THE DILEMMA OF A RESOURCE BASED INDUSTRY

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There is an old French Proverb which says:—
"Farm as if you farm forever,
Live as if you die tomorrow."

It summarises the dilemma which faces urban resource-based industries, such as B.M.I. You will be aware that B.M.I. has, over the years, expanded its original involvement in the quarrying of stones and gravel in the Sydney metropolitan area to investment in associated products. The group's activities now embrace timber milling, land development, timber merchandising, transport, precast concrete, as well as other less clearly related products such as fly—ash, motor trucks and heavy engineering.

The group, however, retains as the core of its operation the winning of natural resources such as sand, gravel and timber, and a major part of these activities is concentrated in urban areas. As with mining, the scale of these operations requires a long—term view to be taken of any project; the longevity of the equipment, the extensive site development necessary to establish a quarry, or a mill, each requires that projects must have a long life expectancy to be viable.

In contrast with the mining of valuable ores, however, useful reserves of building materials are limited to those which can be won and transported to produce what must be at, its point of delivery, a low cost construction material.

Transport through urban areas is expensive, limiting the radius from point of use, in which supplies can be drawn. Further, as these reserves are always located under land which is equally suitable for development for housing or industrial purposes, a conflict of community interest immediately emerges — between having the resource, and having land for development compounded in recent years by the popular distaste of the urban community to having before its view the evidence of its own consumption.

The Wollongong, Sydney, Newcastle conurbation is estimated by Dr. I. Wallace to require up to 700 million tons of hard rock and up to 385 million tons of construction sand in the period between now and the year 2,000, representing an increase of per capita use of hard rock from 3.2 tons per capita/annum to 6.2 tons per capita/annum. Wallace's point of view is that if such large quantities of material are to be available to the community, a planned approach to the reservation of suitable areas of land for extractive industry, with a planned conversion of use from farming, through extractive use, to final application as residential/industrial land, is necessary. However, currently this enlightened approach is not followed, hence resource industries in urban areas must compete at high cost with land developers, and others, to ensure the availability of the relatively larger quantities of material which will be required if they are to be in business in twenty years time. If a company establishes a twenty year cycle for its replenishment of reserves, it must, on average in each year, purchase the requirements of its operation twenty years hence, which, based on a 7% growth rate, requires a purchase in each year of reserves equal to four times its sales for the existing year, assuming a constant share of the market.

The purchase price of existing reserves is not cheap: Not only must one contend with competition for suitable properties, but one is limited to those areas where the most carefully planned extraction will not cause affront to the heightened sensitivity of the community to changed landscapes.

The impact of this need to purchase one's future working capital in the form of stocks some twenty years in advance of need — a situation where the quantum in physical terms is multiplied, whilst the price of purchase is simultaneously increased through scarcity — imposes terrific burdens for an urban resource—based industry. It is all very well to argue from the point of view of the future with attractive D.C.F. calculations, that the royalty in the period will rise from 23c per ton to $2.50 per ton, and that therefore large investments at this stage to acquire reserves sufficient to meet this future demand, will, at some future date earn appropriate profit, but this does not overcome the present burden of outlaying capital to obtain reserves, and as an annual event paying interest on that capital outlay, thus reducing current profits. The dilemma therefore is between that of maximising profit in the short term by avoidance of such recurring investment, and preserving the profits of the future by acquiring all of the necessary reserves.

To a degree the position is aggravated by the lack of a depletion allowance attitude in these industries. The reserves are purchased as "Fixed Assets" and few, if any companies, attribute a value to underground reserves, other than as "Land". Taxation legislation provides no comfort for the operator who might wish to recognise the stock—in—trade nature of his purchase, and then sensibly to value the asset appropriately, and thence apply a depletion allowance to the amounts of the reserves which are withdrawn from time to time, in a quasi—Consumable Stock manner. The present accounting stance is effectively that the reserves cost nothing, apparently on the assumption that all such land holdings appreciate, either through development of a valuable hole in an urban area, through inflation of land prices during the period of extraction, or because of the change in useage of the area, as urban areas encroach on what were hitherto rural extractive sites. This assumption is not universally true. In some regions a hole in the ground is a positive disadvantage, whilst in others, those who have control of zoning, use the situation to advantage by ensuring that the asset in the hole is transferred to the most likely user in the community at the lowest possible cost.

In some circumstances of low interest rate, and high appreciation of land values the sale of worked-out reserves areas does provide sufficient capital to cover future acquisitions. In recent times this has not been the case. High interest rates and the appreciation of land have led to an imbalance between the cost of providing future reserves as against the benefits resulting from their extraction and conversion. The dilemma of the industry is very real for any manager who takes the point of view that the company is in business, not to jump from industry to industry, but to realise an apparent intention of the investor to have his funds invested in that industry in which the company is involved at the time of his original investment.

The objectives for B.M.I. are to seek to maximise long term profit in the construction material supply industry. Such an objective focuses attention on the long term trends in markets and in performance, and inclines one to cope with the departures from trends as best one can, but without deviation from long term aims set to suit industry trends. Consistent with this attitude, the company is, for instance, proceeding to establish a brick works at Kempsey costing at the order of $4 million at a time, when construction of brick works might appear to be the last thing that is needed in New South Wales.

Here, to divert, I would like to comment on expectations of the construction supply industry in New South Wales in the medium term. There have been various bullish forecasts derived from various considerations of the pattern of housing and money supplies and the like. The group's own economists have studied housing commencements, and have arrived at our expectation of a considerable increase in demand in the near future, probably to a level in March 1976 that will rival peak demand of November 1973. The basis was statistical information as presented by the Bureau of Census and Statistics, with the important modification, of reducing the numbers of commencements, to eliminate the bias which presently results from the inclusion in that figure of individual renovations exceeding $10,000. Adjustment of the figures available gives an amended expectation of new housing commencements, somewhat lower than those commonly expressed, but still nevertheless relatively encouraging as compared with today's rather depressed experience.

B.M.I.'s present position is that we have recently re–budgetted, to align our forecasts to the somewhat firmer view of the future, which has resulted from recent political and economic changes, and have tightened capital expenditure control. Prior to last year ample funds were available to satisfy all the desires of managers whose projects passed a desirable hurdle rate for cash generation, but today's straitened circumstances, and the continuing initiative of managers has resulted in many more desirable and, in terms of profit–generating capacity, acceptable projects being brought forward than the company can finance. The normal batching and ranking systems are now in force, with a consequent lift in the minimum hurdle rate for acceptability of capital projects.

Some continuation of the process of integration of management structure, which was initiated early last year, is in train. Corporate structure – presently based on 79 different companies – is being simplified to avoid unnecessary cost and to streamline management control. Along the same lines the management structure, which still reflects to a large degree the many acquisitions of the last decade, is being altered to avoid duplication of function and to enable a greater concentration of managerial effort.

Company management attitudes are rather analytical, tending to work from long term trends, expecting that, despite a dividend history of smoothing out the curves of fortune, actual profits will fluctuate considerably, in keeping with the volatility of demand of the construction industry.

With recent changes in the fortunes of certain sectors of the building industry, some of which may not recover in the manner of the general housing industry, the product range of the Group is being reviewed. A long term planning investigation, due to commence in early May, is expected to yield a new view on future areas of expansion and involvement of the Group.

However, no matter what internal management systems are evolved, what market stratagems tried, the same question always arises – "do we plough for today's – or tomorrow's crop?"