THE TASMAN CONNECTION

THE BIG KIWI SPREADS ITS WINGS

by RONALD TROTTER

Closer Economic Relations across the Tasman have focused Australian attention on New Zealand's surge of financial deregulation and reform. For New Zealand corporations, horizons are broader and more challenging.

The managing director of Fletcher Challenge Ltd, Mr Hugh Fletcher, was a key speaker last year at the Securities Institute seminar titled *Australian Business: The Kiwi Conquest*. Mr Fletcher reassured his audience that his company did not view Australia as a market to be conquered or pillaged. 'We are traders, not raiders,' he said. But in its growth and internationalisation, Fletcher Challenge intended to expand its investment and trade in Australia.

In this article, an edited version of an address given in March to the NSW division of the Institute, Sir Ronald Trotter, chairman of Fletcher Challenge, describes the global growth strategies of New Zealand's biggest company.

Nearly two years ago we came to Australia to seek a listing on your Stock Exchange. This was part of a move which recognised the growing internationalisation of our trade, of our debt raising and the spread of our equity.

Then we ranked No. 1 in profit in New Zealand, and were projecting earnings for 1985 of $180 million. With a market capitalisation of $1.25 billion, we represented about 9 per cent of the value of the New Zealand stock market.

Two years later we are still No. 1 in profit. We have just earned $153 million for the half year, with projected earnings for the 1987 June year in excess of $300 million. Our market capitalisation is now around $4 billion, and despite the dramatic growth of the New Zealand Stock Exchange we still represent over 9 per cent of its capitalisation. Incidentally we currently rank about No. 7 on your Australian Stock Exchange.

Then we were clearly a major New Zealand stock with an international forest presence. Today we are clearly first and foremost an international forest products stock with a Pacific Rim emphasis, which also offers an entry into other key New Zealand industries.

Following the divestment of our financial services business in 1985 we now operate in three basic areas of business — the Forest Industry, Building Industry, Primary Industry and Trading.

In February of this year we acquired a 48 per cent interest for $A580 million in British Columbia Forest Products, which is one of the largest integrated forest products companies in Canada.

On a normalised annual basis which reflects the current trading levels, some 63 per cent of our assets are in the forest products industry and we derive some 57 per cent of our earnings from this product grouping.

Equally important is the geographic spread of our earnings and turnover. With 47 per cent of our assets offshore we expect to earn more than half our profits from operations outside New Zealand.

This move into the paper and forest products industry and the internationalisation of our revenues and earnings has been a conscious one over the past five years as we have sought to divest peripheral activities or those where we could not achieve a position of competitive leadership; to strengthen our mainstream businesses by acquisition, capital expenditure and innovative management; and to achieve profitable growth internationally.

The international forest products industry is obviously the one to which we have made the biggest commitment.

Australia does not have any companies which offer substantial international exposure to this industry, which is a huge one. You do have some newsprint, kraft pulp manufacture and timber production, but in the main you do not achieve self-sufficiency, let alone have sufficient volumes to engage in world trade.

Our earnings flow from six product categories: newsprint, market pulp, market forests, lightweight coated paper, timber and wood panels, and packaging and paper distribution.

Because of the efficient production of wood fibre in New Zealand and its physical characteristics which make excellent quality chemical pulp and newsprint, we have tended to specialise in those grades. With our latest expansion we now have the second-largest production capacity in the world for both newsprint and pulp.

The newsprint market is huge. The value of consumption is around $US14 billion a year.

The US dominates consumption. Canada, by virtue of its extensive forests and abundance of cheap hydro electricity, is the major producer, accounting for nearly one third of world production. By way of comparison, Australia produces and consumes around one to two per cent.

The newsprint industry has an excellent future. In the US, which is the largest and most highly developed market, newsprint consumption rose by 40 per cent in the 10 years to 1985. It is projected to grow a further 2.9 million tonnes, or 25 per cent to 14.5 million tonnes in the next 10 years on low GNP growth forecasts. With growth of this order of magnitude in the US, and prospects of much higher growth as literacy rises in Asian and other third-world countries, there is a sound outlook for newsprint producers.

Market pulp is also traded in great volume (more than 24 million tonnes a year), with nearly half of it being produced in North America. Scandinavia is the other major producer. We are very conscious of the need to ensure that not only do we make a good quality pulp but that we do so at low cost. In Crown's Elk Falls Mill and BCFP's McKenzie Mill we have two of the lowest-cost producing mills in North America.

In newsprint markets the increasing demand has virtually utilised all existing capacity. And because it takes two to three years to build new machines, North American analysts in particular are very bullish about newsprint.

Even conservative forecasters are expecting newsprint to rise by at least $US44 a tonne in 1987 and $US39 a tonne in 1988.

Similarly, an improving supply-demand balance in pulp has already led to an increase of $US68 a tonne. It is expected to rise a further $US74 a tonne before levelling off.

A $US35 a tonne increase will add something of the order of $A51 million to our pre-tax earnings whilst for every $US30 per tonne, $A29 million is added.

However, we are not relying just on price increases to give us an increasing return. At Crown we have undertaken a series of very major rationalisation programs. And we are currently spending $C50-100 million per year to improve both quality and output and keep our equipment at "state-of-the-art".

Since taking over Crown Forest in 1983 we have lifted its rated newsprint capacity from 404,000 tonnes to 460,000 tonnes, without adding a machine. Next year, after increasing our pulp capacity we will move to 503,000 tonnes. Our man hours per tonne of newsprint have dropped from 3.42 in 1982 to 2.5 in 1986, an improvement of 27 per cent, and we have significantly upgraded quality. In the field, we have reduced logging and hence fibre costs.

These factors enabled us to take Crown from a pre-tax $A52 million loss in 1983 to a $A79 million pre-tax profit in 1986, a turn-around of $A131 million.

With BCFP having been capital-constrained over the past few years there is a similar ability to make substantial productivity gains in its business. We have already injected $C120 million which will allow them to get on with numerous medium-sized projects that have a high short-term pay-back.

So the move into BCFP has given us a number of superbly positioned mills both in relation to their market and their ranking on the cost curve. The BCFP move has also given us an entry into large-scale production of lightweight coated paper (the type used in quality magazines), one of the fastest growing paper grades. Equally important, the mill gives us our first manufacturing base in the United States.

Lumber and wood panels are relatively less important than pulp and newsprint in our overall product mix. Nevertheless we are still a big producer of these products. Sales this year are in excess of $900 million. The key influence on this market is the housing industry, particuarly in the US and Canada, but of course our NZ activity is affected by moves in the Australian and New Zealand housing scene.

Although forest products are our largest and fastest growing business area, we should not overlook our two traditional core areas — the building industry, and primary industries and trading — which produce around 43 per cent of our profit.

Within New Zealand we are the No. 1 company in such activities as commercial construction, house building, building material distribution, cement usage, steel merchandising, particle-board and door manufacture, wool, livestock, bloodstock and kiwifruit marketing, motor vehicle distribution, appliance selling and renting, as well as fishing.

We are constantly striving to improve our competitive position either from internal growth or from acquisition.

Recent moves include the acquisition by our rural servicing company (Wrightson NMA) of its leading competitor (Dalgety Crown) so that it now controls about two-thirds of the rural servicing business in New Zealand, proportionately a good deal more than Elders in Australia. Challenge Meats took out the minorities in Southland Frozen Meat Ltd and opened its own marketing office in London. Fletcher Fishing spent $20 million on additional quotas. The steel sector acquired an additional 44 per cent of Pacific Steel and is spending $65 million

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to upgrade the rolling mill. It also acquired the interest of Armco Incorporated in Australia.

Other investments were made offshore. Tasman Forestry entered into a 50 per cent joint venture which controls 25,000 hectares of planted forests and a small newsprint mill (74,000 tonnes) in Chile. Our construction division extended its coverage of the Pacific with the acquisition of 80 per cent of Hawaii's second-largest construction company. In Australia, a position was taken in Jennings Industries which will eventually give us a 39 per cent stake in that company. This gives us the chance to obtain a significant position in Australian businesses of building and property management.

We also acquired ten percent of Goodman Fielder. While the timing of this is not necessarily of our choosing, our increasing involvement in the food industry gives us a useful base from which to move if and when we decide we should.

Our growth has been profitable. The $153 million result for the first half of 1986 includes sectors like North America and primary and trading, which have already turned in a performance that is ahead of the whole 12 months of last year. So we are on track to progress from the $45 million we earned in 1983 to, say, the $315 million which many analysts are picking for 1987. This is 31 per cent ahead of 1986. Equally important, there has been growth of our EPS which has in bonus-adjusted terms risen from 10.5 cents to 47.9 cents a share. We are confident that growth in EPS will continue.

We are comfortable with the thought of further diversification, particularly in building up our food interests. We already have a considerable involvement through fishing, meat and horticulture of the order of some $400 million of annual revenue. You will, I am sure, see more of us in the future in Australia.

The New Zealand economy has been going through a period of rapid deregulation since the election of a Labour Government 2½ years ago. Many of our problems are similar to, and in some cases worse than, those of Australia, but I think we have been more consistent and more vigorous in our approach. There has been complete deregulation of financial markets, a removal of most subsidies and a major reduction in industry protection.

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The taxation system is going through a complete reconstruction with the introduction of the goods and services tax (a 10 per cent value-added tax), a reduction and harmonisation in income tax rates and with the introduction of imputation to come. Government services are being commercialised (corporatised with the creation of state-owned enterprises) and the first steps towards privatisation have been made with the sale of some shares in the Bank of New Zealand and Petrocorp.

We are still facing the problem of a high fiscal deficit and high debt. A tight monetary policy is resulting in high interest rates and a strong New Zealand dollar. The government has failed so far to take significant steps to deregulate the labour market which is their major policy weakness — although I think our system is less centralised than yours, which must be beneficial to all concerned.

Even the conservative forecasters are expecting newsprint to rise by at least $US44 a tonne in 1987 and $US39 a tonne in 1988.

We face a general election in August and the outcome is uncertain. I think a reversion to heavy government intervention is unlikely, whatever the result. If the present policies are preserved and strengthened, New Zealand will come through a difficult period of transition in good shape for a greatly improved economic performance in the next decade. □

NAVIGATING THE TASMAN

Despite the benefits flowing from Closer Economic Relations between Australia and New Zealand, some difficulties still stand in the way of successful trans-Tasman enterprises, according to Mr Stan Wallis, managing director of Amcor Limited. One of the chief impediments is the complicated New Zealand legislation governing mergers.

Mr Wallis made his comments last month at a seminar on Australia-NZ trade and investment opportunities, sponsored by the Commonwealth Bank, Moore and Bevins, and Touche Ross and Co.

New Zealand's regulatory processes were largely incompatible with the normal decision-making process in a well-run business, Mr Wallis said. Unlike the Australian system which operated on a "strike-down" basis if mergers were deemed to violate the Trade Practices Act, the New Zealand system operated on a "prior clearance" basis, meaning all merger or takeover proposals must be approved in advance by the Commerce Commission.

"To complicate the issue, the commission has no power to accept undertakings or to negotiate a deal, even one that is acceptable to both sides," he said.

"On the one hand, the regulatory process required you to spell out your exact plans and prove one of two things: either that the merger or takeover will not result in greater dominance in any of the markets concerned or, failing this, that the proposal will generate substantial benefits for the New Zealand public at large.

"On the other hand, normal business decision-making dictates that on occasions you back your judgment in the light of incomplete knowledge, and that you take an opportunity when a window opens and exercise a degree of calculated risk in order to attain a certain goal.

"Given these two contradictory positions, it is not surprising that our trans-Tasman enterprise objectives are not yet a reality to any significant extent."

Much had been achieved in establishing free trade flows between Australia and New Zealand, Mr Wallis said.

"The formalisation of CER in 1983 was based on the perception that each country's interests would be enhanced by closer economic relations, and that their competitiveness with third countries would improve.

"Stage one of CER focused on goods — the objective being to eliminate all tariffs and quantitative trade barriers between the two countries. This stage proceeded faster than anticipated and while some problem areas remain, the focus is now turning to the so-called 'second-generation issues'. These include company law, competition, investment, services, banking and so on."

One issue that was an important factor in establishing a trans-Tasman enterprise was the cost of freight, he said. "In Amcor's experience, the Tasman Sea is about the most expensive stretch of water in the world.

"It costs more to send a tonne of paper by sea from Australia to New Zealand than it does to ship an identical quantity of paper from the US to Australia." □