

2005 AGM - CEO's report

Transcript of 2005 AWI Annual General Meeting

CEO's Report

LEN STEPHENS: Thank you, Ian, and good afternoon everybody. I know you are all keen to get to the election, but I would like to take a moment if I could, please, to describe the potential that I see for the Australian Merino industry.

Last week I was in New York at a meeting of the CEOs of some of the major apparel retail companies in the world. They are selling a lot of wool and they are very keen to find out how to sell more Australian Merino fibre. The week before I was with the team in Shanghai at (indistinct) Expo, a fair attended by the world's major spinners. Over a two-day period more than 40 companies approached us looking for opportunities to do more with Australian Merino fibre.

These are ideal opportunities for me to talk to our customers. The retail apparel and fashion industries, of which we the Australian Merino industry are a critical part, are vibrant and fast moving and low margin. The people in those industries, fashion designers, garment makers, retailers, are innovative people - they have to be; they need to make three or four new ranges of garments each year to stay in business - and they are our ultimate customers.

We need to learn to run as fast as our customers. So over the past year we in the AWI staff have gone past some of the political chatter that occasionally distracts us and we have gone around the world talking to our customers, knocking on their doors. As a result of listening to them, we have developed a new business strategy that puts products on retail shelves.

Our business, the AWI business, is now a combination of research, innovation and marketing. It is designed to add value to our customers' business and therefore boost your bottom line. I understand that you are not making as much money as you would like from your wool operations. But AWI is doing as much as we believe we can to improve things through our new approach to textiles, our on-farm R&D and strong financial management. I would like to look at these three issues in turn, please.

First of all, the textile and trade R&D we are doing. We work to build demand for Australian Merino wool so that you can get a better bottom line. This requires a global operation capacity, and Pascal Senkoff and Graham Stewart I believe have done a great job reorganising and rationalising the work we are doing to operate globally.

Many of the projects that we started about two years ago were focused on fundamental and fairly complex technical studies aimed at improving the processing of wool. The problem was that those projects either have not delivered outcomes or have been slow to deliver or have not delivered projects to the extent that we believed they would when they were initiated.

Therefore, over the past year we have focused particularly on working with retailers. The work we have done with Kookai here in Australia, with LL Bean, with Marks & Spencer in the UK have put Australian Merino products on shelves, and many more are on the way that you saw this morning, products from Heilan and Nanshan in China, Novetex in Hong Kong, Nippon Keori in Japan and so on.

When we were working with our customers we had to be very clear about what we could offer them as a company. In business terms we have to get our value proposition very clear. This is our value proposition when we are talking to our customers, or our business offer. We provide three things: knowledge, a whole lot of information available to them; innovation, either in products or processing; and market support to get those innovations to the market.

An example of this business strategy in action is the work we did with Kookai in Australia this year to get the Posh Merino garments into the market. AWI provided the knowledge for Kookai to source better buying quality wool, the wool that produced those beautiful soft garments. We then worked with the spinner, the knitter and the designers to help them to develop the new range of dresses. Then we sat down with Kookai and helped them develop the Posh Merino brand so that they could then take the product to market. So knowledge, innovation and market.

We have taken this approach as well with some of Australia's internationally recognised designers, Akira Isogawa and Josh Goot, whom you heard from this morning.

But these are Australian success stories, and we know that 95 per cent of Australia's wool is exported. That means that we need to go to the garment makers, the textile makers, the designers in countries throughout the world, because they are not going to come and knock on our door. In today's textile world that means you need to go to China.

That is the name of your company in Mandarin. Pretty soon there will be probably more people in the world who know the company by that name than AWI. (Mandarin spoken). We must be in China. That is why we opened an office there this year and staffed it with six young Chinese textile experts. They understand textiles, they understand their industry, and they can grow that company with us in their own country and build a better Merino industry with us. We are doing some great business in China. The work with Heilan alone is aimed to produce 100,000 washable suits by the end of next year per annum.

Another part of our global strategy is to establish an office in the USA. We have put one person in New York and I am certain we will soon put more over there. Our first project in the USA sold total easy care Merino wool knitwear through companies such as LL Bean and Talbots. We have recently concluded a contract with (inaudible) in San Francisco to develop Merino products that are stain-resistant and water-resistant, and we are intensely examining the enormous US sportswear market. There is the total easy care product.

Our people on the ground in the US and China and in Europe are armed with a stunning new package of consumer marketing material that we provide to apparel companies for them to use in their marketing strategies. You would have seen it demonstrated out in the foyer earlier today. This is one of the ways that we can be in contact with retail companies anywhere in the world via Internet without spending mega bucks on advertising.

The Board has swung a lot more money to resource these programs, as the Chairman said to you a moment ago. The updated strategic plan released a few months ago allows for \$150 million worth of investment in textile R&D over the next four years, including this financial one. In this graph, you can see how the investment in textile and trade R&D has been increasing over the last three years. That is the green box, as you can see there.

All these projects will boost demand for Australian Merino wool, and for some of you that must mean a boost to your bottom line.

But of course building demand is only part of the answer. We are also focused on improving your bottom line by reducing the cost of production. The on-farm R&D team this year has really delivered the goods. There are some industry-transforming technologies that you saw this morning. A few quick examples.

The Peak Hill product that you see here today is one of several that we hope we will be bringing to market over the next couple of years. That shearing R&D program has been an incredible team effort. I would like to particularly thank my Deputy CEO, Les Targ, for his drive in its coordination.

You heard this morning that more than 3,000 shearers and wool handlers have been trained since our national shearer training program was initiated last year.

We have put a lot of effort into sheep genetics because genetic improvement once it is established assists for all generations into the future. Ian Rogan and his team have done a great job there, and as our Chairman said the launch of SGA here in Adelaide last month is a major milestone for the industry.

One of the most important things we need to do to keep our customers happy is to find a replacement for mulesing. There has been intense activity in the company in this area, and it has resulted in not one, not two, but three or four potential products that look extremely promising. You saw a lot of those this morning. We must get those products to market as soon as possible.

Of course high-performing sheep need high-performing pastures. The Land, Water & Wool project is now in its fifth and final year. Over 7,600 woolgrowers have been involved in workshops, field days, seminars, obtaining publications and so on from that program. Last year alone there were 50 workshops in Land, Water & Wool run across Australia, with growers addressing things like natural resource management, management of rivers and creeks, salinity, native vegetation, biodiversity and so on. That is a program which we only pay half of because it is jointly funded by many other organisations.

With the support of AWI, commercial seed producers have released six new annual pasture legumes this year, three clovers, two medics and two serradellas, many of which are used by people in this room.

We have established grower networks in each state to assist growers take up R&D. Here in South Australia producers are involved in SheepPlus, and in the pastoral zone the longstanding Bestprac project.

There are a number of neat Internet tools. WormBoss, the ultimate package for nematode parasite control, developed in conjunction with the Sheep Cooperative Research Centre, was only released a few months ago and it is receiving 4,000 hits a month. Woolcheque has been a very big success as an independent source of pricing information, using the information that is provided by all of the brokers to (indistinct). In the three months since Woolcheque was launched there has been an average of 30,000 lots of wool valued each month.

All of these projects, from shearing and genetics to Internet based products, will hopefully provide you with the capacity to improve efficiency. There are many more projects that I would like to talk about, but I encourage you instead to get this Product Catalogue which describes many of our products.

Communication of all of those products through forums, the catalogue, the media, the Internet and so on is the job of Matt Flugge and his communications team. Matt has really turned that around, and I would like to thank him and his team for all the work that they have done. They also do all of the fashion communication work both in Australia and overseas.

All of this work is done with your money, and I have a great finance team ably led by David Smullen. That is the last issue that I would like to consider today, a review of the finances. Of course the details of the finances are in the company's annual report, and the slides that I am about to present to you all cover the financial year ending 30 June 2005.

This is the statement of financial performance. You can see that revenue last year was \$65 million, with your levies of \$42.8 million, the important government contribution of \$13.5 million, and interest, royalties and so on \$8.7 million.

Expenditure, \$78.5 million, which was over \$20 million more than last year, which is in line with our strategic plan. Here are some more details of our expenditure. You can see that last year, the year ended June 30 2005,

the expenditure in textiles and trade was less than wool production, but as the Chairman has indicated that ratio will be reversed in this and future years. Those overhead expenses are all the expenses which cannot be in some way directly related to individual projects.

So that results in a cashflow which sees us beginning the year with \$113 million, ending the year with \$101 million in the bank, a net decrease of \$12 million, which is directly in line with our strategic direction to invest more money in R&D than we are gaining each year as per the strategic plan.

In fact, looking at that in a little bit more detail, this is a graph showing you the forward financial position of the company for the years 2005 to 2009, that is the period of the current strategic plan update. You can see our reserves are in blue, and then you add the income each year in green and subtract the expenditure. You can see that after three years income and expenditure about equilibrate and its reserves settle down at about \$27 million.

Obviously these figures are monitored very closely by the company and the board, and they are adjusted according to the funds available. I stress, these are only a plan. As they say, there are very few plans that survive their collision with reality. You will have noted, though, that those numbers go out to 2009. There is one assumption that is made, and that is that the R&D levy will continue to be two per cent. All levy payers will vote on that at WoolPoll next year.

Everybody at AWI is acutely aware of the forthcoming WoolPoll and the fact that we will be judged on our performance by you. In the front of this year's annual report you will see a list of 200 targets, 80 per cent of which were either achieved or fully achieved during the year. I would like to particularly thank our growing and expert global team for the incredibly hard work that they have done to try to meet all of those targets, and I would also like to acknowledge the assistance of the Chairman and the Board of Directors in the work that we are doing. We are all trying very hard to lift Australia's Merino industry.

So, I do believe that the Australian Merino industry has plenty of potential, tremendous potential. AWI cannot solve all of the problems of the Australian Merino industry, but in our drive to boost your bottom line we are knocking on the door of the garment makers and apparel retailers all over the world and helping them sell Merino products to their consumers. We are producing products that you can use on your farm if you want to attempt to improve productivity. We have plans for the future and a strong financial management to take us there.

I am confident in the results we have achieved this year, and I am very confident that the AWI team is committed to the future of this industry.

To conclude, I would now like to show you a very brief video of some young woolgrowers who also have confidence in the Australian wool industry. This is a video of some of the Australian Merino industry's next generation taken at a workshop held by AWI just two weeks ago.

(Video shown.)

Thank you, ladies and gentlemen.

It is now my task to move on to questions on notice. The WoolProducers have provided AWI with a list of 11 questions on notice, and a detailed written response will be provided to WoolProducers. What I would like to do, however, is to go through a summary of those questions with you now. Each of those questions will appear on the screen and I will provide my response to each of those questions. There is one question which we did receive in writing which related to the discussions between AWI and AWS about integration, and I won't be addressing that. The Chairman has already discussed that in his address and the questions from the floor.

This first question relates to staffing. In essence the question concerns the fact that, although staff numbers increased by 12, salary costs actually reduced last year. The answer to that is really threefold. We are talking about activities almost two years ago now, and in the year ending 2004 \$500,000 was paid out in redundancy costs to staff. That was not repeated this year.

In addition, although the numbers of staff are increasing, you need to be careful about looking at numbers and costs because, for example, in China where we have increased staffing the cost of employment is much lower than in Australia. The other factored influence of that is we are getting better at outsourcing and managing consultancy contracts, vis-a-vis employees.

The next question relates to government funding and how the percentage of government funding relating to levy payments changes over time. It is actually quite a complex issue and it really relates to the timing difference between collection of levies and the contribution by the government of their contribution.

You remember you pay your levy income at two per cent and the government pays 0.5 per cent. If the wool clip was exactly the same size every year, then the ratio of levy income to the company and government income to the company would be exactly four to one. But the government works out how much it will pay us based on a three-year rolling average, in exactly the same way when you do your income tax and you are able to average your income over I think five years. So what happens is, even though your levy comes into us each year, the amount of money we get from the government varies. That is basically the explanation for why those numbers don't appear to be logical when you first look at them.

The next question came under the heading of Corporate Affairs, and the reason for that is Corporate Affairs is where we have allocated expenditure in the ongoing program against extreme animal rightists, including PETA. Fundamentally the question points out an overspend in that area of \$6.393 million and asks: is that in relation to PETA? The answer is yes.

The expenditure on PETA and animal rightists during this year was \$6.422 million. This amount was spent over a number of areas, including \$1.3 million in public relations and supporting the Wool and Sheep Industry Taskforce which brought together the players throughout the industry, as the Chairman has identified, and serious public relations in a number of countries throughout the world; \$1.5 million to pay for the trade advertising in the USA which touched an estimated 4 million people in the textile industry, and that came in \$1 million under budget thanks to good management; and, lastly, \$3.6 million in reviewing the industry's legal options both in Australia and overseas. These funds paved the way for the recently announced ground-breaking declaration between the Australian wool industry, the US Retail Federation and the British Retail Consortium.

There is also a question about costs. Most people I guess would know that PETA's application to the Federal Court to strike out AWI's statement of claim failed, and as a result of that the late Justice Hely directed PETA to pay AWI's costs. We don't have those costs yet. That is a long and tedious process. We estimate the amount we will receive in that area will be something between \$50,000 and \$75,000.

The final question relates to company reserves. I think I addressed most of this question in the last slide in my financial presentation during my address in which I hope I showed everybody that we have tremendous flexibility as we move forward as years go ahead. But our intention is to reduce the reserves of the company progressively.

The board has established some minimum level of reserves as good business. First of all, there is a \$5 million emergency reserve, which is part of our industry obligations to the government for exotic disease control and contingency; secondly, \$10 million or about 15 per cent of our operating expenditure against the risk of material shortfall or variations in income.

That concludes my responses to the questions on notice, chairman.

IAN MCLACHLAN: Thank you very much indeed, Len. I now invite your questions and comments on the financial report and on those responses which he has just given to the questions on notice. Those people therefore holding yellow, orange or blue cards may now ask questions or make comments at this point. To ask a question, please proceed to the microphone nearest to you and show your card to the AWI staff member. When I give you the signal, proceed, please, to introduce yourself to the meeting by stating your name et cetera.

ROBERT McBRIDE: I guess a couple of issues. John Maynard Keynes was the father of modern day economics and he suggested in discussions about long and short runs, he said in the long run we are dead. Look over the last couple of years, our wool price has dropped about 40 per cent or 50 per cent. Oil prices have gone up towards 300 per cent increase. Even as late as last week the Australian dollar went down to about 74 cents, it dropped about three or four cents and there was no change in the price of wool.

It is good that Len is interaction with the buyers on the processing line, down the line, and they are all very positive about their industry. I just hope they don't forget the grassroots level people that, if we are not here, the processors aren't there. That is to say, Len, how do you view or what is the next two to three year view from the middle processors' view of the price of wool and where do we go from here, please?

LEN STEPHENS: Robert, if I could paraphrase the question. I think you were asking, you know, we have growers here, retailers here, processing sector in the middle. How does the processing sector see things? I think we all know that they are having a very tough time. I mean, there is enormous rationalisation going on in that industry and enormous over-capacity of plants, and China really taking the lion's share of the deal.

I frankly don't think there is a single thing that AWI can do about that. In fact, it makes it incredibly difficult when you are working with companies only to find out that they go into receivership between when you start a deal and sign the contract.

I think the answer there, look, it is evolution. It happens in every industry. The good always survive and the bad don't. All I could say to you is that we have no shortage of processing companies to work with. There is a technology, training, expertise, skill issue in China, say, vis-a-vis Italy, and that worries the Italians to death, quite rightly. I think we can have no influence over that. I think we can just elect to work with the people who emerge as winners.

PETER DOCKING: We have listened to you probably for many, many years explaining the virtues to the world of pure new wool. But from my view of the general retailer, and basically Mr and Mrs Average shop at K-Mart, Coles, Bi-Lo, Woolworths, Big W, Target, I think the Australian wool industry would be better served by targeting the smaller budget consumer with blends of wool instead of pure new wool. My personal view of the pure new wool thing, it has got the Australian wool industry in a hell of a lot of trouble and I want to know, and I am sure a lot of other people would want to know, just how much effort is the AWI putting into wool blends, because if we have a five per cent wool blends in a pair of jeans, then basically every person who buys a pair of jeans is going to be buying Australian wool and we don't have to do a heck of a lot of work to promote that.

LEN STEPHENS: We work with any form of wool, be it pure or blended, so long as it is Australian. There is absolutely no restriction, direction, policy, feeling whatever to deal with pure wool 100 per cent versus blends. In fact just a few weeks ago Marks & Spencer launched a new set of pyjamas developed in conjunction with WoolMark Company and us which is 80 per cent cotton and 20 per cent wool. It is on the market in London right now. In China, blends are the way forward. In sportswear, probably blends will be essential. So we do a lot of work with blends.

SIMON RAMSAY: I perhaps had some reservations about the strategies of the Board to run down reserves from \$101 million to \$26 million in 2009. I do that on the basis that Chairman McLachlan indicated that it was the wool

industry that was covering the cost of the PETA campaign at the same time it talked about this national industry body all working together, which is marvellous, but at the end of the day unfortunately it is the woolgrowers funding the costs of litigation against PETA.

My view is that all of industry should share that cost, and I think I shared that view with you last year, yet I actually have not seen too much to convince me that is happening. We are all benefactors of the PETA litigation. I don't see why we as the wool industry have to reduce our reserves to accommodate a whole range of things. Some of that promotional work that is being done AWS carried the responsibility for. But in relation to litigation, certainly with PETA, I believe MLA and other industry bodies should also contribute to the cost of that litigation, and not have to be fully borne by the woolgrower that is actually depleting our reserves.

The question I put to you is: are other bodies, other industry bodies, the meat industry in particular, sharing some of this cost burden, as are the exporters and the processors and others that will benefit by the actions that we are taking? I fully support the AWI in that manner, as an aside. Thank you.

LEN STEPHENS: In answer to your specific question "Is MLA supporting the litigation specifically", I believe and I will be corrected by Les Targ if I am wrong, but that specific issue is no. But MLA are strongly supporting the industry task force. I know we have people from MLA here, and I am sure they will take your message back about a suggestion that they contribute more.

Does that answer your question, Simon? I am trying to be very specific.

SIMON RAMSAY: I actually was not pointing at MLA. I was saying is any other industry body in Australia, the Australian government included, supporting the wool industry shareholders in its fight against PETA which is not directed just at the wool industry, it is directed at Australian agriculture, in supporting AWI in its litigation against PETA.

IAN MCLACHLAN: I will add to that. I think, Simon, when the Cormo Express incident took place, the livestock exporters, they had to do a whole lot of things. They have had to expend a lot of money and make a lot of arrangements. Now, this is a different issue. It is really a Merino wool sheep issue, Merino sheep issue. You know, you might say it is a bit of a cross-bred issue, but not much.

So we thought it was appropriate that we paid most of the expenditure. Now, we have also been helped by one commercial firm. Elders have helped not half or something, but they have put a substantial amount of money into this court case.

I would say to you that if, for example, somebody like PETA started to take on other areas, live sheep, for example, seriously or whatever else, then other groups would come into it. But I have to say there aren't many

people who don't think that this issue, which is really a mulesing issue, shouldn't be paid for by the industry that is trying to solve the mulesing problem. You know, when the mulesing problem is solved, the issue will go away.

We are not (inaudible) that the issue will move over effectively to live exports, although that subject was introduced. But we are not worried and we know that the retailers around the world would simply dismiss any protests to them on the subject of us not appeasing the animal rightists on live exports.

So all I can say to you is we felt it was appropriate that the wool industry should fund most of it. I know you have a different view. But I think the fact of the matter is we would be flat out getting other people to contribute. If it got to other issues, live cow exports, live sheep exports, what have you, then other people would be funding it and we wouldn't.

DIGBY CROZIER: Dr Stevens, could you confirm that the legal action against PETA primarily relies on two grounds: firstly, an alleged violation of the Trade Practices Act under section 45D and, secondly, on the grounds of conspiracy?

LEN STEPHENS: That's correct, and there are additional grounds which I believe relate to the common law concerns as well. So there are three elements to it. Do you want me to get specific legal advice, because when you are talking about constitutional sections of parts and things, if you would like us to give you specific legal statement on that, I can call on that.

DIGBY CROZIER: I would like a little supplementary advice, Dr Stevens, because it is my understanding that the late Justice Hely struck out the first two grounds.

LEN STEPHENS: No, that is not true. It is not true. What happened was he struck out the 45DB issue, which was a Trade Practices Act area, and left in section 45D, which is also a Trade Practices area, but the first one he struck out was to do with the new legislation which was passed in 1996, which intended to extend the arm of the Trade Practices overseas. So you are not correct in that.