LEIGHTON HOLDINGS LIMITED

An Evening Meeting Address by

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Managing Director, Leighton Holdings Limited to The Securities Institute of Australia, New South Wales Division, Sydney, February 8, 1983.

Today I would like to speak about the present situation of Leighton, the environment we anticipate, our business philosophy and strategies and the results we expect to achieve over the next few years.

Late last week we announced a buoyant interim report which revealed the continuation of strong results in the 6-month period to December 31st, 1982. Operating profit attributable to shareholders increased substantially to $6.5 million, up 55 per cent over the previous year, whereas turnover rose 21 per cent to $173 million. Directors have recommended a one-for-five bonus issue.

Even more pleasing is the fact that the contracts we have won in the period have yielded a current uncompleted work position of $342 million, well ahead of the $309 million in hand 6 months ago and a very good increase on the $300 million in hand at this time last year.

I believe this to be an excellent result considering that the market as a whole has declined in real terms compared to a year ago in most of our business areas.

This performance, under present conditions, reflects very well on the capabilities of our people and strongly underpins management's confidence in being able to maintain turnover and profit growth in the next one to two years, despite the recession.

A few of the larger contracts won during the last six months include:-

- conversion of old GMH car plant at Pagewood into automated cigarette factory for W.D. & H.O. Wills — a contract worth ........... $45 million
- an ocean outfall at Cape Peron W.A. for Metropolitan Sewerage Board in joint-venture with Candac — worth ............... $20 million
- site preparation for the Kohima Barracks project for Public Works Department, in Hong Kong — worth ......................... $16 million
- a multi-storey car park at Garden Island Sydney, for Department of Navy — worth ... $12 million
- and again in Hong Kong the North Point underground station for Mass Transit Railway — worth ......................... $18 million

The major highlights of our construction operations during the period were the successful completion of two large and very challenging projects.

At the remote North West Shelf, we completed the $75 million site preparation contract for Woodside LNG in October, only 16 months after commencement. This enormous undertaking required the amassing of huge resources of construction equipment — probably the largest fleet of bulldozers, loaders, scrapers, trucks, drills etc. ever seen on one site in Australia. We had people working around the clock to ensure completion on time, despite a lengthy period of industrial disruption.

The other major contract was in Fiji, where Leighton and its joint venture partners had undertaken a $70 million water supply scheme for the Government to service the areas of Nadi and Lautoka. The project, including a major dam in the highlands, water treatment plant and pipelines, was completed and officially opened by the Prime Minister of Fiji in early December.

Property development activities have continued profitably, although effects of the general economic downturn are being felt.

The Ridgewood residential estate in Brisbane is currently developing and selling about 8 to 10 blocks per month at prices well ahead of last year. This long-term development now provides a very attractive product in a sought after location and can be expected to achieve at least this level of production and sales in the next several years.

Stage 1 of the Pacific Keys project at Broadbeach on the Gold Coast, comprising some 60 high-rise units and 20
townhouses, was completed last November. Currently settlements on approximately 40 per cent of the development have been achieved. The company believes it has a good product in this development but is being realistic in view of the general fall-off in demand for Gold Coast properties. Accordingly we are ensuring that our investment is valued in the accounts at realisable values and we are writing off all holding charges. In addition, we are renting some of the units and townhouses on a 12 months basis.

The Black Hill coal mining project is proceeding towards its initial objective of obtaining a mining lease from the N.S.W. Government before the end of 1983. In the light of recent rescheduling of future coal demand in Japan and the downturn currently being experienced, it is unlikely that a start-up on the planned 600,000 tonnes per annum production from Black Hill will occur before 1986.

Investment activities aimed at broadening the base and reducing the cyclicality of earnings, are contributing to profitability. We are particularly pleased with the performance of our investment in Multicon Holdings in which we hold a 40 per cent interest. Multicon is involved in a range of mechanical engineering and specialist steel fabrication and erection, which complements our own civil engineering and building services. Our confidence in the management and prospects of the company has been confirmed by its strong growth in profitability and workload, which extends several years into the future.

I cannot say I am as happy with our 19.5 per cent investment in Kemtron. At the time we decided to invest in Kemtron some 18 months ago, we felt that the new management team had got their act together and could be expected to achieve sound performance. The Company’s basic activities in electrical products and building construction in Victoria complemented our own needs and it held a strong market position in most of its product ranges.

Due to the size of Kemtron and our own relative inexperience with some of their activities, we decided initially to buy up to a 20 per cent holding as a long-term investment and seek representation on the Board.

Our interest was intended to be friendly but unfortunately our approach was not welcomed. I say “unfortunately” because I believe we would have been a positive influence and some of their present difficulties may have been reduced as a result.

We are currently adopting a wait and see attitude, maintaining the position of long-term investor and writing down the investment to realistic values taking into account current market conditions.

I should now like to turn to the future and look firstly at the economic and market environment that we expect to be influencing our business in the next 2 to 3 years. At best it can be described as a very difficult period in which we can expect our traditional markets to be either flat or depressed.

In the USA, which I visited in December, both inflation and interest rates have dropped markedly and there are some hopeful signs of an economic upturn starting in 1983, but I would stress that the process of recovery will be long and slow. In Australia, we do not fully appreciate the length and depth of the recession in the USA and its shattering effect on business confidence. Getting business and people to spend again and getting industry back on to a competitive production basis are two essential needs that will take some time to develop.

In Australia we have been lagging the US recession and I believe that 1983 and 1984 are going to be very difficult years, particularly for our rural and manufacturing industries. Unemployment will be in excess of 10 percent, G.D.P. will contract perhaps 1 or 2 per cent and inflation will reduce only a couple of per cent or so from present high levels. Interest rates can be expected to be lower reflecting slack demand for funds from the private sector and substantial overseas capital inflow, but will still remain higher than comparative overseas rates.

If community attitudes strengthen towards more restraint in real wages as the recession deepens, there may be some chance of winding back our excessive wage cost structure and improving industry’s competitiveness. However, to make real progress would also require a significant reduction in industrial disputes which is difficult to see with current attitudes.

In regard to the construction market, the volume of work available is expected to be flat or experience a small decline, whilst competition will be severe. There will be more emphasis on building construction which will help to offset the sharp decline in resource development work. Governments are also expected to stimulate the economy by introducing public works programmes, good examples of which are the recently introduced bi-centennial national highway programme and the water resources development programme.
Similar low growth conditions are also expected to prevail for the next one to two years in South-East Asia and Hong Kong with consequent decline in the level of construction work available. In Hong Kong in particular, the combination of world recession, the shakeout in the property market and concern for Hong Kong’s long-term future, are having a particularly depressing effect. Fortunately Leighton’s traditional market, the provision of prepared land areas and related infrastructure as part of the Government’s mass housing programme, can be expected to suffer much less than the speculative commercial sector, although fierce competition will be experienced.

On the specific question of Hong Kong’s future, recent official reports from the mainland indicate that China will re-establish Sovereignty by 1997 and treat the former colony as a special zone, in which the present status quo will be maintained as far as possible. It would remain a free port and international financial centre, but the British-dominated public service would be gradually replaced with Hong Kong Chinese.

Despite the rather depressing outlook I have described for the next few years, we are maintaining a very positive approach to the business opportunities that will exist during these times and are very determined to maintain real growth in our profitability. By no means do we see it as a period of doom and gloom, in fact strong contractors have traditionally performed very well in periods of downturn. Leighton as a market leader in the construction industry and having very strong managerial, technological and financial resources, is indeed very well positioned to maintain growth in results despite difficult conditions.

Certainly in the more immediate future we are confident of achieving these aims. For the balance of the current year, I would expect us to increase or at least maintain our forward work position based on the success of current tendering, and to report a profit attributable to shareholders of not less than $13 million for the year. I would expect that level of profit at least to be maintained in the following year, despite the difficult conditions and uncertain economic outlook.

Let me now summarise our principal objectives for the next two to three years and the main strategies we are adopting, assuming a recessionary climate in all of our traditional business areas.

Our objectives will be to:

- maintain real growth in profitability
- improve market position in Australia and Hong Kong
- complete the establishment of a profitable construction
- operation in Singapore and Malaysia
- rationalise our investment in Kemtron
- achieve a substantial investment in construction in U.S.A. to
- derive early benefit from the recovery
- prepare for further diversification investment.

Achieving these aims in a difficult climate will require the following strategic priorities which are aimed primarily at the fundamental trading performance of our current business sectors.

We will be:

- adopting a very aggressive approach in the marketplace and ensuring that we maintain our forward order book.
- ensuring that acceptable job margins are being achieved by being innovative and cost-efficient.
- maintaining strong liquidity and sound financial structure.
- closely monitoring and evaluating our financial performance to ensure control, accurate reporting and early recognition of trends.
- ensuring that our people continue to be more highly motivated and better performing than those of our competitors, through good leadership, training, employment conditions and reward for performance.
- ensuring that a tight, lean operation is maintained by regular internal review and action to redeploy or divest under-utilised resources and to minimise unnecessary expenditure.
- investing in new technology and innovative systems and processes to ensure operations are more cost-effective than our competitors.
- keeping the largest, most modern and efficiently operated and maintained equipment fleet in Australia to increase our competitive edge.
- limiting diversification investment to only first-class opportunities meeting strict criteria and ensuring that investment decisions are based on thorough study and evaluation.

Whilst on the subject of diversification, let me say a few words about our philosophies, for I believe they are not well understood and this combined with our track record to date, may have a lot to do with our current high-risk stock market rating.
Since Leighton became a listed public company some 21 years ago, we have always worked actively at diversifying our activities. The original business of being civil engineering contractors in a single geographic region could not have produced the excellent long term profit growth that has been achieved despite the one major downturn in 1974. You might be interested to know that over these 21 years we have achieved an annual compound growth rate of 15.9 per cent after discounting for the effects of inflation. Not a bad effort when you consider that we are diversified. We have diversified our activities. The continuing objective has therefore been to spread opportunities for growth and expansion and to adapt our operational challenges. In construction, the company could foreseeably be ranked by turnover within the top 50 construction groups in the world and be providing its services from permanent bases in Australia, USA, Hong Kong and Singapore. On a broader international front, we will be engaged in selected major projects on a job-by-job basis.

The predictable growth patterns of the sixties and early seventies have gone. They have been replaced by a rapidly changing and less certain business environment in which the role of versatile and responsive management will be critical. I see in Leighton today some of these qualities being demonstrated in our approach to diversification.

Some of the principal features guiding our further diversification are:

- that it complements our existing activities and its services and products are related to building and construction.
- that the quality of its earnings enhances our own and provides some counter-cyclical effect.
- that its activities provide some synergy with our own.
- that management has a good track record and its receptive to our own.
- that its business has growth potential.

Geographic diversification in construction will be centred primarily in South-East Asia and the United States, which in our view will provide the major growth opportunities as the world economies recover. Additionally we are building a track record in major international construction projects. The $70 million Fiji joint venture is a good example of this. In seeking these project-by-project opportunities, we will concentrate initially on those selected projects in which our specialised skills in marine construction or large-scale earthmoving will provide the necessary competitive edge.

Now let me touch briefly on our longer-term aspirations. If you were to ask me what will Leighton look like in ten years from now, I would broadly describe the company as a major international construction and engineering group, having widely diversified activities in providing services and products related to the construction and mining industries.

Probably half of the group earnings would be derived from construction and engineering and the balance from diversified activities. In terms of market capitalisation, the group would be approaching a ranking within the top 50 Australian corporations.

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The scope of diversified activities would be largely centred on Australia and could include interests in the following areas:

- property development and investment.
- construction related services and products.
- open-cut mining including long-term contract mining.

Before concluding you may be interested in a few words about the “personality” of Leighton and its management style as reflected in our approach to our business.

First and foremost, we are a people company and we will do everything in our power to ensure our people are kept highly motivated, particularly those key people that are critical to profit performance. The best and most “hungry” construction people will always make a profit no matter what the conditions and you have to recognise them, look after them and encourage them to greater things. The difference between having a high performing team of people compared to a mediocre team in our business is the difference between success and failure.
If you were to ask me how one develops such a team, I would say it is probably a mixture of things, which include management attitude, leadership, reward, security, training, the work environment and incentive related to profit performance.

With regard to relationships with our workforce and unions, we generally have few serious industrial problems other than those of an industry-wide nature. We believe that industrial relations is the responsibility of line management and that avoidance or resolution of potential disputes is best done at the job level. This means training of our job people in what must be avoided and what must be provided. An associate remarked to me the other day how impressed he was to see on one of our building sites in North Sydney, that we had provided iced water for the men. A small item perhaps, but a significant one to an outdoor worker in Sydney’s summer. Job safety is another critical factor to good industrial relations. Quite apart from the obvious cost benefits in being safety conscious, it is impossible to win an industrial argument on a safety-related issue, hence the critical importance of safety management to job performance.

Now what about the “style” of Leighton, or what corporate capabilities do we believe are important. Words like — innovative, competent, adaptable, timely, aggressive, responsive, sound, resourceful—in my mind tend to reflect our better qualities. Additionally I believe we are a good mixture of professionalism and commercialism.

What does all this mean? Firstly, say in terms of opportunity, it means we are not restricted to a single product or service in a single market area but can be responsive to market forces and can offer a wide range of construction services virtually anywhere. The best example of this is that whereas two years ago our maximum concentration was on heavy, remote resource-related construction in Australia, today a far larger proportion of our activity is in commercial and industrial building construction in the major capital cities.

What about in terms of our clients? Our approach is always to provide quality and competitive services, ahead of the time expected, in accordance with the clients’ needs. But we also want a sound and fair contractual basis for doing so, and will always attempt to ensure our contracts are written so that we are paid in full for the work done. I include in this the reimbursement of those costs, which may necessarily be incurred to complete a job, for which we were not contractually liable. We maintain a strong but fair approach and many of our clients have a healthy regard for our competence in this respect.

A similar hard but fair attitude is maintained in our dealings with our subcontractors and suppliers. We demand good performance at the lowest price and will drive a hard bargain in regard to terms of payment. Creditor finance is a cheap source of short-term funding from which we benefit without apology, but at least it is known that early payment can be obtained in the case of established need.

Perhaps the only other aspect of “style” that I would like to mention is our preoccupation with financial strength and soundness. Unquestionably 1974 and the recovery years thereafter left an indelible mark on Leighton and its management, 80 to 90 per cent of whom have been with the company since before that time. In that period Leighton came of age and the hard lessons learnt have influenced our corporate thinking ever since. Recently a stockbroking financial analyst asked me whether I thought the current conditions would create another 1974 crisis for Leighton. My reply was that on the contrary we have been more fortunate than most in having experienced those difficult years, for they prepared us for what may now prove to be a very deep recession. We are now strongly positioned to maintain solid growth and will be able to outperform those corporate brethren not so well prepared as ourselves.