Scales Corporation 100 year Celebration

Speech, Adrian Orr 21 July 2012

1. Introduction

It's a pleasure and a privilege to be here tonight.

I'd like to thank Andy Borland CEO for my invite.

I would like to congratulate all present and past directors, management and staff for their success.

While humans are increasingly celebrating their 100th birthdays, few businesses do so. The average lifespan of a company in the Standard and Poors index of the top 500 US companies has decreased by more than 50 years over the last century, from 67 years in the 1920s to just 15 years today.

And the pace of change is faster than ever. Earlier this year, academics from Yale University predicted that by 2020, more than three-quarters of the S&P 500 will be companies that we have not heard of yet.

Creative destruction is a realistic part of economic development, and only those companies that are well founded on clear natural advantages and beliefs, and are able to evolve and adapt, survive.

NZSF invested in Scales via Direct Capital in 2011 and now owns around a third of the company. It was our first co-investment with Direct Capital where we took a larger direct share because we saw value.

We are pleased as shareholders to be part of this venture. The features we liked included:

- good diversification
- consistent financial performance; and
- a strong alignment with our investment themes – in particular the long-term growth potential in agriculture and food production, thanks to fast-developing Asian markets.

Tonight I will talk a little about what has changed over the last 100 years, and what remains the same.

I will then look forward with all of the usual humbleness the next 100 years and consider the challenges and opportunities - and also emphasise what is likely to remain the same.

2. NZSF and investing

The Fund is a long-term absolute return fund, with 20+ year investment horizons.

We actively seek risk – because returns are attached. We take direct equity stakes in many companies, and through doing so expect to make risk-free+2.5% per annum over long periods.

Our Fund is global, and around 80% growth assets, mostly in listed assets.

Occasionally we invest direct, and in an 'active' sense i.e., we take larger risk positions on specific companies when we believe we will be 'excessively' rewarded.

When would we take a larger stake?

When we are confident:

- The opportunity is clear i.e., the risks and returns can be well identified and managed;
- It fits our natural advantages (horizon, liquidity, location, and governance);
- It fits our beliefs i.e., the price can vary from its long-term value (opportunity) but will mean revert over time;
- It is anchored by our investment themes looking forward;
- There is a clear strategy for managing the investment; and
- We have the operational capacity to manage the investment on an ongoing basis.

Scales Corporation ticked all of these boxes when we invested.

It is a tangible company, with clear goals and management, it is anchored to our investment themes, and Direct Capital is playing an important role in assisting our investment management.

The challenge is to maintain these ticks, as opportunities change.

3. Surviving the past and next 100 years

Economic growth is the same for the firm as it is for the country. It depends on a few basic premises – which are simple, not easy.

a) More output can be created by ever more inputs – but eventually you will gain diminishing marginal returns for your efforts. Often this is called economic 'catch up' which many emerging market economies are currently undergoing (high investment and employment, adopting current technologies albeit at lower prices);
b) Doing the same thing better i.e., productivity growth. This increased output per person or per input is critical for sustainable economic growth. But even then it is not permanently value creating – it is still about 'lowest cost' production as of the firms or countries inevitably 'catch up'.

c) Doing better things i.e., innovation. This is the only means of achieving increasing returns to scale and permanent value and wealth creation on a sustainable basis. An example is using a round table on its side as a wheel, or using wool fibre growing technology to cure baldness, or dairy protein in medicines and so on.

In reality, all three steps to growth are witnessed in all countries at all times. What we most want is b) and c) as this will create sustainable growth.

It was Alan Greenspan who famously described the weightless economy. Developed countries like New Zealand are about 20 times better off now than a hundred years ago. Most of us are leading lives that our grandparents and great-grandparents would have considered luxurious beyond imagination.

The curious thing, though, about this huge increase in wellbeing, is that the output of our much larger developed economies today physically weighs about the same as that of those same economies at the end of the nineteenth century.

This is the impact of technology – the push for smaller, lighter, more efficient things, and the knowledge economy. Increasingly, ideas are becoming the commodity.

4. So how has Scales survived the last 100 years?

By investing and moving with the times – in the shipping world, from sail to steam to containerisation.

By lifting productivity and being innovative – like the reflective ripening cloth and high-tech sorters I saw mentioned in the Press earlier this week.

And by having a clear vision and purpose; strong corporate governance to bring investor confidence; and having an open mind to markets, products, and increasing value-add.

Scales' history is testament to the benefits of diversification and the importance of adding and growing new revenue streams.

Also incredibly important is the resilience and commitment of employees – like the work done to salvage food products during the February earthquake. It was well done.

5. What about the next 100 years?

The employee engagement, vision and governance necessary to sustain investment, productivity, and innovation will remain part of the growth story.

What might be the opportunities?

Our Fund, when investing, looks to identify opportunities where returns are greater than risks taken on. One way we do this to by considering core investment themes –

slow burners – that over time will ensure ongoing innovation and productivity for our investments.

Our themes are:

70% world demand will come from current EMs by 2050, along with 80% of the population. 25% of these people will be over 65 years of age compared to 12% now. NZ will have a population of around 6 million people. There will be a massive demand for:

- EM – infrastructure, tourism, protein, food security, age care
- Demand Pattern – demographics, high quality, security, housing, schools.
- Sustainability – property rights, water, energy, ESG in general

Our challenge is to identify tangible investment opportunities, where these slow burner themes are not already in the price. We will need to rely fully on our natural advantages (horizon, liquidity, ownership, governance) and beliefs (life cycle, ESG) to invest sensibly.

Scales can play a role in these themes, but will be competing strongly for the highest value, most innovative, uses of our capital.

6. What will be the same in the next 100 years?

- NZ's natural advantages if we utilise them properly (ESG)
- Distance to markets
- The importance of drive and ownership.

But, we will be challenged on:

Markets, language, culture, sustainability, proof of security, quality, competition for capital and resource.

NZ is up for this challenge and with our natural advantages and geography we are well poised. Let's show the desire, with companies like Scales leading the way into an increasingly prosperous and sustainable future.