



# Cost Pressures

Factors impacting product pricing and availability in our industry

## Introduction

As we come to the end of another turbulent year for businesses across the UK, it is important that we discuss openly the challenges we face due to the ongoing global disruption of the Covid-19 pandemic.

These are exceptional and testing times, as various factors have combined to create greater levels of cost volatility than we have seen in recent years. This “perfect storm” confronts all within our industry and demands ever greater understanding of the current pressures up and down the supply chain. **DEOS GROUP** is well positioned to see both sides of the current issues surrounding cost pricing and stock availability. It is certainly no exaggeration to say that on both fronts we are in a period of high instability, which unfortunately looks set to continue as we move into 2022.

While price increases are rarely welcome, the cost pressures responsible for the current situation can be explained and are supported by readily available market data and raw materials indices. This document pulls together the key broader themes that are affecting market prices, with specific data points also provided to help substantiate the increases we are seeing. The situation demands action, and we hope that the detail here highlights the current market challenges for ourselves and our valued customers.

**We continue to see much higher levels of cost volatility than in recent years, with unprecedented product cost increases being applied in recent months and from January 2022.**

**In these challenging times we appreciate the need to share as much detail to substantiate these increases as possible.**

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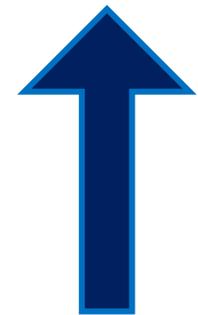
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## Freight Costs

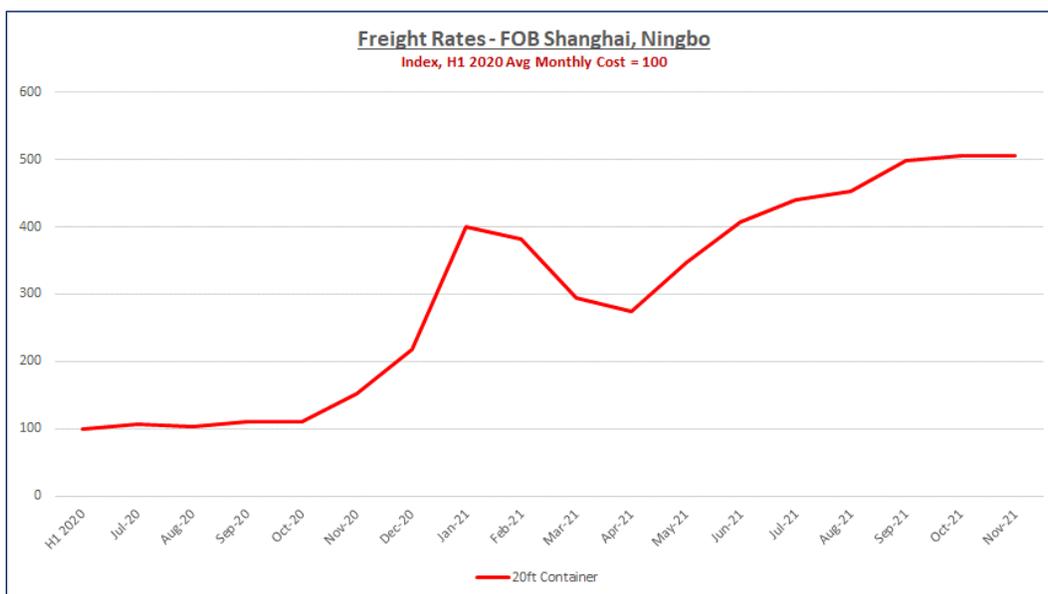
The global repercussions of the Covid-19 pandemic continue to have an impact on the movement of goods around the world. For many years preceding the cost of freight had been a consistent factor on the delivered cost of products that DEOS GROUP sells from Asia. Rates for shipping containers were set monthly and historically there was little variation in the cost from month to month.

The effective shutting down of the global economy through large parts of 2020 put significant strain on capacity, with vessel and container availability impacted. The subsequent increase in demand, as economies recovered and certain regions came out of lockdown caused prices to spike, as did adjacent factors such as Chinese New Year and congestion at UK ports.

**At their peak, container rates were 370% above those through much of 2020.** Prices have remained high since mid-year. In Q4, the \$ price for the movement of the container stabilized and then fell slightly; however, new surcharges and UK haulage costs mean the full cost hasn't fallen. The market consensus is that these levels will continue in 2022, as instability and disruptions are forecast to remain.

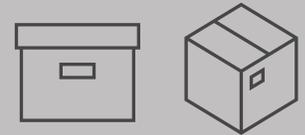
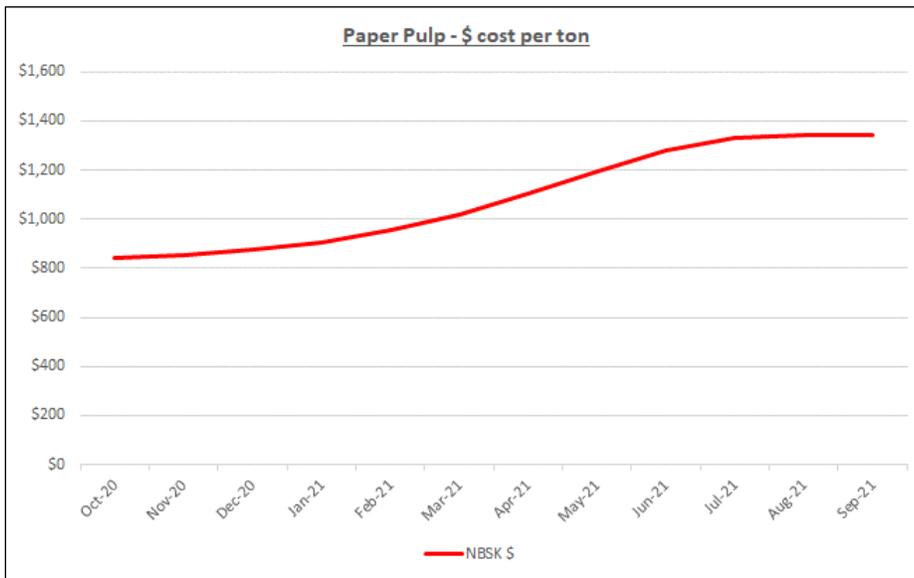


Container rates  
**372%**  
higher than  
January 2020



## Raw Materials – Paper & Cardboard

Product cost increases here can be directly attributed to the significant pulp price increases seen over the past 12 months, caused in part by greater demand as economies have recovered. Pure pulp has increased by 60% since October 2020, with prices now at record highs. Paper producers have been increasing prices throughout the year to allow for these higher input costs, however other cost pressures remain.



*Demand for packaging – driven by the increase in online sales through lockdown – continues and is driving high demand for packaging products. As a result, the cost of corrugated board has risen; for example, Testliner paper has increased by 51% since January 2020.*

**Soaring energy costs** have also led to some mills and converters implementing immediate surcharges. Recent energy cost increases have been widely reported and are particularly pressing for mills and converters due to their high energy consumption.

Wholesale gas prices have risen

**250%**

since January 2020



*As has been reported in the national media, there has been a worldwide squeeze on gas and energy supplies through the latter half of 2021. A colder winter in Europe last year put pressure on supplies and reduced stored gas levels. At the same time there has been increased demand from Asia for liquefied natural gas.*

## Raw Materials – Other

As has already been mentioned, record freight costs have an impact on the cost of raw materials, though they are not the only determining factor here. Throughout 2021 raw material indexes and key indicators in commodity areas such as plastics, rubber, and steel have continued to contribute to higher costs. Again, the global impact of the Covid-19 pandemic cannot be understated, with fluctuating demand and material availability putting significant pressure on prices. The causes and subsequent challenges here differ between material types but have serious implications for manufacturers; some examples relevant to our industry are covered below.

### Metals

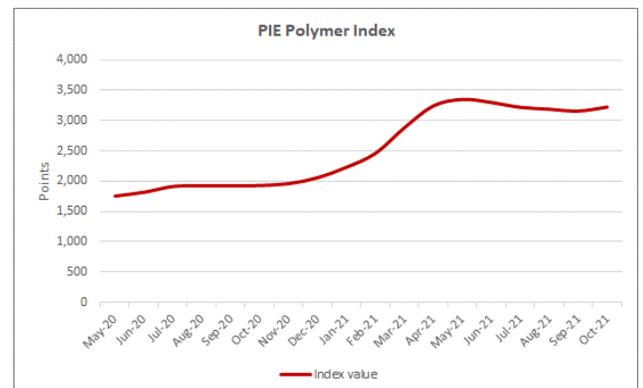
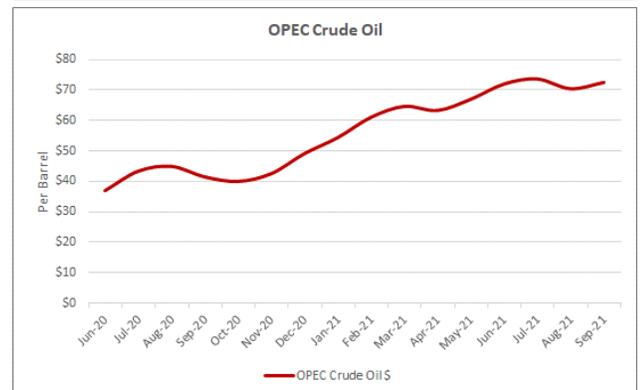
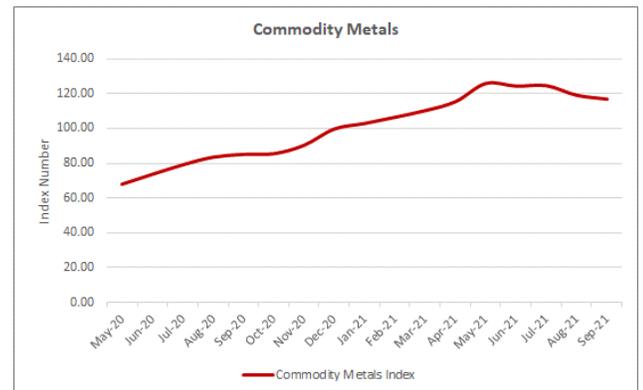
Raw material prices have risen significantly with commodity barometers such as copper doubling in price in the last year and hitting a 10-year high. Similarly, the price of hot rolled steel in Europe recently reached its highest level since 2008, buoyed by strong demand and supply disruptions caused by the pandemic. Demand linked to the post-pandemic economic recovery efforts initiated by governments around the world are also driving the price surge.

### Crude Oil

As with metal pricing, the price of oil has recovered from the crash and historic lows seen at the height of the pandemic. Global demand is a key driver here, but so is the ability of OPEC+ to manipulate pricing through product levels and market rebalancing. The challenge here is that for some manufacturers the previous low cost of oil compared to the pre-pandemic period was a useful offset for increases in other areas, which now need to be passed on.

### Plastics / Polymers

Raw material shortages have put the market for polymers under sustained pressure throughout 2021. Resin availability has been a key concern, with demand high and production capacity limited. Here again the impact of increased freight costs has upstream consequences, adding further to the pressure to margins of converters.



## Transport Costs

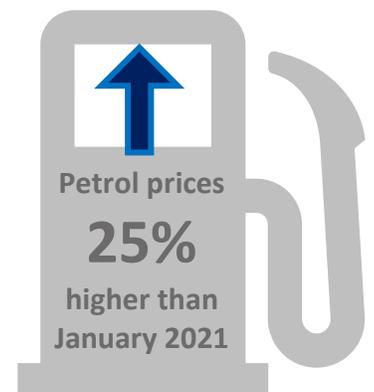
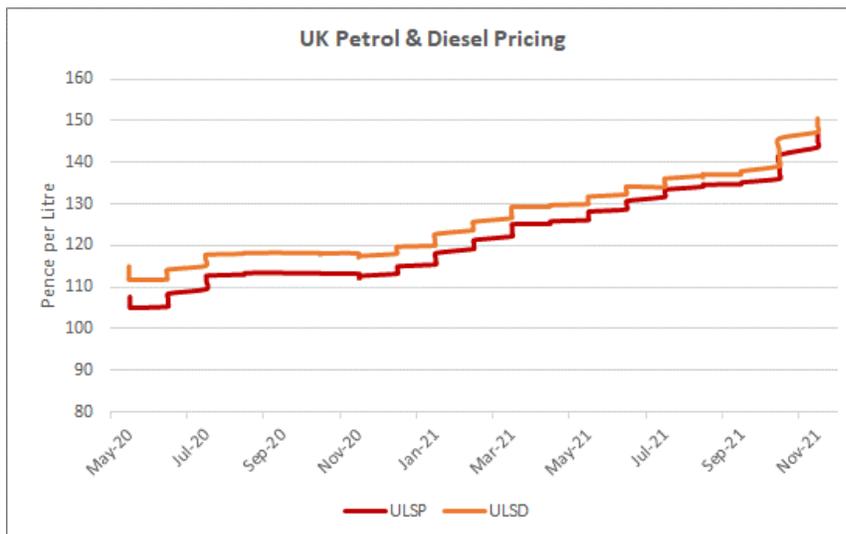
As has been well reported in the national press, there is currently an acute shortage of HGV drivers in the UK. A combination of delays in HGV tests, retirements and lower numbers of EU nationals have led to a national shortfall of around 100,000 drivers.

External hauliers and third-party carriers have taken action to address this by offering higher salaries to drivers, and this coupled with increased demand for capacity has led to a further escalation of costs.

Rising fuel prices continue to add to the cost burden. Prices have steadily increased throughout the year, accelerating in recent months following the fuel shortage and subsequent panic buying in September. Record price highs set in April 2012 were exceeded in October and prices have continued to increase since. In response, external hauliers and third-party carriers have sought to implement fuel surcharges, adding to the overall delivered cost of products.



*Higher transport costs have an impact up and down the supply chain. This has seen the cost of deliveries increase leading to price movements from January.*



## Labour Costs

Businesses across Britain have been impacted by a chronic shortage of workers, as post-Brexit labour and freedom of movement regulations mean the historic labour pool of European workers is no longer available. This has posed a particular problem in low paid, low skilled sectors, such as manufacturing, warehouses, and distribution centres.

The reduced pool of workers in these areas has resulted in greater competition, with employers having to increase wages significantly to recruit and maintain staffing levels. The 'UK Warehousing Association' has reported that many of their members have had to increase pay by between 20% and 30% to secure workers for entry level jobs.

All levels of the supply chain are impacted by this imbalance within the labour market and consumer price inflation due to these higher costs is inevitable.



*It is estimated that the year-on-year change in size of the UK labour force from workers holding EU citizenship is -7.4%, with the Transport & Storage sectors seeing a 56% increase in the number of advertised vacancies since April 2021.*

### Additional Detail / Sources

[iNews - UK revealed to have the highest shipping costs in Europe](#)

[The Manufacturer - Cost volatility in raw materials and transport](#)

[Spotlight Metal - Raw material and energy costs](#)

[Data - Commodity Metals Price Index](#)

[Data - Oil OPEC Reference Basket](#)

[Data - Plastics / Polymers Price Index](#)

[The Guardian - UK businesses pushed to raise prices amid jump in costs](#)

[The Independent - Surging energy and fuel costs push inflation high](#)

[The Loadstar - Driver shortages and rising costs make UK a tough market](#)

[Financial Times - UK labour shortages drive up wages](#)

## Availability

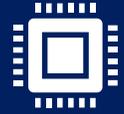
As supply chains across the world adapt to the new situation, there are consistent problems with product availability across all sectors.

The 'just in time' approach to production planning has been stressed by material, labour, and power shortages. Raw materials and components have been in constraint. An example is the specific issue regarding the shortage of semiconductor chips, which has impacted availability on all electrical items. Elsewhere, lockdown measures in producing countries have limited production capacity of commodities like rubber at the same time as demand elsewhere in the world has recovered. In China during Q4 we have seen manufacturers working shortened working weeks due to access to power, resulting in delayed deliveries and extended lead times.

The deep-sea supply chain has been hampered by an imbalance of containers around the world, creating availability issues and delays at ports. As a result, the shipping schedule is now unreliable, with dwell times up and cancelled vessels or skipping ports a regular occurrence. In the UK there have been specific issues around haulage and more recently congestion at the port in Felixstowe.

Within the UK, we are seeing the impact of the labour shortages in transport and distribution. Inconsistent labour resource throughout the supply chain is creating missed deliveries; we estimate roughly 10% of our inbound capacity has been lost due to non-arrival of deliveries. This has a material impact on our immediate product availability and the ability to predict future availability.

The consequence of this disruption is a need to hold more stock and the aggregate impact of that additional stock requirement exacerbates the issues across the supply chain, through un-forecast higher demand.



*According to analysis by Goldman Sachs, at least 169 industries have been impacted by the global chip shortage, including the automotive and consumer electronics sectors.*



*A major global logistic business recently estimated that vessels need up to 54 extra days to complete the China → Europe → China trade route.*

## Actions to Mitigate

DEOS GROUP continue to utilise all options available to limit both the impact of cost price increases and the product availability issues caused by current supply chain challenges.

We can better influence product availability, though many of the supply chain issues currently having an impact on fill rates are beyond our control and span all industries. Throughout the year we have worked with our suppliers to put various measures in place to limit supply disruption and achieve greater operational efficiency, including holding more stock and taking a more flexible approach to product substitutions. The extent of the issues being faced by manufacturers and our suppliers have also prompted weekly reviews to be undertaken with key brands on constraint lines and availability.

As we approach the end of the year, we have worked with our suppliers to initiate three distinct stock builds, which cover our fastest selling volume lines, all major brands and all branded products that are manufactured in Asia. The last of these was commenced at the beginning of Q4 2021, to provide sufficient time for stock to land ahead of anticipated disruption around Chinese New Year.

**We will continue to review and take all necessary action to limit the impact of increased costs and the disruption caused by product availability issues.**



*Additional (Insert Business Name) activity to support fill-rates includes:*

- Targeted stock builds
- Increased safety stock levels
- Resourcing constraint lines
- Product substitutions
- Prioritisation of critical lines