# HOWARD SMITH LIMITED

An Evening Meeting Address by

**Captain J.G. Evans**

Chief General Manager, Howard Smith Limited to The Securities Institute of Australia, New South Wales Division, Sydney, November 11, 1982.

Ladies and Gentlemen:

I am assuming that the nature of your professional duties ensures your access to one of the many detailed brokers' assessments of The Howard Smith Group of Companies and I therefore do not intend to outline the scope of the Group's activities.

I don't think many company executives would choose the present time to give an address on his company's prospects. I personally would have enjoyed this task much more, say, two years ago when the world was scrambling for coal and we had a steady stream of visitors from overseas pleading to enter into long term contracts to purchase our coal; but, the current depression is a fact of life and it so overshadows all economic activity that I feel the sensible thing for me to do is to discuss its impact on Howard Smith and on our prospects.

I shall cover only the main areas of the Group's activities as we are, as you know, a widely diversified organisation.

## Shipping

Shipping is at the historical and commercial heart of Howard Smith's operations. Origins of the Howard Smith Group were established in 1854 when Captain William Howard Smith (great grandfather of our present chairman) first sailed his 135 ton "Express" into Port Phillip Bay laden with goods for the Victorian goldfields.

Competition for cargoes led eventually to investment in industries capable of providing such cargoes and the company's involvement in coal and sugar, as well as stevedoring, tugowning and travel, can be directly attributed to shipping.

A long period of prosperity was enjoyed by shipping pioneers as they shared in the development of Australia which was always overshadowed by the tyranny of distance. But development of roads and motor transport, removal of legal restraints on interstate commerce, extension and modernisation of subsidised rail services, commencement of air travel and now, the age of pipelines, have all served to diminish the market for Australian coastal shipping. In a comparatively short period there has been a brutal rationalisation of the Australian shipping scene — proud coastal passenger ships have vanished and general cargo ships no longer ply the coast. The names of Huddart Parker, James Paterson, Melbourne Steamship Company, North Coast Steam Navigation, Illawarra Steamship Company, AUSN, Newcastle & Hunter River Steamship — to name but a few — have vanished. The Adelaide Steamship company, I think is still an active company, as is McIlwraith McEacharn, but their shipowning days are behind them leaving Howard Smith and TNT Bulkships as the sole surviving independent private shipping operators.

The only coastal market now available on a consistent basis is the transport of bulk materials, including oil products and our tankers comprise the only non-oil company tanker operation in Australia, being also the largest operator of oil tanker tonnage.

We believe that there is an opportunity to participate in the transport of international bulk cargoes to and from Australia. Several years ago we owned and operated the 60,000 tonne oil/ore carrier "Howard Smith" but without the support of the oil industry, we were forced to dispose of the vessel.

The Australian shipping industry has in the past found it impossible to compete against heavily subsidised international lines but after years of agitation we have been able to demonstrate this to the government which, by its adoption of the Crawford Report, has made it possible for Australian owned vessels to compete internationally on something approaching equal terms. Obviously the present is not the time to take advantage of this opportunity but when the up-turn comes, Howard Smith will be there. In the meantime, we have, bare-boat chartered and converted for Australian conditions, an 81,131 tonne oil tanker which is profitably engaged in carrying crude oil to Australia from the Middle East as well as the movement of indigenous crude within Australia.

Our bulk carrier "Howard Smith", of 37,300 tonnes, is the first Australian flag ship, manned by Australians, to enter successfully into the international coal trade. She is dedicated to carrying Coal & Allied Coal to UBE Industries Ltd. The vessel was built at Kasado dockyard, which is a subsidiary of UBE Industries, and an extremely attractive financing deal was arranged to cover the cost of the vessel.

Because of our involvement in the New South Wales coal mining industry, it was a natural progression that we studied the feasibility of introducing coal fired vessels into the overseas coal export trade, however, for various reasons this project has been shelved for the time being but the design criteria remains and our studies are continuing to be updated in line with technological advancement.

Our vessels are all on long term charters and we do not expect any repercussions from the current depression.

## Towage

Howard Smith is the largest towage operator in Australia, both in terms of tonnage and area of operation. Either independently or in partnership, operations extend over twenty ports in Western Australia, Victoria, New South Wales, Queensland and the Northern Territory. In addition, Howard Smith is the only Australian operator with towage operations outside continental Australia, these being in Bougainville and Suva.

The Company either directly operates or has an interest in 53 large tugs ranging from 1800 horsepower to 5700 horsepower, and 13 small tugs with Bollard pulls of less than 20 tons. These include two offshore service craft used for anchor handling and supply in the Bass Strait oilfield platform construction programme.

Most of these vessels have been built since 1970 and a new generation of harbour and seagoing tugs, which are currently entering service, establishes the company at the forefront of providing the best service available to suit conditions in Australian ports.

The company is well placed to engage any interstate and overseas tows with the features that have been included in the latest new buildings. This work is spasmodic, but nevertheless, is of great assistance in improving utilistion of vessels. Additionally, the company provides linesboat and launch services at a number of ports. These services are worked in conjunction, in many cases, with the major towage service. The services include transportation of pilots, ship agents, crew, etc., as well as mooring services. On an Australia-wide basis, these services utilise some 50 craft of various types.

Through the Queensland tug company, based at Brisbane, Howard Smith maintains a salvage posture in the event of major ship casualties involving strandings, etc.

These salvages are undertaken by a consortium headed and organised by Howard Smith and during 1981, the two major casualties of the year were successfully refloated, one being a large R/O R/O vessel which stranded at high speed entering Moreton Bay, Queensland, and the other being a fully laden iron-ore carrier of 115,000 tonne deadweight which ran aground onto a limestone shoal at full speed, whilst outward bound from Port Hedland, Western Australia.

These operations have demonstrated the ability of Australian companies to handle major ship salvage and as the use of tugs is usually allied with any major salvage, it is natural that the company has extended into this type of new business.

Howard Smith are now well placed to cope with, and provide, towage services to the ever increasing size of vessel calling at Australian ports, with particular emphasis on those areas and ports from which natural resources are shipped. In the current year, earnings from our towage operations have been well above those of previous years and this is without bringing in any rewards for the successful salvage operations we carried out. So far as the future is concerned, undoubtedly the depressed trading will affect shipping movements and this in turn will have some impact on our tug earnings.

## Stevedoring

You will be aware that through our James Patrick Stevedoring subsidiary, we play a major role in Australian stevedoring and ships agency. Our share of conventional stevedoring ranges from 80 per cent at Sydney and Newcastle, to 65 per cent at Melbourne and 55 per cent at Brisbane. I believe that overall, we would have 75 per cent of the Australian market in terms of tonnage handled.

Recently the death occurred of Sir Reginald Reed, Managing Director of James Patrick, and a dominant influence in Australian stevedoring. Following his death, senior executives of the Patrick Companies and I, in my capacity as Chairman of the Patrick Group, have visited Russia, Poland and the United Kingdom, and yesterday I returned from China. The purpose of our visits was to assure the relative governments and shipping organisations of the continuity of our service and in some cases, to renew contracts. Our reception in all areas was most friendly and encouraging.

Patricks are having a very good year but the almost complete collapse of the wheat crop in eastern Australia will have an impact on next year's results, as will also the effects of the depression to the extent that this may be reflected in overseas trade.

## Engineering

Our Heavy Engineering Division and principally, A. Goninan & Co. Limited, is also having an excellent year. Apart from having a healthy order book, the disruptive industrial disputes and bans which have been experienced for so long, have almost completely vanished.

Earlier this year Goninan's purchased an existing engineering establishment at Taree where we are now engaged in fulfilling a $12M order for the manufacture of 660 rigid frame bogies for the State Rail Authority. Fabricated rail bogies, although used extensively in the United Kingdom and in Europe, have only recently been introduced into Australia and those we manufacture are under licence from the Gloucester Railway Carriage & Wagon Company, U.K. We believe that the State Rail Authority of New South Wales will be looking to order a further 5 1/2 thousand of these bogies over future years.

Last month Goninan's received a $19M order from the Queensland Railways to supply 13 diesel electric locomotives. It is a condition of the order that manufacture of the locomotives be carried out in Townsville and we are currently engaged in negotiations for the purchase of a suitable manufacturing facility. Our tender was based on plans supplied by our long time licensor and associate, General Electric Company of America and is the first supply of General Electric locomotives to Queensland for over twenty five years. General Electric has recently assumed a position of dominance in the U.S.A. locomotive market and we believe that the breakthrough in Queensland with GE locos will give further opportunities for sales to other State Rail Authorities. We have received advice that the Western Australian Government intends calling tenders early in 1983 for 20 locomotives of similar specification to the Queensland units.

Since commencing construction of the double deck rail cars for the State Rail Authority, Goninans have delivered 226 cars and are working on a further 24 to complete firm orders. We confidently expect to receive an order for a further 100 double deck passenger cars within the next few weeks.

Because of the long lead time associated with the type of work carried out by Goninans, there is an element of insulation although obviously a prolonged down-turn in industrial activity must eventually find its way through to Goninan.

In association with a leading United States defence contractor. FMC Ordnance Division of San Jose, California, Goninans have been successful in being awarded a contract by the Australian Defence Department to investigate and submit recommendations for future design concepts for Australian Army mobile equipment. Our submission is the only one based on American military technology and this project has great potential for the future.

## Sugar

Howard Smith operates two sugar mills in Queensland which have in the past contributed (at times substantially) to the total group profit but in 1982, we are budgeting for a "break even" situation which is more than can be said for many other Queensland mills.

Sugar is the most price volatile of all commodities traded internationally. Produced in temperate and tropical areas from beet and cane, only about one-quarter of the world's production of sugar is traded and much of that under special arrangements. Consequently, the residual nature of the world trade in sugar makes it sensitive to small changes in the total world production or consumption. However, the recent decline in world sugar prices was greater than could have been anticipated from previous cyclical trends. The fall in world production between 1978/79 and 1980/81 led to a decline of some 6 million tonnes in world sugar stocks, which was reflected in higher world prices received during 1980/81. World sugar production has made a dramatic recovery with total production in 1981/82 of 99.8 million tonnes which was 11 million tonnes greater than in the previous statistical year.

While it is expected that in 1982/83 world production will decline by about 2 million tonnes, it will still be in excess of the anticipated world consumption of sugar which has shown only moderate growth in recent years because of high domestic prices in some countries and general world recession coupled with high interest rates. World sugar stocks at the end of August 1983 are expected to be at record high levels.

There is no doubt that the fundamental problem in the current world sugar market is the EEC's lack of meaningful co-operation with other exporters to regulate exports to world markets and to co-ordinate stocking arrangements.

Since 1975, when the community was a net importer of sugar it has expanded its production and subsidised exports to the extent that the EEC now supplies almost one-quarter of the total sugar to the world free market (double Australia's share). Australia is working actively with other major exporters and through the International Sugar Organisation and GATT to bring pressure on the EEC to reduce its plantings and subsidies. International co-operation is needed between all major exporters, including the EEC, to ensure production is regulated to conform with the steadily rising world consumption of sugar.

Without the occurrence of a natural or political disaster, world sugar stocks are likely to remain in a surplus position throughout 1983; with reduced plantings in prospect in many countries, a balance between production and consumption can be expected in 1983/84.

The Australian Sugar Industry has always taken the long term view in its planning, e.g. by expanding only to meet new markets, rather than in response to price. Consequently, all of Australia's 1982 season production will be sold.

Australia, which exports almost 80 per cent of its total production, has consistently sought "stabilisation" through various long term contracts. These now total approximately 1 million tonnes annually, although a marginal quantity of these contracts does not contain pricing provisions. The price agreement provisions under various long term contracts, including sales to the domestic market in Australia, assures Australian sugar producers of disposal of approximately half of 1982 season at prices well above the prevailing depressed world market returns. Despite these arrangements, the BAE estimates that the gross value of exports in 1982/83 will be 31 per cent less than in 1981/82.

The current down-turn will provide the industry with the continuing incentive to increase its price competitiveness to take advantage of improved marketing conditions when the present cycle moves upwards.

The current harvesting season is almost completed and has progressed well with minimum industrial or wet weather delays. It is anticipated that a total of 25.4 million tonnes of cane will be harvested and crushed, compared with 25.1 million tonnnes last season. Total sugar production should be about 2 per cent above last year's level of 3.43 million tonnes 94 N.T. Our two mills produce 138,000 tonnes 94 N.T. sugar compared with 120,500 tonnes last year.

The sugar industry is greatly concerned that real returns for raw sugar sold for refining to meet Australian consumption needs has declined since the Government set a new price for refining sugar in October, 1979 after a very extensive inquiry under the auspices of the I.A.C. The price for refined sugar in Australia is low in comparison with the prices paid in other developed countries, reflecting the efficiency of the raw and refining sugar industries in Australia. The industry is pressing governments for the establishment of a realistic price for refined sugar and a method of ensuring that the real returns to raw producers are maintained.

In the context of current world surpluses and very low world prices, it is quite inappropriate for any State Government to consider the establishment of a new sugar industry. The industry as presently constituted, has ample capacity to cater for any increased demand by expansion of existing low cost facilities.

## Financial

Howard Smith traditionally has been a liquid company with no long term debt. Our last published balance sheet at December 31, 1981, confirms that we still have no long term debt of any consequence but our liquidity is not so evident as of yore. Compared with the previous balance sheet, there was an increase of approximately $54M in external borrowings which included a $20M loan from a group of Japanese banks for a period of five years connected with the purchase of the M.V. "Howard Smith". This loan is at a fixed rate of interest well below that offered on the Australian market and is free of any currency risk. The balance of the increase in external borrowings was largely due to construction of Mount Thorley.

Since the beginning of the year, a further $38M has been invested in Mount Thorley, bringing R.W. Miller's share of the total expenditure to date to $86M with a further $82M yet to spend before the project is brought to its full scope. The intricacies of consolidated accountancy do not permit us to demonstrate on the balance sheet that approximately one-third of the responsibility for R.W. Miller's outgoings lies with our American partner, Atlantic Richfield.

It was intended that Mount Thorley should be project financed off balance sheet but the coal recession has made it apparent that the project is not capable of being treated in this manner at the present time. Until markets pick up, expenditure in excess of $60M has been deferred and the financing will be carried on balance sheet. However, we are not happy with a continuance of short term finance and currently are negotiating to replace this with some medium term borrowings, possibly with the option of early repayment. We still have not utilised our $50M promissory note facility and you will all be aware that we have many millions of dollars in listed investments excluding both Adelaide Steamship and Coal & Allied.

## Coal

The most sensitive area of our activities, of course, is coal and it was our coal investments which changed our image from that of a very conservative marine orientated group to that of a resource stock. Our share price once reflected more traditional values and fluctuated only within narrow bands, reacting to issues which affected the market as a whole. Indeed, it used to be not uncommon for variations in our share price to be related to movements in BHP share prices. We never thought this had much merit but I cannot say we enjoyed seeing our share prices spiral to $10 on the strength of the resources boom either.

It is no joy to company management to see the market's perception of a share so extravagantly at variance with management's own assessment. But there is little we can do in such circumstances other than wait with some trepidation for the perfectly understandable, if not logical, reaction from irate shareholders when the share inevitably sinks to a more sensible level.

The Howard Smith involvement in the coal industry dates back well into the last century and this has given us considerable experience with the "booms" (few as they have been), and the "busts" (numerous and lengthy as they have been). Unfortunately, what is happening at the moment in the Australian coal industry is not unusual. It is merely history repeating itself with a 1982 type variation.

May I quote — "the cumulative effect of ... industrial stoppages, shrinkage of colliery sales is reflected in the decrease in the earnings of the past year" — this is an extract from an address to shareholders by our then Chairman in March 1928.

A further quote, April 1936 — "keen competition again resulted in no dividends being received from your company's large investment in coal" — and to finish the history lesson, in April 1955 — "there would appear to be little prospect of selling Australian coal in the existing highly competitive overseas markets due to its high price" — that forecast was fortunately quite incorrect.

There has been much written about the current malaise of the coal industry and I don't know that I can usefully add to your store of knowledge. The overriding problem at the moment is reduced demand and, of course, the crucial question is when, and to what extent, will our sales recover and our potential be realised.

In the heat and fury of battle, we sometimes lose sight of tangible achievements. Australian coal exports have increased from 21.8 million tonnes in 1972 to 47.2 million tonnes in 1982. Infrastructure requirements are under control and are capable of meeting all foreseeable requirements. By the end of 1982, all Australian east coast coal ports will be able to load 120,000+ deadweight vessels.

The industrial scene is relatively calm although undoubtedly much of that is due to the unions' awareness of depressed markets, and governments, belatedly, have accepted that their greediness has seriously impaired the investment profile of the coal industry. In passing, let me express my surprise at the indifference of the Australian financial community to the unprecedented grab by the New South Wales Government of freehold coal without granting a legal entitlement to just compensation. It is the money of the investing public which has been taken and the apathy of influential institutional investors has been unbelievable.

There has been a plethora of studies on world coal usage prospects and associated supply sources, etc., and these continue to emerge with confusing frequency.

Most of the studies were overly optimistic and have done as much to feed the "boom" mentality in financial markets as anything else. All the studies were based on growth rates that at the time seemed reasonable but which did not take into account a recession as tough as the present one. Some of the forecasts made no attempt to write in upper or lower levels based on different rates of economic growth and energy demand. Most ignored the relationship between economic growth and energy demand. Of course, so did the coal companies — so did many people wanting a peice of the coal action, such as governments, state, local and federal, unions and employees. The great Winchester South tender race in Queensland will be remembered as a highlight of the boom mentality. It caused problems for the coal industry in Queensland and New South Wales with governments and unions both seeing that companies were prepared to sink millions of dollars into the race and deciding therefore that there must be millions of dollars available to them. Of course, Winchester South is now well down the list of projects to be developed in Australia over the next few years and there has been a marked lessening of enthusiasm in New South Wales regarding similar developments. The Mt. Arthur and Birds Rock projects are, perhaps, cases in point.

Revised estimates of coal usage are still appearing. We have several sets from the 1982 Australia/Japan coal conference held in Kyoto two weeks ago, but I don't intend confusing you by quoting the figures because they are as reliable (or unreliable — take your pick) as any estimate which has appeared over the past three years.

The so-called coal boom saw many local and foreign companies displaying an interest in coal that really was outside their true aspirations, but I would like to point out that Howard Smith is not in this category. We have always been in coal and intend to stay in coal. The past has taught us that the coal industry demands of its participants a commitment to see it through thick and thin and a cautious and flexible approach is part of our heritage. That has always been the reality of the mining industry, not the glamour that many people believed in recent years.

Dramatic change has always been a feature of the coal industry but some changes are permanent. A permanent change is the unwillingness of energy users to rely so completely on oil as they were once inclined to do. Another permanent change is the realisation that oil is a commodity with a relatively short supply span. Some surveys indicate that a rise in oil demand could lead to sharply increased oil prices creating another world crisis by 1986. Even a small percentage increase in world primary energy consumption could lead to an expansion in demand for OPEC oil. The decline in world oil demand in recent years has been due mainly to the recession, much more so than to conservation efforts and there has been little progress in developing new energy sources. What could be more permanent than the political instability of the Middle East. Mention of Iran, Iraq, Lebanon and so on is enough to send a shiver down the collective spines of oil users.

We were too optimistic in the recent past, maybe we are to pessimistic now.

Many of you here tonight have visited our developments and you will have discussed our widespread operations with our field staff and made your assessments accordingly.

Let me say that Howard Smith's plans for our involvement in coal will in the long term remain the same — a change of emphasis here and there, a postponement of some developments because that is the prudent thing to do — certainly not a withdrawal. Let me outline how our Group's coal involvement will progress over the next few years.

Our major interests are through Coal & Allied Industries Ltd. in which we have a 50 per cent stake, R.W. Miller, in which we have a 67 per cent stake, a 22 1/2 per cent interest in Port Waratah Coal Services and 12 1/2 per cent of Kooragang Coal Loader Limited which is developing the third export coal loader at Newcastle. Incidentally, our substantial towage operations give us a further share of the increasing coal and other resources trade at many ports such as the new Abbot Point Port of MIM (Holdings) Ltd. in Queensland and Westernport, Victoria. Excluding the Curragh project in Queensland in which R.W. Miller has a 30 per cent carried stake, the Howard Smith Group has an interest in a total of 14 operating mines in New South Wales. There are 10 underground mines, 2 large open cuts in Hunter Valley No. 1 and Mount Thorley, plus 2 small open cut operations. The Group also has the capacity for 2 further large open cuts in Hunter Valley No. 2 and the Ironbark Prospect, both of which will be of considerable importance to the Group in the closing years of this decade and into the 1990's. By 1985 we have budgeted for a saleable production of 12.4 million tonnes but I will point out that there is the capacity, provided the market demand is there, for a further 6 million tonnes of a saleable coal by 1986. Our existing spread gives the Howard Smith Group a diversified sales base, exporting to Japan, South Korea, Pakistan, Hong Kong, West Germany, Taiwan and Israel.

I might point out that our major customer, UBE Industries Ltd. of Japan is a shareholder in Howard Smith, as are Mitsubishi Chemicals, Nissho Iwai and Mitsui. We in turn hold cross shareholdings in UBE Industries, Mitsubishi Chemicals and Nissho Iwai. Pohang Iron and Steel of Korea owns 20 per cent of Mount Thorley, is R.W. Miller's largest customer and is anxious to see the project prosper. These links have helped us in the past and will, we believe, provide us with a special relationship in the difficult years which may lie ahead of us. Our proportion of coal from lower cost open cuts is steadily increasing and will continue to do so, but I must emphasise that the production will be brought on only to meet market demands.

I believe that Australia still has a real competitive edge over the U.S.A. and Canada in sales to Asia. The Japanese still recognise Australia as their most reliable and suitable source of supply. A small example — it was from the Tex Report of November 5th — "China seems positively unable to wholly ship out Japanese coking coal contracts for this year" — the article went on to say "It is seen positive that Chinese shipments of coking coal for Japan will fall far short . apparently casting a dark shadow over its future coking coal exports for Japan".

The Canadian and U.S. coal suppliers have their problems too. Rail freights and infrastructure deficiencies are but two of the worries the Japanese mention, and, of course, at the present time the depreciated Australian dollar has placed us in a most favourable position. Summing up, and with the detachment that passage of time gives, I believe that most of our local problems, traumatic and frustrating as they were, were growing pains of an unparalleled expansion and largely are behind us. The cause of the current decline is the world economic recession and the cure will be a world economic recovery. The Australian coal industry will be sharper, leaner and more competitive as the result of the current experience and within the Australian coal industry, the Howard Smith Group is the best placed to take full advantage of that inevitable upsurge.

Time unfortunately has not permitted me to deal with all areas of the company's activities, nor have I been able to explore in depth those operations I have covered, but if any or you would like further information, please come and see me.

These are difficult times and no one really can forecast what lies ahead in the next few years. If I may be permitted to lapse into seagoing parlance, we at Howard Smith are battening down the hatches and keeping a tight rein on our money outlays and commitments. We have weathered many storms over the past 128 years and the present holds no real terrors for us.

We have many strengths, and I might list a few —

- Expertise in all our activities.
- Wide diversification.
- Financial strength and stability.
- Some degree of control of our markets.
- Involvement in industries which will benefit from Government pump pruning.
- Hard-headed realism.

Would it surprise you to learn of our claim to be the most internationally orientated group in Australia? This has in the main occurred in quite recent years. We have cross shareholdings with Japanese corporations; joint ventures with Korea, France and the United States; manufacturing agreements with the United Kingdom, U.S.A., West Germany and Japan; stevedoring contracts with Finland, Sweden, Norway, Denmark, United Kingdom, Poland, Yugoslavia, Romania, USSR, Greece, Italy, Egypt, Israel, Canada, U.S.A., Chile, China, Japan, Korea, Taiwan, Hong Kong and Singapore; coal contracts with West Germany, Israel, Pakistan, Hong Kong, Taiwan, Japan and Korea.

We maintain contact with all of these business friends and regard our wide circle of associates as an underlying source of strength and support to our diverse activities.

From time to time suggestions are made that Howard Smith should have a corporate philosophy and in search of desirable attributes we collected a group of contemporary balance sheets with the devious aim of "cribbing" the good bits. After a short session inspecting these philosophical gems and alternating between hilarity and embarrassment, we decided that we had better do our own thing. Here it is —

We aim to —

- Make maximum profits for our shareholders and having made the profits, distribute a fair share to the owners of the company.
- Protect our assets.
- Look after our employees.
- Cope with change and try always to recognise change.
- Seek out and take advantage of new opportunities.
- Survive.