CRA'S RESPONSE TO TRENDS IN INTERNATIONAL MARKETS

An Address by

J T Ralph

Managing Director, CRA Limited to the Securities Institute of Australia
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This presentation is about how the CRA Group has adapted to the current metals market: what we think the future of the metals market is likely to be, and what we are doing to be able to operate under the sort of tough conditions we predict.

The first point to be made is that the currently depressed metals market does not come as a complete surprise to CRA, although the persistence of the trough in base metal prices is greater than we had earlier expected. You may recall that we forecast some time ago that tough times were ahead. In 1980 and 1981 Sir Roderick Carnegie spoke out bluntly about the "mirage" of a new resources boom and the dangers inherent in the inflated expectations that such misplaced optimism aroused. We began to respond at that time to the pressures we anticipated and have had an ongoing program to improve productivity and the effectiveness of our organisation since then.

The world economic picture over the last 10 — 15 years has been quite different from the twenty years that preceded it. In that earlier period we experienced sustained economic growth and there was a widespread belief in the inevitability of this growth continuing. Capacity was added to satisfy this growth and these additions to capacity continued when growth itself was choked off. Decisions to install new capacity inevitably have to be taken well in advance of the time at which supply is required. With growth in demand flattening as it has during the 1980's there has been a continuing overhang in capacity.

The oil price shocks of the 1970's brought about sharp adjustments to the world economics scene. The effects of these adjustments are still being felt. Economic growth in the industrialised economies has slowed but metal demand growth has slowed even more.

Let me take a few examples. Growth in G.D.P. in the USA averaged 5 per cent in the 1960's, 3½ per cent in the 1970's and less than 2½ per cent in the period 1979-84. For the same three periods Europe went from 5.3 per cent p.a. to 3.3 per cent p.a. and only averaged 1.2 per cent p.a. from 1979-84. Japan's annual growth in 1979-84 was less than a third of what was achieved in the 1960's.

The effect on metals was more marked. Let me again take a few examples covering the same periods. Growth in aluminium consumption in the 1960's was 9.3 per cent p.a. In the 1970's it fell to 4.6 per cent and for the period 1979-84 growth was only 1 per cent p.a. Steel fell from 5.8 per cent in the 1960's to 1 per cent in the 1970's and consumption actually declined by over 3 per cent p.a. in the period 1979-84. Annual growth in copper consumption fell from 4.3 per cent in the 1960's to 2.3 per cent in the 1970's to zero growth between 1979 and 1984. We should note in passing that 1979 and 1984 were peak years in the economic cycle.

There are several reasons why this slowdown in metal consumption growth has occurred. The first is that economic growth, itself, has slowed. The second is that the economic growth which is taking place is largely concentrated in sectors that are not metal intensive, namely in services and high technology areas. The third is that metal intensity is correlated to the stage of economic maturity of a nation. With the maturing of the economies of the developed countries, metal intensity has fallen. The fourth is the effect of substitution, such as optical fibres, plastics, etc. The fifth is increased recycling, partly driven by cost considerations, partly by environmental requirements.

The sixth is the ability of a tonne of metal to do much more than previously. The trend towards lighter, thinner, stronger products has reduced the amount of metal needed to accomplish a particular task. This trend was substantially accelerated by the oil shocks. There are two implications for metal producing companies in this latter change. The first is the effect on total demand. The second is the need to meet the higher quality specifications of metals that are capable of doing more. This is influencing where investment is being directed in the metal producing industry and where it will increasingly be directed. It also opens up opportunities for the Australian industry.

Accentuating the effect of these fundamental shifts in demand has been the changes in inventory management in response to improved techniques as well as to the effect of high interest rates. As a result, inventory requirements of fabricators and their customers are lower than previously, adding to the pressure of inventories on prices.

The slowdown in steel consumption worldwide has also affected Japan, Australia's major market for iron ore and coal. Japanese steel production grew extremely rapidly during the 1960's and up until 1973 but after 1973 it flattened out and there has been virtually no growth in that market since. Japan has moved downstream in its processing and in producing higher valued and more sophisticated products but it does not require additional raw materials to do this. Some of the growth has been taken up by South Korea and Taiwan but Australian producers have faced a much tougher environment over the last decade.

At the same time as demand growth has been generally stagnant, developing countries have been seeking to exploit their natural resources. Often the objectives go beyond the economic, and encompass social and balance of payments considerations. Some of the developing countries also have relatively recently discovered high grade resources because exploration had not previously been as intensive as in the developed countries. Given availability to technology, capital and lower wage rates, they are very competitive suppliers to world markets.

Some of these developments are spectacular in size and quality. The high quality Carajas iron ore deposit currently being developed in Brazil is an example and the development of this deposit will add a substantial increment to world iron ore supply.

Our projections of demand have been steadily downgraded during this first half of the 1980's despite the fact that we were more pessimistic than most commentators about the prospects for metal demand at the beginning of the decade. Because we have felt that demand for metals and minerals throughout the eighties was likely to be fairly flat and that there would be difficult times ahead for a group such as ours we have been following a consistent improvement program.

In developing this program we analysed the strengths and weaknesses of our situation:

— We operate a number of world class mineral ore bodies and associated downstream processing plants that operate at the lower end of the cost curve.

— We have a considerable reservoir of human talent. Generally we have high calibre experienced people with a wide range of skills — and a group of people conscious of the need to be internationally competitive.

— Our geographical position which was long seen as a drawback by virtue of distance from Europe and the east coast of North America has become an advantage because the Pacific has become the centre of world economic growth.

— Because of the competitive nature of our basic operations we are able to generate a strong cash flow, even during difficult times for the industry worldwide. This means that we can take advantage of opportunities as they occur.

— Finally, our investment in research and development, as well as our considerable expenditure on exploration have provided a base for future development.

Against this

— We operate in a country with a comparatively poor trading record, in which exports are acounting for a decreasing proportion of our GDP, thereby building up substantial problems for the future.

— Also we operate in a country where only a small proportion of the population has an understanding of the need for all of our economic activities to be internationally competitive.

— Profitability in our industry has remained conspicuously low for four consecutive years yet it is still viewed as a prime source of revenue by governments which do not always recognise the cyclical nature of the mining industry.

— We operate in an environment with a poor industrial relations record, and with entrenched institutions that are reluctant to modify outdated practices in the face of hard evidence that these practices bring dubious benefits to a minority at considerable costs to the majority.

— Because of the mirage of unlimited wealth generated by a perceived "resources boom", Government policies have consistently sought to extract an unreasonable share of mining profits, thus damaging our ability to compete and causing loss of markets. Rail freights on the eastern seaboard are among the highest on a tonne/kilometre basis in the world and the advantages that should accrue from short hauls to the ports vanish through unrealistically high charges.

All of these factors must be recognised if we are to achieve success in our industry. To be in a strong position to enter the 21st century we believe:

— We need to achieve and maintain a competitive cost position in all our operations.

— We need to achieve a more secure position in our international markets by being more involved in those markets and being closer to our customers.

— We need to be able to add value competitively to diversify our market opportunities.

— We need to be able to generate and follow through on opportunities to provide the basis of future growth.

We tackled the first objective — a competitive cost position — through organisational change, through the exploration of opportunities to improve productivity and reduce costs, and through the application of technology to do better what we are already doing and to find ways of substantially changing the economics of producing metals.

On the organisational front we established business units led by Managing Directors who have profit and loss responsibility. We are encouraging these Managing Directors to be more entrepreneurial and to address their efforts to improving the long term competitive position of their business units.

Within business units the number of levels of management have been reduced. A substantial amount of effort has been devoted to encouraging greater involvement and commitment, a greater degree of delegation and to defining more specifically accountabilities.

We have not only done this for our operating business units but have also placed our services on a stand alone basis, providing services on a commercial basis. This not only has beneficial effects in terms of cost control but, more importantly, it generates a much better set of relationships between service providers and consumers.

We have placed increased emphasis on training and communications and on developing better relationships between people in the different levels in the organisation. Our objective is to improve the industrial relations of each of our operating sites through more involvement and more open communications.

We have continued to spend on exploration to provide future opportunities, but we have directed an increased proportion of our discretionary expenditure to research and development. We are working again, through organisational changes, to bring increased application of technology to improving productivity and reducing costs. This is directed to what we are already doing as well as seeking to make substantial breakthroughs which will open up new opportunities. This is behind the research efforts into steel and aluminium production technologies. As well we are looking for ways to expand markets by, for example, the development of new alloys.

Our business unit Managing Directors are also aggressively pursuing new markets as a means of enhancing their market security and to compensate for lack of growth in some existing markets. As previously indicated we are encouraging them to be more entrepreneurial.

We are focussing more on our core activities and have disposed of a number of assets that were not central to these activities. During the year we have sold the timber divisions and interests in Chloride and Air Queensland. We have sold the properties which we owned in the Melbourne central business district and also Placer (PNG) Pty Ltd, which is the manager of the project recently agreed to acquire CRA's 50 per cent interest in the Misima Island gold prospect. We have also been consolidating our interests in Asia and are currently seeking a buyer for the diecasting operation in Singapore. We have also decided to close the Kanmantoo Copper mine in South Australia — a mine that has been on a care and maintenance basis since 1976.

Effectively what we are doing is to redeploy our assets, disposing of interests that are not central to our strategic thrust and acquiring positions which are a necessary part of establishing an international materials business based on and controlled from Australia.

It is this strategy which has led us to acquire the investments in Commonwealth Aluminium (previously Martin Marietta Aluminium) and Showa Aluminium, and to become involved in the steel industry in Germany. This has become colloquially known as "buying straw hats in winter". Obtaining market access for valued added products requires a different strategy than for raw materials. Despite the immediate weight of carrying these investments we believe that a significant foothold in the major markets of our region is essential for long term success.

Of course, these moves do not always go smoothly. The recent suspension of the advanced negotiations to effect a merger of the Krupp and Kloeckner Werke steel interests to form a strong and internationally competitive steel group is an example. We believe that basic economic pressures will work towards eventual rationalisation of the European steel industry and that other opportunities will present themselves in due course. In the meantime our arrangements with Kloeckner Werke to work on the development of new steel-making technologies is undisturbed. This jointly owned entity is already selling know-how and equipment to steel producers, and the money from these sales is being channelled into further research and development.

While there is a sharp focus on making our existing operations more competitive and on reducing our debt through generation of a strong cash flow we continue to pursue opportunities which are soundly based.

We are making some relatively small bets in new technologies which have the potential to provide bases for growth in the future. Chief among these is the development of structural high performance ceramics in partnership with Nilsen Sintered Products and our investment in biotechnology. The first product from this group is now being marketed commercially.

The Argyle diamond mine will come into production from the beginning of next year and the Blair Athol and Tarong steaming coal operations will be coming up to capacity. Kaolin production based on the Weipa resource will commence in 1986. The development of a broader range of industrial mineral products at Weipa will enable better utilisation to be made of existing infrastructure.

Discussions are still continuing with the Chinese on the development of the Channar iron ore deposits, and I am hopeful of seeing this development get under way at an early date.

Conclusion

Our program to improve our position in the industry is an ongoing one. It is imperative that we make continued progress in a period of constrained growth. Judgments on how well we are doing in our reorganisation, for example, are nesessarily subjective, but I believe our people have a greater awareness of the need to make their businesses more internationally competitive. They are aware of the substantial improvements our competitors in other countries are achieving and are determined to match them.

I believe we are making significant progress in industrial relations, even though there are setbacks from time to time.

We have strenghened our position in international markets and we have a strong resource base domestically.

I believe we, in CRA, are realistic about the future but there lingers in the community the belief, generated in the seventies, that in Australia we are the possessors of a storehouse of raw materials that the world wants to buy. So it does — but at a competitive price. The seventies were a window of opportunity but we have passed that window — and I do not see another like it for some time to come. Its memory, however, continues to bedevil our current operations, because governments and the community have had their expectations formed by those more expansive years.

We must recognise that any advantages which are bestowed on us by possession of world class mineral resources can be and are negated by high government imposts; excessive regulation; inefficient state monopolies permitting inflated power and freight costs, as well as high labour costs and an industrial relations system designed to meet the needs of a long gone era.

Realistically there probably never has been, and probably never will be, a time when conditions are completed to the liking of the mining industry. While we hope that governments will come to realise the imortance of the industry for the economy, we are not going to sit back and wait for major shifts in policies to happen. The measure that we have taken are those that we believe will see us through the lean times ahead.