



**Joint Standing Committee On Foreign Affairs,
Defence and Trade**

**Inquiry into Australia's trade and investment
relationships with countries of the Middle East**

Austal Submission

19 May 2014

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INTRODUCTION

On 20 March 2014, the Minister for Trade and Investment, the Hon Andrew Robb MP, asked the Joint Standing Committee on Foreign Affairs, Defence and Trade to inquire into and report on *trade and investment relationships with countries of the Middle East*.

This inquiry will be conducted by the Trade Sub-Committee and chaired by the Hon Bruce Scott MP. The inquiry's terms of reference include:

- The nature of Australia's existing trade and investment relationships with countries of the region;
- Emerging and possible future trends in these relationships;
- Barriers and impediments to trade and investment with Middle Eastern countries for Australian businesses, including examination of supply chain costs;
- Opportunities for deepening existing commercial and cultural links, and developing new ones, with the countries of the Middle East; and
- The role of government, including DFAT and Austrade, in identifying new opportunities and assisting Australian companies to access existing and potential opportunities in the Middle East.

Members of parliament have highlighted Austal's business links to the Middle East in supplying naval vessels, so the Trade Sub-Committee has invited Austal to contribute to this inquiry.

Austal is pleased to provide this submission in accordance with the terms of reference.

ABOUT AUSTAL

Austal is a global defence prime contractor, designer, and manufacturer of defence and commercial ships. For more than 25 years, Austal has been a leader in the design, construction, and maintenance of revolutionary ships for Governments, Navies and Ferry operators around the world. More than 250 vessels have been delivered in that time.

Ships

Defence vessels designed and built by Austal include multi-mission combatants, such as the Littoral Combat Ship (LCS) for the United States Navy, and military high-speed vessels for transport and humanitarian relief, such as the Joint High Speed Vessel (JHSV) for the United States Navy and High Speed Support Vessel (HSSV) for the Royal Navy of Oman. Austal also designs, constructs, integrates, and maintains an extensive range of patrol and auxiliary vessels for government agencies globally, including the Cape Class Patrol Boat Program for Australian Customs and Border Protection. Defence vessels are designed and constructed in Mobile, Alabama and in Henderson, Western Australia.

Austal has been at the forefront of the high-speed ferry market since the early days of the industry. Our market leading designs of high performance aluminium vessels have long been at the heart of Austal's research and development. Today, commercial ship construction is centred on our shipyard in Balamban, Philippines.

Systems

Austal has expertise in integrating complex systems into its ships, including ride control, ship management, and communication, sensors, and weapon systems.

Support

Austal provides a wide range of support services, including through life support, integrated logistics support, vessel sustainment and systems support. These services are delivered through our global support network in the USA, Australia, Asia, the Caribbean, and the Middle East together with partner shipyards worldwide.

AUSTAL'S EXISTING TRADE AND INVESTMENT RELATIONSHIPS WITH COUNTRIES OF THE REGION

Austal has delivered, or has under contract vessels for the following countries in the Middle East:

COUNTRY	YEAR OF DELIVERY	CLIENT	VESSEL TYPE AND QUANTITY
Oman	2016	Royal Navy of Oman	2 x 72m High Speed Support Vessels
UAE	2015	Abu Dhabi National Oil Company	2 x 45m High Speed Catamaran Ferries
Saudi Arabia	2009	The Maritime Company for Navigation	2 x 69m High Speed Vehicle-Passenger Catamaran Ferries
Saudi Arabia	2008	Government of Saudi Arabia	2 x 88m High Speed Vehicle-Passenger Catamaran Ferries
Oman	2008	The Sultanate of Oman (National Ferries Company)	2 x 65m High Speed Vehicle-Passenger Ferries
Yemen	2005	Ministry of Defence	10 x 38m Patrol Boats
Kuwait	2004	Government of Kuwait	3 x 22m Patrol Boats
Egypt	2002	El Salam Maritime and Transport Company	1 x 56m High Speed Catamaran Ferry

Austal opened its regional representative office in the Dubai Multi Commodities Centre in the UAE in 2010, with responsibility for the Middle East, Africa and South Asia. This office will relocate to the UAE capital Abu Dhabi during 2014.

Also, Austal has been delivering maintenance and repair services to government-owned aluminium high speed vessels in the Sultanate of Oman since 2009. These services are delivered through Austal's subsidiary company, Austal Muscat LLC.

As with most international companies seeking to do business in the region, Austal maintains a network of relationships in countries of interest, including agency/consultancy agreements where appropriate.

EMERGING AND POSSIBLE FUTURE TRENDS IN THESE RELATIONSHIPS

The Middle East is a strategic area of opportunity for Austal across the product line, in both Commercial and Defence markets.

General

Although circumstances differ between countries, as a generalisation the Middle East is experiencing an expansion in trade and investment, inwards and outwards, in both volume and also range.

There are many complex and often interdependent factors behind this, but again as a generalisation these can be characterised as:

- The pursuit of food, water and energy security for the future;
- The diversification of national economies beyond primarily energy-driven income i.e. oil & gas reserves, into manufacturing, financial services, education and tourism;
- Nation-building initiatives to provide indigenous employment and reduce reliance on expatriate skills and expertise; and
- Changing national security concerns resulting from the rise of non-state actors, increases in smuggling (people, drugs & contraband), piracy etc.

Defence Markets

Austal's range of platforms for Navy, Coast Guard and Police applications are well suited to regional operations. Most countries maintain a capability for conventional 'blue water' surface combatants and will continue to do so, however, the requirement to protect offshore assets and fishing grounds, and to interdict activities such as piracy and smuggling, is becoming more prevalent in acquisition programs.

Austal patrol vessels have been successful in the region, and the recent gifting to Sri Lanka, by Australia, of the first Austal-built *Bay Class* patrol vessels after 15 years of reliable service, is a positive reflection on that capability. Austal is active in patrol boat acquisitions currently underway, and will continue to position for and contest future opportunities.

There is also an increase in the need for high speed logistics vessels for both security and humanitarian missions. The March 2014 award of a contract for two (2) x 72m High Speed Support Vessels for the Royal Navy of Oman, similar in concept to the Austal Joint High Speed Support Vessel (JHSV) being delivered to the United States Navy from Austal's Mobile shipyard, is indicative of the relevance of this type of capability.

Increasingly, vessel acquisition programs are including post-delivery In-Service Support contracts, typically 3-5 years, to ensure valuable assets are properly maintained. These also create job and skills training opportunities for local workers. This requirement, and other contractual obligations such as 'offsets', can be barriers to trade – see next section – however Austal has a proven business model for supporting its vessels post-delivery and considers this an important part of our value proposition for our customers.

Commercial Markets

The high price of oil fuel in the late 2000s, followed by the Global Financial Crisis, resulted in a depressed market for Austal's traditional high speed ferry market, particularly in the historically strong European markets. However, this market is slowly recovering, more so for smaller vessels and for 'medium speed' vessels. The latter operate at a higher speed than conventional steel ferries, but slower and more economically than those at the top of the speed range.

In the Middle East, the market for commercial ferries is opening up as countries promote tourism on offshore islands, or as inter-country trade links e.g. Iran-Oman improve. Other developments such as the reinvigoration of Dubai's pre-GFC masterplan, and Abu Dhabi's 2030 vision, are creating a need for domestic ferry and water-taxi routes, and Austal is well placed to participate in these programs.

Offshore industries are another growth opportunity. Historically shift workers have been transferred to offshore platforms and islands by helicopter, however this carries a higher safety risk and high speed vessels can move more personnel (and stores) than helicopters at a lower price per head. Austal's April 2014 award of two (2) x 45m high speed ferries for this purpose by the Abu Dhabi National Oil Company (ADNOC) is a positive endorsement of the versatility of our high speed ferries.

As with our defence products, new vessel sales also open up the possibility for post-delivery support.

The Marine Environment

The operating environment in the Middle East for vessels can be extreme, with summer air temperatures of 50°C, water temperatures of 35°C, high water salinity (which accelerates marine growth underwater), and high concentrations of sand and dust in the air. Austal has successfully engineered its designs around these conditions. Given that all vessels are still operational in the region, Austal is fortunate to enjoy a good reputation for quality and for standing by its product. In a region where relationships in business are very important, maintaining this reputation is paramount for our future prospects.

BARRIERS AND IMPEDIMENTS TO TRADE AND INVESTMENT WITH MIDDLE EASTERN COUNTRIES FOR AUSTRALIAN BUSINESSES

It is generally understood that the culture and customs of the Middle East, as they relate to both business and personal life, are different to what most Australians experience in their day-to-day business. There are extensive resources covering the fundamental principles and Austal does not propose to cover these here other than to highlight that all of the countries are different and have their own idiosyncracies in business.

Austal's assessment of barriers to trade is determined from our perspective as a manufacturer of niche, relatively expensive products i.e. prices start with seven figures. They can be categorised as follows:

Presence

It is very difficult to do business in the Middle East without actually being in the Middle East, either with a permanent presence, or willingness for staff to spend significant time on the ground. This has direct implications for sales and marketing budgets. Meetings in person are generally most effective for furthering relationships, followed by telephone, and then emails. It should be remembered that while much of the Middle East speaks very good English, it is a second language and one that they are generally more comfortable speaking than writing.

Local agents/consultants/representatives can play a pivotal role in identifying opportunities for trade and investment, establishing and fostering relationships with potential customers and suppliers, and gaining important market intelligence. There are various mechanisms for engaging and retaining a local representative, and with all business partnerships, finding the right partner is crucial. This includes their suitability for a given industry e.g. Austal's representatives are familiar and experienced in our markets; but also ensuring they are properly registered under local laws, and conduct business appropriately. Austal has strict ethical and legal obligations, and policy with regards to the manner in which it conducts business and effective due diligence is required when selecting a local representative.

Businesses should be prepared to research extensively, utilising local Chambers of Commerce, business groups, Austrade & DFAT. The rules under which agents can and can't represent foreign businesses vary from country to country, particularly for government contracts, so it is important to research or take advice.

Compliance with Laws & Legislation

Local laws and legislation vary from country to country and touch multiple aspects of a business: labour law; contract administration and dispute resolution; finance regulations including repatriations of profits; ownership laws for local subsidiaries etc. As in Australia, laws and regulations change and it is difficult for an Australian company to remain current. Fortunately, there are well established legal firms and advisors in the Middle East who can provide advice. Naturally this advice comes at a price, and businesses should factor this into their budgeting and be targeted in determining when such advice is required.

Patience

Opportunities can take years to mature, particularly high value projects and even more so when they involve government. Decision making authority is seldom delegated from the highest levels, and projects can be delayed waiting for 'their turn'. There is a high expectation of immediate action once a decision has been taken. Specific issues to consider:

- As above, businesses need to be prepared for high pre-contract sales and marketing costs e.g. travel & accommodation, tendering costs etc. In particular this may be an issue for smaller firms;
- Businesses need to be mindful of the validity of their pricing/proposals, and how/when to factor in price indexing to account for delays, without becoming uncompetitive;
- In-country partners & agents should know when a visit is genuinely required to further an opportunity, to avoid unnecessary travel and expenses.

Offsets

Offset programs are increasingly prevalent on government (defence) contracts and require the contractor to either deliver some of the contract in-country, or otherwise invest in the country to a specified percentage of the contract value. For a company such as Austal, one example might be to form a partnership with a local shipyard and build some or all of its vessels in that yard.

Offset programs are intended to encourage companies to invest and establish local businesses, facilitate technology transfer, provide skills and jobs, help to diversify the economy, provide self-reliance etc. The Australian Industry Capability (AIC) program, run by the Defence Material Organisation, is a form of offset program with similar objectives.

Offset requirements, and the extent to which they are enforced, vary from country to country. It is very important that businesses bidding on government contracts understand their potential offset obligations and have a plan to meet them. Penalties for non-compliance can be significant.

The Art of Negotiation

The locals of the Middle East have been traders for centuries and are masters of negotiation. It is fundamental for businesses to understand their market, their competitors, and their products; be very clear as to the scope of their offering, price to win and be prepared to negotiate hard to preserve a profitable outcome.

Government Support

For a company such as Austal bidding on high value defence opportunities, the support of the Australian Government can be vital and indeed the difference between winning and losing. Many Middle Eastern governments view the award of their strategic defence contracts as an opportunity to strengthen relationships, and seek agreements and concessions from the host government.

This is well understood, particularly in Europe and the US, and political capital is often brought to bear in support of business. More recently Austal has been increasingly fortunate to enjoy good cross-party support in the region, from the Prime Minister through to travelling Ministers and Parliamentary delegations. Similarly, the local Embassies and DFAT/Austrade have been supportive of Austal's activities to secure business.

Supply Chain Costs

This subject is mentioned as it was specifically identified in the terms of reference. Austal does not currently manufacture in the Middle East, although it does source spare parts and materials in support of its maintenance and repair activities.

However, many of the equipment and materials used in Austal vessels are actually manufactured in Europe; hence in many respects the Middle East is an ideal hub for the importation of materials. This will be a consideration for Austal when required to satisfy offset requirements.

OPPORTUNITIES FOR DEEPENING EXISTING COMMERCIAL AND CULTURAL LINKS, AND DEVELOPING NEW ONES, WITH COUNTRIES OF THE MIDDLE EAST

Australia already enjoys strong commercial and cultural links with the countries of the Middle East, and the increasing number of flights between Australia and the Middle East is indicative of the growing trade and tourism links. Australia has a reputation for tolerance and equality and a vibrant culture, and Australians in general are seen as honest, helpful and pragmatic in their business dealings. Australian products are generally regarded as high quality and will command a fair price; Australian expertise and ingenuity in certain fields is respected as being world-class.

Whereas historically locals may have been schooled in Europe, the UK or USA, increasingly Australian secondary and tertiary education is available in the region, or students are travelling to Australian universities and tertiary colleges for their undergraduate and postgraduate education.

Given the challenges faced by Middle Eastern countries, and their national priorities, there are significant opportunities to expand Australia's links with those countries. Arguably Australia is closer to some countries than others, so there is scope to broaden and deepen links with some countries, and aim to replicate successes where appropriate in others.

From Austal's perspective, our defence products have evolved from our experiences in meeting similar operational requirements for maritime security and border protection, and our commercial products have a strong pedigree in quality, high speed passenger transport at the forefront of aluminium shipbuilding technology. In the future we see a broadening of our offering into other countries where we do not currently have vessels in service, and a deeper integration into existing countries in support of our vessels through life.

THE ROLE OF GOVERNMENT, INCLUDING DFAT AND AUSTRADE, IN IDENTIFYING NEW OPPORTUNITIES AND ASSISTING AUSTRALIAN COMPANIES

As advised earlier, from Austal's perspective the overt support of government is important for securing business with Middle Eastern governments. As an observation, Australian Ministerial representation is higher in some countries than others, and Austal would certainly appreciate any increase in visits across the region.

Austal enjoys good relationships with the DFAT and Austrade representatives where we are most active (and perhaps unsurprisingly have been successful recently), specifically the UAE and Oman. As Austal's presence in the region continues to expand, similarly Austal will seek to work closer with DFAT and Austrade in those countries we seek to penetrate.

In one country in particular, Austrade has been particularly proactive in facilitating meetings across government in support of a defence opportunity. Whilst this is not realistic for all companies in all countries, it is nevertheless a good model of productive cooperation between government and industry.

CONCLUSION

The countries of the Middle East present significant opportunities for trade and investment for Australian business. Many countries are seeking to utilise their wealth in natural resources to diversify their economies and create alternative industries for their populations over the longer term. Food, water and energy security are increasingly important, as are more conventional concerns around border security and protection of national assets.

Similarly the future direction of the Middle East presents strategic opportunities for Austal in both defence and commercial markets, as indicated with the recent award of contracts for vessels for the Royal Navy of Oman, and Abu Dhabi National Oil Company. Austal will continue to pursue business across the region as new opportunities arise.

Austal has enjoyed good support from DFAT and Austrade and is grateful for the role they have played in Austal's success in the region.

Finally, Austal appreciates the opportunity to present this submission to Trade Sub-Committee and looks forward to reading the outcomes of the inquiry.