The Colonial Motor Company Limited

CHAIRMANS ADDRESS TO THE 100th ANNUAL MEETING

Centennial year

2018 is our centennial year or, to be technically correct, the Company has published its 100th annual report. However, the Company is much older, but past dates have not been recognised, so 100 annual reports will do. Other possible dates are:

- 1859. A blacksmith starts at 89 Courtenay Place in Wellington. Significant because the address was the continuously occupied by the successor businesses until 2014, but a bit tenuous as it went into receivership in 1880. From that emerged a coach building partnership, Rouse and Hurrell. From then on there has been an unbroken sequence that continues today.
- The partnership became a limited liability company in 1902, The Rouse and Hurrell Coach Building Company Limited, with separate shareholders and management.
- 1908 was significant. The company took on the Ford Motor Company agency for New Zealand, a business relationship that remains central to the Company's operations.
- By 1911 the Company was fully involved with Ford and the retail motor industry, and the coach building part of the business had been sold off; so the Company changed its name to 'The Colonial Motor Company Limited' to recognise this.
- 1918, 100 years ago, saw a major change in the shareholding, when the Managing Director, Charles Lamour, sold his 45% interest in the Company to the family of Hope Gibbons. Interestingly, Hope Gibbons did not buy the shareholding into a holding company, instead it went to himself, his five children and all of their respective wives, in approximately equal proportions.
- Then a year later in 1919, the Company was refinanced into a new company with the same name. The 100 annual reports start from that date.

Results

We have had a good year, a very good year. It is really fantastic to celebrate a centennial with a record profit.

Last year's result, also a record profit up to then, was driven by the car dealerships. This year's even better result was driven by heavy trucks. Last year, to June 2017, the new car and light commercial market hit record highs, growing 14% from the previous period. This year that market growth has slipped to a much more modest 2.5%. With heavy trucks, however, the market growth has continued. Better still, Southpac Trucks has been in that very good space, with a growing share in a growing market.

Southpac Trucks is the New Zealand distributor for its franchisors and, as such, has more ability to influence the supply chain. When done well the results are correspondingly better, but equally the consequences of mistakes can be greater.

Southpac Trucks has nurtured its customers and its franchisors by taking a long-term approach, looking at the whole of the life of the product for the customer and translating this into recognised brand values. Some things, such as product life cycles, are outside its control and the perfect truck for New Zealand conditions is not always available. Carefully nurtured brand values will help when product cycles are less favourable.

Southpac's success has been recognised by its franchisors. It received Dealer of the Year from Kenworth Australia and World Parts and Service Dealer of the Year from DAF in Holland.

Southpac Trucks' growth has impacted on the balance sheet. Heavy trucks are expensive and even when they arrive pre-sold, they still take time to be prepared for the customer. Many have extensive fittings and specialised bodies, many are personalised. It all takes time and so requires significant working capital. The increased activity shows up as increased inventory and receivables, funded by increased bank borrowings.

Since the low point in 2010, the Company has increased its trading profit after tax, year over year in 7 of the 8 following years. In 2010, the trading profit after tax was $6 million with a 15cps dividend. This year the trading profit after tax was $25 million, with a 50cps dividend. Another statistic that highlights the current success of the company is the ten year total return to shareholders. This ten year return includes the poor years of the GFC 2009 and 2010. The average return over the ten years is 15.5% per annum. This is a combination of both share price gains and the fully imputed dividends. The return is an annual calculation based on the share price at the start of each year. There is no compounding of the dividend income. To put that in context, the total return for the same period of time for the NZX all company return is 10.4% and for the NZX top 50 return is 9.5%.

The business has benefited from a favourable economic environment. New Zealand has enjoyed favourable terms of trade and a high exchange rate for most of the last decade. Add to that low interest rates and full employment. The heavy truck market has grown on the back of exports and major infrastructure projects. Consumer confidence has been strong, new vehicles have been affordable and the markets in which we sell have grown. We have been riding a very favourable wave.

However, we are dependent on our franchisors to supply product to New Zealand that is desirable to buyers today. We have to acknowledge the role that vehicles play in global warming and city pollution and that is driving the development of new products. Vehicles will change, they always have, but the future is not obvious. We depend on our franchise suppliers to bring products to the NZ market that meet consumer expectations at an affordable price. It is easy to demand electric vehicles on the expectation that they are solving our environmental problems; but right now electric cars cost about twice as much and have severe limitations, compared to a conventionally powered vehicle. We need our suppliers to bring in new technology, not too late, not too soon. It has to be desirable and affordable.

The future

As the market changes, we have to adapt to the new realities. To face the future we have to be adaptable. The fundamental structure of our balance sheet reflects this.

We do not carry long-term debt. Our short-term debt is linked to inventory. At 30 June we had $181 million of inventory, financed by $41 million of bank borrowing, $61 million of floorplan finance and $21 million of at-call deposits; all up $124 million of borrowing to the $181 million of inventory. Our debt levels can and do move with our inventory.

Most of our operating business units are in Company owned facilities; not all, but most. We have very few large long-term lease commitments. The new financial reporting standard, due next year, will require companies to publish their lease liabilities on their balance sheet. Our lease commitments will be in the $10-12 million range, small in the context of a land and property portfolio of $120 million. We can expand our properties, add to them, reduce them, sell them, invest in brand-required identity programs. We are not locked into fixed term leases.

Financially we are adaptable. We can continue to invest in facilities, or in inventory, in our people, in our business software; or we can change quite quickly with little historical carry-over costs. We are not locked into today's pathways. We can adapt without the weight of past decisions preventing change.

We cannot control the economy or consumer confidence; they will go up and down. We do not control the product supply, but we can adapt to changes in both. In the last 100 years, there have been substantial swings in the New Zealand economy. There have been very substantial changes in the product supply from our franchisors. The Company has adapted.

The Company has a strong balance sheet but the Company is more than just a balance sheet. It also has a depth of dedicated skilled and enthusiastic employees. This culture comes from many areas; being a customer-facing business encourages engagement and emotional involvement. Another driver to the culture is stability. It starts with a stable shareholding, which flows through to stability in the directors, at senior management level, and right through the dealerships. Employee stability enables people to develop as individuals, to develop as a team, to care for each other and their customers. Length of service by itself is not success, but it is when it comes with enthusiasm and commitment. There are 17 Dealer Principals and senior managers, 15 of them have grown into the job from an internal promotion. They bring enthusiasm, depth, and experience.

The Company has dedicated, skilled, and enthusiastic people. It is their efforts that have turned the opportunities of the last decade into real trading profits.

Developments over the last year

Christchurch

The Company continues to develop its business properties. Some projects take a long time and the redevelopment of the Tuam Street site of Team Hutchinson Ford is one of them. The buildings were damaged in the Christchurch earthquakes in 2010 and 2011, resulting in the site being in the red zone. When access was restored, the damaged buildings were pulled down and a new exterior wall to the workshop was built. Then in 2012, the Christchurch regeneration plan was announced. The block around the dealership was to be part of the low-density South Frame and the entire property became subject to compulsory purchase by the Crown. In the following years, a more specific plan emerged with a proposal to put a greenway straight through the middle of the dealership on an east west axis, with only the land required for the greenway being subject to compulsory purchase. The Company could not oppose this greenway, but, after reviewing many alternatives, decided that continuing to operate on the Tuam Street site was the best option. On several occasions over the years, it appeared that a final plan might emerge, but did not. Finally, in April of this year, agreement was reached between the Company, the Christchurch City Council, Ōtākāro Limited, and LINZ; a full six years after the South Frame was announced.

The greenway project will involve the demolition of part of the workshop buildings; ironically, the area of the workshop that was rebuilt post-earthquake. On completion, the dealership service bays will be on the south side of the greenway, with service reception and sales on the north side. The main access will be from Tuam Street. Work on this project has begun and will ramp up in the New Year.

Queenstown

This is another project that has taken a long time. In late 2016, the company signed an agreement to purchase a block of land near the airport at Frankton, subject to resource consents. That has now come through and building work commenced in the middle of this year. Completion of this purpose-built new facility for Macaulay Motors Ford and Mazda, is expected in December.

Auckland

The purpose-built, leased facility for South Auckland Motors at Takanini was opened in December 2017. South Auckland Motors Ford and Mazda now consists of its main hub site at Manukau, an outlying sales and service facility at Pukekohe, plus three large service facilities, at the Airport, Botany, and now Takanini. The business model is regional service centres covering the territory, with a large base sales facility.

Separate to South Auckland Motors, but immediately next door, is Southern Autos - Manukau. This dealership acquired the Suzuki franchise in January of this year following the closure of Moyes in Panmure.

The growth of Southpac Trucks has meant adding capacity at Wiri Station Road. During the year, the truck engineering shop was expanded and an extension to the parts warehouse on the same site is now complete and operational. This is in addition to the parts and service branch at Hamilton. These additions follow the significant growth of both Kenworth and DAF. The company is now delivering around 50 new vehicles per month, compared to 30 a month only two years ago.

Palmerston North

Southpac Trucks has opened a parts distribution centre in Palmerston North. It now has a network of 5 company locations, in Manukau, Hamilton, Rotorua, Palmerston North, and Christchurch; plus 21 independent parts and service locations to service the Kenworth and DAF brands.

Wellington

The company has purchased land around Stevens Motors in Lower Hutt to enable that site to be expanded. In Wellington City, we will soon be opening a new company-owned retail service centre at 258 Taranaki Street, similar to South Auckland’s service centres at Takanini and the Airport. Concurrent with this are the two new waterfront facilities, on the ground floor of the newly constructed PWC building just along the waterfront from here. Mazda Connect and Ford Link will take car retailing to the central business district.

Nelson

Planning is well under way to refurbish MS Ford’s facility at Haven Road in Nelson. This is a leased facility and the complexity that comes from this highlights the advantages of owning our facilities.

Directors

Falcon Clouston will be retiring soon after this AGM. Falcon joined the Board in 2011 as an independent director and has been Chair of the Audit & Compliance Committee since 2014. Falcon’s contribution came from his wide business experience, from his awareness of the commercial world beyond the areas the Company operates in and especially from his judgement.

Normally the directors would have put forward a nomination for a replacement director at this AGM but, unfortunately, the process has taken longer than expected, despite an early start. We expect to make an announcement soon.

Given that all of the current directors are men, emphasis was placed on selecting a female director, but not at the expense of the over-riding criteria. There are some qualified female directors with the background experience we are looking for but it has proved to be difficult to find female directors who are not already fully committed.

The outlook

The consolidated result for the first quarter this year is down on the same period last year, but very close to the first quarter of the year before that. The new light vehicle market has levelled off, but the heavy truck market remains strong. How will the year ahead play out?

It is our centennial year, so I will end with a quote from a past annual meeting 1939, when Hope Gibbons said "You would all like me to forecast the future, but at this time that is a little beyond my powers. If it could be done by accepting business and economic conditions, I might arrive at some reasonably definite conclusions, but politics both here and abroad will most likely play an important part, and to forecast the future of politics is difficult".

2 November 2018