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TO: Johns-Manville Case Team

FROM: S. Tilles and T. Pyle

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SUBJECT:

The Boston Consulting Group

These notes are from a discussion between Sy Tilles and Tom Pyle of The Boston Consulting Group with Dr. Max Schmidheiny, Mr. Claus Kreis (Managing Director of Eternit's operating company in Switzerland), Mr. Hans Stoffel (an aide to Dr. Schmidheiny), and Mr. Robert Dorner (Manager, Asbestos Division - Amiantus S. A.) of the Swiss Eternit group, held on August 13th at Dr. Schmidheiny's villa in Herrbrugg, Switzerland.

Major Points of Discussion

1. Swiss Eternit saw J-M as acting in a very uncoordinated way.

   Evidence:

   - handling of original contract negotiation
   - the Advocate mine controversy
   - J-M purchases of blue fiber from Cape
   - the Belgian problem

   in light of their being the largest buyer of asbestos fiber.

2. While Swiss Eternit saw J-M as a partner, they were somewhat disconcerted by the fact that J-M apparently did not view them in this way.

3. Swiss Eternit was concerned about the stature of the person within J-M with whom they will deal. They want top-level contact with J-M, someone whose promises are backed up. They feel their position in the world asbestos market justifies it, and they are fully prepared to reciprocate.

4. Eternit views J-M as a "sleeping giant" that does no marketing and is very susceptible to the vagaries of the market place.

The Eternit Group

Asbestos cement outside the U.S. is largely dominated by the Eternit group. This group consists of companies in each of the continental European countries. The two principal controlling groups are the Swiss Schmidheiny family (see Attachment) and the Belgian Emsens family. A French group has a minor position. The German Eternit company (in which J-M has a 10% share and has reputedly earned a huge return) is dominated by the Swiss group. The Belgians control Holland and France. Outside of Europe, the Swiss group controls the Middle East, Central American, and northeast part of South America (Brazil, Colombia, Ecuador, etc.). The Belgian group controls the rest of South America (Argentina, Peru, Uruguay). In South America it is customary for the ownership to be divided three ways: Swiss group, Belgian group, and local partner. In each case, the controlling European group will have 60% of the non-local ownership and the other European group 40%.

There seems to be no single central coordinative agency for the whole of Eternit. In fact, the relationship between the Swiss Eternit group and Belgian Eternit group seem quite armslength. Mr. Schmidheiny pointed out that the Belgian group is about to go through a transition of managerial generation, and it is not yet clear who will emerge as their undisputed leader. Given Mr. Schmidheiny's age (63), it is quite likely that in the next 5-7 years the same thing will occur within Swiss Eternit.

For purposes of dealing with fiber producers, the Belgians handle Q.A.M.A. producers, while the Swiss deal with Turner & Newall, Cassiar, Bell, the Russians, and the S. African producers.

During the last 40 years, the role and stature of Swiss Eternit has changed substantially. Mr. Dorner pointed out that during and shortly after World War II their ownership position within the European Eternit family had gone from around 3% to around 50% including 20% of the Belgian group. The Belgians are proud and resent the dominant role of the Swiss.

Dr. Schmidheiny asserts that overall Eternit is larger than J-M and is growing at around 5% per year.

Fiber Supply as Seen by Swiss Eternit

Before World War II, all of Swiss Eternit's fiber supply came from Russia and from Turner & Newall. During the war, both suppliers cut off Eternit's supplies.

After the war, they decided to spread their sources of supply, and contacted J-M. In addition, they integrated backwards with the purchase of mines in South Africa and in Rhodesia. They now produce 50% of the world output of blue fiber. They see their ownership in these mines as supply insurance, even though they don't currently use much of their output. (Apparently the Belgian group opposed this integration).

They reported that there had been a very severe shortage of fiber from 1946 to 1958, but that after 1958, the world supply situation eased somewhat. Up until 1960, they bought about 1/3 of their tonnage from J-M. However, in 1960, they began to appreciate that they were running considerable risks in having virtually all of their fiber coming from the same geographic area. They were at that time buying largely from J-M, ASARCO, and Asbestos Corporation, all of them in the same general area. (They originally began buying from ASARCO because they were concerned that that company's inability to move its fiber might cause it to enter the asbestos cement business.) They were concerned that a shipping or miner's strike might leave them without material. As a result, they started to develop other sources, especially Cassiar and South Africa. Another is Russia (they viewed as idiocy the magnitude of the Canadian contribution to the Russian's ability to produce fiber). They indicated that Russian fiber was often available at a price about 10-15% below Canadian fiber on one year contracts and they didn't feel they could leave this price differential to their competitors. They view the Russians as a possible source of major market disruption.

A third source is Advocate, where Eternit has recently increased its ownership to 50%.

A fourth source is local mines in underdeveloped countries where Swiss Eternit has a producing plant. As an example, they cited Colombia, where they have a plant, and where a small mine was developed by Nicollette. However, the development of this mine required more money than Nicollette wanted to invest, and Swiss Eternit wanted to have the mine, since they were sure the government would prohibit fiber imports as soon as the mine was open.

Another example was Brazil, where a large deposit is jointly controlled by both Swiss Eternit and Pont-a-Mousson, with the latter having the management contract for the mines.

Dorner felt there would continue to be a general shortage of fiber. He said that an annual increase of 5% in fiber consumption required a new mine the size of Jeffrey each year, and he didn't see where this was going to come from. However, he felt that there might be a surplus in some of the poorer grades, since he believed that J-M could undoubtedly produce more of grade 7 than it was now selling.

He felt there was some danger that the Japanese could be an upsetting influence on the market. He said that in many of the places in the world where there was known to be asbestos fiber which had not yet been commercially developed, the Japanese had been there talking up the magnitude of their future requirements, and offering firm contracts as a way of facilitating financing. He said that this was how the Australian mines had come into production, but he didn't think that they would make money. On the other hand, he admitted that once a mine came into production, it very rarely shut down until the ore ran out.

As far as Mr. Dorner knows, no one had done a careful study of the future of asbestos demand or supply.

Mr. Dorner felt that it was quite possible to make money with small mines, and said that Eternit was doing it. He indicated that the secret of doing so was to have the mines in the same area. This made possible the blending of fiber from each mine, which he felt was essential; and also made possible the sharing of overhead expenses such as the cost of head office and mining engineers. Another essential ingredient is location on a low-cost labor area. This observation is in sharp contrast to the feelings of J-M people about the economies of scale in mining operations.

<u>Other Supply Observations</u>

- There is a difference of opinion within Eternit as to how soon Nordenham will work. But there is unanimity that when it does, it will spoil the existing market. Having inventory available in Europe is particularly attractive to Eternit, enabling it to reduce its safety stocks.

- ASARCO (Lake) and Asbestos Corp. are both currently oversold.

- There is "as much Russian fiber as you want" available this year.

Asbestos Cement

The overwhelming majority of output of the Swiss group's output is sheet--both flat and corrugated. The major application for flat is for residential building. The major application for corrugated is for industrial building. In addition to ordinary large sheets, the Swiss group produces a flat shingle which seems to have wide acceptance within Switzerland. Dorner estimates that sheet is 65% of overall A/C production and 85% in Europe.

The Swiss group does not understand why the asbestos-cement sheet market in the U.S. has been exploited so little by J-M. They feel that if they had been active in the U.S. market, more would have been done with sheet. They have also been more aggressive with pipe; non-pressure A/C pipe up to 7 feet in diameter is marketed.

An important new product for Swiss Eternit is A/C colored panels for residential construction. Asbestos Corporation fibers are ideal for this because they are white and grit-free. Eternit believes through such product innovation A/C can have a strong future; in fact, they assert its past growth has been obscured by improvements in asbestos fiber quality (grade 5 has improved from 55 strength units to 70 strength units in the last 5 years). On the other hand, Kreis was concerned about the impact of escalating fiber prices (4-6% price increase plus 7% revaluation of Canadian dollar last year) encouraging substitution of steel and aluminum products for A/C sheet.

Eternit expects growth of 10-15% per year for A/C in the LDC's.

It is interesting to note that Eternit does not view itself as a producer of building products, but rather as an A/C producer. They have been unsuccessful with PVC and are closing down their Techite plant. Later, Schrafl (Schmidheiny's nephew) told me they will diversify rather than attempt to build a position in substitute products. However, he hopes to protect their position in cement and draws the analogy to J-M's position in fiber.

Swiss Eternit View of J-M

Swiss Eternit feels that J-M has been a sleeping giant, uncoordinated, and changing its policies without adequate explanation to its major customers. They believe J-M should have one coordinator for all asbestos matters. Among the specific complaints Swiss Eternit has are the following:

1) The fiber supply contract: In 1960, Eternit began long-term contracts with a few suppliers. They said that three years ago they received a unilateral revocation of the supply contract that they had with J-M. Three years notice was required, and this was given by J-M without any attempt to explain why they were doing so, or what alternative supply terms they would prefer. These supply arrangements are currently being continued on an interim basis, but Eternit remains puzzled about J-M's behavior. Even more puzzling was the 1 1/2 years which J-M took to reject a proposed renewal at higher prices. The latest proposal is to continue the old contract, but with Eternit purchasing a greater share of its requirements from J-M. Eternit views this as a foolish concentration for J-M (implication was made that J-M overly concentrates on a few customers.).

2) The Advocate Mine: Eternit originally had about a 30% ownership, but subsequently increased its ownership to somewhat more than 50%. It is clear to them that Advocate should run at full capacity, and they are prepared to take all of its output, if necessary, in order to assure that the mine makes money. The more they take from Advocate, the less they will take from Jeffrey.

J-M has a management contract for Advocate, which Eternit implies is generous. Eternit is unhappy about several aspects of the way this is being carried out. First, they feel that J-M is running Advocate as if it were part of the J-M system, rather than in the best interests of Eternit. Thus, they feel that any trade-off between Jeffrey and Advocate is automatically made in favor of Jeffrey and for J-M's internal fiber requirements. Dr. Schmidheiny claims that J-M has never sold any Advocate fiber on the open market and further that it became angry when Eternit resold some Advocate fiber. Second, they are very unhappy with the quality of the financial planning at Advocate, something they pay alot of attention to within Swiss Eternit. At Advocate, the errors in the profit projections have been very large and consistently negative. Third, they feel that J-M is using the Advocate mine as an executive training grounds at their expense. Dr. Schmidheiny feels a need to discuss the Advocate problems with someone from J-M, but claims he doesn't know with whom to talk.

3) J-M Belgium: Swiss Eternit does not understand why J-M would jeopardize its relationship with a very large fiber customer by permitting its Mol plant to be an aggressive price competitor in that customer's area of interest. It is a matter of some embarassment that this plant competes against German Eternit, in which J-M has an interest. Swiss Eternit would buy the J-M plant, but the Belgians are "too cheap" to do so.

4) ACE: Swiss Eternit has seen J-M blow both hot and cold on this subject. At first courted and encouraged to take a license, they have since been treated very coldly by J-M when they tried to visit an ACE plant in preparation for building a German factory. Colton has asserted that the license did not include know-how, which he admits is vital to the product's profitability. In this and other matters, J-M is seen as a legalistic nit-picker given to hiding behind technicalities.

5) Know-how: Swiss Eternit is concerned about J-M's giving away know-how to asbestos fiber buyers who are competitors of Eternit within its own area of interest. Especially distressing is the relationship with the Indian machinery manufacturer, which tried to take on Eternit in Saudi Arabia.

Other Observations:

- The major advantage of Jeffrey is that it is big-- the largest known deposit. The major disadvantage of Jeffrey is that its fiber contains a great deal of "talc".

- Eternit is generally satisfied in the area of sales service.

. Eternit feels that despite the fact that J-M spends a lot of money on research, it hasn't done very much to develop new uses for fiber.

. Eternit feels that Burnett did not properly handle the health hazard problem. They feel he should have switched to dust-free bags, and absorbed the cost of about $2/bag. Instead, he chose simply to label the bags as potentially harmful.

. Dr. Schmidheiny expressed an interest in participating in J-M's diversification activities. In a later conversation, Dr. Schrafl mentioned land which they own in Ibeza which J-M might wish to develop.

Note: We promised to share our market research findings with them, and requested their help in identifying other people who we might talk to.

S. Tilles

ST:jl
Attachment

Attachment 1

The Schmidheiny Family

The family is active in a variety of industries, most significantly in cement. They are not only the dominant producers of cement in Switzerland; they operate about 50 cement plants around the world. They have a plant in the U.S. at Dundee, Michigan, which by itself represents about 3% of total U.S. production. Many of the other plants are in underdeveloped countries. Mr. Dorner pointed out that these were large gambles, because while an asbestos-cement plant could be built for around $1 million, a cement plant required an investment of $10-15 million. Mr. Dorner also pointed out that some time ago, they had commissioned a study by a Swiss professor to decide whether there was any need for additional cement capacity in Switzerland. The approach was to plot a general correlation between GNP growth and per capita cement consumption. Based on this study, they decided not to expand cement capacity in Switzerland. In retrospect, they felt this was a wrong decision, because demand in Switzerland was strongly pressing on supply.

A second area of interest of the family is asbestos cement. They pointed out that the original asbestos-cement process was developed in Austria, and they had been interested in the process since about the early '30's.

A third major activity of Dr. Schmidheiny is the optical factory at Wild, which produces special optical devices, including theodolites, aircraft instruments, and a number of other things. The factory is just below the ancestral home, and employs many of the people who live in the valley where the Schmidheiny home is located.

The family members are:

- Dr. Max Schmidheiny - aged 63. Leading industrialist in Switzerland.
- His brother, Ernst, now retired. Aged 70. Former Chairman of Swissair.
- Herr Claus Kriess. Now manager of Swiss Eternit plant. Son of Mrs. Schmidheiny by a former marriage, and considered to be the eldest son of the family.
- Miss Schmidheiny - now living in Israel.

ETERNIT COMPANIES - 1978

The Saudi Arabian
Amiantit Co. Ltd.
P. O. Box 589
Dammam, Saudi Arabia

Amiantit S.p.A.
I - 25028 Verolanuova (Brescia)
Italy

Amiantit (Oman) Ltd.
P. O. Box 4807 Ruwi
Muscat, Sultanate of Oman

Asbestos Cement Ind.
(Bangladesh) Ltd.
53 Kalurghat Heavy Ind. Estate
PO Mohara
Chittagong
Bangladesh

Asbestos Cement Industries
P. O. Box 32
Nahariya
Israel

Asbestos Cement Prods. Nigeria Ltd. Nigerite
PMB 1032
Ikeja Airport, Lagos.
Nigeria

Asbestos Cement Industries Ltd.
Shirin Manzil, Randil Rd.
P. O. Box 7429
Karachi 3
W. Pakistan

Cimianto de Angola Sarl
Estrada Do Cacuaco
Caixa Postal NR 2437-0
Luanda
Republica Popular de Angola
Angola
Attn:

Coverit S.A. Fabrecim
Harmignies
Hainaut
Belgium

Ductoven S.A.
Apartado 10363 Carmelitas
Caracas, Venezuela

Cia. Ind. Y Com Eternit
Argentina S.A.
Casilla de Correo No. 1|
Moron (Prov. Buenos Aires)
Rep. Argentina

Eternit AG
8867 Niederurnen
Switzerland

Eternit Atlantico S.A.
Apartado aereo 853
Barranquilla, Colombia

Eternit Burundi
B.P. 465
Bujumbura
Royaume Du Burundi

Eternit Colombiana S.A.
Apartado aereo 4256
Bogota, Colombia

Eternit Corporation
P. O. Box 3364
Manila, Philippines

Eternit Ecuadotiana S.A.
Apartado 3340
Guayaquil, Ecuador

P.T. Eternit Gresik
Trommol pos 51
Surabaya
Indonesia

Eternit-Werke Ludwig Hatschek
Postfach 50
4840 Vocklabruck
Upper Austria
Attn: Mr. F. Hatschek

Industries Eternit S.A.
Caixa postal 30.484
Sao Paulo, Brasil

MT 012607