefore be expected with any material change in the manufacturing sector, be it on a global, national or regional basis.

Recent Experience

Despite a booming economy and insatiable consumer demand, a combination of statistical, anecdotal and actual events suggests that the Victorian manufacturing sector is under increasing pressure.

The sector:-

- Is becoming increasingly exposed to the effects of globalisation, with decreased government protection and subsidies, and the advent of Free Trade Agreements.
- Is experiencing significant foreign competition from emerging economies, in particular China and India, who have significant cost advantages, particularly in labour,

and fewer regulatory constraints, such as environmental requirements.

- Has recently experienced a number of business failures, including ION, Ajax Fasteners, Huon Corporation, and Feltex Carpets.
- Has reported three consecutive quarters of negative growth to June 2006 in both gross profits and sales.
- Has endured a sustained period of higher exchange rates, increasing the comparative cost of exports and making imports more competitive.
- In a labour intensive industry, has faced higher wages and skills shortages.
- Has experienced considerable growth in the costs of other major inputs, with high commodity prices, in particular metals and oil, rising interest rates, and rising property (infrastructure) costs.
- At the same time as having rising costs, has been at the mercy of large customers incorporating "price down" requirements into supply agreements.

Trends and Direction – Who will Survive?

There is no doubt a place still exists for a substantial manufacturing industry in both Victoria and throughout Australia. However, as the economy begins to slow, new particularly foreign competitors are established, and consumer demand decreases, participants are going to have to change and evolve in order to survive.

Key attributes and success factors for businesses going forward in the manufacturing industry include:-

- An ability to compete on a global scale, including seeking broader domestic and foreign markets.
- Embracing innovation and research and development – value adding through developing and commercialising superior knowledge.
- Taking appropriate steps to protect intellectual property/patents.
- Efficient production techniques and high capacity utilisation.
- Ability to identify and manufacture products locally that are less likely to be subject to foreign competition.
- Have "balanced" contracts that enable the passing on of increases in input costs, such as for wages, metals and transport, not just having "price down" clauses.
- Minimal reliance on a few customers and/or suppliers.



- A focus on "value added" stages of manufactured goods, potentially outsourcing part of or complete processes.
- Broadening opportunities, potentially becoming an importer and distributor through having operations in cheaper foreign-based manufacturing centres for certain components or complete finished products.
- Exploiting competitive advantages, offering superior customer service, and being market responsive.
- Developing and investing in mutually beneficial long-term customer relationships, such as via offering "just in time" deliveries, creating customer loyalty and dependency.
- An ability to readily adapt to changing market conditions and demonstrate flexibility and adaptability in their manufacturing processes and capabilities.
- Seek constant improvement and efficiency gains across the whole value add supply chain, through design to purchasing, manufacture and distribution.
- A move towards automated, more capital and less labour intensive manufacturing techniques.
- Recruiting, developing and retaining a capable workforce, with strong employee (union) relations.
- Ensuring the ability and strategies exist to address current and potential increased regulatory requirements, such as OH&S, environmental and emission requirements.
- Taking advantage of government support and initiatives.

In addition to the above, we have found that many underperforming or failed manufacturing businesses lack fundamental management disciplines, such as:-

- Proper costing and pricing of products.
- Having appropriate accounting systems and controls in place.
- Lack of planning, control and efficiency across direct processes, from procurement to manufacture to distribution.
- Maintaining adequate margins and controlling costs.
- Managing cashflow.
- Lack of budgeting and strategic planning.
- No or poorly documented supply and customer agreements.
- Inefficient management practices and structure.

Taylor Woodings' Experience

The Partners of Taylor Woodings have extensive experience across a number of businesses in the manufacturing sector and related industries, including

automotive components, food, appliances and electronics, technology and telecommunications, plastic moldings, clothing and fabric manufacturing, foundries, mechanical services, mining equipment and steel fabrication.

We have acted in both formal and informal capacities, including as Receivers, Administrators, and in conducting pre lending and investigating accountant reviews.

In our various capacities, we have assisted stakeholders in:-

- Conducting viability assessments.
- Managing manufacturing businesses on an interim basis.
- Preparing and reviewing budgets and costing models.
- Conducting complete strategic and operational reviews.
- Determining and implementing systems and process improvement initiatives.
- Compiling information memorandums and managing the due diligence sale of businesses.
- Reviewing and "testing" business and strategic plans and funding proposals.
- Monitoring performance and covenants on behalf of financiers.
- Formulating, implementing and monitoring turnaround and exit strategies.
- Customer and supplier contract reviews and negotiations.
- Debt restructuring and refinancing.

Should you wish to discuss this matter or require more detailed advice on a particular situation please contact:

Sydney Office:

Quentin Olde, Partner - Quentin.Olde@twcs.com.au
Matt Adams, Partner - Matt.Adams@twcs.com.au

Ph: (02) 8247 8000 Fax: (02) 8247 8099

Melbourne Office:

Ross Blakeley, Partner - Ross.Blakeley@twcs.com.au

Ph: (03) 9909 7130 Fax: (03) 9909 7134

Perth Office:

Ian Francis, Partner - Ian.Francis@twcs.com.au
Michael Ryan, Partner - Michael.Ryan@twcs.com.au
Mark Englebert, Partner - Mark.Englebert@twcs.com.au

Ph: (08) 9321 8533 Fax: (08) 9321 8544

If you would like to read previous versions of Taylor Woodings Industry briefs about the Pharmacy Industry or other topics please visit our website at:

www.taylorwoodings.com.au/publications.html

Disclaimer: This publication is for information purposes only and should not be relied on in place of advice.