

## MANAGING DIRECTOR'S ADDRESS 2013

- 2** Thank you Mr Chairman and before I second the motion I would like to review the year to 31 August 2013, update the meeting on our recent activities and provide some insight into the year ahead – the beginning of the next 100 years.
  
- 3** We have achieved many highlights. The first, and perhaps one of the most significant, is completing 100 years in business and as your Chairman noted, we have recognised this with a supplementary two cent dividend. The company has continued along the lines of the last several years, maintaining a strong balance sheet, and has delivered an extensive and growing range of products to a diverse range of countries and customers - all underpinned by an ongoing commitment to research and development.
  
- 4** I always like showing these old photographs to our customers. These old photos are a wonderful reminder of our humble beginnings and the different
- 5** stages of the company's life.

**6** These appear in reasonably stark contrast to our modern products of today, not just because they are in colour, but also because of the technology.

These past few months thinking about the centenary celebrations and the past history has also made me think about the more recent history of Scott, of which the staff of today have been so much a part of and like any cycle in the company's history, it has seen significant change. The change does not happen easily, it happens slowly – one day at a time. There are some interesting comparisons if we look back 10 or 12 years ago to where we are today.

## **7** *Run video*

12 years ago we had slow, or no growth. Today we have seen growth in double digits over the past several years. We were in a single geographic market and single industry.

Today we export to 88 countries, North America totals 37% of our exports, we have customers in New Zealand and our diversification has seen us spread to many industries.

In the past we did not have any recurring revenue, we had no partnerships and had an inward focus. Today we have many standard products that create a recurring revenue stream. We have a comprehensive service offering and our standard products deliver us a steady stream of spare parts and consumables. We now have multiple strategic partnerships and joint ventures. Joint ventures have been important for us over the past several years as we develop new markets because this forces us to be customer and market-led.

Back then we were dominated by our mechanical engineering skills. Today our many staff are multi-skilled and multi-talented and cover a diverse range of related, but complimentary areas. I can remember a time when we had only a few degree-qualified engineers. Today we have many, but we also have five staff with PhDs with none of these in engineering that add to our engineering skill base.

In the past we didn't have any formal Intellectual Property. Our business was focused on our know-how; our bespoke systems were design led and we were dependent on selling our skills and services afresh every time. We did undertake some R&D, although it was minimal, as required and ad-

hoc. Today we have a strong IP portfolio. We now have 23 inventions covered by 56 patents. Our R&D intensity is high and we have a disciplined approach to evaluating and managing our R&D investment.

This does not tell you a lot about what we have done in this past year but I believe it is important for shareholders to understand the changing nature of the business as this helps explain where we have come from, where we are now, but more importantly, where we are heading.

The last year certainly had some challenges. We started seeing the slowdown in the Mining sector in the first half of the year and this had quite an impact in the second half. Our standard product and standard equipment sales growth slowed, however, our sales of spare parts and consumables remained strong. Our project work for customers in both the Meat Processing and Appliance Manufacturing sector increased.

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Sales of our Meat Processing technology to several customers in Australia underpinned the growth in this area. Our installation at Silver Fern Farms at Finegand, South Otago, is a showcase for our technology in New Zealand. In Australia we now have two installations that are attracting

significant interest and demand from processors who have been holding back waiting for the technology to be proven.

**9** These photos are of our Middle machine recently installed at JBS Bordertown, South Australia. This was our first commercial sale of a  
**10** Middle machine and is integrated with the X-Ray Primal installed at JBS Bordertown three months ago. A second Middle machine is today on the water on its way to Australian Lamb Company in Melbourne Victoria, again to be integrated with their existing X-Ray Primal.

**11** In the year to 31 August we have seen a major uplift in the interest and enquiries for Appliance manufacturing systems. Contract work was completed for China, New Zealand and the USA. At times of the year we have had peak workloads that have stretched our resources. With current confidence in our forward work we are once again expanding our resources, primarily in Christchurch and Dunedin. The projects are not without their difficulties as we see a stretch in the technology and squeeze on margins due to the pricing pressure on the customers' end products which translates to a requirement for lower cost capital equipment. All this

is heightened for us by the high value of the New Zealand dollar. The key to rebuilding our margins in the future is to focus on standardisation; build and develop technology that keeps us at the forefront where we can gain a premium; and focus on alliances with key customers. Working closely with customers on their automation projects and being involved at an early stage with product design and process optimisation provides a superior solution where both parties can benefit.

**12** This system was supplied to Electrolux North America for manufacturing range cooktops. The product is superimposed on the bottom right hand corner and yes, it is out of scale with the equipment. This equipment was installed in May 2013 and since that time has produced over 400,000 parts.

**13** As noted, our range of standard products continues to grow. This is most evident in our sample preparation or Mining sector customers. Our joint venture with XRF Scientific which we announced last year has been very successful in lifting our presence in Australia. The joint venture, known as XRock Automation, has contributed positively to the bottom line and at the same time it has improved access to major customers in Australia. The level of sales and enquiries for automated systems are at a record high.

**14** This automated system is our most recent, was system shipped to a gold mine in Western Australia. This is a fully automated sample preparation system complete with XRF for pre-selecting samples prior to further analysis.

**15** One of our most promising sectors also turned out to be one of our most challenging in the year to 31 August. This was our superconductor or electro magnets business. We have several products ready, or near ready for commercialisation and we face the most difficult task of commercialising new technologies into new markets. The technology has many advantages but not always accepted and so much of our focus is on providing demonstration systems to industries, showing them that the benefits are real and worth the premium.

**16** This is our development MRI (Magnetic Resonance Imaging) system - a joint project with Callaghan Innovation. The person demonstrating is Tye Husheer, the CEO of HTS-110. The insert on the left hand side shows the magnet and cooling unit contained within the housing. The key advantages of our superconducting electro magnets are that they are small, compact, portable and easily maintained.

**17** Moving onto financials, this slide shows our trading history since relisting in 1997. Over the past 16 years we have certainly had our share of ups and downs. The bars represent revenue (on the left hand axis) and the green line is our net profit after tax (on the right hand axis).

**18** These charts show our 2013 revenue by country of destination. One that always amazes me is the 8%, which we supply to Russia and the former Russian states.

**19** This slide is our revenue broken down by end user industry. Sales of our sample preparation mining equipment was close to 48% of our revenues in the year to 31 August. Appliance Systems and Meat Processing at 27% and 13% respectively, followed by Industrial Automation at 9% and Superconductivity at 3%.

**20** No discussion by an exporter would be complete without some mention of the impact of the exchange rate. In this chart we have mapped our sales and profit against the New Zealand to US dollar exchange rate inverted and by one year. In the past there has been strong correlation between movements in the exchange rate and our sales and profit. What this shows is that in the last few years we have, I believe, managed to break some of that correlation in our sales and profits and the exchange rate has had less impact on our revenue and profit.

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### Recent Activities

As we sit today we have a full order book for our major project work. We have recently signed a \$10 million dollar contract for a US manufacturer and this follows a \$14 million contract for the US signed earlier in the year. On top of this we have recently received a \$4 million contract for China via a New Zealand manufacturer.

Dairy Farm Automation – I know some of you will be very interested to hear of our progress on this exciting project. Last year we advised that we achieved a significant milestone with our system on 5 bails at our test farm.

This season we took the bold step and moved the prototype into production mode. We are currently running this in production in an 80 bail rotary dairy shed milking 800 cows.

We expect that it will take the remainder of this season to have this performing at our targeted performance criteria.

Once we are comfortable with the system's performance we would expect to roll out to a limited number of sites in the following season.

Today I am very pleased to report that we have just been advised that Scott has been successful with our application for a Government R&D Growth grant. The grant is for an amount up to \$5 million over the next three years and is paid at the rate of 20% of our R&D expenditure over that time.

**22** All in all 2013 was another interesting year, not without its challenges and we are in a strong position as we look forward to 2014 and beyond.

Our Lean Sigma programme has already had a positive impact on our operations in 2013 and we expect this to continue into 2014.

We have several new products and technologies available for commercialisation. This includes meat processing equipment, mine laboratory equipment and appliance manufacturing systems.

There are numerous opportunities for further development and application of our meat processing technology. This includes application of our unique patented x-ray technology to beyond lamb to beef and pork processing.

Although the mining industry has slowed, we are seeing a strong interest in automation that will reduce costs for our customers.

Our China operations completed a successful year. We have added Scott type engineering capability and expect strong growth within China beyond our current contract manufacturing business.

Growth is important to Scott and we continue to seek growth through increased presence and activity in our target geographic markets. We will also look for growth through acquisitions – but only where we can make economic gains for shareholders.

**23** This final slide is significant in many ways. This is Mr Bob Hyslop, a long serving staff member being presented a trophy by The Prime Minister at the time of a recent visit to Scott here in Dunedin. The trophy was made by

his colleagues to recognise and celebrate 45 years of service with Scott Technology. Long serving staff is a hallmark of Scott which reflects well on the company and all those who are part of it.

Finally I would like to personally thank all of our dedicated and talented staff, Stuart for being an active and supportive Chairman, my fellow directors.

I would now like to formally second the motion moved by the Chairman, that the annual report, including the directors report, financial statements and audit report of Scott Technology Ltd for the year ended 31 August 2013 be adopted.