Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO AUSTRALIA'S EXPORT CREDIT ARRANGEMENTS

MS P. SCOTT, Presiding Commissioner
DR W. MUNDY, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT PERTH ON FRIDAY, 23 MARCH 2012, AT 8.59 AM

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MS SCOTT: Good morning, everyone. Welcome to today's hearing in Perth. We're very pleased to see participants attending our hearing today. My name is Patricia Scott. I am the presiding commissioner for this inquiry, and my fellow commissioner is Dr Warren Mundy. Now, we're happy for you to refer to us as Patricia and Warren.

The purpose of this round of hearings is to facilitate public scrutiny of the commission's work and to get comment and feedback on the draft report. There may be some media representatives in the audience. Can I just check if that's the case. No-one? Okay, thank you. Following this hearing in Perth the hearings will also be held in Sydney and Canberra. We will then be working towards completing a final report to government in May, having considered all the evidence presented at the hearings and in submissions, as well as initial consultations.

Participants in this inquiry will automatically receive a copy of the final report once it is released by the government. We can't indicate at this stage when that is. It is normally the case that reports are released within 25 parliamentary sitting days of the completion of the report, but a sitting day is not the same as an ordinary calendar day. We like to conduct all hearings in a reasonably informal manner but I remind participants that a full transcript is being taken. For this reason, we won't be taking comments from the floor. But we expect to finish our proceedings around 2 o'clock today, and if there is anyone who would like to come forward at that stage and make a comment for the purposes of the transcript we will give you an opportunity to do so.

Participants are not required to take an oath but should be truthful in their remarks. Participants are welcome to comment on issues not only raised in our draft report but on issues raised in other submissions or on information they hear today. Transcripts will be made available to participants and will be available on the commission's web site following the hearings. Submissions, as you know, are also available on the web site. In case there is an emergency, the evacuation procedure at the hotel is for us to go out through the front door of the hotel, turn right and walk down the street to Langley Park.

So I'm very pleased to welcome to the table Craig Williams. Mr Willams, for the record please, will you state your position in the firm and your company, and if you would like to - would you like to make an opening statement and then Warren and I will probably have some questions for you.

MR WILLIAMS (OG): Certainly. Thank you, Patricia, for the opportunity to speak here today. My name is Craig Russell Williams. I have a consulting company called Orpheus Geoscience, of which I am a director, but I guess the reason that I am here today is that I was the president and CEO of a company called

Equinox Minerals. We had a lot of involvement with EFIC on an asset in Zambia in Africa, that I will talk about. So I guess I'm here essentially as a case study for EFIC investment. I will declare right at the start I'm very supportive of EFIC's efforts for us. I don't think we would be where we were if it wasn't for EFIC.

Just a snapshot of the company. I co-founded it back in 1994 with a financing of about $9 million, so it was a very small company at that time. It was taken over in the middle of last year for $7 billion by Barrick, so obviously it was a pretty successful company. We became the world's 18th largest copper producer, Australia's seventh largest mining company and Australia's 37th largest company. Where did this success come from? Well, basically through the development of a world class copper mine in Zambia called the Lumwana copper mine. We acquired the asset back in 1999 in a remote part of Zambia that was totally undeveloped. We, through 10 long, hard years of work and financing, managed to get it into production in 2009. Total development cost was about a billion dollars. Essentially our market cap rose from about $10 million at the start of 1999 when we first acquired the project - through the process we had to raise and finance around about a billion dollars on that development. So it was quite a challenge for a $10 million company at that time.

We achieved that financing - and really I guess this is the crux of the story with regard to EFIC. We achieved that financing firstly through equity raisings in the Australian and Canadian markets - total equity raisings over that period was about 700 million - and putting in place a crucial debt financing package which initially was 584 million. This is US dollars, by the way. I think it's important to understand the composition of that financing facility, because it was a syndicate of a number of commercial banks and development agencies: the two key commercial banks were Standard Bank and Standard Chartered Bank, both out of London, and they put in 81 million; then there was an export credit agency tranche of 110 million from the ECIC of South Africa and Hermes of France; development agency tranche of 173 million comprised EFIC, African Development Bank, DEG, EIB, FMO, KfW and OFID, so a broad cross-section of development agencies from Australia, the African Union, Germany, the European Union, Dutch, another German one and OPEC; then there was a mining fleet tranche of 166 million from Fortis, EDC, Caterpillar and Sandvik; and a subordinate debt component of 54 million from EIB, the European Investment Bank.

So all told there were nine development institutions involved, DFIs, as we call them, and, you know, frankly it would have looked fairly odd to have all of those European, African and OPEC DFIs involved and not have an Australian DFI involved, us being an Australian company. So we were very pleased with the support that EFIC gave us. They made an initial contribution of $40 million into that funding package, into the DFI tranche, and that was later expanded to 52.5 million.

They provided, very crucially, the political risk insurance, the PRI, for a total of 240 million. That was to provide the political risk insurance for both the commercial banks and the DFIs. That, I understand, was subsequently sold down by about 80 per cent to various other commercial insurers. But the importance was that EFIC provided that PRI coverage at the time that were signing the debt facility with the syndicate. The facility terms by the way, EFIC was essentially benchmarked with the other DFIs, and of course the commercial banks as well, but the key negotiation, I guess, was with the DFIs more or less as a group.

EFIC's support was underpinned by the participation of Ausenco, which is an Australian mine builder, mining contractor. Their contract for Lumwana was 70 million, and that was essentially - one of the keys to the EFIC participation was to recognise Australian content in the development. I just make a note here, and I have to say, I haven't read the 514 pages of the draft but I understand there is a proposition that - and forgive me if I'm wrong, but I think if there is a company that has revenue greater than 25 million it would not be satisfied with the mandate. I note that that would have precluded Ausenco, it would have precluded Equinox. So that's certainly a concern to me.

I also note that - you know, if you look back on that last I just gave you of all the participants in our $584 million facility, there were no Australian banks. The reason for that is that Australian banks, in my experience, are very much risk averse. They have invested only minimally - and I'm talking from the mining perspective - very minimal investment into Africa and I think elsewhere overseas as well. Certainly in the mining industry there has been very little participation by the Australian banks, and hence we had to go to London, in effect. As a postscript to that financing, as is common in the case of a mining project, once we reached commercial production in 2010 then that whole debt facility was restructured and taken out by a much smaller syndicate of commercial banks. Hence EFIC's participation ceased at that time, they were paid back with interest, but I think it's fair to say that EFIC played a pretty key role in that financing.

Benefits of the Lumwana development to Zambia I think are worth just commenting on. I mean there has been a massive benefit to the Zambian economy. It now provides about 20 per cent of the copper in Zambia for export, and copper exports in Zambia comprise about 75 per cent or more of the country's exports. The country is really very, very heavily dependent on copper. We have provided direct employment to about four and a half thousand people, and continue to do so, but indirectly we would employ through various contractors and part-timers three to five times that number. Effectively there is a community of 100 to 150 thousand people that are more or less, one way or another, dependent on the mine.

LMC, the Lumwana Mining Company, has done a lot in the local community, we've built over 20 schools, built health clinics, women's centres, libraries and done a lot of very intensive health and education and social programs throughout the community. Because the mine was there there was a lot of regional infrastructure that the government then could justify coming into the region; so, for instance, power lines, highways and so forth, and in future quite likely a railway. In 2010, which was the last full year that I was driving the company, through taxes and royalties we contributed about 170 million to the Zambian economy. That was from gross sales of a bit over a billion dollars.

So that's all very well, that we've made a terrific contribution to Zambia. What have we done for Australia, I guess is a fair question. Well, we were an Australian company. We were founded and managed and operated in Australia with a head office here in Perth. We had three to four hundred expat employees that were primarily Australians, and, through that, income tax is probably - I don't have the specific figures but they would have been - in the order of 10 to 20 million a year would have been going to Australia. The key contractors, a lot of them were Australian, as I've mentioned, Ausenco had a $70 million contract, so I'm sure they've made their contributions. A lot of the capital items were sourced in or through Australia.

Lastly, but very importantly, Australian investors dominated the register of Equinox. So as I mentioned in my preamble here our share price had risen about 10,000 per cent over the last 10 years. I can assure you that anybody that has got a superannuation fund in Australia made enormous benefits from Equinox and the investment. I think, also very importantly, reputationally Lumwana has been seen as a real showcase of Australian expertise and investment in Africa and overseas. We won five international awards for that debt financing facility. In fact, just a few weeks ago the takeover by Barrick was awarded offshore deal of the year in the PDAC of Canada, which is the world's premiere mining conference.

So what would have happened without EFIC? You know, to be absolutely honest I think we probably wouldn't have survived without them. It would have been difficult. I think we would have almost certainly have had delays, and quite likely - you know, delays generally translate to costs - without them. I think the support that they showed, particularly with the provision of the PRI, really in effect gave a stamp of approval to a company the size of Equinox at that time, that that gave the confidence to the European DFIs to come in as well. So I think that EFIC really played a key role in allowing what at that time was a little known Australian company with a fairly modest market cap to get the confidence of the international debt and equity markets and insurance markets to provide that funding for what eventually became a showcase project. So I think it was a very positive outcome for EFIC, I believe they made good money out of it, but I think more importantly it was a very positive lesson and example for Australian companies going into Africa. I think the support of the Australian government through EFIC was greatly appreciated.

MS SCOTT: Thank you very much.

MR WILLIAMS (OG): Thanks.

MS SCOTT: Thank you also for your submission. It was very good to get it in advance of you coming here today so we could have a look at it and consider your submission. Thank you for making yourself available for questions as well.

Could you just explain a little bit more about the local content requirement and maybe how that affected your purchasing decisions, or was it the case that Ausenco was in your sights already? Could you just explain a little bit more? Was that a fairly natural relationship to develop, was it one that was slightly artificial? Could you tell me whether that arrangement - - -

MR WILLIAMS (OG): Yes, in the case of Ausenco it was natural. We knew the people at Ausenco, had had confidence in them. They had, through a joint venture with a South African company called Bateman built a large copper project in Laos that was similar to our development in some respects. Hence it was a logical extension to engage that same two partners, Bateman and Ausenco, for our development. So I think we would have done that irrespective of any financing considerations. The ECIC participation in South Africa, which is essentially their equivalent of EFIC, I must admit there were times when we had to make decisions to acquire items through South Africa to satisfy their requirements, but that wasn't the case with EFIC. I think we had a natural affinity there with Ausenco and a natural confidence in equipment that we were buying from Australia.

MS SCOTT: It was the case that your firm identified Ausenco rather than - - -

MR WILLIAMS (OG): Yes.

MS SCOTT: Yes, okay, thank you. Warren?

DR MUNDY: You mentioned that there were a reasonably large number of effectively aid agencies involved in the project - - -

MR WILLIAMS (OG): Yes.

DR MUNDY: - - - who obviously have aid-related objectives rather than trade-related objectives, particularly the multinational, multilateral agencies. If those agencies focused on the aid aspects of the project had have been absent, if there had have been no aid aspect to the project, do you think it would have still gone ahead?

MR WILLIAMS (OG): I think you're correct in saying that the development agencies, that group I mentioned, a lot of them do have an aid component to their rationale and their justification and participation. That's certainly the case. Certainly during our development we had to make sure that everything was complying with Equator Principles and World Bank guidelines and so forth, for that reason. We would have done so anyway. But they, the DFIs, I guess, take on a sort of policeman-type role on that sort of stuff, but they still have to be able to justify rigorously that the project is economically viable. So they would take the lead from the commercial banks, which take a very hard-nosed view on that, for obvious reasons; but they certainly still have to justify the project as economically viable notwithstanding the aid components.

DR MUNDY: Just on the governance issues and the human rights environment-type issues, you mentioned that the aid agencies were taking the lead and that. Could you just step us through what EFIC's requirements of you in particular were with respect to your compliance with international human rights and environment standards, or indeed local ones, and specifically through your interaction with EFIC rather than the aid agencies as such.

MR WILLIAMS (OG): Yes. I have to say that EFIC was - amongst the DFIs probably EFIC and EIB took a more active role on that - let's say proactive role on those issues. We, of course, did a very comprehensive environmental and social impact statement. That was both a study of the environment, and the social environment, before we got involved and also a plan for the future of what we would be doing with the local communities, for instance. Certainly EFIC had a lot of input into that and was - it was, I suppose you could say, a negotiated process with both EFIC and the other DFIs, but EFIC took one of the leads there to finish up with an outcome that was going to be satisfactory to all participants.

DR MUNDY: So no issues, criticism from NGOs, concerns run by law enforcement agencies?

MR WILLIAMS (OG): No, I think I'm right in saying we had virtually no NGO criticism of our environmental impact study, and subsequently. There has been, to my knowledge - and of course I've been out of it for about a year now - there has not really been significant NGO activity or criticism in the region.

DR MUNDY: Okay.

MS SCOTT: Mr Williams, could you take us back to when you first got involved with EFIC. Did you approach them? Were you introduced to them by a commercial intermediary? Could you tell us a little bit about that experience and how long negotiations took, how you would characterise those negotiations?

MR WILLIAMS (OG): To be honest, I can't recall the initial meeting with EFIC. I think it was - we had mandated Standard Bank out of London to be the lead arranger of the financing. They had obviously worked with EFIC before. On our staff we had a fellow that was engaged to coordinate that process. He had had previous involvement with EFIC as well. Pretty early in the piece we made contact. I'm not exactly sure whether it was us contacting them or whether they had heard about what we were doing and they contacted us. I can't recall exactly. But quite early in the piece we initiated discussions with them. Look, at times response times were a little frustrating but I think you can probably say that for virtually all of the - certainly the development agencies that we were dealing with. They have a more bureaucratic process than the commercial banks, and in some instances have to go back to government for specific issues. That can be frustrating at times but you have to bear that in mind in the context of somebody who was trying to build a project as quick as they can.

We did have, at one stage - the copper ore body at Lumwana is a very large copper ore body. Within that ore body there are a couple of small sort of sub-ore bodies if you like that include some uranium. This was an issue that was looked at very closely in the environmental impact study and in the development plan. At the moment that uranium has been separately mined and stockpiled. It was never processed or extracted but it's a very valuable uranium resource that is sitting on stockpile. I think ultimately it will be extracted and processed, but it hasn't. There are no plans to do that at this stage. There was discussions with EFIC regarding what the possibilities there were for processing that. There certainly was, I believe, concern at government level because of it being uranium. Frankly, that was a bit of a frustration for us. I don't think it was in fact EFIC's issue. I think it was a political government issue that they weren't allowed to consider supporting a uranium component to the development.

MS SCOTT: Okay, thank you. On that, was it your intention at the outset to involve government bodies? Were you interested in getting government support for your project or was that something that you got into in some ways because the bank suggested it was a good way to go, there's a shortfall of capital? I guess what I'm trying to understand is was it something you initiated and sought to get because it was part of a overall corporate plan or was it something that you get into as it necessitated?

MR WILLIAMS (OG): Well, really, both. 2005, putting together a $584 million debt facility in Africa frankly was a stretch and I don't think we could have got there with just commercial banks. We really needed the development agencies in there to fill the gap that was in the funding capacity, but, secondly, we always recognise that having development agencies in there in a relatively undeveloped country, in Africa, I think is very beneficial in that you have the weight of foreign governments behind you, not that we ever really sort of wielded a stick over the Zambian government utilising that, but I think nevertheless having the development agencies involved did get the attention of the Zambian government that there are other governments standing behind us and I have to say that the Australian high commissioner for the region was pretty useful from time to time with lobbying the Zambian government on various issues.

MS SCOTT: Was Equinox in receipt of other government assistance at that time in relation to this project?

MR WILLIAMS (OG): Yes. It all came together as a package.

MS SCOTT: Aside from EFIC support and aside from the other development organisations' support, were you receiving in Australia any other Australian or WA government or any other state government support?

MR WILLIAMS (OG): No.

MS SCOTT: No. Okay. I imagine, in some ways, dealing with government development organisations or export credit agencies comes with pluses and minuses. You talked about the frustrations you've had. There would also be, I suppose, a series of requirements they would have placed on your firm. Arrangements, I imagine, move over time, but do you recall any difficulties relating to requirements regarding assurances about bribery and facilitation payments, because I imagine in some African countries that's probably more prominent than others.

MR WILLIAMS (OG): Yes, and, frankly, it's ubiquitous in Africa. It's something you have to live through if you're going to operate in Africa and certainly our attitude was always to play it with a very straight bat. I think once you go down that path, it's a slippery slope. So our people were always instructed that there was zero tolerance of any bribery or corruption. I think it held us in good stead, because once it became known that we wouldn't tolerate that sort of thing, it enhanced our reputation and people knew they couldn't mess around with us. Yes, it is an important component of Equator Principles and world bank guidelines and we undertook right from the start to comply with those principles and we discussed these with all the DFIs and EFIC in particular, as I say, was one of the more vocal and proactive DFIs, so we did have discussions with them on those issues.

MS SCOTT: Can I just clarify a couple of points. You sought the involvement of the DFIs after you couldn't get sufficient finance from other sources.

MR WILLIAMS (OG): It's a theme that it sort of grows together. I guess the initial discussions, once we believed we had a project that was economically viable, the initial discussions were with commercial banks, Standard Bank in particular and at a very early stage also with the European investment bank. Coming out of those discussions was a recognition that the commercial bank capacity was going to be limited and that we really needed the DFIs involved.

DR MUNDY: That limitation regarding the commercial banks was primarily because of the location of the project, as opposed to the underlying characteristics of the ore body?

MR WILLIAMS (OG): Yes, it's - - -

DR MUNDY: If it had have been in Western Australia or Canada - - -

MR WILLIAMS (OG): Yes, I think that's true. If it had been in Western Australia or Canada, you would probably not require DFI involvement, so I think it's a combination of risk and - - -

DR MUNDY: Infrastructure around it and aid benefits and - - -

MR WILLIAMS (OG): All sorts of issues like that. Yes, so it - - -

MS SCOTT: EFIC's products to Equinox were comparable in terms of price, terms and conditions to - - -

MR WILLIAMS (OG): Yes, comparable to the other development agencies.

DR MUNDY: And relevant to the commercial parties in the syndicate?

MR WILLIAMS (OG): The commercial would generally be a little bit more expensive. There wasn't a big difference in the margins, but the development agencies were generally prepared to take a longer tenor to the facility, which helped our payback equations.

MS SCOTT: I think you referred to the fact that financiers' confidence improved because of EFIC's involvement in the project. If EFIC's place had been taken by an Australia bank, do you think it would have the same status?

MR WILLIAMS (OG): Sorry, with respect to the - - -

MS SCOTT: I understood you to say in your testimony that in some ways EFIC improved the confidence of other participants about the quality of the project and so on. If EFIC's place had been taken by an Australian bank, do you consider that would have had the same standing? I'm trying to get some sense of the standing of EFIC versus other commercial entities.

MR WILLIAMS (OG): I don't think so, to be honest. I think an Australian commercial bank would just be seen as that: another player in the commercial tranche. I would have been delighted if we could have attracted one in, but we couldn't at the time. They weren't interested. I think EFIC probably played more of a role with the other DFIs in attracting them in or helping us attract them in, rather than necessarily the other commercial banks. I think that's probably the greatest impact.

DR MUNDY: You mention that you had received some useful assistance from the high commissioner.

MR WILLIAMS (OG): Yes.

DR MUNDY: Do you believe that that was because you were an Australian firm involved in what was a commercial and a good project? Do you believe that you would have still got that assistance absent EFIC?

MR WILLIAMS (OG): Yes. As an Australian company abroad, I think it's an obligation of the high commissioners and the embassies to assist Australian companies and I'm sure he would have still given us assistance.

MS SCOTT: Do you have any suggestions of how EFIC's performance could be improved?

MR WILLIAMS (OG): Look, to be honest, I don't really have a specific recommendation there. I think the way they have operated has been pretty good. I've been honest and critical of the bureaucracy but I guess that could probably go to any government organisations. It's the way things are. But I think the people that I have dealt with there have worked very hard and showed commitment to what we were trying to do. They were often just slow because of the process they had to go through to get their own internal approvals. So not knowing what is involved on the inside there I suspect there could be improvements in the process internally. But I think in terms of what EFIC did for us in providing both debt and PRI I think it was a very valuable contribution and I don't think I would have changed that much.

MS SCOTT: In your submission and your testimony today I think you've referred to the fact that without EFIC there would have been delays. Do you have any sense of what the longer time frame would have eventuated to?

MR WILLIAMS (OG): It really is hard to say. I mean we were - to try and get these, what was it, 13 or 14 banks all to the one point where, you know, on a fairly momentous day in London in 2006 we all sat down and signed multitudinous copies of an agreement, it was - how long would it have taken without EFIC? I really don't know. It would have been longer. Whether that was three months or six months or a year or two years I really don't know. All I know is that in our business you have to see a window to get through and you've got to do it when you can, because things can change pretty rapidly in debt and equity markets and you've just got to nail things when you can.

MS SCOTT: Well, thank you very much, Mr Williams, for coming along today, and thank you for your submission.

MR WILLIAMS (OG): Well, thanks for the opportunity.

MS SCOTT: I welcome to the table Marine Western Australia. Mr Tweddle, would you like to state your name for the record, please, and your position with your company, and would you like to make a short opening statement? You don't have to. If you'd like us to move straight to questions, that's fine.

MR TWEDDLE (MWA): Rod Tweddle. I'm the chief executive officer of Marine Western Australia. Historically that was WA Shipbuilders Association and Superyacht Base WA but it has merged into one. It has been around since the mid-90s. I have been executive officer for 14 years.

MS SCOTT: Thank you.

MR TWEDDLE (MWA): I would like to just briefly say that in talking for the marine industry I think that EFIC has historically been the dominant government, Australian government, agency to support the shipbuilding industry. In our submission we talked about the bounty. The bounty started as a rebate to the shipbuilders in the form of a percentage of the cost of the hull, not the entire vessel but the cost of the hull. That started in excess of 30 per cent and I think it finished at around 5 per cent. When an agreement was drawn up by the OECD countries not to subsidise shipbuilding Australia stopped paying the bounty, which was through EFIC, and no country signed the agreement. So that was a blow.

In today's climate probably the biggest impediment to shipbuilding is the height of the Australian dollar. There are other impediments as well, but as an industry association we're working on both the state and federal government. But the issue of where EFIC can support the industry is in trying to encourage or maintain shipbuilding in Australia as a very competitive and clever industry. It's highly technical, it's what you might call a boutique manufacturing sector. Vessels in Australia are not mass produced. The big vessels are all individually designed and individually built and have, in the past and not very distant future, been very high employers. Austal not so long ago employed 2000 employees as the major employer in Western Australia, or in Australia, for shipbuilding. They have been forced to set up a manufacturing facility in America because of the Jones Act which doesn't allow Americans to import vessels and operate vessels built outside the country, so they've got around it. In our opinion that is protection by the US government.

There's a lot of anecdotal evidence on the value of building in Australia, whether it's exported or whether it's for an Australian buyer. Helen Cripps from Edith Cowan University has put a multiplier effect of 2.38 per cent on any spend. So if a vessel was built in Australia for $11 million the value to the community is around $19 million. There's a expert, Dan Swinney from the Chicago Manufacturing Renaissance Group that spoke in Victoria at the request of Enterprise Connect. He states that every job in advanced manufacturing will create another five jobs. So it is our aim to try and get EFIC to support some sort of bounty system again for building and helping Australian shipbuilders to compete in the world market.

MS SCOTT: Would you mind if I asked a few questions about that early part of your testimony, if that's all right?

MR TWEDDLE (MWA): Certainly.

MS SCOTT: Firstly, thank you again for coming along. If you had your druthers would you prefer to have a bounty rather than EFIC support?

MR TWEDDLE (MWA): I don't really think the name of what it's called is relevant as to the form of the support.

MS SCOTT: When the bounty was abolished were you given any commitments by the government of the day that effectively EFIC would stand ready to support your organisation and your organisation's members?

MR TWEDDLE (MWA): I really can't comment on that because that would have been amongst the individual shipbuilders who were getting bounty, but generally - there's another member of the industry here today who may be able to answer that question.

MS SCOTT: Okay. But you're not aware of any understanding that - - -

MR TWEDDLE (MWA): No.

MS SCOTT: Okay.

MR TWEDDLE (MWA): I am aware that in today's climate it's very difficult to get much support from EFIC. There are cases of the Vietnamese government offering 2 per cent finance for projects built in Vietnam, and Australia just can't compete with that.

DR MUNDY: Are there any other programs, infrastructure support arrangements, land tax concessions, those sorts of things offered to the industry or have been offered to the industry here in Western Australia by the Commonwealth?

MR TWEDDLE (MWA): There was an investment scheme for purchasers. If they purchased a vessel built in Australia there was a 10 per cent investment scheme, so they would get 10 per cent of their purchase back. That's no longer available. I don't think that there are any tax concessions or any local land concessions or anything really available to manufacturers in WA.

MS SCOTT: If the Australian dollar stayed at approximately the levels that it's at now, what do you see for the future of shipbuilding here in Western Australia?

MR TWEDDLE (MWA): Fairly limited. There are people who are still doing well because they have a very unique product and a very good quality product, but they still need some support in getting competitive finance, and as the Export Finance and Insurance Commission that's the first place that these companies look.

MS SCOTT: I think you indicated just in answer to an earlier question that in some ways EFIC's capacity or maybe interest - I'm not too sure which - in relation to your sector may not be as high as you would like. What was the evidence for that, because there have been a significant number of projects in the past that EFIC has supported.

MR TWEDDLE (MWA): There have been a significant number in the past, but not so many now and it's probably more important now than it's ever been, because of the value of the dollar.

MS SCOTT: So it's just on the number of transactions that you can see that are supported by EFIC and you think that - - -

MR TWEDDLE (MWA): Generally the production of shipbuilding in Australia is fairly low at the moment, so there's a lot less projects to be applying for.

MS SCOTT: I wanted to see if that's attributable to EFIC itself or it's a reflection of Australia's competitiveness in the market generally.

MR TWEDDLE (MWA): My personal opinion is that it's mostly because the other countries we're competing against are getting government support and we're not.

MS SCOTT: So it's not EFIC itself per se that - - -

MR TWEDDLE (MWA): Not necessarily EFIC per se, no. That has been the dominant agency that's assisted in the past.

DR MUNDY: You mentioned in the submission that the commercial banks were reluctant in providing finance for shipbuilding. Do you have any sense of why this is?

MR TWEDDLE (MWA): I think probably because of lack of knowledge of the industry. I think that it's the risk factor of dealing offshore. I think there's a number of factors that limit it and also they're not as competitive as EFIC can and should be.

DR MUNDY: Sorry. Could you just unpack that a bit more please. In what sense should EFIC be more competitive than the commercial banks?

MR TWEDDLE (MWA): I think that EFIC have the capacity to get closer to matching other countries' finance packages.

DR MUNDY: Commercial banks can't, because obviously they have - - -

MR TWEDDLE (MWA): They can't borrow.

DR MUNDY: Okay. So it's your view that EFIC should be using its preferential funding capacity to subsidise shipbuilders.

MR TWEDDLE (MWA): I think the advantages of that are just outstanding, that the employment within Australia has so many flow-on effect benefits, to encourage manufacturing and specialised manufacturing in particular. Holden have just been given $275 million and they're not really a competitive manufacturer because they're doing process manufacturing. Those sorts of industries can more easily be copied in some of the Asian countries than in the US and Australia.

MS SCOTT: In your submission, you have a paragraph here about risk assessment processes. I'll just read a part of the submission to you. "As Marine WA understands, EFIC's risk assessment currently has favourable bias to shipbuilding projects destined for commercial vessel buyers, operators of luxury motor vehicle yachts, buyers, operators. This places businesses building luxury motor yachts at a further disadvantage." Could you talk about how Marine WA came to that view about what particular weighting individual-type projects receive. Does this reflect the discussions you've had with EFIC?

MR TWEDDLE (MWA): This is more the discussions that I've had with some of our members and the difficulties that they have encountered.

MS SCOTT: What do you think lies behind the fact that you see EFIC attributing particular risk weightings to some projects rather than others? What do you think distinguishes commercial vessel buyers over, say, luxury motor yachts at the - - -

MR TWEDDLE (MWA): Again, it's probably just an opinion perhaps by those making the decisions in effect that if you're providing commercial vessels for commercial use in other countries, that might be a better risk than a privately owned motor yacht.

MS SCOTT: So it's your contention that EFIC should put that risk consideration to one side.

MR TWEDDLE (MWA): I think the proper assessment should be made, but certainly there's a huge market in luxury motor yachts worldwide and Australia can be in that market if they're given the right sort of support.

MS SCOTT: So it's more about you'd like each individual potential transaction to be assessed on its merits, rather - - -

MR TWEDDLE (MWA): On its own merits, yes.

DR MUNDY: Sorry. You think EFIC doesn't do that?

MR TWEDDLE (MWA): I think they probably do, but I think there is a bias towards commercial, rather than private.

DR MUNDY: Over and above what might be reflected by the underlying risks of the two types of transactions.

MR TWEDDLE (MWA): Yes.

MS SCOTT: You talked about the dominant means of support from the federal government for your industry is now through EFIC. Could you talk about the relative value of that compared to, say, assistance provided by Austrade or AusIndustry or all those things?

MR TWEDDLE (MWA): Austrade have just cut back all export assistance, particularly in marine, and they're focusing on - and we have this first hand - encouraging internal investment or external investment in Australia. There's very little support and the cost of using Austrade services now is just almost prohibitive. It's not commercial at all. That's a fairly recent decision. Austrade have just undergone quite a large change of their policies.

MS SCOTT: Thank you. Other sources of support, for example, AusIndustry's programs, would - - -

MR TWEDDLE (MWA): AusIndustry have some programs. They're available for companies, I think, with a turnover in excess of $5 million and there's a process. We've just had recent discussions with companies like AusIndustry, but they're more for particular projects. They're not in the business of financing shipbuilding or supporting major shipbuilding contracts, which may go for two years and need that sort of input. There's a vessel that's just been launched in Western Australia that is probably worth in the vicinity of $70 million. It took two and a half years to build. That's the sort of project that we believe EFIC could be far more involved in.

MS SCOTT: Could you talk about state government support to your sector?

MR TWEDDLE (MWA): There's a very small amount of government support to the shipbuilding industry. The Western Australian government have built the AMC and a floating dock, which was primary built for defence purposes. I think there's been a commercial ferry and one private yacht that have been launched on that facility. The rest of it's all been used for the resource sector and the commercial lease terms and so on that are dealt with by the LandCorp arm of the Western Australian government are by no means specialised to the industry. There are certainly no concessions.

DR MUNDY: So roughly what proportion of your membership would be receiving some sort of assistance from EFIC?

MR TWEDDLE (MWA): Maybe 5 per cent.

DR MUNDY: 5 per cent. So a relatively small amount of the business.

MR TWEDDLE (MWA): Yes.

DR MUNDY: Can you characterise that part of it? Is it the big end, the little end? How would you identify it within your membership broadly?

MR TWEDDLE (MWA): I think it's represented a couple of ways: (1) that those building large vessels are relatively small numbers of individual companies with the membership, but it's also represented in the fact that Austal have bought a shipyard in Vietnam to try and compete and are virtually doing no manufacturing in Australia.

MS SCOTT: Those firms in receipt of EFIC support, does your organisation have a view about what the value of that support is, the value of their packages of finance are worth to the firm over and above what they - - -

MR TWEDDLE (MWA): I think historically they've been very good but I think in recent years they're not very - the biggest assistance of getting EFIC involved is recognition of the Australian government in a project for offshore sale.

MS SCOTT: Okay. So it's almost like name recognition or government recognition?

MR TWEDDLE (MWA): Yes.

DR MUNDY: Are you aware that the OECD is again having another discussion about export credit agency support for shipping?

MR TWEDDLE (MWA): No.

DR MUNDY: That ends that question then. 24 February 2012 was the first statement. You might want to have a look. My next question is have you had a discussion with government about it? The answer to that is obviously no.

MR TWEDDLE (MWA): No. I believe that Austal put in a submission and maybe they have some discussion about that, but no, we haven't at this stage.

DR MUNDY: I'll have a discussion with Austal.

MS SCOTT: Could you talk about the attitude of Australian banks to your sector, and has it changed over time?

MR TWEDDLE (MWA): Well, certainly I think changed since the GFC. They're more reluctant to be involved in offshore projects. Certainly the amount of local support or the amount of the value of the company support must be much higher than it used to be. They're setting their risks much lower.

DR MUNDY: So if you really did have your druthers, what would an appropriate package for the shipbuilding industry in Australia look like? Would it just be more support from EFIC or would you see there would be other things that would be part of it?

MR TWEDDLE (MWA): As I said before, really, the name of it or the agency is not as important as the actual assistance, but EFIC has been historically the most important government agency to support this industry. I mean the package to I think General Motors has probably come from the state government, the package to Ford came from the federal government.

DR MUNDY: Most of the General Motors package comes from the Commonwealth.

MR TWEDDLE (MWA): Sorry?

DR MUNDY: Most of the General Motors package through the Commonwealth.

MR TWEDDLE (MWA): So if that's through EFIC then - is that through EFIC?

DR MUNDY: No. It's through their own program.

MR TWEDDLE (MWA): The agency that issues the funding or the support is not as important as the support itself. If EFIC is not the key agency to support an industry like the shipbuilders in export and in local production then I guess the industry needs to look at who the other agencies are that we can go to for assistance.

DR MUNDY: So if the government was to develop an alternative policy for shipbuilding which led effectively to the same dollar value of assistance you would essentially be indifferent?

MR TWEDDLE (MWA): Mm.

MS SCOTT: Would it be of a concern to your members if there was transparency, public transparency, about the level of support that your sector received, that things were published or available on a web site?

MR TWEDDLE (MWA): No, provided no commercial confidentiality was breached as far as perhaps clients and various other - like people, material, was concerned.

MS SCOTT: Would that be the same in terms of if EFIC published information on the terms and conditions of transactions that it had with your members?

MR TWEDDLE (MWA): I don't think so. But again, there's another shipbuilder here today, so you can ask that question and he can answer that first-hand.

MS SCOTT: Okay.

MR TWEDDLE (MWA): If I can have more item. I know that there's a shipbuilder in Perth who had quoted for an offshore support vessel, $8 million, and the vessel - the construction contract was awarded to a company to build in Vietnam for about $6 million. They believe had they got a 10 per cent investment allowance or a bounty, whatever name you'd like to call it, from state or federal government, that they could have won that contract because of the flow-on effect of employing Australian labour against that $6 million just going offshore. I mean the downside is that the purchasing company still gets some depreciation asset off their tax, I believe, whether they buy offshore or onshore. But if they buy offshore all the money goes offshore, and if they buy onshore the money stays here and it has a flow-on effect through the community of this multiplier effect, so the benefits of supporting the shipbuilding industry for both local consumption and export consumption is huge.

MS SCOTT: You think that buy at home type strategy, support local industry, should apply to other sectors more generally?

MR TWEDDLE (MWA): Yes.

MS SCOTT: Have any of your members raised issues regarding any local content requirements?

MR TWEDDLE (MWA): Many, I think.

MS SCOTT: Could you make comments on that, please?

MR TWEDDLE (MWA): Well, I think that certainly the state government have made some demands about local content, but what has been happening there is that local companies have been securing contracts and manufacturing offshore.

MS SCOTT: Okay.

MR TWEDDLE (MWA): So they're perceived to be - - -

MS SCOTT: Local in name only?

MR TWEDDLE (MWA): Yes.

MS SCOTT: And maybe location of the head office?

MR TWEDDLE (MWA): There may be some small component in design and whatever in Australia, but the bulk of the work is done offshore.

MS SCOTT: Okay, all right. Well, thank you very much for your attending today and for answering our questions and for your submission. It's very much appreciated.

MR TWEDDLE (MWA): Thank you very much.

MS SCOTT: Thank you. Welcome to the table.

MR SIMONS (A): Good morning.

MS SCOTT: For the purposes of the transcript would you please identify yourself, your role and your company, please?

MR SIMONS (A): Certainly. Good morning, my name is Richard Simons. I'm the chief financial officer of Austal Ltd. We very much welcome the opportunity to present to you this morning.

MS SCOTT: Well, thank you for coming along. Thank you also for your preparatory paper to us. It was very useful to have. Would you like to make an opening statement?

MR SIMONS (A): I would, please. I would also like to, just before I commence the statement, say that we have had an opportunity to review the draft report now and we would like to make a further submission, which we will do formally next week.

MS SCOTT: Okay, thank you.

MR SIMONS (A): Okay, if I may?

MS SCOTT: Yes, go ahead.

MR SIMONS (A): Austal is an award-winning exporter and is the world's leading designer and manufacturer of high-speed aluminium ships. The company started from very humble beginnings some 25 years ago building fishing boats in an industrial estate south of Fremantle and we developed to become the world leader in the commercial high-speed ferry market. In recent years we've evolved again to become Australia's own defence prime contractor. Today we're the prime contractor on three major projects worth in excess of $6 billion supplying revolutionary warships to the United States navy and a fleet of vessels to the Australian Customs and Border Protection Service. We are a Western Australian headquartered company and employ well over 3000 people around the world and we are continuing to grow.

Austal's journey is a story of which many Australians, and particularly Western Australians, are justifiably proud. We are, in reality, a minnow in the global defence markets in which we compete, but in that cherished Australian tradition of backing yourself as the underdog our small company has from Henderson, Western Australia, taken on the world's largest defence contractors in the biggest and most sophisticated defence market in the world and we won. Our success has been wrung from simple hard work and toil from some stunning innovation and creativity and from taking some big risks.

We've had a lot of help to get to this point. Over the years we've benefited from many federal and state government schemes to incentivise investment and research and development, to train apprentices, to train employees and the like. These types of assistance schemes have allowed us to continue to invest in the development of our capability and intellectual property. However, the most valuable assistance that we have had has been that which has helped us sell our ships in the global marketplace to generate revenue from export sales, and that assistance has been provided to us by EFIC. I hope to convey to you this morning the extent to which EFIC has contributed to our global success over the years and how important it is, particularly in the current global economic environment, that they continue to bridge the gap and support Australian exporters when the free market fails to meet our needs. Indeed, it is our view that the government needs to expand the breadth of EFIC's remit to help Australian companies such as Austal continue to be clever manufacturers of world class technology in Australia.

Our business is, and always has been, export driven. Our success today is a direct consequence of our ability to export our products and the future growth of our business is fundamentally reliant upon us continuing to be an innovative and efficient exporter, whether that be of ships, vessel systems or support service systems. Of the 250 vessels that we have built over the years, over 75 per cent have been for export customers, and if measured by value that percentage is much higher. The markets that Austal operates in are niche markets. They're small and very specialised with very specific characteristics, and they're not perfect markets. There is no perfect competition in our commercial world. They're influenced by many diverse factors that vary between geographies such as the availability of credit, labour and input costs, defence policies, tax policies, trade protection policies, freedom of movement across international borders, security, industry development policies, just to name but a few.

In most instances as a corporation we can deal with and manage around these market imperfections. Sometimes, however, we need help. We need a circuit-breaker and we need someone to temporarily bridge the gap created by the conditions that exist within imperfect markets. That is the role that EFIC has performed for Austal, or to be precise, the role that EFIC has performed for Austal's customers. This direct assistance to Austal's customers benefits not only Austal and its employees and shareholders, but also the myriad of small contractors and privately owned businesses that make up our supply chain and for whom Austal is their conduit to export markets.

I would like to describe to you in a little more detail, please, who our customers are so that you have an appreciation of the role that EFIC performs in helping Austal achieve its export sales. In the commercial vessel market, the market for ferries, 93 per cent of the vessels that we've built are for export customers. Customers for our commercial vessels tend to be privately held, often family-run entities of small to medium size. They tend to be reliant on asset-based finance from banks who have little knowledge of ship acquisitions. In recent years a number of government-backed or partly-owned government entities have become customers for Austal vessels. This is logical when you consider that the provision of the ferry service is often provided by a government as a service to a local community. This introduces sovereign risk, and often commercial banks are unable to assess and accept this risk. In both of these situations EFIC can enhance the buyer's credit through the provision of guarantees which closes the financing package to permit the sale by Austal.

In the defence vessel market the buyers are of course sovereign states, and they always have a preference for an indigenous product. This preference for an indigenous product often translates as a price disadvantage for Austal. Any additional benefit that we can bring with our proposal, such as the impression of government to government financing via EFIC, helps us to even out the competition. Sovereign states that do not have an indigenous shipbuilding capacity tend to be smaller, developing nations with high levels of sovereign risk, countries such as Yemen, Bermuda, Malta, Trinidad - countries that we've supplied patrol vessels to. Commercial banks aren't willing to take on this role without support from EFIC. EFIC's participation in these situations is the difference between achieving an export sale or not.

Over the years EFIC has helped to facilitate the sale of more than 30 of Austal's 250 vessel sales, principally through participation in the buyer's financing structure. This participation has often been cited by clients as a precondition for a sale where the commercial lending sector in the buyer's country is unable to fully fund the transaction and EFIC's involvement is necessary to bridge the gap. There is no doubt that these sales, worth approximately $1 billion, would not have occurred had EFIC not participated, and Austal today would be a vastly different organisation.

It's important to note that when we ask EFIC to consider participation in a transaction it's because the market is unable to meet the need. They do not displace the private sector financiers, and indeed, will withdraw from a transaction should a private sector solution emerge. Also, EFIC's participation does not come cheap. It is regularly, in our experience, more expensive than commercial funding and is always more costly than the funding provided by ECAs resident in our competitors' home countries.

Apart from facilitating transactions for our clients, EFIC has also directly assisted Austal. Two years ago we undertook a $225 million bond raising in the United States to support the $4 billion littoral combat ship program that we were competing for. That bond raising required support from our Australian banks, who for various reasons declined to participate. We took the transaction to EFIC and their willingness to consider the matter, to bridge the gap, allowed Austal to secure this game-changing contract. EFIC's participation gave our commercial banks the confidence to participate, with the effect that EFIC subsequently withdrew from the transaction as the market was now in a position to fulfil our needs.

Austal notes that the commission's draft report places great emphasis on the need to support SMEs in their ambition to become exporters. Having once been an SME we can attest to the importance of that role. What must not be overlooked, however, is that there are a substantial number of SMEs in Austal's supply chain who are indirectly also exporters reliant on EFIC's continued participation in supporting Austal's customers. Through Austal's global supply chain we have provided tangible support and assistance to SMEs to supply products and services into the international marketplace, leveraging off our presence in some of those markets. This occurs through new construction programs which we undertake in Australia for the export market; it occurs through the direct supply programs to Austal's shipyards in the United States and the Philippines; and it occurs through the direct supply to Austal's regional service centres located in Europe, the Middle East and the Caribbean. By way of example, construction programs at our Australian facilities rely on sourcing approximately 75 per cent of materials from suppliers within Australia and New Zealand, and 79 per cent of the total expenditure takes place with suppliers in Australia and New Zealand, most of them SMEs.

MS SCOTT: Mr Simons, we could draw out some of your points through questions.

MR SIMONS (A): Certainly.

MS SCOTT: We'll give you a chance at the end in case we don't hit on some of the points that you would like to make.

MR SIMONS (A): Sure.

MS SCOTT: So thank you very much for that but we might now move to questions, if that's all right. Could I go back to your firm's structure now. Could you talk a little bit about your firm? You've mentioned your production facilities in the Philippines and America and you mentioned the Jones Act, so I'm familiar with that, but could you talk about the Philippines operation? I think the gentleman before you mentioned Vietnam. Could you talk about your operations in Vietnam? We'll start there and then might stay with your firm - the structure of your firm and how it has funded its expansion say a good couple of minutes and then we might move then to your interactions with EFIC. Let's go back to - I think you said you had 3000 employees?

MR SIMONS (A): Yes, that's correct.

MS SCOTT: Worldwide?

MR SIMONS (A): Correct.

MS SCOTT: Okay. You've got production facilities in?

MR SIMONS (A): We have - so maybe if I just take a step back?

MS SCOTT: Sure. So can you please just take us through that?

MR SIMONS (A): Certainly. So we're headquartered in Western Australia. We're listed on the Australian stock exchange and our corporate headquarters is here in Perth.

DR MUNDY: Roughly what's your market capitalisation?

MR SIMONS (A): Our market capitalisation at the moment is approximately $400 million.

DR MUNDY: And your gearing ratio, roughly?

MR SIMONS (A): Our gearing ratio is approximately 85 per cent.

MS SCOTT: Okay, thank you.

MR SIMONS (A): So we are headquartered here. The corporate headquarters is here and we run shipbuilding operations in three locations: here in Henderson, Western Australia, and the focus of that operation is defence vessel manufacture, support and defence systems.

MS SCOTT: Yes.

MR SIMONS (A): We have recently established a commercial shipbuilding operation in the Philippines.

MS SCOTT: Yes.

MR SIMONS (A): That location builds only commercial vessels. We have an operation in the United States, which originally started off as a commercial vessel manufacturing operation, but has in recent years become a dedicated defence shipyard, building ships exclusively for the United States Navy.

MS SCOTT: Thank you. That's very helpful. Then you have operations in other locations, but mainly to service your vessels.

MR SIMONS (A): Correct. That's right. Support operations.

DR MUNDY: So roughly how many people in the Philippines?

MR SIMONS (A): Presently about 20. It's a very new operation. It literally started a few weeks ago.

DR MUNDY: The US?

MR SIMONS (A): The US is around 2700.

DR MUNDY: And here in WA?

MR SIMONS (A): Here in WA, it's about 400, 500.

DR MUNDY: 400. So the bulk of your employees are actually offshore.

MR SIMONS (A): That's right, and I might just add that all of those operations are wholly-owned subsidiaries, so of course profits and dividends are repatriated into Australia.

DR MUNDY: Would you have some idea roughly of the presence of non-Australian domiciles on your share register?

MR SIMONS (A): I can't be precise, but I would say something in the order of probably 7 per cent of the company would be owned by international investors.

DR MUNDY: So that's like a lot of listed companies, around about that sort of - - -

MR SIMONS (A): Yes. We are predominantly Australian and, dare I say it, Western Australian owned.

MS SCOTT: In terms of your access to loan funds, would they predominantly come from Australian sources?

MR SIMONS (A): Loan funds to support the company's own requirements, yes, come from Australian banks.

MS SCOTT: Okay.

DR MUNDY: The bond raising you spoke of in the US, could you just take us through that in a little bit more detail, what EFIC was proposing to do, what it did. I wasn't quite sure then whether EFIC's presence ultimately wasn't required, but I'm interested in what they were going to do.

MR SIMONS (A): During the course of 2010 and indeed for a couple of years prior to that Austal was bidding for a program for the United States Navy called the Littoral Combat Ship Program and through a very long and drawn-out selection process we were down-selected to 2. The competitor was a consortium headed by Lockheed Martin, the world's largest defence contractor. We primed our bid, supported by General Dynamics Advanced Information Systems. To be able to undertake the production of the ships in the time frame required, it required us to undertake a fairly substantial capital expansion in the United States and, as Mr Tweddle noted beforehand, it's a requirement of the Jones Act and other US government, predominantly security, regulations that those assets had to be constructed in the United States.

So we were required to raise approximately $165 million to undertake the expansion of that capital footprint and we did that via a US-government-backed bond scheme, which gave us access to basically concessionary costed money, far less than commercial rates, which was part of an assistance scheme that the US federal government was running. For us to be able to access that scheme, we were required to provide letters of credit as collateral for the bond raising and that was a requirement because of the size of our company. We don't have the investment grade rating that many other participants in these types of schemes do and therefore we had to get that assistance from an external source.

We had already gained assistance from one of our Australian banks for an earlier bond tranche, a much smaller amount of $60 million. When we went to discuss with them their appetite for substantially increasing their exposure, they were reluctant. We have two other Australian banks in our banking group.

MS SCOTT: Sorry to interrupt, but just for clarity. They said no or they said, "We'd be keen for you to try other places and come back to us if it doesn't work out."

MR SIMONS (A): They said no to taking on the full exposure.

MS SCOTT: Right.

MR SIMONS (A): They said they would consider increasing their exposure from its current level if we could find someone else to partner with them.

DR MUNDY: Sorry. That reluctance, in your view, because they were already partially exposed and they just had a limit which at some point you reached.

MR SIMONS (A): I think there are many factors. I think probably the most prevalent factor is that Austal was doing something quite extraordinary. We were bidding for a contract worth several times more our market capitalisation in one of the most difficult and sophisticated markets in the world, competing against some extraordinarily big players and I think they were worried about our ability to pull it off, quite frankly.

MS SCOTT: Did your bank suggest that you go to EFIC?

MR SIMONS (A): Yes, they did. We already had a very longstanding relationship with EFIC, a relationship that extends back some 25 years, from the inception of the company, and we worked closely with them. But, yes, they did suggest EFIC.

MS SCOTT: Once you had secured EFIC's support, did this bank then increase their exposure in this deal?

MR SIMONS (A): They sought to. If I can just give you a little bit more detail about it. So before approaching EFIC, we had approached our other two Australian banks and they declined to get involved, I think for those reasons I just mentioned previously. When we spoke to EFIC and discussed it with them, they said that this is exactly what their mandate is about, helping companies such as us reach far beyond the country's borders. So we discussed the funding package with them and in conjunction with the existing Australian bank and negotiated that for some months or, from memory, approximately four or five months.

There was quite a lot of machinations going on behind the scenes in the United States at that time with respect to budgets and political processes, et cetera. There was also, I guess, a degree of concern as to whether or not Austal was going to be awarded this contract at all. In any event, on 29 December 2010 we were awarded the contract and very quickly after being awarded the contract, the other two Australian banks who had declined to participate said that they would now look at it. We had an initial discussion and they were proposing terms which were better than EFIC's terms. EFIC made it very clear to us from the outset that they would be expensive, which they were, and their commercial terms would be onerous, which I assure you they were.

When the other Australian banks expressed interest in becoming involved, we opened that dialogue with them and they offered us substantially better terms and substantially better pricing. It's important to note though that had EFIC not stepped up to the plate when we asked them to, we would have had an immense difficulty demonstrating our financial capacity to the US government to undertake the work. I dare say that could have been the difference between us being where we are today and not having the contract.

MS SCOTT: So, just to be absolutely clear for the record, you suspect it was the difference or you know it was the difference.

MR SIMONS (A): I can't point to any piece of evidence that would categorically say it was the difference. I have a very strong suspicion that it was. The United States government sent independent auditors out to Australia to review our books and get a sense of our financial capacity to undertake the work. It was very clear and evident to them that we needed to raise a large sum of money to undertake the capital expansion in the United States and we had to provide evidence to them of our ability to raise that money at a point in the future and for that review EFIC provided us a letter which stated that they would support us in the bond raising. I personally believe that that letter was critical to us being able to demonstrate financial capacity.

DR MUNDY: Precisely what was the nature of that support going to be?

MR SIMONS (A): The nature of the support would be providing a letter of credit to act as security for the bond issue.

DR MUNDY: So it was effectively a commitment to provide a letter of credit?

MR SIMONS (A): Let me put it this way: it was an expression of interest to provide that.

DR MUNDY: So it was not a letter - - -

MR SIMONS (A): At the time it was not a binding offer. It was still subject to EFIC board approval.

DR MUNDY: It was not something upon which your directors could have relied to procure the letter of credit?

MR SIMONS (A): At that particular time, no.

DR MUNDY: So it was a - - -

MR SIMONS (A): Subsequently - so I need to explain - - -

DR MUNDY: It was a letter - okay, sorry, go on.

MR SIMONS (A): I need to explain that there was an elapse of time here. The United States navy sent their auditors out in approximately March or April of 2010. EFIC provided us with a letter saying that they would be prepared to participate in the fund raising, subject to board approval, negotiation of terms et cetera. As 2010 progressed and we were getting closer and closer to award date we then pursued a commercial discussion with EFIC and our Australian bank where we got to a terms sheet, an agreed terms sheet, which was then credit approved by EFIC - and had been through all of EFIC's normal internal approval processes and through the internal approval processes within the Australian bank. There was then a further delay whilst the American government made their decision and finalised their decision. Subsequent to making their decision and announcing it our other Australian banks then said that they would be prepared to participate.

DR MUNDY: Okay.

MR SIMONS (A): So EFIC's involvement allowed us to demonstrate financial capacity in that very important lead-up time prior to the award of the contract.

DR MUNDY: If the other banks had not come to the party it would have been your expectation that EFIC would have proceeded - - -

MR SIMONS (A): Yes.

DR MUNDY: - - - to provide the letter of credit?

MR SIMONS (A): Absolutely. We had a terms sheet from them which was capable of acceptance. As I said, it wasn't cheap and it wasn't by any means on what I would call normal commercial terms. It was extremely onerous. However, it was the only offer that was open to us to proceed. There was no alternative.

DR MUNDY: But it was ultimately not relied upon?

MR SIMONS (A): Ultimately not relied upon.

MS SCOTT: What was the quantum involved?

MR SIMONS (A): The total facility was $225 million.

DR MUNDY: US?

MR SIMONS (A): US. EFIC was positioning itself to take 50 per cent of that exposure.

MS SCOTT: Thank you.

DR MUNDY: You mentioned in your introductory comments that there are - well, you indicated there are benefits from EFIC's activities for customers, who I presume are primarily - well, they must be by definition almost if EFIC is involved, non-Australian residents?

MR SIMONS (A): Correct.

DR MUNDY: How do you see that distribution of benefit that arises from EFIC's activity between your shareholders, your customers and whoever else - you know, other suppliers? Where do you see the bulk of the benefits falling?

MR SIMONS (A): Okay. Well, as I noted before we're an Australian-owned entity. All of the profits that we make from our operations around the world are ultimately distributed to our shareholders, the vast majority of whom are Australians. We rely upon our facility here in Western Australia, which was our first facility, to provide the intellectual capital and intellectual property to basically derive the products that we sell around the world. So we directly employ people in our business here who develop products for our other operations. The benefit that EFIC's involvement provides our customers is obviously that it allows them to transact on the sale. But of course we're interested in receiving a revenue from that sale. That's obviously the reason that we are in existence.

We have a number of SMEs in our supply chain for whom, as I mentioned before, we are their direct conduit to export markets. Our experience over the years has been that many of these entities have grown as we have grown and have followed us around the world as we have moved around the world. I have a few examples I can provide, if you would like?

MS SCOTT: Yes.

MR SIMONS (A): Our two combat ship programs in the United States generated $9 million of export revenue for our Australia business. So we manufacture products here, we supply services from here that we export to our US subsidiary. There are a number of SMEs who support that. There is a company called PT Metalwerx in the light industrial area of Malaga. They manufacture electrical switchboards which we use on our Joint High-Speed Vessel program and on our Littoral Combat Ship Program. Not only do they provide the original electronic switchboards but they also provide spare parts for those vessels, and those vessels will have a 30-year life, so there's a long-term supply relationship for them.

Another company that we deal with is called Ayres Composite Panels. They've worked with Austal for over 15 years providing a lightweight internal panel system which we use in the full range of Austal vessels. So their products have, by virtue of their incorporation in our vessels, been exported globally for a number of years. When we established our shipyard in the United States Ayers was provided with an entry point into the US market and they are now the preferred supplier for the lightweight panel system installed on the Joint High-Speed Vessel and the Littoral Combat Ship. Further, Ayres is now directly - in its own right without any involvement from Austal - now supplying its products to other US defence programs and the US commercial vessel market.

Another company that we've worked very closely with is VEEM Engineering. VEEM is another Western Australia company that has achieved international export sales via their involvement with Austal. They provide very high quality metal alloy and bronze-cast products such as propellers, shafts, ride control fins and foils. We use VEEM products on virtually all of the vessels that we export from Australia. Furthermore, we have specified VEEM products as part of our proprietary ride control system which we manufacture here in Australia at our Australian shipyard and export to our United States shipyard for inclusion on the warships for the US navy.

MS SCOTT: Can I just get you to pause there. It's very useful to get this and I'd certainly encourage you to include these in your final submission. But I just go back a little to the US defence contract. I have to say I came across the Jones Act previously, so I'm slightly familiar with that.

MR SIMONS (A): So you have sympathy for me?

MS SCOTT: There's all sorts of issues that arise there. You also mentioned the security aspects and regulations and legislation requiring US location for security reasons. Does this mean that your capacity - I can see you engage any number of small firms and they are able to beneficiaries of your product. Is there an effective limit on how much non-US content there can be as a result of all these regulations? I mean does the American government in effect or explicitly say that, well, for these - "It's a very significant contract that you are awarded" - I don't know - "75 per cent of it has got to be manufactured, assembled here in the US." Can you just talk a little bit about the restraints that the US system imposes on the location, on the manufacture of your inputs?

MR SIMONS (A): So as you're familiar with the Jones Act you would be aware that under the Jones Act 51 per cent of the vessel has to be built in the United States if the vessel is to fly the US flag. In the context of the ships that we build, a substantial proportion of the cost of the ship - and I can't be too specific, but more than 50 per cent - is labour. So our ability to meet that requirement is easily complied with just by the labour content that we put in. Again, as you would be aware, with the defence hardware that the Americans procure, the componentry for that is sourced globally. Press articles in recent months have talked about, you know, computer chips from China being installed in the joint strike fighter and all of that sort of thing. So I think the United States recognises that they can't practically limit where inputs are sourced from but what they can control is the manufacturing process and the, if you like, secret aspects of that manufacturing process, and more importantly the way in which the various components are integrated. So that, I think, is the key thing that they seek to control.

So your question is, is there a practical limit to what Australian manufacturers can provide to support our programs? I don't believe that there is. Another reason why I would make that statement - the vessels that we produce in the United States are solely for the United States Navy. The United States Navy owns the intellectual property, they own the designs, they can take our design and give it to a third party to produce should they wish. They can also take the product, because they own it, and sell it to their friends and allies; a program which is called Foreign Military Sales. To the extent that the United States Navy achieves a foreign military sale for an Austal-built product, then that is an order that we would undertake in our United States shipyard utilising Austal's global supply chain, including our Australian suppliers.

A substantial flow-on benefit from our US military programs is the opportunity for us to build variants of those vessels outside of the United States. Indeed, the reason our Henderson shipyard exists today in spite of the economic challenges I think that you heard Mr Tweddle speak of previously, is because we believe that there is a significant opportunity for it to be a defence export sales yard. That is, we produce defence vessels here for export to other friendly nations. We have a history of doing that from our Henderson shipyard with our patrol boats, but now the opportunity that has been afforded to us by our success in the United States is that we believe there is a significant opportunity for us to produce variants on those vessels ie. vessels which don't infringe the intellectual property ownership rights, for sale to other nations. That is a sales strategy that we are actively pursuing.

MS SCOTT: Okay.

DR MUNDY: Those friendly nations, would they be friendly nations as determined by the United States government or friend nations as determined by the Australian government?

MR SIMONS (A): Whenever we build a defence vessel in Australia we are required to obtain Australian government clearance. The vessel is being exported with arms on it, and as you know there are rules and regulations which prohibit or regulate the export and traffick in arms, so we obtain that approval from the Australian government.

MS SCOTT: Going back to this very significant contract that your firm has been successful in winning, the $4 billion contract. Approximately what proportion of the value of that contract will be US production?

MR SIMONS (A): It is all US production.

MS SCOTT: All US production?

MR SIMONS (A): That's right. With, as I said before, inputs being sourced from many places including Australia.

MS SCOTT: So what proportion of that $4 billion project will be effectively local content in Australia?

MR SIMONS (A): It would be minute.

MS SCOTT: Minute? Okay.

MR SIMONS (A): Very, very small.

DR MUNDY: This is the contract that EFIC assisted you in getting the finance for?

MR SIMONS (A): Yes, that's correct.

MS SCOTT: You mentioned earlier on how significant your firm was in selling vessels. I think you referred to the fact that 75 per cent of vessels have been sold to customers outside Australia?

MR SIMONS (A): Correct.

MS SCOTT: But I'm just trying to work out given you've got these - you know, your offshore activity in America and this very new one in Vietnam and a facility in the Philippines, I'm just trying to work out what proportion of those 246 vessels represent exports from Australia. I would imagine, going back in history, quite a large proportion would be, but given effectively your international operation now I imagine almost all of you - if you go on the employment numbers it would suggest that your US arm is your dominant production facility?

MR SIMONS (A): Yes, today our US arm is our dominant production facility, and by every measure it's the biggest part of our business.

MS SCOTT: Yes. Of the 246 vessels would I be right in thinking that because so much of those are historical that most of those would have been Australian exports?

MR SIMONS (A): 242, 240, yes.

MS SCOTT: Okay. So looking back, Australian exports, present stage looking forward, an Australian-based firm, Australian-owned firm, but predominantly undertaking activity, production activity, in the US, Philippines and - and what about your Vietnam venture? You said it was - - -

MR SIMONS (A): We don't have a venture in Vietnam. I think that was an incorrect statement Mr Tweddle made. So we only have three production facilities.

MS SCOTT: I'm sorry, I misunderstood. I thought you said you had 20 employees there. So it's not actually a production facility, it's a - - -

MR SIMONS (A): About 20 in the Philippines.

MS SCOTT: 20 in the Philippines?

MR SIMONS (A): Yes. We don't have anything in Vietnam.

MS SCOTT: Nothing at all?

MR SIMONS (A): No.

MS SCOTT: Okay, all right. Thank you for that clarification.

DR MUNDY: I mean the story that you paint is a bit similar to that which those of us who have thought about these things in the past, a bit like the old TNT which started out life as Mr Thomas and his friend delivering parcels around Sydney and ultimately became the Dutch post office. The business grows and ultimately the offshore activity becomes more important, at least in relative terms, in financial terms, to the onshore one. Do you envisage a time will come where you will no longer need or because of the nature of your business lawfully no longer be able to access the services of EFIC?

MR SIMONS (A): No, I don't believe that time ever will come. You only need to look around the world at the size and scale of entities that access the support of other ECAs. It's very common for the likes of monoliths as big as Chevron to rely upon ECA support for various ventures in various countries. So would we ever get too big? No, I don't believe so. Are we too big today? Absolutely not. Do we need EFIC's assistance today in going forward? Absolutely yes. I can tell you, in fact, ma'am - if I can just continue for a moment. I can tell you as recently as two weeks ago we had EFIC representatives in Europe working for us on trying to secure the funding for a patrol boat contract which will be manufactured here in Western Australia.

MS SCOTT: Can I go back to one of your statements that you said you thought EFIC was more important than any other form of government assistance that has been provided in the past. I just want to clarify this, because EFIC has been around for a long time.

MR SIMONS (A): Yes.

MS SCOTT: The bounty existed for a long time. So in your estimation EFIC's assistance now or then - now and then - was more valuable to your firm's success than the bounty per se?

MR SIMONS (A): I can give you my personal opinion. I think others in the company may have a different slant on it, but from my personal perspective I would say that EFIC's participation has been more important than those other schemes. I can't talk so much about the past because I haven't been in the company for 25 years. I've been with the company for a little over two years and in the two years that I have been involved, EFIC's assistance has been paramount, and that is because we have seen the global financial markets collapse. Traditional sources of financing for our clients just simply do not exist in the way that they did three years ago, four years ago, five years ago.

MS SCOTT: Continuing along that theme about the paramount importance of EFIC's assistance to your firm, I note - and I think your earlier testimony made the same point, but I just want to clarify this and then draw you out a little bit more on this - that 64 per cent of your export sales by value have not had EFIC's involvement. I think you said that of the approximately 250 vessels, 30 involved EFIC. So, at face value, you seem to be able to do a lot of business without EFIC. So could you then clarify why EFIC is of paramount importance when so much of your business doesn't involve them?

MR SIMONS (A): Certainly. Probably the best way to do that is to give you an example.

MS SCOTT: Okay.

MR SIMONS (A): Austal is a company which has a very strong sense of innovation. We distinguish ourselves in the global landscape by producing products that are game changers, they move paradigms, and that involves a certain level of commercial risk and it involves a certain level of, I guess, design and product risk. In 2005 we entered into a contract with a customer in Spain for a ship which is called the Benchijigua Express. That particular ship was a revolutionary new type of hull. Austal had been developing this for some years and we were desperate to get it into commercial production because we saw it as being a game changer, something that would allow us to just completely set ourselves apart from the market. We worked with the client - - -

MS SCOTT: Sorry, what was the name of the type of the vessel?

MR SIMONS (A): Let's just call it a trimaran, for everyone's benefit, because I don't think I can spell it that well.

MS SCOTT: Okay. Fair enough.

MR SIMONS (A): This particular product had the potential to deliver a huge range of operational benefits for the client, but because it was so new and so different and such a radical departure from anything else available in the market, we were having difficulty getting clients to want to be involved in this prototype exercise. Eventually we did find a client for whom the idea was appealing, they could see the advantage, but we could not get financing for it because it was so different. Banks of course want to understand operational performance, they want to understand operational characteristics, they want to understand maintenance costs, they want to understand residual value. On something which was so new, it was impossible to do that.

We managed to get a commercial bank interested, but they would not and could not finance the whole amount and we sought EFIC's assistance. After some protracted period, EFIC did become a party to that transaction, which allowed us to complete the sale. It was a $100 million transaction. $100 million is important in and of itself, but even more important, that vessel became the prototype for what we then went on to sell to the United States Navy. So, joining the dots, had we not had EFIC's involvement in that key transaction, arguably we would not be where we are today.

MS SCOTT: Okay.

MR SIMONS (A): So EFIC's involvement, as you note, is not in every transaction because we don't need it in every transaction. We need it where we're doing something different. We need it when we're doing something where the market cannot respond because it doesn't understand the product or it doesn't understand the industry or funds simply aren't there, which is the case at the moment.

MS SCOTT: What's your attitude towards Australian banks, given you've had this two-year exposure within the firm when, at various times, your firm has been at breakthrough moments and they've shown considerable hesitancy? Is your attitude, "That's fair enough. They're making solid commercial decisions," or is your view that there is something about the Australian banking system? Would you like to comment on that?

MR SIMONS (A): I don't think that Australian banks in general are any more risk-averse than any other banks that we have dealt with over the years around the world. We are not a widget business. What we do is not simple and straightforward and we have to spend a lot of time with our banks and with our investors making sure they understand exactly what we do and the various areas of the market that we participate in. So it's essential that you have a long-term relationship. EFIC understands us very well because they've worked with us for so many years.

MS SCOTT: Sorry to interrupt you, but wouldn't your banks understand you well too? It seems to me that you've been a highly-successful firm. You've raised capital here in Australia. You're a listed firm. You've won any number of Australian government awards. You've got a strong track record. At various times when you've sought to expand, Australian banks appear to have shown a reluctance to commit and yet EFIC has engaged any number of times.

MR SIMONS (A): Why?

MS SCOTT: Yes, why? Why is it that - - -

MR SIMONS (A): I think it's a function of what the specific opportunity is, where it is, remember of course that Australian banks understand Australia and this region very well. They don't necessarily understand parts of Europe very well. They don't understand parts of America very well. They certainly don't understand some of the other more, shall we call them exotic locations, that we've provided vessels into. In the early 90s we were selling vessels into China. There were no Australian banks who knew anything about China in the early 90s.

MS SCOTT: So because of EFIC's characteristics, do you consider they've shown superior commercial judgment to Australian domestic banks?

MR SIMONS (A): I think they show an appreciation and a knowledge of world factors, world events. They have a perspective which is far broader than just our shores and just the Asia-Pacific region.

MS SCOTT: Would you say superior?

MR SIMONS (A): In some areas, yes. The Australian banks of course have internationalised their operations substantially in recent years. That hasn't always been the case of course.

MS SCOTT: No, but I think in answer to a question that Warren asked earlier, you see an ongoing role for EFIC.

MR SIMONS (A): We do.

MS SCOTT: So, in some ways - I don't want to put words in your mouth - while you think Australia's domestic banks are increasingly internationalising, you don't think there will ever be a day when - - -

MR SIMONS (A): No, I don't, and the reason for that is because I don't think Australian banks are good at understanding sovereign risk. A big part of what we do is sell defence vessels to foreign countries. Foreign countries sometimes look for finance or support from the Australian government.

MS SCOTT: We've suggested in the draft report - and we welcome your comments either now or in your final submission - the idea that EFIC could play a large demonstration role by, in some ways, publishing some of the terms and conditions of its arrangements so that the domestic banks and other institutions could over time see the opportunities and then possibly seize the opportunities by then undertaking similar activities. I think you're portraying the banks as a very poor set of learners relative to EFIC. I'm sort of trying to work out - - -

MR SIMONS (A): I don't think I said that.

MS SCOTT: You didn't say that. Okay. Could you comment a bit more on this idea that maybe publications would assist Australia's domestic banks to understand for EFIC superior commercial decision-making?

MR SIMONS (A): I think what it is - and, to be honest, I don't think publication is really going to make any significant difference. At the end of the day, banking is a small industry in Australia and those parts of the banks that work with EFIC and have worked with EFIC and I think have got a close working relationship, they generally have an understanding of what EFIC can and can't do. The distinguishing factor is that Australian banks are not well placed to understand sovereign risk, to understand the risk of working with a foreign government. They're not well placed to take a risk on, for argument's sake, a vessel which might one day be used in a combat situation.

MS SCOTT: I just want to explore this further. So you're not in favour of the publication of terms and conditions on the basis that you think the banks won't pay attention to those, they won't actually learn from that?

MR SIMONS (A): I don't think they'll learn anything from it, because I don't think that there's anything terribly proprietary about it.

MS SCOTT: Okay. So there's no proprietary problems but - okay.

DR MUNDY: So no harm would come of it?

MS SCOTT: No harm would - - -

MR SIMONS (A): No harm would come of it, I don't believe.

MS SCOTT: Okay, so no harm, but not necessarily any good either because it's EFIC's superior appreciation and judgments regarding sovereign risk that you think - - -

MR SIMONS (A): Sovereign risk, risk of foreign governments as well as country risk, I think is extremely - - -

MS SCOTT: So country risk?

MR SIMONS (A): Yes.

DR MUNDY: So can I just tease that out? What particular insights do you think EFIC brings with respect to the kingdom of Denmark, which is a transaction you've recently been involved with with them, where there is sovereign risk; but presumably associated with the kingdom of Denmark less country risk. It's a well-functioning, modern, EU, OECD country that - future queen of Denmark is Australian.

MR SIMONS (A): That helps. I think that EFIC's participation in that transaction helped to lower the overall cost of the transaction.

DR MUNDY: So it's acting as effectively a subsidy?

MR SIMONS (A): I'm not sure that it actually did that for us, but maybe it helped the relationship with the Danish government.

DR MUNDY: If it lowered the cost of the transaction, as you've just said, and it didn't help you then presumably it's helping someone else, by definition. So is it helping lower the cost for the buyer?

MR SIMONS (A): I guess ultimately it would do.

DR MUNDY: So the effect of that is a subsidy by the Australian taxpayer to the buyer, in this case?

MR SIMONS (A): Which was important in helping Austal, I guess, get the sale done.

DR MUNDY: Okay.

MS SCOTT: So indirectly it assisted your firm but primarily the assistance went to Denmark?

MR SIMONS (A): The client.

DR MUNDY: Otherwise they would have procured the ferry, perhaps, from a Polish shipyard or they mightn't have bought it all or they might have done something else to move their people around - - -

MR SIMONS (A): Correct.

DR MUNDY: - - - the Baltic or wherever the ship was to operate.

MS SCOTT: So this then suggests that there are three aspects to this superior performance, as you see it, by EFIC. One is their superior judgments on sovereign risk, country risk and their capacity to offer, effectively, a subsidy to buyers?

MR SIMONS (A): Well, I don't know if again subsidy is a term that I would use, but perhaps in that specific instance it may have been, but in many other instances that we have been involved in they have provided support and financial support where the market wasn't.

MS SCOTT: Can I come back to this superior set of skills they have. We can explore this a little bit further in hearings on Monday but I understood that a fair few of the personnel, senior personnel in EFIC, come from the financial sector itself. So maybe there's something about EFIC that inculcates a set of skills that they didn't have in the financial market, because if they had in the financial market I would have thought they would have been able to - - -

MR SIMONS (A): Possibly. But also, I guess, it's where are your hours during the day spent? If you work for one of the big four banks you're spending your hours working predominantly on clients, transactions, markets in Australia.

DR MUNDY: What engagement do you have with - let's put aside the big four banks who may be focused on domestic mortgage lending more than anything else, certainly. But people like UBS, Deutsche Bank, the major international banks, Citigroup, the Americans, some of the Japanese banks. I mean do you engage with them, because presumably they have a - I mean if - I don't dispute your description of the major Australian trading banks' world view, but clearly these other banks, long established in Australia with substantial activities providing all sorts of financial services both to governments and to corporates in Australia - do you engage with them about the - some of which may even be domiciled in countries or have strong presences in certain regions in the world which you - - -

MR SIMONS (A): Certainly, we do, and we engage with them via our clients. Our clients choose to sometimes get us involved in their financing discussions, other times they choose not to. So remembering of course that when we talk of EFIC's assistance, EFIC's assistance is to Austal's customers, not to Austal. So we do from time to time deal with international banks who are looking at supporting various financing propositions. We often find that the degree of expertise and knowledge within those banks varies widely. Remembering that Austal's products are, as I said at the outset, niche products, they're not widgets, and quite often financiers do not understand the specific attributes of financing a high-speed vessel. They don't understand operational characteristics, they don't understand the regulatory environment, they will not understand residual value, the second-hand market value.

MS SCOTT: Given where you are now in the market, do your Australian principal banks have dedicated areas, areas within their bank, that do have expertise in your operations or are they still quite amateurish and still learning?

MR SIMONS (A): They do have people who understand our operations very well, but - - -

MS SCOTT: But they're not equal to EFIC's understanding of your operation?

MR SIMONS (A): No, I don't believe so. But probably the more important distinction, a "big four" Australia bank is not going to finance a European ferry operator. They're not going to finance a friendly North African government to buy a fleet of patrol boats. That is not the remit of their geographical bounds. Banks operate within certain territories. So you are reliant upon - for Austal to achieve a sale Austal's customer has to be able to, nine times out of 10, procure that finance locally, and there is a gap generally, and that's where EFIC helps to close the sale.

MS SCOTT: Thank you very much for that. That's very useful. Can we now move to what you see as opportunities for a larger role for EFIC? I'm interested in exploring that. This might have been something that you were going to cover in your opening statement but where do you think EFIC could have a larger role, what arguments would you suggest that we should consider in thinking about that? A number of organisations have suggested that EFIC could take a larger role in financing their growth. Would that be something that you'd welcome?

MR SIMONS (A): I think no-one would dispute the difficulties that global financial markets are presently in, and no-one would dispute that there has been a distinct withdrawal of capital from those markets. As a consequence it's extremely difficult now to raise money, and it's expensive and terms are onerous. We see that problem every day in that we have people who want to talk to us about buying boats, replacing existing vessels that we built for them some years ago, wanting to maybe look at a new type of vessel for a new type of route, potentially even a new product platform altogether. But the market appetite for risk is virtually non-existent in this current environment and it's extremely difficult for us to be able to achieve sales.

Again, to give you another very pertinent and relevant example, Austal has developed a new type of vessel to support the offshore wind farm market, which is a big market in Europe, as I'm sure you're aware. Austal has brought its considerable intellectual property to bear to develop a concept which we believe will be truly market changing, as is Austal's way to shift the market. The biggest problem that we have in getting that vessel out to market is that the ultimate buyers of these vessels are SMEs, small privately-owned businesses who have contracts with the large wind farm operators. They are all predominantly European based and they all have immense obstacles in their way to raise finance to proceed with these vessel acquisitions. Such is the difficulty, that Austal has, off its own balance sheet, financed four vessels so that we can get our product platform out in the market to get it operating and demonstrate the superiority of our product to everything else that's available.

That's not a long-term solution. Austal does not have limitless cash. Austal does not want to become a banker. We need others to do that. That's not our expertise. So there is a clear role for someone to take in developing a finance product for that market. I have lost track of how many banks I've spoken to internationally to try and support that. They all have a very risk-averse view. They all want to have extensive security and long-term contracts and things of that nature, which the industry just hasn't developed yet. That industry has not advanced to the point that it's offering five-year contracts and seven-year contracts, which is what the banks want to support the financing of these vessels.

So, to me, that seems like a logical starting point for someone who has a role to play to support Australian exporters to exploit new markets to become involved. We don't consider that type of involvement to be a long-term perpetual involvement. It's simply something that needs to happen to get the market going, to seed the market. So we would like to see EFIC play a greater role in direct financing of vessels. We would like to see EFIC perhaps even become an owner of vessels and charter them to SMEs to be able to stimulate demand for our product.

We've done an extensive amount of research on the wind farm market in Europe. We believe that the market for these vessels is something like 300 vessels over the next 10 years. We know that if we can get our market-changing platform out to the market quickly, that we will own a substantial stake in that market. That's been Austal's history throughout it's years. The difficulty though is that there is no-one available to support the financing of the product and our balance sheet simply isn't big enough to do it on our own. So, to us, that would be a logical opportunity for someone like EFIC to participate until the market has developed to the extent that commercial financiers can step into that.

MS SCOTT: In the draft report in one of the pages you may not have got to, we draw attention to the significant exposure that EFIC over time has had to your sector, but you're advocating potentially EFIC becoming an owner of vessels and stimulating demand for your products and so on. Would you see this direct equity activity by EFIC applying to other sectors as well or do you think this is only warranted for your ship sector?

MR SIMONS (A): I will confess not to have previously thought about it in any great detail, so I'm not sure that I could give you a considered response. I'm sure that there would be other Australian exporters who would like to see that degree of participation by EFIC. A point that I can make though is that what we suggest as being a future role for EFIC is not something which is by any means unusual on the world scale. It's just that we're asking and we would like to see EFIC do it in an overt way. What we see happen regularly around the world is that government support is provided to our competitors in a covert manner.

MS SCOTT: In a non-transparent way.

MR SIMONS (A): Correct, and that puts us at a distinct disadvantage. I think also industry policy in Australia puts us at a disadvantage. We compete for programs for the Australian government in competition against foreign shipbuilders. That doesn't happen in the United States. It doesn't happen in many of the other countries that we operate in. However, we're free market people and we can accept that, but what we ask for from time to time is a helping hand when the market doesn't offer a response.

MS SCOTT: I'm conscious we've gone over our time, but this has been a very helpful discussion.

DR MUNDY: Could I just ask you, what percentage of the market for vessels exported from Australia does Austal have? Is it 50, 60, 70?

MR SIMONS (A): Sir, you need to ask that question in the context of the vessels that we produce. Austal does not build steel-hulled vessels.

DR MUNDY: I appreciate that.

MR SIMONS (A): We only build aluminium vessels. We have only one other competitor in Australia that builds vessels of a similar size, and that's Incat.

DR MUNDY: So, from your point of view, you're in a market with Incat in Australia and pretty much no-one else.

MR SIMONS (A): Yes, that's right. Particularly for the large vessels.

DR MUNDY: Overseas competitors?

MR SIMONS (A): Yes, there are certainly overseas competitors. There's a number of European countries. Again, you have to stratify the market. If you're talking the large end of the market, vessels that are 60 metres and above, there are few international competitors. If you're talking vessels that are 80 metres and above, there's virtual none. That's Austal's capability. If you then get down to the smaller end of the market, 50 metres and below, there are a lot of people around the world who have that capability, particularly in Asia.

DR MUNDY: So the nature of, if you like, the business growth strategy at the big end, is that as much about convincing customers that they actually want to be interested in these sorts of vessels or have they formed the view that they want one, for whatever purpose they may want to put it to? I'm just trying to understand - - -

MR SIMONS (A): There's an awful lot of convincing that goes on.

DR MUNDY: No, but I'm trying to understand what's the nature of the supply and demand relationship between at the top end, where you seem to - I don't want to use the word "dominant position" because it implies something a bit more, but you're there essentially with yourself as a supplier. So what's the nature of the business dynamic of that?

MR SIMONS (A): Again, I think you have to talk about the different market sectors. If you think about defence, what we have to do, probably as with any sales relationship, we have to seed the market, we have to convince the market that we have a product that they can't live without. In the defence sector, that's a very long sales cycle. It can be a decade or longer. But we produce concepts. We illustrate new ideas, new ways of doing the same job more efficiently, more effectively, at greater speed, less manning, more safe, et cetera. So we have to, if you like, create the opportunity. We do get tenders that we respond to. A government will decide that they want a fleet of new ferries or a government will decide that they want a fleet of patrol boats. So there is an element of that as well. But we are constantly and continually talking to the market about how we can differentiate. So I'm sorry I can't give you a straightforward answer on that.

DR MUNDY: No, that's helpful.

MS SCOTT: We're nearing the end, so thank you.

MR SIMONS (A): That's fine. No problem.

MS SCOTT: You've given us some interesting food for thought on buyer finance. Just a specific question on that: approximately what proportion of your buyer finance does EFIC presently provide?

MR SIMONS (A): Over the past probably four years I would say that EFIC has probably been involved in maybe 20 per cent of the commercial vessel sales that we've undertaken.

DR MUNDY: Can you characterise that 20 per cent? Has it got a particular character to it?

MR SIMONS (A): Ferries. Is that what you mean?

DR MUNDY: Yes.

MS SCOTT: Yes.

DR MUNDY: Is it certain markets, is it 80 per cent of some stuff or 20 per cent of others?

MR SIMONS (A): There has been a reasonable number of ferries, but I guess on reflection there has also been a reasonable number of patrol boats that EFIC has assisted in financing, so I guess we're talking about direct vessel sales. Today we have a lot of opportunities on our books that we are trying to get to close. I would say at least half of those are going to need some form of assistance, external assistance, to be able to get them to close, and those are - - -

MS SCOTT: Half, did you say?

MR SIMONS (A): At least half.

MS SCOTT: At leat half?

MR SIMONS (A): Yes.

DR MUNDY: By external you mean beyond your own capital and those provided by your banks?

MR SIMONS (A): Well beyond our own capital and I think beyond the capital that they will be able to secure from normal commercial lenders.

MS SCOTT: This, I guess, refers to this potential future role for EFIC, and you saw it playing a larger role in your sector. What sort of capital requirements would you be envisaging that would need to come into your sector to allow your firm alone to - but there may be others - take advantage of the opportunities available that you - - -

MR SIMONS (A): I'm not sure that I could really put a number on it or be specific. I can say with complete certainty that there are opportunities that we have today that we would be able to close if we were able to get EFIC involved in them.

MS SCOTT: They're commercial ventures that just simply can't attract - - -

MR SIMONS (A): They're commercial ventures or they are opportunities with sovereigns that don't have capacity to fund, they're looking for Australian government support or they are unable to raise money through normal commercial lenders.

MS SCOTT: So a mixture of commercial and non-commercial.

MR SIMONS (A): Yes.

MS SCOTT: I'm going to make this the last question, to possibly everyone's relief. In your submission to the issues paper - commentary to the issues paper - you stated EFIC's participation has been cited by your clients as a precondition of the purchase of your vessels. Can you explain the circumstances in which that would occur, maybe give us a real life example?

MR SIMONS (A): Yes, certainly, I'll give you a couple. We were negotiating - and this is now about two years ago we were negotiating with a Greek client, a repeat client who owns today and has operated a number of Austal-built vessels. We were negotiating the sale of a vessel to them. At that point the financial situation in Greece was nowhere near as bad as what it is today, but even at that time they had identified that their ability to secure all of the financing that they needed would be challenging, and they had identified that the cost of that financing in Europe was also going to be potentially prohibitive. That particular client had in the past worked with EFIC. EFIC had been involved in other transactions with them, and not only for Austal-built vessels, so they had a degree of familiarity with the way that EFIC works and they basically stipulated that for us to be able to close a deal with them we would have to be able to introduce EFIC as a participant in the transaction. That basically is literally a prerequisite. So that is an example.

I spoke earlier about a particular opportunity that we're trying to progress right now to supply patrol boats that will be built here for export. The sovereign nation that we're dealing with has said that they do need funding support for the transaction. They have specifically asked for Australian government support. We say that that's not something that we can arrange but we'll introduce you to EFIC and allow you to pursue that discussion. Where that stands at the moment is that EFIC has been able to find a commercial bank who will take a substantial portion of the risk, so if the contract proceeds it would be a joint financing by EFIC and this European commercial bank, so it happens regularly.

MS SCOTT: I think that's really useful, thank you. Thank you very much for your time. I'm sorry we're over time and I'm sorry to - - -

MR SIMONS (A): My pleasure.

MS SCOTT: - - - people presenting but this was extremely useful and, from our perspective, extremely valuable, so thank you.

MR SIMONS (A): Thank you.

MS SCOTT: We're now going to take a short break. We will resume at 11.35, please. A very short break.

MS SCOTT: Ladies and gentlemen, we may now resume our hearing. Thank you very much. I'm pleased to have at the table Wellard Rural Exports Pty Ltd. For the purpose of the transcript would you please state your name and your position with the firm and would you like to make a short opening statement, as we do have some questions for you?

MR MEERWALD (WRE): Stephen Meerwald, the managing director of Wellard Rural Exports.

MR WHEELER (WRE): Greg Wheeler, CFO of Wellard Group Holdings.

MS SCOTT: Thank you.

MR MEERWALD (WRE): Wellard Rural Exports is a 32-year established export business, predominantly exporting livestock to markets around the world. Over recent years, the last decade, we have moved from predominantly exporting sheep to exporting breeding cattle, feeder cattle, slaughter cattle by air and by sea. In the last two years we've acquired the vessels that we were using from a family-owned sister business, so they are now Australian owned, they're on our Australian balance sheet but held through a Singaporean subsidiary.

We employ directly about 120 people. We are also farmers. We're one of the largest - we're in the top 10 sheep farmers in Australia, in terms of production and numbers held, and the top 10 grain producers in Australia. We have a turnover of around about 500 million, 400 to 500 million a year, and that will expand as we have two new vessels being constructed in China by a Korean-owned shipyard that have some possibility of coming into Australia under the new shipping regulations, the shipping reforms Minister Albanese is pushing. That will depend on the outcome of those reforms. It is possible that the other vessels that we have in the fleet could be re-flagged to Australian flag as well.

Our reliance on EFIC has, until recently, been quite obscure. They've provided significant behind the scenes support for export letters of credit, they've been dealing with the banks. It's only in recent times with a more significant effort on our part relative to high-value breeding stock shipments that we have developed a much greater relationship with EFIC. They facilitated some export sales that would not have otherwise been able to have been achieved. So that's our brief opening statement.

MS SCOTT: Thank you very much. Thank you for keeping it brief, that's great. You're still a privately held firm. Is that correct?

MR MEERWALD (WRE): That's correct.

MS SCOTT: So a potential source of capital available to you or finance available to you is actually to go to the market at some stage and go public?

MR MEERWALD (WRE): That's correct. It's not a very good time to be thinking about that at the moment.

MS SCOTT: Would you normally describe yourself as a small business?

MR MEERWALD (WRE): It depends on the definition of small. We have a relatively small group of shareholders. We have a large turnover and we have a modest staff. There are a lot of companies with much greater staff numbers with much less of a turnover. We actually see ourselves as a small business in that it is quite a concise and focused business, it's not a large enterprise in some definitions, it is in others. We struggle particularly because of the field that we're in. Our industry is an industry that is under some significant scrutiny by the public and politically. That has seen, particularly in the last five to seven years, a very conservative approach by finance institutions. In fact, just over 12 months ago we actually took our banking offshore because of uncertainty or a lack of support by the Australian financial sector, so we're actually banking out of Singapore by a foreign bank. That's because the banks see us as a large enterprise. In fact, effectively the reason for that was that the funding and the facilities required were outside of the scope in an agricultural field for a single Australian bank to be able to support.

MS SCOTT: So while in some ways your firm is quite concise and has limited ownership, in terms of turnover you're actually a large firm and in some ways almost too large for the appetite of some Australian banks?

MR MEERWALD (WRE): Australian banks have weathered the storm over the last several years through a very conservative, very stable approach to their business. I think they learnt - it's well recorded that they learnt their lessons some time ago. The agricultural sector has always been at the very conservative edge of that portfolio or profile, with lending ratios that are less than in most other businesses. So we are generally too big - and particularly we're domiciled here in Western Australia, and the focus for banks is that beyond a certain value the account then gets transferred across to the eastern states, which presents another set of challenges for us. Our business is unique, so having credit committees understand our business in Western Australia is already a challenge, having them understand it from the eastern states is another challenge, and then the sheer scale of our operations in terms of assets with international ship finance, property finance, and working capital finance presents challenges to any Australian bank in terms of their will to take on exposure in the agricultural sector.

MS SCOTT: Although this is a recent change, the attitude of a Singaporean bank is distinctly different and superior to what you've experienced more recently in the Australian banks?

MR MEERWALD (WRE): Absolutely.

DR MUNDY: Is that because - the nature of the shipping industry around Singapore, do you think, or is it - because there hasn't - I mean Singapore is not known for its lax prudential regulatory standards.

MR MEERWALD (WRE): That's correct.

DR MUNDY: I mean it's not lot like perhaps the Americans or the Europeans. There has been no banking crisis in Singapore, so they're not a jurisdiction characterised by lax standards. So is it a cultural thing or a - - -

MR MEERWALD (WRE): Well, the ship finance is actually held mostly in Europe, that's the traditional ship finance hub, if you like. The funding that was provided out of Singapore was provided for our agricultural enterprises in Australia, not specifically for shipping.

MR WHEELER (WRE): It's actually the commodity trading section of the Singaporean bank that we're with, not the shipping section.

MS SCOTT: Okay, thank you.

MR MEERWALD (WRE): I should just add that that was despite a reasonably long history of trying to educate Australian banks, even Australian bank subsidiaries running out of Singapore and Hong Kong that are dealing in ship finance, to try and get them on board in terms of ship finance for vessels we're operating from Australia.

MS SCOTT: Extraordinary. What was the reaction of your past Australian banks then to the fact that you moved your banking business offshore? Could you comment on that?

MR MEERWALD (WRE): Yes. I was involved at the time, Greg wasn't on board our ship at that stage. Look, at a local level they were extremely disappointed. We had been banking for some six years with a single bank and the local people knew our business, understood it, understood the profile and had worked with us to develop to the maximum capacity of the facilities available in Australia facilities that suited our business. The decisions that were made were made in the eastern states. The guys in the east weren't particularly upset one way or another because they were meeting the requirements of their credit committees et cetera, and that was what was limiting us. So from the broader perspective probably not a big issue, from the local perspective, significant disappointment.

MS SCOTT: Thank you. That's very useful.

MR WHEELER (WRE): Just to add to that, is we find the banks today is not in a dissimilar spot. We continue to sort of try to work with the local banking community but are still finding it very difficult. We are seeking involvement from other international banks as opposed to seeking domestic assistance.

DR MUNDY: So is this just issues around general working capital? I mean shipping finance is a thing on its own.

MR MEERWALD (WRE): It's a very specialised area.

DR MUNDY: Yes, I've done a bit of it. It's tricky. So is this just a general - I guess what I'm trying to get is - your experience has been of what you describe as, and putting aside the niche issue of shipping finance - is an inability of the Australian banking sector to deal with a large rural-based livestock company. They don't get it.

MR WHEELER (WRE): I think they don't really understand Wellard. I can't talk for how a bank views an AA Co or any of the other large agricultural players, but from Wellard's perspective, and just talking about our ability to finance, not necessarily connected to EFIC at this stage but in talking about that we're quite a different business. We're a very large agricultural hold. We're also a commodity trading business. We have a supply chain integration that enables us to get right the way through that shipping chain as well. So getting a bank to actually understand how do you take a mortgage-style finance piece over your lender; a high-moving sort of working capital intensive commodity trading business and then a shipping piece to ram it all out. So that's the challenge for a bank, I think, is trying to understand the componentry of the supply chain that we actually have internally.

MS SCOTT: If it hadn't been for the global financial crisis, do you think there would be a case that you still wouldn't have approached EFIC, because you operated for a long time without their assistance. I'm just trying to just characterise what happened to change your approach.

MR MEERWALD (WRE): As I said earlier in my opening statement, we're aware that EFIC had an engagement in our - export finance through supporting letters of credit. We trade a lot to the Middle East, and that is another area that Australian banks aren't very strong in, in terms of risk assessment or risk coverage. Every time there's an incident somewhere there the banks in Australia tend to react quite unfavourably in terms of trade to countries that might be quite unrelated to those incidents. So that has been part of our history for a long time. But we were aware informally that EFIC was providing support to letters of credit out of certain countries when we couldn't get cover elsewhere, so the banks would lay off some of their risk through EFIC.

I guess this addresses your question as to whether we're a small, medium or a large enterprise. I mean we have grown considerably in the last few years but whilst we still had a relatively modest turnover, certainly under $100 million, we approached EFIC a number of times for support for different facilities in times gone by and we could never get over the line with those in terms of the resources that we needed to apply to get those particular instruments up and running for certain markets et cetera. So the resource and the intellectual property and the amount of effort that is required to get EFIC support of a facility is quite onerous on a business. So whilst it may be ideal for it to be focused on small enterprises, a lot of those small enterprises in my view, anyway, wouldn't have the wherewithal or the intellectual property or the resources to actually be able to run up a facility through EFIC, certainly in the current circumstances.

Our focus in going to EFIC more recently is that we're looking at supplying very high value relatively low number shipments of breeding livestock into markets that are looking to re-establish their breeding herds, so Turkey, Russia, China and there are a number of others. We're in competition with both Europe and the United States that are also able to supply into those markets and have quite generous support schemes for those exports: two years, five years finance, low interest rates, subsidised - loan forgiveness at the end of those - - -

DR MUNDY: Are they just part of the characterisation of the way they support their agricultural sectors more broadly?

MR MEERWALD (WRE): In part, and in part - particularly in the US where they have a presidential order to double their export in - I'm not sure what the period is but I was in the States recently and it was reinforced to me several times through meetings with the USDA and APHIS that that was their mandate. They had to facilitate - and we've been on the receiving end of quite endless emails providing us with assistance to go and export out of the States. But there has been generally a focus that this is an area that - live cattle exports out of the States, all breeding cattle, have tripled in the last 12 months and are growing quite rapidly, pretty much as a result of the low US dollar. More recently there has been a disease issue in Europe which has closed off Europe to a lot of destination countries; Schmallenberg's disease. So the US market is actually in a very favourable position at the moment. So whether it's the presidential mandate or whether it's the right place at the right time exports are growing quite strongly. There are very significant support schemes that are set up and are being developed further, given that this is a relatively new business for the States in volume. I think it's called Ex-Im, the US export support scheme?

MS SCOTT: Yes.

MR MEERWALD (WRE):   The product that they're putting in has a productive lifespan of eight to 10 years, so dairy heifer going in at a young age, comes into production at eight to 10 years. There's that sort of finance available on low interest rates and there's some forgiveness capability towards the end of that, which obviously the importing countries are seeing as very, very favourable.

MR WHEELER (WRE):   So just to add to that, the move for Wellard to EFIC is very similar to that in that we have identified here a product change. We're predominantly sheep, we're now into slaughter cattle, we've now further progressed that product into the dairy and breeding herds. So the example here is our Sri Lankan contract that we've obtained EFIC assistance on. Here basically if you consider the animal as a machine or as a piece of plant and it actually delivers its product over many years, and as Steve said, the reason why you're willing to get eight-year finance, if it's slaughter cattle, well, they're going into an abattoir and they're boxed meat and they're consumed, so there's not such a requirement for finance. Here, the productive life cycle is some eight years, and so therefore you see a different product for a different market and therefore we need a different financial product that supports that product.

DR MUNDY: So what's the precise nature of the product that EFIC is helping you with to address that?

MR WHEELER (WRE):   Yes, they are actually providing buyer finance on that, so they are supporting the Sri Lankan government in the purchase of a turn-key operation for satisfying their dairy requirements. They're very large importers of powdered milk at the moment. They want to re-establish - obviously after their civil unrest re-establish that operation within their own internal capabilities. So we're providing the dairy cattle, the milking parlours, the management as you go through that life cycle.

DR MUNDY: If you are providing these cattle to let's say Germany or France or the UK, would you expect that you would need the same degree of support from EFIC or do you think your banks or the Bank of Singapore - probably not Singapore, it's pretty hard to develop a dairy herd in Singapore.

MR WHEELER (WRE):   I think it's not.

DR MUNDY: Is it the nature of the buyer country that is - - -

MR WHEELER (WRE): It's the nature of the buyer. I think this is where we've got to make a distinction in buyer finance versus our guarantee support and exactly what product it is that EFIC is providing. Richard spoke at length about the fact that it's not necessarily the customer's banks that are required here, it's actually - it's our customers' banks that need to step up in these arrangements, and whether or not there's a shortfall there. If you look at my banking connections within Wellard you're saying, "Okay, well, why won't they actually want to finance the Sri Lankan government over the next eight years?" Is it to help facilitate my transaction? Well, no, because normal commercial terms in this transaction is when we ship we get paid, so that sort of is the end of that transaction for us. So if that's the ordinary transaction why would my bank want to come along and sort of support me over an eight-year term for a deferred payment profile? So here EFIC sort of steps in, helps facilitate that buyer finance, and actually enables us to conclude the contract under normal trading terms.

MR MEERWALD (WRE): It's also an issue with this one specifically. This is at least three years in the making, and for probably two and a half of those three years this was never going to happen simply because of the country risk, the sovereign risk in Sri Lanka. It was on again, off again throughout that three years. For EFIC, ourselves and Rabobank, which was the partner in that particular deal, it was really an exercise in surviving through. If it hadn't been for the Sri Lankan government - sorry, Sri Lanka sorting out its domestic affairs then probably we would have all walked from the deal. That happened - there was some stability, the risk factors or the sovereign risk factors changed quite quickly and the ongoing support of the Sri Lankan government to that project meant that both Rabo and EFIC could step up to the table - - -

DR MUNDY: So what's Rabo doing in the deal?

MR WHEELER (WRE): They're picking up the balance of the transaction. So they're facilitating the entire funding but with the EFIC support for 85 per cent. So Rabo are funding 15 per cent but the facility flows through them. So EFIC is providing their guarantee through the structure and Rabo are providing liquidity for 85 per cent of the guaranteed piece and then the 100 per cent guarantee and liquidity piece on the remaining 15.

MR MEERWALD (WRE): I guess it's also fair to say that it's quite a unique project. The Sri Lankan government has been trying to support the modernisation of their dairy herd for a long time without support from anywhere because of the sovereign risk. There are a lot of commercial players sitting in the background watching what happens with this deal. The 500 cattle that are the initial shipment are due to discharge later this week - sorry, middle of next week, and there's another 1500 as part of the initial contract and then there's another tranche that flows on behind that given that the project proves successful. It provides significant employment opportunities in Sri Lanka. It's a real development project for Sri Lanka and for the government, and one that has significant commercial potential to flow on, which may or may not require additional funding or support from either ourselves or from EFIC or from anyone else, depends on how the risk factors are assessed once this initial project can be viewed, tested and seen.

MS SCOTT: Can I go back to an earlier question I asked about your relocating your banking services to Singapore. Do you think there's a larger issue there for the Australian government in relation to our financial sector and its attitude to business?

MR MEERWALD (WRE):   For agribusiness and for particularly livestock and grain production I think that the conservative approach of the Australian banks is a significant barrier to expanding into larger enterprises. With pressure on production as it is, we've seen a significant move towards expansion of enterprise, but you do hit barriers in Australia. It is a real challenge. Whether there's a role for the Australian government, I don't know. The larger you get the more resource you have to be able to explore alternative options, but it would be a sad day if all of our agricultural banking was handled offshore because of a lack of risk appetite by Australian banks.

MS SCOTT: Okay.

MR WHEELER: Just to continue on that point, they have such a monopoly interest in Australia, if you like. What we found when we went to Singapore was that - we're now in an environment where we were looking to sort of sell-down to try to get some more involvement into that structure. As we have presented our terms and conditions to the Australian banks they all just say, "Well, that's not Australian boilerplate." So there's several examples of that, things like having a minimum 75 per cent of the guarantor group, you know, issues like that that here in Australia because the banks almost - careful here a little bit but there is such a strangle on the issues around terms and conditions that they won't accept much under 90. So then when you go offshore and you say, "Well, look, it's in a relaxed environment, you've got good credit there," then subsequently trying to get an Australian bank to even consider a sell-down position into that is in itself very difficult.

MS SCOTT: Okay, that's very useful.

DR MUNDY: Just coming back to the Sri Lankan dairy herd, in your dealings with EFIC have there been any discussions about animal welfare?

MR MEERWALD (WRE):   Yes.

DR MUNDY: What were the nature of those discussions?

MR MEERWALD (WRE): It was twofold. Rabobank, the other partner in that deal, had to run our proposal through their - I'm not sure, it's not an ethics committee, but similar - - -

MR WHEELER (WRE): Reputational committee, I think.

MR MEERWALD (WRE): - - - in Europe, and that was one of the processes that this particular deal was put through, and EFIC were a party to that. I think that they defaulted back to the bank's requirements, because there was no precedent for it within EFIC. But we provided significant input to both Rabobank and EFIC as to our management standards, what the deal was; not only for the exports to Sri Lanka but what our background policies were across our entire enterprise in terms of exports of feed and cattle, slaughter cattle, sheep, breeding sheep, basically everything. So there was a fairly significant due diligence on our business. I guess that is one of the issues I am referring to when I am saying that, for a small enterprise - in fact, this deal came to us through another enterprise, a small exporter, who neither EFIC, nor the National Livestock Development Board in Sri Lanka, nor Rabobank could deal with, simply because they didn't have the critical mass, they didn't have the systems, they didn't have the processes. They were a good exporter, but they didn't have the governance that would be required for a deal such as this to get over the line.

DR MUNDY: Okay.

MS SCOTT: Gentlemen, thank you very much for coming along today and thank you for your submission.

MR WHEELER (WRE): Sorry, just one point on that deal.

MS SCOTT: Yes.

MR WHEELER (WRE): I think it is the reach that we provide here. Where we operate a bit differently to most is that we collectively pool together a whole load of exporters. So in the Sri Lankan deal we had 54 farmers providing less than three head of cattle. So if you were to say, "How do we put that deal together without Wellard in that picture?" It would be nearly impossible to do. Of the remaining, there are sort of 82 that put together 500 head, so there are some mathematics in there and I will leave you with those. But really the critical nature of what we do is to pool together lots of little exporters. So to my way of thinking, if we were to start to have recommendations around sort of being available for SMEs, we might actually be knocking players out, like ourselves, as Steve said, that can actually put the horsepower behind getting an EFIC deal together.

MS SCOTT: All right. Well, thank you very much for that information. It was good.

DR MUNDY: Thanks for that.

MR WHEELER (WRE): Great, thank you.

MR MEERWALD (WRE): Thank you.

MS SCOTT: Joan Peters, would you like to come forward, please. I'm sorry to those in our audience that have recently joined us. We are running just a little behind schedule, but we are asking more questions than we anticipated. The evidence is much more interesting and people are giving us very good material, so we're pleased about that. My apologies for the delay, Joan.

MS PETERS (ELEP): That's okay.

MS SCOTT: We're very pleased to have you here. For the record, would you like to both state your name, please, and your role in the firm, and then you might just make a short opening statement, because we have had a look at the material provided and we have got a few questions for you.

MS PETERS (ELEP): Okay. Before I start, I have a problem with my ear this week, so if I say, "Beg your pardon," that's why.

MS SCOTT: That's fine, I'll try to speak more clearly.

MS PETERS (ELEP): Thank you.

MS SCOTT: I'm conscious that we're very - well, it is being recorded for transcript purposes, but apparently the room's acoustics are not very good. So I'm going to try to speak a little bit louder and I'll encourage Dr Mundy to do the same.

MS PETERS (ELEP): Thank you for that. My name is Joan Peters, I'm a lawyer. I have been practising solely in the area of film and television and intellectual property for the past 20 years.

MR DONALDSON (S): And my name is Mark Donaldson. I'm from ScreenWest. I'm the business affairs officer there.

MS SCOTT: Thank you.

MS PETERS (ELEP): Our submission here is firstly to thank EFIC for the wonderful role they've played. They have been critical and absolutely invaluable. So it is against a film financing, which has taken a very innovative leap in 2006 with the introduction of the producer offset, which meant that, if we go back a little bit, film is financed through equity investment, through presales - the presales have to come from Australia and internationally - and from the offset. Very often there is also a little element that is required to be gapped by the producer. So the financing structure is quite complicated and yet not. The area that we have been focusing with EFIC is on the cash flow of the offset. The offset is a very short-term loan: it is a producer entitlement paid on the completion of a production. It is only taken out for, at the most, about six to nine months; that's it.

It is not risk money, because it is against the offset, which is treasury backed, so it doesn't depend on sales or anything. That is the gap that EFIC has been playing a role in, for producers to cash flow this offset. Without this cash flow of this offset, they are unable to get equity investment in the project, because it is a prerequisite that they do cash flow this. So over the years, since 2006, there have been many ways that the producers have been trying to finance this area: in my experience, starting with borrowing on their homes - just crazy things they were doing - and then finding foreign money, which was hit by the GFC. Really, it put them into a huge predicament. From there, a few non-bank lenders arose and a saving-like EFIC arose. So we state that EFIC is filling a gap; it is not pushing somebody else out of the market.

MS SCOTT: Joan, sorry to interrupt, but just on you describe that as people using their home as collateral to get a loan and then foreign money that was initially interested and then dried up with the GFC, and then there were some non-bank lenders in the market for a while. Can you give us some information about those people, please?

MS PETERS (ELEP): Yes. Those people arose - I probably shouldn't be naming them, I don't know.

MS SCOTT: I think it will be all right.

MS PETERS (ELEP): Well, there's Media Finance Group.

MR DONALDSON (S): Yes.

MS PETERS (ELEP): They loan money on the offset. They will loan only on the offset though. Because part of their funding is from superannuation fund, so they are a little bit more risk adverse than EFIC have been. Sometimes they will say, "We will do it, if EFIC will do this bit," like we did on Drift.

MS SCOTT: All right.

MS PETERS (ELEP): But we do get loans from non-bank lenders.

MS SCOTT: Okay. Thank you.

MS PETERS (ELEP): That said, the market is so wide that it is good to have this competition that EFIC provides in the marketplace. With regard to going to the banks, I have spent an enormous amount of time, for years, talking to the standard banks: they will not look at this kind of financing, because it is not land, not bricks and mortar, they will not look at this kind of financing. I have spent that much time and money chasing that avenue; it is a closed door. We do have people like Bendigo Bank that are lending, but it seems to be a very closed shop; that is, it's very hard to get in. I don't know what the triggers are to get their money. Producers are young people who are starting out and they don't have the financial nuances to face all the interrogation with banking systems, whereas EFIC is open-minded, it works well with the producer and it supports the producer so efficiently. With regard to - I don't know whether pricing has been any issue with your - - -

MS SCOTT: We are interested in how comparable EFIC's prices are to those that are charged by the non-bank lenders, or what are the terms and conditions.

MS PETERS (ELEP): In my experience, they're the same.

MS SCOTT: Yes.

MS PETERS (ELEP): Except the legals are a bit cheaper.

MS SCOTT: Right.

MS PETERS (ELEP): Yes, and they don't have things like arrangement fees and those fancy fees that people call different things that pad up the system. They charge interest. The interest rate is comparable with a non-bank lender, and their legals is a bit lower. But anybody who is doing the legals for those things know that after you do a couple they just repeat it. The documents are repetitive documents, so it can be amortised across a lot of projects.

MS SCOTT: Yes, I understand.

DR MUNDY: There's no up-front establishment fee with EFIC that some of the - - -

MS PETERS (ELEP): I'm sorry?

DR MUNDY: There's no up-front establishment fee for EFIC, you said, or other fees?

MS PETERS (ELEP): Is there an establishment fee?

MR DONALDSON (S): I'm not sure.

DR MUNDY: You mentioned some fees?

MS PETERS (ELEP): Yes, there's an interest rate.

DR MUNDY: Yes, no, but you mentioned some other fees?

MS PETERS (ELEP): Establishment fee I cannot honestly recall what it is, but I can bring that to you - - -

DR MUNDY: Yes, I'd be interested as to whether there are any other fees other than the interest rate charged by EFIC and other parties.

MS PETERS (ELEP): Other parties I know charge arrangement fee of about 3 per cent of the loan.

DR MUNDY: Okay, and EFIC doesn't?

MS PETERS (ELEP): I believe it doesn't. I actually can't recall. But EFIC comes in just that much lower than the non-bank lender.

DR MUNDY: So altogether EFIC is a little bit cheaper?

MS PETERS (ELEP): Correct, and it supports the smaller film makers, the documentary makers that need, you know, 150,000 and those sort of things, which the non-bank lenders are probably more interested in the feature film area.

DR MUNDY: Okay, thank you.

MS PETERS (ELEP): The other thing is also - I mean I reiterate the fact that film financing is so short term. When EFIC money comes in, it comes in after everybody's money has come in. It's so low risk. Every equity investor will have paid, the producer would have put in their money, the cash flow comes in right at the very end. The film is almost completed. It is just to complete the film, and once it's completed it's two months before it goes to the ATO and the tax cheque comes for that amount. Also, EFIC lends on 80 per cent of the loan, so there's that little gap that protects it, and virtually it rides behind the comfort of Screen Australia and the state funding bodies who are so experienced in risk protection against this industry.

MS SCOTT: Yes, got that, thank you.

MR DONALDSON (S): They further minimise their risk by requiring a completion guarantor on almost every project that they finance. A completion guarantor's role, just briefly, is in the event that the producer goes belly up or for some reason the film is unable to be completed by the producer who holds all the rights, the completion guarantor steps in and completes the film as a producer.

DR MUNDY: So what sort of person is a completion guarantor?

MR DONALDSON (S): A person with extensive production experience.

DR MUNDY: So this would be an individual or a company or - - -

MR DONALDSON (S): Yes. Well, it's companies, yes, company.

MS PETERS (ELEP): Specialising in it.

MR DONALDSON (S): Yes, and they receive cost reports at intervals during production and monitor the budget, make sure that the right amount of money is being spent at the right time and that the film is on track.

DR MUNDY: Do the non-EFIC lenders have similar requirements for completion guarantors?

MS PETERS (ELEP): Yes.

DR MUNDY: So that's standard practice within the industry?

MS PETERS (S): Yes.

MR DONALDSON (S): Yes, absolutely.

DR MUNDY: Do they lend up to 100 per cent or only up to 80, as EFIC does?

MR DONALDSON (S): They would leave a contingency as well.

DR MUNDY: They would leave a bit? Okay.

MS SCOTT: In our draft report, Joan, we suggest that EFIC concentrates on small and medium size enterprises. Wouldn't these be exactly the sort of firms that are into one-off film production or series of small film productions? Wouldn't in fact the reorientation of EFIC towards SMEs and away from very large firms be to the advantage of the film industry?

MS PETERS (ELEP): Yes, it would be. But I think with film production it goes from this end to that end, you know, you get the $300,000 film and you get the $30 million film. So I don't know what your range of SMEs are but it does fluctuate immensely. Like on Drift, the program that I just finished, EFIC even took another role in that film. It did not lend on the offset, it lent on the distribution advance from the French distributor who bought the film. For the producer to cash flow that $1.9 million US amount was an enormous task, it couldn't do it, and no non-bank lender could do it. The non-bank lender said, "We'll do the offset. We'll share - if EFIC will pick that we'll do it with you." Without that, that film would not have been made. Film is a very high export because the domestic market is so small that it is only the export that matters to film production and television.

MS SCOTT: That makes sense.

MR DONALDSON: That's right. An Australian film might make $50,000 in its opening week in Australia but then it might get sold on hundreds and hundreds of screens overseas.

MS SCOTT: All right, thank you.

DR MUNDY: I don't have any questions.

MS SCOTT: Thank you very much for coming along today. We appreciate it.

MS PETERS (ELEP):   Thank you.

DR MUNDY: Good grief, we're back on schedule.

MS SCOTT: Okay. Well everyone, we are now going to take a break till 1 o'clock. We will resume exactly at 1.00, please, for those that are going to stay. Thank you very much.

(Luncheon adjournment)

MS SCOTT: Well, good afternoon.

MR BLACKWELL (HM): Good afternoon.

MS SCOTT: Thank you for coming along. We are recording this process for other people to be able to read the transcript. The transcript will be available. We have set aside about 30 minutes for the time we can hear from you. We'd like to ask you some questions but maybe give you an opportunity to make your statements yourself and then we'd like to then have an exchange where we ask questions and you can give us your answers. But for the record please could you state your name very clearly and your role in the company, thank you.

MR BLACKWELL (HM): My name is Chris Blackwell. I'm project manager and owners representative.

MS SCOTT: Thank you.

MS NEWALL (HM): My name is Clare Newall. I am the accountant and also the company secretary.

MS SCOTT: Thank you. All right, please proceed.

MR BLACKWELL (HM): Okay. I guess, first of all, we made a submission in confidence. There's no real secrets in there that we can't really talk about in here, I'll let a few little bits and pieces out, but one of the main reasons we chose not to make a public submission was purely because we don't want to give any of our employees the wrong idea so far as ongoing projects and a few things like that, so it was just discretion more than anything.

MS SCOTT: Right, okay.

MR BLACKWELL (HM): So I guess - since this was confidential is it worth me going over this, or you've got the report, haven't you?

MS SCOTT: Well look, I went and got the confidential copy and I think Warren has too. What we might do, if it's all right with you, is we can ask a few questions drawing out, I think, your firm's position. Maybe just start by talking about your firm for a little bit, and I guess - you've got some concerns about EFIC's operations as they are now, then we could talk about that for a bit.

MR BLACKWELL (HM): Okay. So I guess just to highlight - Hanseatic Marine have been in operation since 2002. We started actual physical construction of our first superyacht in 2005. We've sold, built and delivered, two vessels already.

MS SCOTT: Yes.

MR BLACKWELL (HM):   The third one is sold but we have yet to deliver. We've got 203 employees as of today.

MS SCOTT: You produce on a firm order or do you produce in anticipation of a firm order?

MR BLACKWELL (HM):   We've got, a slightly unique arrangement whereby the owner of the company is also in a way the buyer of the vessel. We have an arm's-length pricing agreement that's thoroughly ratified in accordance with the ATO's requirements. You could say he's building on spec, but at the same time he's more than financial when it comes to being able to afford the vessels.

MS SCOTT: Yes.

MR BLACKWELL (HM):   The first two he has on-sold.

MS SCOTT: Yes.

MR BLACKWELL (HM):   There is a market there for these vessels. It's not like the buyer is just keeping them in his garage as toys. For all intents and purposes it's a commercial and viable business proposition.

DR MUNDY: Are you able to tell us who he is?

MR BLACKWELL (HM):   Yes, it's no secret, his name is Mr Guido Krass.

DR MUNDY: He's domiciled in Perth?

MR BLACKWELL (HM):   No, he's German.

DR MUNDY: He's German? Okay, thank you.

MS SCOTT: Okay, that's good. Now we might go to some of the comments that you've made about EFIC. Your firm has approached EFIC for support?

MR BLACKWELL (HM):   Our firm has approached EFIC for support in the past on a couple of different occasions. We've been looking to find out what the possibilities are for some support. Although we have a buyer or, company owner, who has been happy to fund projects and so on ultimately he is looking for the best possible business situation he can operate within. As is no secret we've got huge issues - the industry, I should say, has got huge issues when it comes to the strength of the Australian dollar and those sorts of things, so he is obviously looking for any advantage he can squeeze into the equation along the way.

Now, we're looking to grow. We've essentially done three boats now. We have started the fourth vessel. The fifth vessel could very well be larger, 100 metre, two and a half times the internal volume. When we start talking of those sorts of things he may be looking more for financing rather than totally funding larger projects himself.

MS SCOTT: In the past you haven't been successful with EFIC when you've approached them?

MR BLACKWELL (HM): Clare might jump in here because she has had quite a lot to do with dealings to date. I think that the main point is - there has been discussions and hurdles in dealing with EFIC when it comes to the situation between the purchaser of the boat and the company being linked in some ways. On Hanseatic’s side we've experienced issues whereby if we get an answer that's a little bit grey and it's an uncertain answer and a bit of, "Well, you know, could be a little bit of risk there, we're not quite sure," this, that and the other, "this is probably our sort of position on it," Hanseatic’s response to that has been, "Well look, if you can't categorically give us a straight answer or help us with X, well then why don't you say to us, 'Look, we could maybe offer you Y or Z instead'? Maybe we could find some sort of compromise." The owner has said that he is willing to be flexible, if he needs to put up a certain amount of security. He appreciates that those things may be required. But it's then a matter of he doesn't necessarily want to lock his money away in some low interest bearing account in trust. He's a businessman and there has got to be an incentive for him to keep him buying vessels from an Australian base that keeps our workforce employed.

MS SCOTT: Besides the concern about the vagueness of the answers, have you ever reached agreement on terms and conditions?

MR BLACKWELL (HM): I don't think we have, have we?

MS NEWALL (HM): We've never reached any agreement with EFIC as we have never been able to progress the discussions far enough.

MS SCOTT: No. So it's not so much that EFIC has refused any proposal from your firm, it's just that in discussions they haven't advanced, as you would have liked. Is that - - -

MR BLACKWELL (HM): I think it's pretty much - have to say we haven't really been able to make sufficient headway.

MS SCOTT: Okay.

MR BLACKWELL (HM): There has been too many hurdles and there is not enough reply or interest to engage and help us get to a point where an agreement could be reached.

DR MUNDY: What's the nature of the hurdles? Is it information about the company? Is it the owner?

MS NEWALL (HM): So far we've had three reasons as to why EFIC can't support us. The first one, and probably the biggest one, was the arm's length pricing methodology and our transfer pricing issue. The second was they don't feel that we have enough funds to support the loan. The third was that they felt that luxury yacht building was too much of a risk for them to support us.

DR MUNDY: Okay. Have you had any discussion about - without giving away all the details but what discussions have you had with the banks, domestic banks, foreign banks or - - -

MS NEWALL (HM): We haven't approached other institutions to date - EFIC is the only one.

DR MUNDY: So EFIC's the only - - -

MS NEWALL (HM): Yes, that's right.

DR MUNDY: Okay.

MR BLACKWELL (HM): That's not to say though that separately in the background the buyer has made his own investigations. I guess the main point we want to make here is, not about whether the buyer or the company can get finance from somewhere else at a more expensive rate. What we're highlighting here is the way things are, the high Australian dollar and high labour rates, essentially working against overseas buyers of Australian made products. We believe that the government needs to create as much incentive as possible for buyers. We're not saying that we're expecting to receive handouts, like some industries do.

MS SCOTT: Yes.

MR BLACKWELL (HM): We do appreciate that the overall economic cost of incentives being created do have to be taken into account. We'd be very surprised if the actual full economic cost is calculated that it wouldn't be found that even if we were given a big incentive the returns to the overall economy as a whole would be many times that of whatever the incentive cost the government to put in place.

MS SCOTT: Do you operate in such a niche market that the fact that other firms producing vessels receive EFIC support would disadvantage you, or effectively you don't have a competitor that is in receive of EFIC support?

MR BLACKWELL (HM): At the moment there's no other company in Australia doing what we do.

MS SCOTT: Okay.

MR BLACKWELL (HM): Austal have Oceanfast but they are not producing superyachts any more. It's about us being competitive with overseas shipyards. Other countries support their shipbuilding industry with all sorts of incentives and alternatives to what - we once had in the bounty, for example.

MS SCOTT: Yes.

MR BLACKWELL (HM): We don't have any of those options available to us here.

MS SCOTT: The fact that, if I've got it right, the buyer and the owner are exactly the same entity - have I got that right?

MR BLACKWELL (HM): Well, not strictly speaking. The buyer and seller are two clear and separate entities. For example, the buyer of the first two vessels included Mr Krass and the seller was Hanseatic Marine who is owned by Mr Krass.

MS SCOTT: Okay, right.

MR BLACKWELL (HM): The buyer and seller of the third vessel are again clear and separate entitites although the reality is Mr Krass is 100 per cent the buyer. I guess that answers your question?

MS SCOTT: Yes, it does. Now, your confidential submission did raise a number of other issues that go to issues about, you know, visa entry and so on. We have noted those but perhaps - - -

MR BLACKWELL (HM): I appreciate that they are not necessarily EFIC specific.

MS SCOTT: That's right.

MR BLACKWELL (HM): Yes. I guess the point that we were trying to make there is that essentially on all fronts at the moment there is no Government support and there is no incentive for anybody to buy from an Australian yacht builder or any shipbuilder for that matter. I may be proven wrong but aside from Australian companies that are manufacturing at least some of its product offshore then there is going to be problems for the industry.

MS SCOTT: Okay.

DR MUNDY: I'm doing pretty well at the moment.

MS SCOTT: Well, I think we've - as I said before, we've read your submission in advance of today and had a look at it again. We pretty much appreciate your coming along. I think we've finished our questions. Do you feel you've had a chance to say your key points?

MR BLACKWELL (HM): I don't want to harp on about it but the thing I need to underline is first of all, the owner of the company and the purchaser of the vessel in one, are flexible. They're looking for the best possible business conditions to continue to invest their money in Australia. It's very important to us as a company, irrespective of who owns it, to keep 200-plus people employed. We have concerns about the lack of government incentive in various ways - I think there needs to be a multi-pronged approached. If the government doesn't start to create incentives for buyers then within years, not decades, we'll be lucky to have any shipbuilding industry that can do what ours does. What we're able to produce here in Australia is world class. We're producing technologically advanced vessels. There's no other country out there - and not to blow our own trumpet but there's no other country out there that is producing anything more advanced than what we're doing as far as yacht building is concerned, so it would be a real shame if some initiatives taken or initiatives put in place to improve the situation.

MS SCOTT: Okay. Thank you very much.

MR BLACKWELL (HM): Thank you very much. Sorry, can I just make just one last point?

MS SCOTT: Yes, please.

MR BLACKWELL (HM): Reviewing the report , obviously we understand that EFIC currently has a charter and a scope that it has to work within. We do appreciate that and obviously those things don't change overnight. But if there is any potential or any recommendations that can be made for scope to change or be adjusted, then that's certainly something that we would be asking is reviewed. The other thing is if there is any possibility for EFIC to have a mechanism within its operating structure that can take concerns or even make good representation on a company's behalf and promote it to other government departments, point us in the right direction and help guide us well - I know that's really not what EFIC is there for but anything that's proactive to help our industry. I think needs to be built into the system.

MS SCOTT: All right, thanks for that.

DR MUNDY: Thanks very much.

MS SCOTT: We now invite to the table David Browning, please. Good afternoon, Mr Browning. Welcome to our hearing table. For the purposes of the public record could you state your name and role in the firm and the name of your firm, please?

MR BROWNING (TMA): My name is David Browning. I'm the managing director of Thornycroft Maritime and Associates, and our company is located in Fremantle in Western Australia.

MS SCOTT: Thank you very much. Would you like to make a short opening statement, please?

MR BROWNING (TMA): I hope by now that you may have received a copy of the document that I prepared?

MS SCOTT: I have.

MR BROWNING (TMA): I apologise, it's probably not as descriptive as it should but I was overseas until two days ago, so it was prepared at short notice.

MS SCOTT: We very appreciate having something in writing with all hearings, so thank you.

MR BROWNING (TMA): I would first just like to open this topic with the fact that I'm also a main board member of Marine WA, and as you may know already that's the voice of shipbuilders and marine activity in Western Australia. My company is a fourth generation company. It has its roots in the United Kingdom, was established in 1864. Thornycroft commenced operations in Australia in 1988 and we are naval architects, naval engineers, shipbuilders and suppliers of marine equipment. We primarily operate in the export market. We export technology services, marine equipment for the construction of ships in developing countries in the Asia Pacific region and we offer turn-key systems for the marine industry.

I wish to address the forum today because it's of great concern to us, having been advised as to the content of the Productivity Commission's draft recommendations. I have listed out four points which we would like to mention and discuss together. One point where you have mentioned SMEs can only be supported three times. We believe that is a major problem for some companies.

DR MUNDY: Excuse me, Mr Browning, that isn't actually what we recommended.

MR BROWNING (TMA): It isn't?

DR MUNDY: No, we recommend that after three transactions had occurred, that the board of EFIC should be involved and that should be reported to the minister. At no point did we say that the transactions should cease.

MR BROWNING (TMA): Okay, I would like to just add something to that. Those transactions could consider, perhaps, just supplying a confirmation for three letters of credit, which could take place over two months and three months, and that means we would be out of time and you would have to go back to the board to ask permission to do something else.

DR MUNDY: There's only a notification requirement. Obviously you have misread the report or someone has poorly advised you of what the content of the report was.

MR BROWNING (TMA): We did get a note from somebody else from the West Australian government concerning our point. They were perhaps the ones that didn't understand it either. I think the other point we said was ceasing immediately to assist companies with supplying goods and services onshore for export-focused projects. Would you be able to explain a little as to what that really means?

DR MUNDY: It is directed primarily at activities which relate, for example - and this is the example, I think, which is germane to this recommendation, is of EFIC's involvement with the financing of a railway line in the mid west of WA. That is the sort of project we have in mind.

MR BROWNING (TMA): Would that also be a project, for instance, if we were to build some ships here that were going to be used for exporting iron ore, coal, or some other commodity, that that would be considered to be in the same category?

DR MUNDY: It's not a matter we have brought our minds to, Mr Browning. We are not here to answer questions, we are here to gather information.

MR BROWNING (TMA): Yes. We are just trying to find out what the basis is for the comments made, that's all.

MS SCOTT: I think that's why we write quite lengthy reports, to be perfectly frank. Our concern at this stage is that there is a chance that you are reacting to someone's summary of our report which is not entirely accurate. Now, we do have an interest in pure onshore project versus offshore projects, but we are more interested in hearing your views than for this to be an enunciation of our quite lengthy report. So maybe you would like to go to some other points in your presentation and you might want to, if your week allows, then want to avail yourself of having a look at the report. It is available on the web site.

MR BROWNING (TMA): No, I have finally got a copy today, actually.

MS SCOTT: Okay. Well, it is available on the web site and we are happy to supply hardcopies to people. But why don't you go into other aspects of yours rather than this turning into a session of us explaining quite a lengthy report.

MR BROWNING (TMA): Okay. I mean, what we are trying to understand is the effects of your recommendation on our actual business activity. If we can describe a little more about our business activity that relates to what your suggestions are, perhaps you would understand where are concerns are. We are basically a current exporter and we use the services of Australian banks. More importantly, we use valuable services of EFIC. To elaborate on that, you have heard today many people speak of the financial crisis and the effect it has had on the economy, the various effects it has had on business in general, and why Australian banks - although they have considerable strengths - are very shy of taking credit risk in pretty much every form unless it is fully secured by collateral which is property or cash investment. If you provide any other type of collateral, they are really very shy to take it, and this causes us a great deal of problems. So this is one of the fundamentals of exporting and one of the fundamental problems we face today.

Because of our geographic location, we are based in south-east Asia or Asia generally and therefore that is our marketplace. In the Asian marketplace there are only one or two countries today that have succeeded in coming out, to become more developed, and being able to have sufficient funds of their own in order to fund their own developing needs. Therefore, there is a tremendous requirement in Asian countries surrounding us for buyer credit. Buyer credit is something that we have to have, because without it we cannot export. We are currently involved in a major project with a very close neighbour country of ours where the specific conditions of the contract were that buyer credit must be provided. So when it is a question of whether EFIC can or can't do this in the future, it has a serious impact on the type of business we can do in this region.

You are obviously very familiar with the OECD organisation and its terms and conditions and that obviously allows that if you're a member of OECD you tend to be able to provide buyer credits to various countries, and that the OECD sets the terms and conditions, and also the cost to a certain extent, because most buyer credits relate to insurance premiums charged by EFIC, in this case. If you have an EFIC premium, that premium is related to the credit risk on that country, which is also specified by OECD. I was just questioning whether that relates in any way to your comments concerning EFIC's rate of return, when to some extent the largest part of buyer credit is set by an other organisation?

DR MUNDY: I think the report goes to some length to our concerns about EFIC's rates of return.

MR BROWNING (TMA): Because if we go to a country and we participate in a tender and the contract of the country asks us to provide a buyer credit, we will provide the buyer credit on OECD terms. I ask at what cost the cost is and the terms are set under the OECD requirements. You will ask EFIC, they will say it is in accordance with this because the country rating is whatever it is and that's the rate they charge you. Our own company and others very similar to us face quite major problems at the moment and most of those are due to the strength of the Australian dollar, which makes most exporters very concerned. One of the tools we have to combat that is EFIC, because EFIC can provide a credit system which is much more competitive. Therefore, when you are in competition with others, it has a substantial impact.

MS SCOTT: Can I ask you to explore this a little bit more. So a key aspect of your competitiveness in the market is EFIC's services to your firm?

MR BROWNING (TMA): Yes, absolutely.

MS SCOTT: Do you consider that EFIC charges commercial rates for commercial terms?

MR BROWNING (TMA): If you want to buy credit from EFIC, there are two elements. There's the insurance element, for which there is a charge, which once again comes back to the OECD rating for the country, and in turn they set the values that are needed; that is, percentage values for the insurance. On top of that then are EFIC's own fees and charges, which are comparable with the bank. If a bank is involved, they normally split the charges, so you're not paying twice anyway. We have never had a problem with that. We feel they are very competitive and they are equal in standing with the bank; the bank will charge you a very similar fee. So we don't see them charging more or charging less.

MS SCOTT: Okay.

MR BROWNING (TMA): Where we get the advantage is the insurance.

MS SCOTT: Okay. If there is a competitor of yours operating in another OECD country and they are export credit agency is offering OECD terms and conditions, and let's say those conditions and terms are quite comparable, how then does it actually improve your competitiveness, the fact that both countries have ECAs, both doing the same thing.

MR BROWNING (TMA): Well, let's start from the start. The start of the process is you can't enter the project with your prequalification unless you have EFIC support, so you have to get something from then to say, yes, in the event that you're awarded the contract, you have the support of the buyer to buy credit. That is a condition. If the condition is not there, you're disqualified. So the next thing is, when they do the evaluation of your offer, it is based on the technical part, which is obvious, and then they go into the commercial offer, which are your costs, and then they come down to the actual financial offer, and that is based on the buyer credit. What is it going to cost us to borrow this money from the Australian - from EFIC, from the Commonwealth? Then they will give you a costing. We have to get a detailed costing from EFIC which we submit. In most cases because EFIC are providing the country risk, sovereign risk on the country, the banks, if the bank is involved directly, will give you a much lower interest rate for that country than if you didn't have EFIC. That's where we're competitive.

DR MUNDY: So it's the buyer that's requiring EFIC?

MR BROWNING (TMA): Absolutely.

DR MUNDY: So the buyer is obviously acquiring some benefit from EFIC's participation?

MR BROWNING (TMA): He's asking for a buyer credit from the country who is putting forward the offer.

DR MUNDY: So he obviously - - -

MR BROWNING (TMA): As part of his terms of reference.

DR MUNDY: So he obviously places value upon the presence of that buyer credit?

MR BROWNING (TMA): Absolutely, and they place more value when it's the government providing it or the government associated with who provides it.

DR MUNDY: Obviously, by definition, the buyer is foreign?

MR BROWNING (TMA): Yes.

DR MUNDY: So the buyer is deriving benefit from the Australian taxpayer?

MR BROWNING (TMA): He is getting a benefit because he doesn't have any money to pay for the goods himself.

DR MUNDY: Yes. So he's getting a benefit from the Australian taxpayer?

MR BROWNING (TMA): As with every other country have the same benefit. Every other ECA would have the same benefit.

DR MUNDY: Indeed.

MR BROWNING (TMA): The Koreans will have the same benefit. They all try to do it a little cheaper, because they can be taken advantage.

DR MUNDY: Yes.

MS SCOTT: So how does it improve the long-term competitiveness of your firm if all the ECAs are effectively out there doing effectively the same thing?

MR BROWNING (TMA): I think it's the other around. We can't compete if we don't have an ECA to assist us.

MS SCOTT: No, but you drew attention to the high value of the Australian dollar. I'm trying to see how it improves your competitiveness long term.

MR BROWNING (TMA): It improves our competitiveness if we can have a financing package which is competitive in the marketplace.

MS SCOTT: So they were competitive in the marketplace 10 years ago?

MR BROWNING (TMA): 10 years ago EFIC were not competitive, no.

MS SCOTT: Okay. So you think they've become more competitive?

MR BROWNING (TMA): They've become more competitive.

MS SCOTT: I see.

DR MUNDY: 10 years ago when the exchange rate was down 60-odd cents, 65 cents, maybe - - -

MR BROWNING (TMA): The Australian dollar didn't play a part. It was a benefit then.

DR MUNDY: So really, what you're saying is that when global economic conditions change you need the government to step in and help you out?

MR BROWNING (TMA): I think that's we've got at the present time, yes.

DR MUNDY: So basically - - -

MR BROWNING (TMA): I think we've got two points to it, if I may elaborate a little more. We've got two. We need the government to help us during times of difficulty but we also need the government to provide the export guarantees required by the buyer's country, because if the buyer wants to have the credit line to purchase the goods we need somebody to provide that guarantee. The banks in their own right in Australia will not do that.

We have tried so many times to get the banks to take credit risk on countries in this region and they have all refused to do it. This has become much stronger since the credit crisis that has been recently in the world today. So now everybody says, "Yes, we can do this for you, but we need EFIC to support it, because we won't take the sovereign risk, country risk or a commercial risk on the country on our balance sheet. We'll only take it if EFIC are there." Today, I have five major projects sitting out there all requiring the same support, because they're all in countries in this region that all want a buyer credit for the product. If the buyer credit is not there then we can't enter the race, and the bank won't give it to me unless EFIC support it.

DR MUNDY: There was one other thing. You mentioned in the document that you've provided us that you need EFIC's market intelligence together with that of the Department of Foreign Affairs and Trade. Precisely what intelligence of the Department of Foreign Affairs and Trade are you referring to?

MR BROWNING (TMA): EFIC has access to country intelligence regarding activities and the country stability et cetera et cetera that we gather through DFAT which comes out of our embassies and the people employed in our embassies. That information can be fed back through EFIC, because EFIC has direct access to that, we don't.

DR MUNDY: How do you know that EFIC has access to that?

MR BROWNING (TMA): Because we've asked them previously.

DR MUNDY: So you've asked EFIC or DFAT?

MR BROWNING (TMA): We've asked EFIC. You may know that EFIC provide a report, I think quarterly?

DR MUNDY: Yes, I'm aware - - -

MR BROWNING (TMA): On the risks of countries around the world.

DR MUNDY: Yes, it's the nature of - I'm familiar with those reports, I've read a number of them. It's more the issue of the information that EFIC receives from DFAT that I'm interested in.

MR BROWNING (TMA): Well, normally in the Australian embassy there will be trade people, and those trade people's business is to find out what opportunities may be there. Those normally get passed back to through DFAT and eventually find their way to EFIC or back to Austrade, either way, but one way or the other we get that information back, which is useful.

DR MUNDY: Okay.

MS SCOTT: Could you elaborate a bit more about how EFIC has improved in terms of their competitiveness in the last 10 years? How have you detected these signs of improved competitiveness and do you think there's further opportunities?

MR BROWNING (TMA): I think 10 years ago or more EFIC were running more on stringent guidelines whereby they didn't have - very little flexibility. Sometimes that was detrimental to the deal because they weren't able to move to compensate for other potential competitors. Today they are more flexible, and if you have a good case where they need additional support from them they can help you much better. I think they have a much better understanding of your business.

MS SCOTT: Okay. What would be an example of that - what would be an indication to you of that greater flexibility? What's something that they would have said no to 10 years ago - - -

MR BROWNING (TMA): I think in the past they probably would have had a very stringent view on interest rates and said, "This is the interest rate, it's a fixed rate," and today they're much more flexible on that.

MS SCOTT: That interest rate is better?

MR BROWNING (TMA): Yes, it's much better today. They're much better because they're much more flexible with different currencies and they will lend in different currencies.

MS SCOTT: Right, okay.

MR BROWNING (TMA): So that gives you another advantage whereby you can actually borrow in a different currency. If your client wishes to purchase his goods in Japanese yen, for instance, EFIC would happily lend you yen to fund it, or lend the buyer - the purchaser yen.

MS SCOTT: Do you see areas where you think EFIC's performance could improve?

MR BROWNING (TMA): I think I mentioned that it would be useful if there were some other financial instruments that they could use, such as currency swaps, and maybe an interest in hedging on behalf of some of our clients where we have this volatility in the market.

MS SCOTT: I think you were here for this morning's sessions where people suggested that maybe EFIC could actually become an equity partner or actually be engaged in the charter business. What's your views on that?

MR BROWNING (TMA): Well, the charter business means that you have to take equity or ownership in the vessel. I'm not sure whether the government's mandate would allow them to become ship owners but if there was a mandate that allowed that then it would be a very good thing, because it's quite difficult sometimes to find equity partners in charter. There is a lot of equity partners in tankers, in charter tankers, but in smaller craft and smaller services - I heard about wind farms and things like that. That's an expanding market and it's taking off in Europe and it will come here as well in the not too distant future. But the question there is, yes, if they can get a mandate to do it, it would be a great advantage because they're a leader.

I can give another example. We did a project some time ago where we decided to syndicate the risk on the buyer credit. We approached several other ECAs worldwide. They all said yes, providing EFIC led the charge, so to speak. If they were the leader and the Commonwealth of Australia stood behind it then they would put their support in additionally.

MS SCOTT: How do you think - given you've had exposure to other ECAs how would you rank EFIC in terms of its approach and - - -

MR BROWNING (TMA): I would say they're - I mean they are one of the smallest ones because we're not a great big country, but certainly they're very diligent and I think they - providing you give them the correct information they will do quite a good job for you, but you need to be prepared to give them what they need.

MS SCOTT: So they're small but you consider they're comparable to - - -

MR BROWNING (TMA): Yes, I would say they're quite efficient, providing you give them the correct information. The bureaucracy level is there, you know, and it has to be fulfilled, so you have to be prepared to do what's necessary to look after that.

MS SCOTT: Well, Mr Browning, we've finished our questions. So thank you very much for coming along today.

MR BROWNING (TMA): There was only one other point I would raise, and I did make a comment here but it may not be so relevant after you said that three strikes and you're out is not necessarily what happens. I have first-hand knowledge of certain transactions in this state and over the years we have all run into the same problem with confirmation of LCs. We spent a lot of time working in Malaysia many years ago when the range of banks that were used to provide LCs for the one project varied so greatly that a lot of those LCs could not be confirmed by an Australian bank directly. We also know that in Indonesia particularly there aren't any A grade banks up there. The only A grade banks today are Australian banks, because Indonesian banks are not. So an LC on an Indonesian bank, you would find no Australian bank willing to confirm it. So no matter what happens you have to go to EFIC because that's the only solution you have or take the risk yourself.

DR MUNDY: Just on that question, would you think that as a general proposition corporates should be willing guarantees, letters of credits, from double A rated banks generally?

MR BROWNING (TMA): From a double A rated bank normally they will, but you would be surprised how many large corporates in this state still require confirmation. Some of them - the size of their balance sheet, they still do it.

DR MUNDY: But if they've got confirmation from a bank, double A rated bank, you would normally think that would be sufficient?

MR BROWNING (TMA): That's what we would do as well. Normally we wouldn't ask EFIC to confirm if we can get it from a double A rated bank, there's no need because you're going to pay two lots of fees.

DR MUNDY: So that you don't think generally as a commercial proposition - there's no need for confirmation of double A rated bank - - -

MR BROWNING (TMA): If you're getting an LC from a double A rated bank normally there's not a requirement to confirm it, no. Normally you would expect that bank to honour its agreement.

DR MUNDY: Okay, thank you, Mr Browning.

MR BROWNING (TMA): But you can get confirmation from your own bank on the same bank, there's no problem.

DR MUNDY: Yes.

MR BROWNING (TMA): What you can't get is if it's a B grade bank, and that's what most of the Asian banks are, unfortunately.

MS SCOTT: Is there a particular aspect of - well, sorry, one last question. Is there a particular aspect of shipbuilding that means that it has a particular need to go to EFIC? I'm just conscious that EFIC does a considerable amount of business in the shipbuilding front. Is there a particular - - -

MR BROWNING (TMA): I would say that one of the biggest problems for shipbuilding is that Australian banks are very shy to get involved in it. I think that's just a general thing, they just do not - and they don't have the people that understand it properly. At least at EFIC they have engineers that they have employed specifically to try and understand what you do, and part of their due diligence is to go through that with you, even down to taking the plans there and showing them how you're going to build it, because they have engineers. The banks don't have engineers. They will look at it globally and if they don't understand it they will come back and say, "I think we need someone else to get involved in this." That's always the problem. You've only got four major banks here anyway, and out of those four majors there's probably only one or two of them will even look at shipbuilding business. It has always been a problem.

This country has always had a problem with trying to get shipbuilding finance. I guess that's why EFIC has played such a big part in the past and when you look at the share of their exposure a large proportion has been to shipbuilding. It's for that reasons. If you go to any of the banks with a shipbuilding deal they will be very, very circumspect about whether they get involved, and when they do accept to do it they will say, "Providing you can get EFIC's guarantee we will take it on."

MS SCOTT: Okay, that's clear, all right.

MR BROWNING (TMA): That's why EFIC play a major part in this type of business.

MS SCOTT: All right. Well, thank you very much. Thank you for coming along today. At the opening of our hearings today I indicated if there was anyone in the audience that would like to make a statement, even though they haven't already indicated so, this would be the opportunity to do so. Is there anyone who now wishes to come forward and make a statement? All right, there not being any interest in taking that opportunity up I am pleased to say that we are now going to draw our first hearing, first day of hearings, to a close. We will adjourn now and we will resume our hearings in Sydney. So thank you very much for your attendance today, and your participation in our process is very much appreciated. Thank you.

DR MUNDY: Thank you.

AT 1.45 PM THE INQUIRY WAS ADJOURNED UNTIL
MONDAY, 26 MARCH 2012