

7th May 2002

Automotive Industry Enquiry
Productivity Commission
P.O. Box 180
BELCONNEN ACT 2616

Dear Sir,

**SUBMISSION TO THE PRODUCTIVITY COMMISSION REVIEW OF POST
2005 ASSISTANCE ARRANGEMENTS FOR THE AUSTRALIAN
AUTOMOTIVE INDUSTRY**

Introduction

Australian owned Intercast & Forge Pty Limited is the largest independent ferrous casting and forging operation in Australia. It was established in January 2000 following a move by Australian investors to acquire the casting and forging assets previously owned by the British based BTR Group (now Invensys.) The Company operates from two sites : a newly developed foundry at Wingfield, South Australia and a combined foundry, forge, sintering and machining operation at Seven Hills in New South Wales. It supplies approximately 40 percent of the Australian market for cast iron components (excluding engine blocks,) primarily for the automotive industry and is the only cold forging operation supplying the automotive industry. The various companies (Borg Warner, Astra Engineering and Monier) which now make up Intercast & Forge, have been supplying components to the automotive industry for more than 40 years.

The Seven Hills site is predominately a second tier supplier to the automotive industry with major customers being Spicer Axle, PBR Automotive, BTR Albury, Unidrive, Air International and Australian Automotive Air which supply components to all four car companies : Ford, General Motors, Toyota and Mitsubishi. Castings are also exported directly to Sumitomo and Jatco in Japan and PBR in USA as well as indirectly through PBR's first tier operation in Australia. Forged and sintered components are incorporated in the automatic transmissions that BTR Albury exports to Korea.

The Wingfield site was purpose-built as a greenfield site in 1998 and is a first tier automotive supplier to Mitsubishi and second tier supplier to PBR Automotive, Finlay Engineering, Unidrive and Coghlan and Russell. It also supplies rail track fasteners to One Steel and Pandrol in Australia (including the Alice Springs – Darwin project) and to international markets in Asia, USA and Europe.

Intercast and Forge will have a turnover of \$100 million sales in 2001/02 with 60% currently produced for the Automotive industry. It employs 450 people across a range of professional, trade and non-skilled workplace jobs and enjoys very high Supplier Performance Ratings from its customers.

FAPM Submission

Intercast & Forge is a member of the FAPM and through its nominee, Ray Petty, who is a Vice-President of the Association, has contributed to and supports the FAPM submission to the Productivity Commission. However, there are a number of areas where we wish to reinforce the recommendations made in the FAPM submission as well as additional recommendations we ask the Productivity Commission to consider.

Intercast Submission

We believe it is imperative that the 10% tariff which will be introduced from January 2005 should be maintained until other countries offer equal access to Australian exports.

For the automotive business to remain competitive, it is imperative that suppliers and OEM's can achieve volumes sufficient to match global competitors and this will rely upon export growth to supplement the domestic market. Australian manufacturers have already established export markets into USA, Europe and Japan where import tariffs are similar to those in Australia. However, the future growth opportunity will be in Asia and to a large extent, Australian manufacturers are unable to overcome the tariff barriers that have been erected in most ASEAN countries. We supply a range of brake components to PBR's plants in Australia and USA and they are quite keen that we supply equivalent components to their plant in Thailand, Although our prices including freight are quite comparable to the Thai prices, addition of a 43% import duty prevents us from securing any business. The Australian government must vigorously pursue equal access to ASEAN countries to avoid more of our automotive manufacturers from relocating behind the tariff walls.

Intercast & Forge Strategy

CONFIDENTIAL PARAGRAPH SUBMITTED UNDER SEPERATECOVER

All Wheel Drive (AWD) Vehicle Manufacture

We recommend that the import tariff on all terrain vehicles, 4WD and sports utility vehicles be raised to 10% from January 2005.

The current Government Automotive Policy, covers passenger vehicles produced in Australia (for vehicle models in excess of 30,000 per annum). A grey area of the current Policy has been All Terrain Wagons and Pickup Trucks, incorporating 4WD vehicles currently classified as Light Trucks. Market preference, leisure applications and design change have over time, eroded the Passenger vehicle segment substantially by this fringe application. These vehicles currently represent in excess of 200,000 vehicles or 25% of vehicle registrations in Australia and attract a 5% Duty classification as compared to the

normal Passenger tariff of 15%. The similar light truck vehicle market in the United States attracts a 25% Duty.

Now all four vehicle assemblers have announced plans to produce in Australia an All Wheel Drive (AWD) Passenger vehicle to meet market demand before 2005.

To foster this growth segment of the local Automotive industry, the government must be given an option by the Productivity Commission Option report to include the All Terrain Wagon and Pickup Truck and 4WD vehicles in the Passenger Vehicle tariff within the Automotive Policy as Passenger vehicles to attract a 10% duty tariff (for vehicle models in excess of 15,000 per annum initially) from 1 January 2005.

It is this Light Truck segment that has been the vehicle growth segment of the industry over the last 15 years and the local industry has not been afforded protection for it to develop this segment. Time has now come for this change.

Intercast & Forge ACIS Experience

We believe it is essential that the Automotive Competitiveness and Investment Scheme (ACIS) be continued until at least 2010.

The ACIS scheme has provided the Company with the security and confidence to continue to invest in capacity to support the automotive market. It is providing cash funds for the company to reinvest in the Capital Expenditure and Research and Development necessary to drive its Global competitiveness.

The company, under its banker's funding arrangements, has approximately 3% of sales allocation for Maintenance Capital Expenditure. ACIS credits have effectively increased the value of that to 4.5% by the company reinvesting ACIS credits into Capital Expenditure and Research and Development.

Additionally, the board of directors of Intercast & Forge at its meeting on 21 March 2002, approved a \$10 million Growth Capital Expenditure project to upgrade its Seven Hills site. This upgrade replaces its 23 year old moulding technology with 'state of the art' equipment just released by its Danish equipment manufacturer, which will ensure the site's global competitiveness for the next decade and beyond. The ACIS Credits substantially got the Investment proposal over the company hurdle rate and made the project payback meet the board's investment criteria for a strategic long-term investment project.

This investment delivers productivity to ensure global competitiveness in world markets of Intercast's expertise. It delivers 75% increase in capacity to be filled predominately by import replacement and export opportunities to niche markets. In anticipation of this decision, Intercast & Forge is to participate in the localization project of the next model Toyota Camry through Toyota and PBR Automotive.

Intercast & Forge products and processes have been significantly improved by productivity through development activities which have been funded by ACIS credits. Development of material efficiency, labour productivity and equipment efficiency have

all contributed to a stability in unit cost to the customer and in fact, price downs to the customer in most cases.

Market Access

We believe it is imperative that the 10% tariff which will be introduced from January 2005 should be maintained until other countries offer equal access to Australian exports.

Global competitiveness incorporates productivity and economies of scale. The rate of growth opportunity in the Australian market is not sufficient to absorb investment decisions on capacity utilization. To realize these opportunities, Inter cast & Forge must have equitable access to export markets for its products. We are all aware of the lack of a level playing field through disproportionately high tariffs and non-financial barriers. It is important that the Federal Government accelerates its drive to open up key markets for Automotive Component products, especially in the United States and Thailand and with other countries as appropriate.

This attribute of the package is vital to the success of Inter cast & Forge's expansionary and productivity project. An illustration of this market access denial, Inter cast & Forge, through its strategic business partner, PBR quoted its Thailand Operation for a component the local industry could not meet the PBR specification on manufacture. While Inter cast & Forge could match the local price including shipping costs, etc. it could not totally overcome the 45% duty entry into Thailand. It is these market barriers that deny Australian manufacturers of reciprocal market access.

Anticipated Outcome from FAPM Recommendations

The inquiry into Post 2005 Automotive Industry Arrangements seeks the Productivity Commission to set out options the government might consider for the future. As a strategy the government must consider the maintenance the 10% tariff and seek significant economic benefit, through an aggressive plan for the industry (both vehicle and component) for which the government will support it with a transitional assistance package. This plan must contain vision as well as detailed steps to ensure its fruition. It must be attractive to both the industry and the nation as a whole.

The concept of the vision we propose is that the local Automotive industry undertakes to enhance its capability to produce at least 50% by number of local annual registrations by the year 2010. To facilitate this vision/strategy, the Federal Government would in return structure an ACIS II Package to facilitate necessary Investment, Research and Development of product and processes. This outcome would have significant economic benefits to the Australian economy of reduced imports and increased exports from a globally competitive Australian Automotive Industry.

To illustrate this vision, let us assume that the local market will be 1 million new vehicle registrations by year 2010. This will project to the local industry manufacturing 500,000 vehicles per annum by 2010. The local industry currently produces 350,000 vehicles which represents a 40% increase on current production volumes in Australian manufactured vehicles. The industry has experienced a stable vehicle output for the last 10 years by a reduction in locally consumed vehicles absorbed by increased exports. In

return, the federal government would fund a \$3 billion ACIS II package between 2006 – 2010 to facilitate the industry development and expansion.

The 40% increase in vehicle production would service either increased vehicle sales in the local market or export sales to other countries. Similarly, for the component sector, which currently produces some \$7 Billion, it too would grow its capability by 40% to produce say \$10 billion by 2010.

The economic benefit of this vision/strategy would be outstanding for the Automotive Industry and the nation as a whole. The employment and skills generation capability of the automotive industry is well recognised both for itself and the nation. This strategy would be self-fulfilling in its generating economies of scale for existing producers, enticing new entrants, all being able to produce global competitive vehicles and components for domestic consumption or export.

It is a visionary option for the industry that must be put to the Government so they can satisfy themselves of its future value. It will also demonstrate credibility to the electorate of a substantial Australian Industry benefiting all of the nation.

(The numbers quoted in this illustration are by way only of example and simplicity and should be accurately modeled by the economists to establish real meaningful and achievable targets).

Conclusion

The main points of Intercast & Forge's submission is that it is Australia's largest independent foundry and cold form forge, it supports the FAPM submission, encourages industry sharing by the car companies, acknowledges the benefits of ACIS so far but requires Market Access to be addressed as a matter of urgency by the government and promotes a KPI based industry target with high level incentive.

We thank you for the opportunity to make a submission and management is readily available to discuss or elaborate on the contents of this submission at any time.

Ray Petty
General Manager – Strategic Planning