Exchange for Change
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Dear Brett

Exchange for Change would like to take this opportunity to submit a response to the IPART progress report on the NSW container deposit scheme. Our comments are centred around the recommended changes to trading terms for first suppliers. Exchange for Change is also very willing to work with the NSW State around any potential solutions to the cross-border issues and how to increase the overall efficiency of the scheme.

IPART has recommended that the trading terms between EFC and 1st Suppliers be changed from the current 7 days to 30 days.

First suppliers are required to pay invoices from Exchange for Change in advance and within seven days for their share of the direct costs of the scheme. These payment terms are out of step with standard industry practice, which is to allow 30 days for payment. We consider this may cause financial stress for smaller businesses, particularly as they are invoiced for this cost in advance. We have made a preliminary draft recommendation that Exchange for Change provide all suppliers 30 days to pay these invoices.

EFC has explored several options to address this issue and evaluated the benefits and disadvantages of each. The options explored include:

1. No changes to scheme except to extend trading terms for beverage suppliers from 7 days to 30 days
2. Extending payment terms for small beverage suppliers only
3. Extending payment terms for all suppliers in conjunction with a change to payment terms for the Network Operator
4. Implementing an arrears invoicing model instead of current forecast model

1. **No changes to scheme except to extend trading terms for beverage suppliers from 7 days to 30 days**

EFC has modelled the impact of IPART recommendation on cash reserves and this shows that the Scheme Account would go into a negative balance each quarter at the time of the payment to the MRF's. The size of this negative balance is dependent upon collection volumes through the various channels but is estimated to be in the order of $2.5 million. This is demonstrated in the graph below.

Graph is Commercial in Confidence

Graph 1, payment terms moved to 30 days

To facilitate this option an overdraft facility would need to be established to facilitate the Scheme Account going into a negative balance. The advice from our current banking provider, Westpac, is that the we could obtain an unsecured overdraft of $5 million based on the scenario for option 1. Westpac is yet to price this option but have advised if a security was available for the overdraft it would be at a lower cost.

The cost of servicing this overdraft would be a scheme cost.

2. Extending payment terms for small beverage suppliers only

There have also been discussions with the State suggesting that a simple fix would be to only change the trading terms for small suppliers from 7 days to 30 days but leave all other suppliers on the current arrangement. The scheme has been designed to be simply a pass through of costs and so any discrepancy in payment timing means that effectively one group of suppliers is becoming a lender of working capital funding to the other, which will have commercial impacts, and that is inherently not the intention or mandate of the scheme.

The critical nature of treating all suppliers equally was realised in the original design of the scheme to the extent that it was written into the Scheme Coordinator Agreement. Clause 4.4 of the Scheme Coordinator Agreement requires EFC to treat all scheme participants equally. This clause prevents EFC having different trading terms with various First Suppliers based on their size.

3. Extending payment terms for all suppliers in conjunction with a change to payment terms for the Network Operator

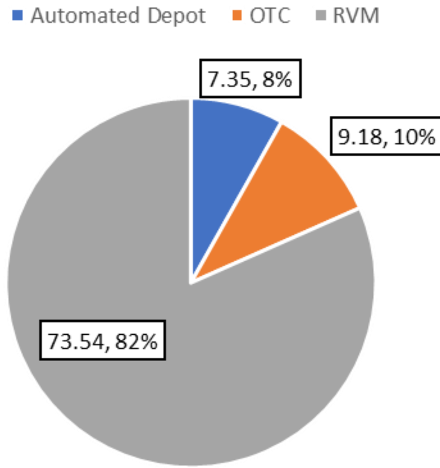
As discussed in option 1, extending the payment terms for the First Suppliers from 7 days to 30 days will result in an overdraft being required. The size of the overdraft could be reduced if we are able to vary the payment terms of the Network Operator. The Network Operator currently invoices EFC weekly, four weeks in advance and EFC is required to pay within ten business days of the invoice.

The Network Operator has three main collection channels & their payment arrangements very as follows:

1. Over the Counter – a cash float is provided
2. Automated Depot – unclear if a cash float is provided
3. RVM's – payment made at the time of container redemption

Graph 2, April collection volumes, shows that 82% of collection volumes occurred via RVM's. This means that the Network Operator payment arrangements could be reduced to two weeks in advance and payment in 7 days. If this was implemented it should not affect their ability to fund the collection points. Changing the payment terms to this arrangement would potentially eliminate the need for an overdraft as EFC modelling shows that the Scheme Account would reduce to $0.9 million as demonstrated in graph 3.

This arrangement will reduce the cost of changing the payment terms for the First Suppliers and will still allow the Network Operator adequate funds to operate.



Graph 2, collection volumes by collection point type for April 2018

Graph is Commercial in Confidence

Graph 3, Network Operator payment terms reduced to 7 days

4. Implementing an arrears invoicing model instead of current forecast model

One of the criticisms of the CDS from many stakeholders has been the forecast price model. Charging First Suppliers an estimated price can result in consumers being charged higher costs for containers than the final CDS price, once actual pricing is determined.

EFC believes this review is an ideal opportunity to look at moving to an arrears payment methodology. Currently the NSW CDS operates on a forecast approach to invoicing first suppliers. EFC is forecasting containers collected by the network operator, MRF's, as well as the container volume first supplied into NSW and export volumes out of NSW. While EFC forecasts are currently achieving an accuracy of greater than 90% this process still results in a true up being paid. The forecast and true up process results in consumers not being charged the final adjusted cost of the CDS.

The alternative to a forecast model is to invoice in arrears. That is, all costs are reported at the end of the month and then the first suppliers are charged actual costs. This typically means that first suppliers are paying invoices approximately 37 days after month end. The major issue of an arrears model is the working capital to fund the scheme.

NSW is the only CDS that is currently operating in Australia that is based on forecast model. Both South Australia and Northern Territory operate on an arrears approach. When the Queensland scheme is introduced later in 2018 it will also operate on an arrears approach. The ACT scheme to be implemented on the 30 June 2018 is a forecast model however invoicing occurs on the first day of the month. This shorter forecast horizon should result in a more accurate invoice and smaller true ups.

EFC believes that an arrears finance model that is based around the South Australian and Queensland scheme would provide the best outcome to industry and consumers. The key elements of these schemes are:

- Beverage suppliers report their supplied volumes by the 20th day after month end
- EFC would determine costs by the 1st day of the next month and invoice suppliers on the next business day
- Payment terms would still be 7 days after invoice

This approach would significantly reduce the need for a true up as well as improving cashflow.

Graph 4, shows the cash flow impacts of moving to the South Australian arrangement. The graph shows that to make this model work a cash reserve of approximately $15 million would be required.

There are two options to fund this:

1. A secured overdraft is obtained from Westpac, EFC's current bank. The NSW Treasury would be requested to provide the security. This is a similar approach to what the Queensland Government is using for their scheme
2. An unsecured overdraft is obtained from Westpac. Advice from Westpac is that they would not provide an unsecured overdraft of this size based on the cashflows presented.

The funding of the overdraft would be a scheme cost and would be paid by all beverage suppliers as part of the cost of running the CDS. It is important that the costs are kept to a minimum as the consumers will potentially end up incurring this cost.

Graph is Commercial in Confidence

Graph 4, South Australian approach used in NSW

The size of the overdraft could be reduced if the Network Operator payment terms were varied in line with option 3 discussed previously. Changing the payment terms to this arrangement would reduce the overdraft to $10.5 million as demonstrated in graph 5.

Graph is Commercial in Confidence

Graph 5, Network Operator payment terms reduced to 7 days

Recommendation

Exchange for Change recommends a change to payment terms as follows:

- All scheme participants are treated equally
- Payment terms for First Suppliers extended to 30 days in conjunction with a change to the payment arrangements for the Network Operator (option 3)
- Consideration of moving to an arrears pricing model be reviewed, (option 4), to address issues raised by stakeholders and most importantly consumers.

Yours sincerely,

P A Bruce

Peter Bruce

Chief Executive Officer