High diesel price will stall us all

What will happen to South Africa if the price of oil hits $200 a barrel? **Paul Ash** speaks to local transport operators

HOW do you keep a business going when one of your input costs starts soaring out of control? Easy — basic business logic says pass the cost onto your customers.

When diesel prices started their long and terrifying march last year, trucker Steve Smith tried that and it didn't work. His customers baulked. Last month, Smith, MD of refrigerated trucking company Cool Cat Carriers, called it a day and pulled 23 of his Freightliners off the road and put them up for sale.

"I can't run at a loss," Smith told industry magazine Fleetwatch.

Smith's story is an increasingly common one in trucking circles. In an industry to which most South Africans pay scant attention, failures of trucking businesses go unheeded. Well maybe not anymore, as more and more companies go to the wall because of high diesel prices.

The crisis has been a long time coming. Four years ago, National Geographic carried a cover story simply titled The End of Cheap Oil. Among the beautiful pictures of oil fields in California and kids playing in front of their mother's Hummer ("I know it's not fuel efficient, but I love knowing that anything I bump into, I win") was the stern warning: we are going to run out of oil. The question every oil analyst asks, and is asked, is: when is Peak Oil — the point at which global oil production peaks before beginning a decline — going to happen?

There is still plenty of oil in the ground but much of the untapped wealth is in hard-to-reach places — try about 5km below the sea floor in the Thunder Horse field in the Gulf of Mexico — or in oil sands and shale from which the extraction process is costly.

Tim Appenzeller, author of the National Geographic cover story, cut right to the heart of the matter: "But in the end, the quest for more cheap oil will prove a losing game. Not just because oil consumption imposes severe costs on the environment, health, and taxpayers, but also because the world's oil addiction is hastening a day of reckoning."

Four years later, the price has climbed from $30 a barrel to $135, having surged to $146 in between, driven by supply shortages, increased demand and, recently, a weaker dollar, the currency in which most oil is traded. In May, a Goldman Sachs analyst, Arjun Murti, stunned the markets by predicting that oil would climb to $200 a barrel, possibly in as little as six months, in what he termed would be a "super spike". Analysts scoffed at Murti when he predicted that oil would hit $100 — now they are silent.

Many analysts also blame speculators

If trucking becomes unsustainable the economy will crash

taking bets in the futures markets for driving oil prices skywards. At the G8 summit in Japan, Europe's ministers are talking remedial action. Italian Prime Minister Silvio Berlusconi and German Chancellor Angela Merkel have proposed action against speculators. That is likely cold comfort for trucking operators like Smith — and to ordinary South Africans.

We know that the price of oil is going to make everything more expensive. What many people don't appreciate though is that when the cost of diesel makes it too expensive to operate a transport business, the economy will come to a crashing halt.

At some point in the supply chain, almost every commodity and product goes by truck. Without trucks, South Africa would plunge very quickly into chaos — no food would get to the cities and deliveries of coal to power stations would slump. Even rail transport depends heavily on trucks at the beginning and end of its logistics chain.

Add the spectre of a weaker rand/dollar exchange rate and the situation becomes critical, says Tony Twine, senior economist at Econometrix. "We calculated that a truck doing 200 trips year a between Durban and the Reef would consume around R1-million in fuel at today's prices."

At a weaker exchange rate of, say, R8.50 to the dollar, says Twine, the price of diesel would be R17.50 and that same truck would consume R1.65-million of fuel.

"That's more than the truck costs."

When hard times come, the spotlight falls on mining and manufacturing but the trucking industry gets little attention, writes Patrick O'Leary, editor of Fleetwatch.

"Yet without these trucks, these other sectors would be the ones dying a slow but sure death, especially in these times when there is no real rail service to speak of," O'Leary writes.

Since road transport was deregulated in 1985, rail freight in South Africa has taken a hiding. Rail's share of the freight business is tiny and many branch lines have been closed.

Most of southern Africa's railway network still relies on diesel locomotives and although much of Transnet's core network is electrified, there are large gaps in the system operated by diesel locomotives.

This is happening with the price of oil at $135 a barrel. What will happen if it hits $200? The experts reply.

TIME BOMB: All sectors of the South African economy depend to some extent on increasingly expensive road transport

Picture: RICH PEDRONCELLI/AP

TAME STUFF: Tony Twine says the current crisis is not as serious as 1973's

ON TRACK: Henry Posner reckons railways have a competitive advantage over truckers

SURVIVAL: Jo Grové says long-term contracts allow increases to be passed on

NO SUPPORT: Patrick O'Leary hasn't heard a word from the country's politicians

Experts' views on soaring oil price

● **The Economist: Tony Twine, senior economist at Econometrix**

"I think that the oil prices that we're seeing at the moment aren't justified by realities of global supply and demand; they are being pushed by speculative players in markets around the industry.

Compared to previous crises, we are in somewhat tame territory, relatively speaking. Diesel at R17.50/l would be around about 150% higher than we remember a year ago. But back in 1973 the fixed rand/dollar rate was 230% higher than 1972.

By historic standards this is all fairly tame stuff. The economy survives; we all make certain adjustments.

Anyone who does not have opportunity to pass on costs through the value chain is going to be most vulnerable — in this case transport operators, who face competition from more efficient operators and modes.

If you're hauling coal from Witbank to Richards Bay, there is no question that moving by rail will be more efficient."

● The Railroader: Henry Posner III, chairman of Railroad Development Corporation; shareholder in Central East African Railways and Corredor de Desenvolvimento do Norte in Mozambique

"Our tariffs are constrained by truck competition via Durban and Beira as well as the combined rail/truck alternative via Dar es Salaam. However, because the competing routes involve truck transportation and rail is more fuel-efficient, we should be able to pass most fuel price increases on to our customers.

A macroeconomic constraint, however, is that at a certain price customers will stop shipping altogether, making the truck versus rail competitive analysis irrelevant.

Railways worldwide are experiencing increased pricing power due to their competitive advantage in fuel economy versus trucking. This is another way of saying that, in general, the rail industry's "contingency plan" is one of passing high oil prices on to the customer.

However, in today's environment, fuel costs have increased to the point where in some cases they exceed payroll costs.

(While) fuel prices are for the most part beyond railways' control, fuel efficiency can usually be improved around the edges through a number of strategies, ranging from a closer focus on idling time and train handling to the purchase of new, more fuel-efficient locomotives.

In the case of RDC's Iowa Interstate Railroad, we are investing more than $20-million on the purchase of new locomotives, driven by a combination of reduced maintenance costs and fuel efficiency."

● **The Trucker: Jo Grové, CEO of Unitrans Holdings**

"Unitrans is in the supply chain solutions business, operating long-term contracts.

The group consumes about 100 million litres of fuel a year and right now fuel accounts for about 40% of our costs.

We have no option but to pass on all statutory increases to our clients. The operators who have structured long-term contracts and the ability to pass on these statutory increases are going to be okay.

The other guys, who don't have these contracts, are likely to find the going quite difficult."

● The Trucking Analyst: Patrick O'Leary, editor of Fleetwatch magazine

"Expensive oil will destroy many companies and it is something that is happening all over the world.

In Australia, hauliers are already closing down. In Germany, which has 52 000 hauliers, 3 000 are facing imminent closure. (German truckers) are going on the rampage.

Truckers don't have many options — they can try and improve their fuel efficiency through things such as better driver training, but this is only a short-term solution. The (higher fuel costs) have to be passed on to consumers, but that takes a long time.

The knock-on effect is going to be massive. Already there have been retrenchments in the industry and carriers have closed down. It's going to continue and there is going to be unemployment.

No one in the political ranks is batting for the trucking industry at a time when it is facing probably its most serious crisis, some form of ministerial intervention with a view to some form of relief is needed.

I have not heard one statement from any politician — not even the Minister of Transport — showing concern, or even empathy, regarding the effect the fuel price hikes are having on the trucking sector.

All the accent seems to fall on sectors such as mining and manufacturing. Yet the trucking industry, which provides a vital service to all these other sectors, is treated as Cinderella — and it is the one which depends entirely on diesel to conduct its operations."

Tractor sales continue to plough ahea

DON ROBERTSON

TRACTOR sales continue to soar and will show further growth in the third quarter of the year, in spite of higher interest rates and rising input costs in the farming sector.

The SA Agricultural Machinery Association (Saama) said that tractor sales in June rose to 525 units from 409 in the same month last year, an increase of more than 28%. Sales so far this year have increased by almost a half to 3 462, compared with 2 246 in the first six months of 2007.

Sales of combine harvesters are up 178% to 198 in the first six months, to harvest the excellent maize crop, while baler sales were 325 compared with 220, a rise of 47%.

Saama said that sentiment is positive, but when farmers look ahead to summer crops they will be carefully considering input costs before deciding what to plant. The late summer rains allowed some farmers to bring forward their ploughing, which also increased demand for machinery.

The total value of agricultural machinery, including equipment such as fertiliser spreaders, tractors, balers and combine harvesters, is about R4.4-billion in the year to June, according to Jim Rankin, managing director of Saama.

Tractors at the lower end of the popular segment cost between R400 000 and R500 000. Sales to date and expected sales for the rest of the year are, however, likely to be well below the record of about 25 000 units sold in 1981.

Harvesting began in May and will probably be finished by the end of this month.

White maize is trading at around R2 060 a ton on the SA Futures Exchange, with yellow maize marginally higher at R2 100 a ton.

The latest report from the Crop Estimates Committee forecasts a total commercial maize crop of 11.59-million tons for the current season, compared with 7.12-million tons for the 2006/2007 season. This will comprise 6.86-million tons of white maize, with a yield of 3.95 tons a hectare. Yellow maize is expected to be 4.73-million tons, with a yield of 4.46 tons a hectare.

General Motors runs low on cash

LIKE a petrol-thirsty SUV crawling to the pump, General Motors needs to fill up fast with cash.

Despite a broad restructuring since 2006, the largest US vehicle manufacturer may soon have to raise new operating capital to offset a steep decline in vehicle sales.

Investors worried about its prospects, including the possibility of bankruptcy, have driven GM's stock down to about $10, its lowest point in more than 50 years.

GM executives dismiss bankruptcy talk, but pressure is building for the company to raise cash in equity and debt markets.

"The rapid change in the external environment, especially fuel prices and demand, has outpaced GM's most aggressive restructuring timetable," said John Casesa, of New York consulting firm Casesa Shapiro. "GM needs capital to finish the job."

GM has $23.9-billion in cash on hand, and credit lines for another $7-billion.

GM chairman Rick Wagoner has declined to comment on funding since announcing a series of plant closures last month.

GM should have enough cash to last through 2009, if analysts' estimates are accurate that GM is spending $1-billion more each month than it is taking in. But the cash cushion seems far from comfortable given the extraordinary sales drop-off.

Soaring petrol prices and a weak economy sent new-vehicle sales down 10% in the first half of the year. GM performed worse than the overall market, with sales down 16%.

The market for big pick-ups and sports utility vehicles, with profits of up to $10 000 on models like the Chevrolet Suburban and Cadillac Escalade, dropped 25% as consumers fled to fuel efficiency.

Along with rivals Ford and Chrysler, GM has laid off thousands of workers and shut plants making SUVs and pick-ups.

It said it was prepared to cut more white-collar jobs. It has also put its Hummer brand up for sale, and may consider eliminating, downsizing or selling off marginal brands such as Saturn and Pontiac.

Cutting jobs or dumping brands will reduce costs, but cannot replace lost revenues. — © (2008) *The New York Times*

Europe's high-speed trains derail airlines

THE lounge was thronged with bleary-eyed and grumpy suits looking in vain for seats. The queue for coffee snaked past whimpering children and inconsiderate backpackers. As the PA speakers announced imminent departure, the throng became a melee at the exit — an escalator had jammed.

It could be a typical morning at Heathrow, but in my case it was a 7am departure from the Eurostar terminal at St Pancras. Don't get me wrong, the fast train to Paris and Brussels is a brilliant success.

Airlines ignore it at their peril and last week Air France threw in the towel and said it was in talks with Veolia, Europe's leading private rail-freight operator, about launching high-speed train services with Air France livery.

The airline industry has been crushed by the price of kerosene and deserted by passengers fed up with delays. After decades of disappointment and false dawns, we have finally arrived at the age of the train and the evidence is at St Pancras.

Only five months after opening its doors in November, the new station is chock-a-block at peak hours, an exciting but slightly nerve-wracking development for Eurostar and its biggest shareholder, SNCF, the French state railway.

Traffic growth on Eurostar is accelerating like an Alstom locomotive, increasing by 21% in the first quarter, compared with the same period in 2007, and revenues are up by a quarter. Traffic in the second quarter has grown at similar rates, insiders say. Squeezing the London-Paris journey time by 20 minutes has boosted Eurostar's income by 25%.

The Terminal 5 fiasco has not helped British Airways, and it is left with the awful question of whether short-haul air traffic has any future in Europe. The answer has to be a resounding "no".

When did you last hear of a service business where the fuel bill represented more than a third of the operating cost, substantially higher than the cost of the staff? BA and Air France are not shipping sand and gravel out of the Port of Rotterdam; they are selling a luxurious padded seat and a journey through the stratosphere to pampered executives.

If a third of revenue is burnt in the turbine needed to keep the executive's bottom in mid-air, it doesn't leave much cash for champagne and truffles, nor the pilot's wages.

To make matters worse, airlines will be included in the European Union's Emissions Trading System.

It is another blow because carbon trading is a tax on business and the electrified railways won't pay it.

Air France has watched over the past decade as SNCF's *Train à Grande Vitesse* (TGV) eroded its domestic business. Air services between Paris and Lyon and between Paris and Brussels have been suspended.

The train is dominating traffic to Marseilles and Geneva and the new line east to Strasbourg will quickly extinguish air links. On the London-Paris route, Eurostar boasted 70% of traffic last year and that must be climbing fast. If the distance travelled is 960km or less, a train travelling at 300km/h has the edge, city centre to city centre.

BA has always struggled to make money on short-haul routes.

If the big European flag carriers can still make their money, it is on long-haul services. What matters to BA, therefore, is wealthy people who want to fly to America, Asia and Africa, a market that is now threatened.

Air France has the opportunity to capture wealthy Britons who live in a wide catchment area east of Heathrow. By 2010, Europe's high-speed rail network will be open to competing operators. The French airline is keeping mum about its plans with Veolia, but it is a reasonable bet that Air France high-speed rail services to Charles de Gaulle airport will be rolling out of St Pancras within the next five years.

Where does this leave BA? While the British airline fusses over extra runways at Heathrow, its big competitor is planning to run trains all over Europe hoovering up passengers.

Forget Heathrow, we need Terminal 2 at St Pancras. — © *The Times London*

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