First Session - Thirty-Fifth Legislature

of the

# Legislative Assembly of Manitoba

## STANDING COMMITTEE

## on

## ECONOMIC DEVELOPMENT

39 Elizabeth II

*Chairman*
*Mr. Eric Stefanson*
*Constituency of Kirkfield Park*

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**MANITOBA LEGISLATIVE ASSEMBLY**
**Thirty-Fifth Legislature**

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# LEGISLATIVE ASSEMBLY OF MANITOBA

# THE STANDING COMMITTEE ON ECONOMIC DEVELOPMENT

## Thursday, November 29, 1990

**TIME — 10 a.m.**

**LOCATION — Winnipeg, Manitoba**

**CHAIRMAN — Mr. Eric Stefanson (Kirkfield Park)**

**ATTENDANCE - 11 — QUORUM - 6**

*Members of the Committee present:*

Hon. Messrs. Connery, Downey, Penner

Messrs. Alcock, Evans (Brandon East), Lathlin, Mrs. McIntosh, Messrs. Rose, Stefanson, Mrs. Vodrey, Ms. Wowchuk

**APPEARING:**

Dale Smeltz, Chairperson, A. E. McKenzie Co. Ltd.

Ray West, Chief Executive Officer, A. E. McKenzie Co. Ltd.

Ken Robinson, Vice-President Finance, A. E. McKenzie Co. Ltd.

**MATTERS UNDER DISCUSSION:**

Auditor's Report and Consolidated Financial Statements of A. E. McKenzie Co. Ltd. as at October 31, 1989 and 1988

**Mr. Chairman:** This morning the committee will be considering the October 31, 1989 and 1988 Auditor's Report and Consolidated Financial Statements of A. E. McKenzie Co. Ltd. I now invite the Honourable Minister responsible for A. E. McKenzie Co. Ltd. to give his opening statement and introduce staff members in attendance.

**Hon. James Downey (Minister responsible for A. E. McKenzie Co. Ltd.):** Mr. Chairman, first of all, let me say that I am pleased to have the report of McKenzie Seeds before the committee this morning after making several other attempts, and acknowledge that staff of McKenzie's and the management and the board chairman have been on standby on a few occasions and thank them for their tolerance and for making themselves available today. Let me introduce Dale Smeltz, who is the chairman of the board, Ray West, who is the CEO of McKenzie Seeds, and Ken Robinson, who is the vice-president of finance.

A. E. McKenzie Co. Ltd.'s Annual Report shows that once again excellent progress has been made by the company during its 1989 operating year. During 1989 the company increased its profits to $416,000, an increase of $122,000 over 1988 levels. Several growth opportunities were researched and evaluated by the company during the 1989 fiscal, including the expansion of McFayden Mail Order Division into the north central United States. McFayden also researched an expansion opportunity through acquisition into the Province of Quebec.

* (1005)

McKenzie's consumer products division researched the feasibility of marketing packaged birdseed to some 12,000 retail stores that presently handle its other horticulture products throughout Canada.

From the projects researched, only the expansion of the McFayden mail order business to the United States proved feasible, and accordingly McFayden commenced marketing to eight northern central states on January 1, 1990.

It pleases me to report that McKenzie Co. is comprised of dedicated, hardworking people who are committed to profitable growth of the company. One only has to visit the company to see the vibrant and enthusiastic atmosphere that prevails. Employee spirit and morale is strong at McKenzie's, which bodes well for the future.

I am also very pleased to report that every McKenzie employee received a performance bonus during 1989 through a new profit-sharing plan recently approved by the McKenzie board of directors. Overall, I am pleased that the company continues to make solid progress. I want to thank the chairman, Dale Smeltz, and other members of the board for the excellent job that they have done. Also, I want to thank the McKenzie employees for their strong commitment to the profitable growth of McKenzie Co., and particularly thank the CEO and Mr. Robinson for their attitude, their hard work and the leadership that they have shown for McKenzie

Seeds in the work that they have done. I am pleased, Mr. Chairman, to report the report that is here before us today.

Let me further add that it is my intention after the Opposition Members make their comment to have the chairman make a brief comment, and as well Mr. West make a brief comment as it relates to McKenzie's.

**Mr. Chairman:** We thank the Honourable Minister for those comments. Does the critic from the official Opposition Party, the Honourable Member for Brandon East, have an opening statement?

**Mr. Leonard Evans (Brandon East):** Not necessarily, Mr. Chairman. We have a lot of specific questions based on the consolidated financial statements of the company, but certainly share the views expressed by the Minister. I think McKenzie Seeds has an excellent staff, a dedicated, loyal staff. If anything, loyalty is a term that is well-deserved for the employees, management and staff of McKenzie Seeds. It is like a big family operation, and the people of Brandon and Manitoba should very well be proud of the company. Having said that, I have a number of specific questions, some specific concerns which I would like to raise, which we will during the normal course of the deliberations.

**Mr. Chairman:** I thank the Member for Brandon East for those comments. Does the critic from the Second Opposition Party, the Honourable Member for Osborne, have an opening statement?

**Mr. Reg Alcock (Osborne):** Mr. Chairperson, any time we see a financial statement that is improved like this, I think we are all quite pleased, and given that it has not been the trend with this particular Minister, I am most anxious to hear the explanation for it and will indeed join with the Member for Brandon East in asking some questions. I think overall we should be pleased with the performance of this company, and I am interested in particular in—I note from a very cursory glance at this that the gross sales have not increased, but the bottom line has improved. I would like to hear some detailed explanation of how that has been achieved.

**Mr. Chairman:** We thank the Honourable Member for those remarks.

**Mr. Downey:** Before the Member arrived, I just want to say I indicated that I was going to have the chairman make a brief comment and the CEO, if that is okay with committee Members, to the committee.

**Mr. Dale Smeltz (Chairperson of the Board, A. E. McKenzie Co. Ltd.):** Mr. Chairman, the McKenzie board was pleased with the company's overall performance during its 1989 fiscal year, and most especially in its improved profit position.

McKenzie is an exciting company with which to be associated. The company holds a very strong position in the Canadian marketplace through both its consumer products division that markets its product through 12,000 Canadian retail stores, and also its direct marketing division, which is McFayden, that sells directly to the consumer through spring and fall catalogues.

McKenzie's strategic plan calls for the company to continue to look for new market opportunities in both Canada and the United States for its direct marketing division, once again McFayden. It further calls for the company to improve its Canadian market share in the consumer products area through aggressive selling as well as through the marketing of specialty seed packet lines.

To sum up, the McKenzie board of directors feels that the company has an exciting future because of its market position, its excellent management, and most importantly, its wonderful group of extremely capable employees. Thank you.

**Mr. Ray West (Chief Executive Officer, A. E. McKenzie Co. Ltd.):** In 1989, the company had a profit of $416,000, which is an increase from the 1988 profit of $294,000, for a profit increase of $121,000.00. Company sales actually decreased in 1989 by $189,000.00. This decrease however was expected because of the discontinuation of our money-losing retail store division from which we knowingly gave up over $1 million in annual sales. Therefore, the other parts of the business which we wish to develop actually had sales increases of over $800,000.00.

* (1010)

Most of the sales increases were attributable to the McKenzie packet seeds, approximately $418,000, and McFayden Mail Order, approximately $247,000.00. Both McKenzie and McFayden sell on a national basis, and in 1989 over 86 percent of all company sales were to areas outside of the Province of Manitoba. McKenzie has an annual payroll of almost $4 million and has the equivalent of approximately 160 full-time jobs.

The company is doing considerably better today than it has in the past, but it is still not without problems. The single largest problem facing the company during these tough economic times is to be able to put a decent profit on the bottom line. Our 1989 profit, although greater than 1988 levels, still falls considerably below the profit levels management would like to see. However, McKenzie is a good company with a good product and excellent employees. For these reasons I am confident that we will be able to gradually increase company profits over the next few years to levels that are much more acceptable.

**Mr. Chairman:** Thank you, Mr. West. At this time I seek some guidance from the committee. Does it wish to consider the report on a page-by-page basis, or does the committee wish to address questions in general and pass the report as a whole?

**Mr. Leonard Evans:** My preference would be to pass the report as a whole, but some of the questions detailed are on specific pages obviously. Rather than going page by page, I think it is more flexible and more efficient actually.

**Mr. Alcock:** The Minister in the past has been amenable to questions that ranged throughout the report, so we deal with the report as a whole.

**Mr. Downey:** Mr. Chairman, usually they find the Minister they are dealing with reasonably co-operative, and I am again prepared to co-operate. Yes, we will deal with the report in its total context, dealing with the specifics the Members want to deal with within that report.

**Mr. Chairman:** Okay, we will proceed on that basis.

**Mr. Leonard Evans:** Firstly, I am not sure whether I heard the Minister, or perhaps it was Ray West who talked about the Quebec expansion, birdseed expansion. It was the comment that this was looked at, it was researched, and there was a decision not to, or was the statement that the company had actually moved into Quebec on an expanded basis and had gone into birdseed?

**Mr. West:** We researched handling birdseed in all provinces in Canada, and it is a very big market, a lot of sales, but we could not figure out how to make any money at it, so we did not go into birdseed at all. We do not sell birdseed anywhere. It is not in our product line.

**Mr. Leonard Evans:** What about the Quebec expansion then? It was the same thing there. You researched some possibility of expansion. Was that the statement?

**Mr. West:** We looked at an acquisition of a Quebec seed company, and we spent a considerable amount of time looking at how that might—it was mail order operation and a retail store. We looked at trying to bring it into the operation because we now do not market in Quebec under our mail order division. Once again, we could not see how we could make this operation profitable. The amount of monies that they were asking for it, the risk was so great that we just decided not to proceed with that.

**Mr. Leonard Evans:** What is the estimated percentage that the company has now of the retail package business in Canada? McKenzie's is the No. 1, only national packaged seed company, and it does have a high percentage, but I was not sure what the latest estimate was of that percentage of the national market in retail packaged seeds.

**Mr. West:** Mr. Chairman, we calculate somewhere between 60-65 percent of the Canadian marketplace for the packet seed business in Canada here.

**Mr. Leonard Evans:** Could the president give us sort of an idea of what percentage of the 60-65 percent is from what we would call large accounts, large customers, as opposed to the smaller ones? I do not know what the definition might be. Maybe he has it in his own mind where you would cut off between large and small.

**Mr. West:** Mr. Chairman, basically about half of our sales are for smaller independent-type accounts, and the other half are for major chain accounts. These would be Woolco, Canadian Tire and people like that.

* (1015)

**Mr. Leonard Evans:** Mr. Chairman, I assume that if one were to calculate it, the profitability of the large accounts, certainly marginally they are much more profitable than the smaller accounts just by virtue of the sheer volume. That may not follow, so I am asking you that.

**Mr. West:** I might ask our vice-president of finance here to get involved in this, but the larger accounts are sometimes more difficult to service, and they require more attention and in-store service during the season. They also demand higher percentages of discounts because of the volumes that they are giving to us. In actual fact, I do not think that we as a company have broken this out between the profitability or the contribution from those types of accounts as opposed to the smaller ones, but if I could ask our vice-president.

**Mr. Ken Robinson (Vice-President Finance):** We have in actual fact looked at the profitability of what we call chain accounts versus independents, and often it is difficult to develop a definition; for example, included in the independent accounts are people like Canadian Tire. Given that definition, the profitability of both segments of the businesses are probably about the same. What we have done in addition to, and in order to maximize profits on, the smaller accounts, we have moved them into telemarketing groups where we can control the service costs aspect of it, turning them from a loss account into a profitable, simply because we do not have to spend the extra marketing and selling costs to service.

**Mr. Leonard Evans:** I suppose on the catalogue sale, where I think there has been quite a bit of growth the last few years, I guess it is difficult to tell what percentage you have of the catalogue market, because you are not only selling seeds through the catalogue, but you are selling other related products. Do you have any idea where you stand there?

**Mr. West:** Mr. Chairman, we feel we have 15 percent of the Canadian marketplace in seed and nursery products that are sold by direct mail in Canada.

**Mr. Leonard Evans:** Reference is made to hoped-for improvement in profits. Profit improvement can come through cost cutting; it also comes through sales expansion. On the sales side, where does the company expect it to have growth in the next couple of years?

**Mr. West:** As our chairman stated, we are aggressively going after market expansion in our direct marketing area both in Canada and in the United States, and we expect that there will be significant expansion in our activities and sales activities in that area.

Also, we have such a large percentage of the packet seed business in Canada that it is difficult to gain a whole bunch there, but we are gaining market share in nearly all our Canadian markets, and we have done that through the advent of specialty seed packets, packets that are a little bit different than the common radishes and beets and carrots, and things of that nature. They are more of a special nature.

We have several lines of those kinds of seeds now, and in each of those areas we are gaining market share from the competition, and also gaining space in most of the stores that are handling our seeds.

* (1020)

**Mr. Leonard Evans:** When the president refers to direct marketing possibilities, you referring to the catalogue sales at that point?

**Mr. West:** That is correct, the McFayden. I might just clarify that direct marketing activities are the catalogue area, and that is done through McFayden. Consumer products sales are done through McKenzie, and that is to the retail stores that we service.

**Mr. Leonard Evans:** As we say, profit can be improved either through expanded sales or through cost-efficiency measures. Can the president indicate what cost-efficiency measures the company has been engaged in the last short while, and is there any opportunity for further improved efficiencies in terms of the costs of handling, the costs of the operation?

**Mr. West:** Mr. Chairman, we have productivity improvements throughout the company and the plant. We have each manager prepare at the beginning of the operating year objectives as to what he is going to try to achieve in extra productivity and ways to hold or reduce operating costs. We zero-base budget at McKenzie's, which means that we do not assume that any cost is a given. We have to justify the cost each and every budget year.

Over the years we have been relatively good at holding our operating expenses, and it is because of that that we have been able to have profit come out at the bottom line. We have gained a lot of productivity in the plant and the offices. Each year there is about a quarter of a million dollars that we have as what I would call "cost push" that is inflationary, things like extra cost for freight, extra costs for travel, extra costs for taxes, extra costs for things of that nature. We have salaries.

We have about a quarter of million dollars of that each and every year that we have to pick up. That is assuming rather that we are also passing on to the consumer any cost push we have in our cost of goods; in other words, if our seed goes up or our packets go up or things of that nature, we have to make sure that we pass that on by price increases to the consumer. Otherwise we have to pick up some of that as well.

Basically we have been able to hold our gross profit levels, which means that we are passing on to the consumer the increased costs of the goods that are coming to us, and we have been relatively successful at holding our operating expenses at a pretty good level.

**Mr. Leonard Evans:** I guess the whole question in the matter of pricing the product is a very intriguing one. To what extent can you pass the costs on through the increase in the packages of the seeds? To what extent will this be self-defeating, because you do have competition, not only nationally or domestically, you have foreign competition? I guess my question relates to the competitive aspect and the limitations, therefore, that you have in raising the prices of the packaged seeds. You have to compete with a regional company such as Lindenberg, I suppose, as an example in the Brandon area, and these these companies across the country, as I understand, plus the foreign competitors who are always around behind your shoulders sort of thing. To what extent then are you limited in price increases that you would like to see, by this competition?

**Mr. West:** Mr. Chairman, we have a three-year plan in place where we know what our cost increases are as it relates to seed and packets and so on. We know if we do not manage this plan and use the strategies within it to pass price increases on to the consumer, we are going to eat that up in lost contribution to the company.

It is only in recent years that we have actually had a strategy to have a price plan in place. I just mention that because it is extremely important. If you do not have a plan and it is just a sort of hit-and-miss kind of situation as it was sometimes in the past, then you run the risk of not pricing your packets, some of which are printed almost a year before they go into the marketplace, with the increased prices on them, and then you or the company has to absorb the extra inflationary costs for product. That plan is very important, that it is in place. It is very important that we adhere to it.

I guess the other thing is because we are the leader in the field, we obviously monitor competition right from coast to coast and what they are doing. It is very important to us that we see and keep abreast of their activity. We have also done a whole lot of research into the pricing of packet seeds and the elasticity that can go along with it without having a fall-off in the units that are sold.

Without divulging all the things that came out in that extensive study, research program, which cost quite a bit of money and was quite extensive, I can say we use that to a great extent to watch what our competition does and price in accordance with them, so we are not the lowest end anywhere across the country.

* (1025)

We generally are the leader in pricing, but we figure we have a really good handle on it to make sure we are not pricing to the extent where we lose our market, nor are we not pricing to the extent where—putting in price increases to the extent where we are losing gross profit.

**Mr. Leonard Evans:** Is this the pattern across the country in the various regional markets? Do regional competitors tend to price just under your price, or do they match you? Do they just follow you in terms of matching you, or do they price just below McKenzie's?

**Mr. West:** Mr. Chairman, it varies by region. In some regions they watch what we do and price just under us. In other regions, they are considerably under us, for example in Manitoba, Saskatchewan, they are considerably below where we are, and we just could not afford to sell packets at that price and still be able to carry on.

**Mr. Leonard Evans:** Where you have that situation do you find that your market share is diminished? You would think so, but on the other hand there is the other factor, and that is the brand loyalty which always comes into it. I mean, price is one thing when you buy any commodity; the quality of the product is another matter. Brand name often denotes a certain level of quality, and you are prepared to buy an item even though it is more expensive because you have confidence in the quality of the product.

**Mr. West:** Our sales force obviously is armed with the knowledge of what the competition is doing, and we fight the competition on a regional basis with things that make sense to the dealer. For example, sometimes we can offer a better service, or sometimes we can offer a broader width of product such as the specialty seeds that I mentioned. Sometimes we can offer a larger discount because we have a little bit more of a retail price level to work with.

Actually today one of things a lot of the dealers are interested in is making a fair percentage on a bigger dollar rather than not as big a percentage on a very much smaller dollar. If you are selling packet seeds at 50 cents, you do not sell twice as many packet seeds than if you are selling them at a dollar. People only go in and buy six and eight packets of seeds for their garden, and they do not really care a whole lot whether it is 50 cents or a dollar, providing they are not side by side.

Most of the chains that we deal with only want to have one line of seeds in there, and they would rather have a percentage of a big dollar rather than a percentage of a small dollar, and it really, to them, makes a lot of sense.

**Mr. Leonard Evans:** I thank Mr. West for that information. I would like to move on to the one area you did research and made a decision to follow through, and that is the U.S. market. There were reports in the newspapers about sales to the U.S. not having paid off, or words to that effect.

I am not trying to put words in anyone's mouth, but I think that is what I read in the different articles in the Brandon Sun or Brandon Today, one or the other. Yes, in the Tuesday, November 6 issue of the Brandon Sun, quoting a paragraph here, " 'The company's decision to enter the U.S. market selling in eight northern central states still has not paid off, but in the near future it should be making profits there,' he said." I think that is Mr. West. " 'Promotions which have worked well in Canada failed south of the Border,' West said, explaining that it takes time to establish in a new area."

I just wanted to get an update for the committee for the record. Just how big is this sales effort in the United States? What was the targeted amount of sales, and what exactly has been happening? Have we lost money? How much has the company lost?

* (1030)

**Mr. Downey:** Mr. Chairman, my response will be that the report we are dealing with does not reflect the activities in the United States to date. It would be shown in the 1990 report. Protocol I think would have it that in detail we should wait until the annual report, or the audited report goes to the board of directors of McKenzie Seeds. This would take place some time in the new year and would be able to deal with more specifics as it relates to the details of the U.S. sales. However, there was a plan that was entered into, and as I understand it the initial plan was not to have shown any profit in the first year of operations but would in fact show a loss. Let me put it this way, it is operating to plan.

**Mr. Leonard Evans:** The Minister brings up an interesting point. I think in the past we have tended to talk about current matters when the annual report has been rather late, and the reason it is late, of course, is because of the legislative cycle. I am not criticizing anyone for that. It is a matter of fact that we are behind in our legislative program.

I appreciate the Minister's point about not getting into specific details because it has not been audited and the board has not considered it. Nevertheless could we not then just in generality, without getting into all the detailed finances and that, get some impression it is according to plan? Does that mean the sales are more or less what is expected? Without going into a lot of detail on finances, are you more or less getting the sales volume that you expected there? If not, is there a problem? If there is no problem, that is fine.

**Mr. Downey:** Mr. Chairman, I will let Mr. West talk in more explicit terms, but my understanding of it is that when you enter into a new product, a new market, it is a matter of trying certain things and doing some work in that market to see what might be profitable and what is not. As I said, it was to plan. There was not any plan to make money in the first year. In fact, there was a plan that it would not make any money—the cost to the company, but it is done at a time when the company is showing strength and is able to do that, and that is I think a sound business decision.

As far as the details of what the strategy is at this point, I will let Mr. West refer to that, because I think it is important we all clearly understand. One of the reasons we took this on was to try to open the market opportunities and continue to strengthen the company for creation of jobs in the Westman region. We felt it was an important program to enter into. I will let Mr. West—if there is some market activity that he could refer to that would be helpful to the committee, I am quite prepared to have him respond.

**Mr. West:** Mr. Chairman, a mail order business generally makes a profit from its house list. Very seldom does a mail order business make money from its prospecting activities. For example, if you go back just 10 or 12 years ago when McFayden was first looked at for expansion possibilities, McFayden 10 or 12 years ago was basically a nothing company. It had about $200,000 in sales and obviously was not making money. We took a commitment at that time to try to build that operation, and in its early years it lost money. Today it is a very important part of McKenzie's and will continue to be an important part of the company in the future in its profit growth.

The same situation applies in the United States. The Minister indicated we did not go into the marketplace assuming we were going to make money in the first year. We did not have one name to whom we could mail. We now have about 20,000 names of people who we can mail to. We actually thought that over a three-year period we would do slightly better than break even. Initially, the first year we thought we would lose money; the second year, we thought we would break even; the third year, we thought we would be making some money.

As the Minister indicated, we are pretty much on plan. Does that mean that everything happened exactly as we thought it was going to happen? No, it did not. We had a lot of surprises. We took what we knew from our mail order operation in Canada and thought that if we used the things that worked for us well in Canada, they should work for us well in the United States. Such was not always the case. We found things that did not work quite as well for us, we found things that did not work at all in terms of return, and we found things that worked very, very well that do not work in Canada.

By using that information, and without really going into all the details of all of the various methods that we are using for prospecting and so on, we are now going to take all that we learned in the first year, and we are applying it now for the second year. We are just starting our second year of marketing in the United States as of December of this year and January of next year. We fully expect that the operation will be break-evenish in its second operating year. If there is anything specific that you have, I—

**Mr. Leonard Evans:** Just to make sure we understand and the committee understands what Mr. West is talking about, we are strictly talking about catalogue sales here, we are not talking about putting displays of packaged seeds in American stores and so on. It is strictly the catalogue, and it goes under the name, I assume, of McFayden in the States.

How does the company intend to get more customers? Are you stepping up your advertising? Somehow or other people have to know that there is such a thing as the McFayden catalogue to order and so on. I wonder if the president could enlighten the committee as to how the company is going about getting the names, the lists of people to send catalogues to.

**Mr. West:** Mr. Chairman, there are several ways that you can build a mailing list. One of them is to advertise through print media. Another one is to rent mailing lists of other people who might have an interest in your type of product. For example, a magazine called Organic Gardening would have their mailing list available for rental purposes. A magazine called Harrowsmith would have their magazine available, or at least the list available for rental purposes. You can rent those names to whom you can then send your catalogue. That is another way.

The electronic media is another way that you can use in prospecting for new customers. Obviously, the referral business—your customer will get a customer. In other words, your best people are your customers, and if they have friends that they can give you their names to, then that is almost an endorsement of your product.

Those are the methods you use generally in building a mailing list. We use the same ones in the United States as we did in Canada, in the same mix as we did in Canada. The mix was not the same. It does not work the same. It does not respond in the same way, so now we are changing the mix. We are using the same kind of methods of prospecting, but we are going to change the mix considerably for the second year in the marketplace.

**Mr. Leonard Evans:** Can Mr. West tell us whether the prices are the same in the Canadian catalogue going to the States as in Canada, or is this a different catalogue with different prices?

**Mr. West:** Mr. Chairman, 90 percent of it is exactly the same. The only thing that changed would be things that are big-ticketed items that are bought initially from the United States like a garden cart perhaps that sells in Canada, because it has exchange on it and duties and taxes on importation and so on, it might sell for $400, where in the United States we could sell it for $200 or $250 and have the same kind of margins. Just big-ticketed items were the only things that we changed. Seed packets that were selling for $1 are sold for $1 in the United States. We just take U.S. dollars, that is all.

**Mr. Leonard Evans:** I guess we talked about this before, but I would gather that the Free Trade Agreement as such has not made any impact on this. It is essentially deciding that here is a market opportunity and then going after it. It is not the change in the tariff that has had any impact on this business.

**Mr. West:** Mr. Chairman, the tariffs were small to start with, and they take 10 years to come off, as you are aware, so they are not a significant item. The standardization of the regulations are the big key issue here, and they will probably take about eight to 10 years to get standardized, but once they are standardized, it will be a lot easier for us to trade in Canada as well as the United States, because we will only have one set of regulations with which to deal. That will have a big bearing on it.

* (1040)

The other thing was just the awareness of it, the attention. I think we have to—like to know that it was there, but it was kind of out of sight, out of mind. This focussed our attention, and it probably also focussed the attention of others in the United States maybe at our market. We wanted to be early into the marketplace, because it is a big market. There are 17 million people in those eight states just below us. McFayden does not sell now in Quebec, and so it is an equal market really to the size that McFayden now sells into. There is big opportunity there if we can figure out how to make it work.

**Mr. Leonard Evans:** Yes, we will certainly look forward to progress in this area. Certainly we want the company to be successful at it. I would like to now ask a few questions about the financial statements in more detail and try to get some explanation as to why some numbers are up and some numbers are down. I am looking at the very first page of the statement, that is the statement which is headed "Consolidated Statements of Operations for the Years Ended October 31, 1989". You have your sales, expenses, and you have the net income shown on that. It is the very first table.

As the Member for Osborne (Mr. Alcock) has noted, the sales are down, I gather by about $189,000 approximately. I accepted the president's explanation for that. That is not necessarily a bad thing. If the sales are profitable sales, you are better off to have lower sales. You do not want to sell and lose money.

I would like to ask the question on the next line. The cost of sales is down also by $146,000.00. Is that related to the closure of one of the stores, or is there another area of reduction of cost?

**Mr. West:** In actual fact, is directly related to just the difference in the sales itself. If you look at the gross profit percentage, we went up by about two-tenths of a percentage point in gross profit, which means that on the sales that we did have we maintained our gross profit percentage and actually slightly improved it. The $1 million in sales that we gave up from our retail store operations, we just could not figure out how to make those things profitable. When you net that out of there, there are sales increases in the areas that we really want sales increases in, and that is our mail order division and our packet seed division.

**Mr. Leonard Evans:** I am looking at expenses. The selling, marketing and distribution expenses are up by about $109,000 approximately, but administration is down by almost $34,000.00. Can the president or vice-president explain? It is always nice to see administrative expenses being cut.

**Mr. Robinson:** Mr. Chairman, administrative expenses went down approximately $30,000.00. The major item in that category that went down was related to computer costs, and I think if you read the balance of the statements and notes, you will see that at the end of 1989 we replaced our computer with a new computer. The old computer was on a lease program, and in the last year of the lease program the costs of interest on that lease were substantially less than in 1988, so that is the major factor there.

Looking at the total impact of the expense categories, and Mr. West referred to cost controls and an annual cost push of about a quarter of a million dollars, if you look at the increase from '88, $6,065,000 million to $6,140,000 million, we have approximately an $80,000 increase in cost there. Given that the cost push inflation-wise for salaries and related costs is $240,000, we were able to retain the difference of $160,000, and obviously that flows right through.

**Mr. Leonard Evans:** As Mr. Robinson is explaining then, the expenses as a category will increase about $75,000.00. At any rate, taking that into account plus the fact that the gross profit is down by $42,000, your income now is down by $117,000 from $423,000 down to the $306,000, so your operating income is down.

Your next item is other income and the question simply is: What does comprise other income? What are the significant items in this one for 1989?

**Mr. Robinson:** Mr. Chairman, the indication there is that the increase is about $88,000.00. The major component changes in that category are comprised of term deposits, where we invested excess cash when we got into surplus cash positions over the previous year. If you look at the balance sheet, we were up substantially in the cash category, so $37,000 of the $88,000 increase was related to the interest on those deposits.

The balance of the increase was related to list rentals, and that was $17,000.00. That is where we rent our lists for the McFayden to other people in the garden-related or in some other category. There was also a small gain on some computer equipment that we sold, so that total, $77,000 represents the majority of the increase of $88,000.00.

**Mr. Leonard Evans:** I thank Mr. Robinson for that explanation, but the bottom line then is, on a net operating basis, the company is down by almost $29,000. In operations you are down by $29,000.00.

What has given you a boost, or maybe not, has been—there is another item further down—we could talk about that in a minute. What about the interest? There is a drop. You were paying $166,881 in interest. Now you are down by $90,000 almost, or more that $90,000 to $76,000 in interest. You have long/short-term interest as down, and the capital lease is down. Could the company give us an explanation of that?

**Mr. Robinson:** Mr. Chairman, you are certainly correct. The difference in interest is substantial. Long-term interest of $16,891 shown for 1989 represents the interest that we were paying on the long-term debt back to the Province of Manitoba. That was the final year of that program, so the total debt being down from the previous year, that is the reason why the interest is down in that category.

**Mr. Leonard Evans:** Excuse me, Mr. Chairman, did he say this is the last year?

**Mr. Robinson:** Yes, Mr. Chairman, 1989 was the final year of the payment of the five-year program on the million that we paid back to the Government.

The last year, because that was interest bearing, and the debt had been reduced from the original $1 million down to approximately $200,000 principal by the end of 1988, the interest would be substantially reduced over the previous year because you are dealing with less principal.

The short-term category again reflects lower bank loans than we had in the previous year, and as we indicated earlier, a substantial increase in our cash position over the previous year, so we were able to control our inventories and receivables to a greater extent than we did in the previous year, therefore less requirement for bank loans and less interest. There may have been some rate differences as well.

The final category, capital leases, had to do with the computer that I mentioned earlier, where the cost in the last year of financing that lease was less.

* (1050)

**Mr. Leonard Evans:** I thank Mr. Robinson for that explanation. The payment now—this is the last year of a five-year payback. Could the company officials tell us how much has been paid back? There has been the initial amount plus interest, so I am really interested in knowing what the bottom line is or what is the estimated—just approximate, it does not have to be to the last dollar.

**Mr. Downey:** Mr. Chairman, it should be reported in the previous reports. It may take a few minutes to get that number for the Member, but it has been reported annually in the reports. Mr. Robinson may have it.

**Mr. West:** It is approximately $1.4 million that was paid back on that $1 million in long-term debt. That is the paying back of the principal plus the interest.

**Mr. Leonard Evans:** Yes, that is very good. People should realize that the company has been paying off this loan and has been paying the interest as well, so roughly $1.4 million. This interest burden should be less now because of this; the long-term interest should be less or should be zero, as I understand it, next year.

**Mr. West:** The million dollars in long-term debt was cleaned up at the end of the 1989 fiscal year. That is correct.

**Mr. Leonard Evans:** What I gather from looking at this statement then is that the improvement is really more on the cost side than on the revenue side. The sales have not gone up. We may be a little bit more efficient in handling those sales, but net operating income is down by $29,000, but when you take into consideration these very significant reductions in interest, then you have your net income improved from $354,000 to $416,000.00.

The other reason for the big improvement is you do not have a repeat of last year, of the loss of $60,000.00. That is sort of a one-time gain, I suppose, or it is a one-time cost, I guess, in a sense that you show last year that you do not have to show this year, so you have that $60,000 in addition. Therefore, you are right to the bottom line of the $416,000 compared to $294,000.00.

The other question I have relates to retained earnings, if we could slip over past the sheet on the cash items, just pass over to the deficit and then the retained earnings. I am just wondering what is happening really, because there is reference also—there are some notes on it but it is still not clear from reading it as to exactly what is happening. The retained earnings are down. Retained earnings had a deficit in 1988 of $6.2 million approximately, and they are down to a plus $894,524 this year, and that is because you have put $6.6 million into contributed surplus.

There is note 7, I believe, which is supposed to explain this or has some reference to it and it is rather—it is on page 5 of the notes, and I am just wondering what this is all about? It is almost like magic, accounting magic.

**Mr. Robinson:** Mr. Chairman, I will attempt to take you through the process that we went through. I think I have to go back in time to what the board of directors and management objectives were, given that by the end of 1989 we would have completed the repayment of the original million dollar long-term debt and the company's desire and the board's desire to continue a repayment program back to the Province of Manitoba.

The movement of the categories that took place at the end of 1989 enabled the company to continue to repay to the province funds the province had originally invested in McKenzie Seeds. That is the objective.

Going back in time, in 1987 the previous Government wrote down the value of the shares on the province's books by $6 million-plus to reflect the fact that the assets of the corporation were substantially less than the value of the shares that the province held.

As a company and board of directors, and because it related to The Corporations Act, in order for us to continue to repay capital to the province, we had to meet all the criteria on the solvency test. The solvency test is outlined in Section 34(2) of The Corporations Act, whereby the company could not continue to repay to the province unless we met that test. In order to meet the test then, we had to take the write-down that the Government had previously authorized on their books and reflect that in the corporation's books. That enables us to now continue to repay capital to the province. As I think you probably saw in the newspapers, at the end of October of this year we returned to the province $249,000.00. That is a very brief explanation of the changes.

In actual fact, when you look at that category on the balance sheet, it is called shareholders' investment. Basically, the shareholder is not any worse off because of that particular movement of funds from one category to another. If you think of it as a bank where you have two accounts and one is overdraft and one has positive numbers, then you combine the two together, you come up with a net number on that particular page, the balance sheet page.

If you turn back to page 1, which is before the operating statement, I refer you to the bottom part where it shows total shareholders' investment. Prior to the movement of funds in '88, that category netted $6,107,687.00. At the end of 1989, when we moved numbers from one category to the other, the total amount in that category went from $6,107,687 to $6,524,000 reflecting the $416,000 in earnings that occurred in 1989. That I hope provides an explanation, and again that enables us now as a company and a board to continue on an annual ongoing basis to return capital to the Province of Manitoba as we did at the end of October of 1990.

**Mr. Leonard Evans:** Mr. Chairman, yes, so I would gather then, looking at the liabilities and shareholders' investment information here, whereas you have shown as deficit $6,160,813 what you have done is written down the nominal value I guess of the number of the share capital. Therefore, the bottom line is essentially in line. There is a change of course, just reflecting the real difference from one year to another, but it does not substantially affect the bottom line of total liabilities.

**Mr. Robinson:** That is correct.

**Mr. Leonard Evans:** I guess you had to get the agreement of the Government or specifically the Manitoba Development Corporation because these are preferred shares held by the corporation?

**Mr. Robinson:** Yes, Mr. Chairman, this program was all set up through the Manitoba Development Corporation as well as the Province of Manitoba, and the board of directors passed all of the required necessary resolutions.

**Mr. Leonard Evans:** I note, looking again at the notes on page 5, actually note 7. iii): The shareholder of Class A preferred shares waived the right to dividends in arrears as of October 31, 1989, of $2.1 million, and the previous year is $1.8 million.

I guess the province has been doing this each year since '82 or '83 when the substantial investment was made of about $12 million.

* (1100)

**Mr. Robinson:** The dividends had, since 1983 or '84—I cannot recall the exact date—been accumulating at an annual rate and had never been declared. That was one of the features of the preferred A share, it had accumulative dividend attached to it. With the change and with the company's and the board of director's desire to return capital to the province, we believe that we could not return both dividends and capital. Our objective is to return the capital first, and ongoing then, the province will retain any of the earnings that accumulate from time to time. In order to get past the solvency test under The Corporations Act, this had to be amended as well.

**Mr. Leonard Evans:** I know there is some explanation here, but can Mr. Robinson give the committee a brief explanation of the difference between Class A and Class B preferred shares? They are both at a rate of 6 percent per share per annum. There is some slight difference, but I am just trying to understand what the essential difference is between Class A and Class B preferred shares.

**Mr. Robinson:** Mr. Chairman, the original difference was substantial. Class A were set up to be cumulative dividends and Class B were set up to be non-cumulative. There is now, after the amendment, some slight difference in the class of A and B. I am not technical enough to be able to explain that at this particular time. One has a convertible option and the other one does not. I am not knowledgeable enough at this point. I would have to get back to you with that.

**Mr. Leonard Evans:** Yes, because on page 6, there is some reference to the Share Capital (continued) under note 7. There is reference in the third paragraph, page 6: The preferred shares are convertible only with the written approval of the Cabinet, in effect. The terms of conversion have not been specified.

Is this something that might happen in the future? Is this a possibility?

**Mr. Robinson:** Again, specifically I would have to do a little bit of research in order to answer that question intelligently.

**Mr. Leonard Evans:** Maybe at some subsequent time the company, through the Minister, can send a note with some explanation of that. I am more curious than anything else.

**Mr. Downey:** We will attempt to do that, Mr. Chairman.

**Mr. Leonard Evans:** Just a general question then to the Minister, in order to bring about this change which the board certainly has endorsed, did the Cabinet have to pass any Order-in-Council or any directive or agreement?

**Mr. Downey:** Yes, Mr. Chairman.

**Mr. Leonard Evans:** Did the Minister say that he was successful in getting an Order-in-Council passed?

**Mr. Downey:** Yes, as part of the process, there had to be an Order-in-Council passed.

**Mr. Leonard Evans:** Okay, thank you. The Government issued a news release on November 5, 1990 with respect to the redemption of shares. I gather really what has been going on is the company has been able each year to have enough cash to pay back the five-year loan plus interest. Now that that is away, you are still able to generate sufficient cash that you can begin to redeem a portion of the Class B preferred shares, but the Class B preferred shares have been reduced substantially in value now, so if you have paid the $249,998, which is referred to in the press release of November 5, how does that jibe with the value here of $515,088? Do you deduct it from the $515,088 or am I not coming at this the right way?

**Mr. Robinson:** Mr. Chairman, the answer to that question is as follows: The B preferred shares were in total number, 7,154,000 shares at $1. The write-down that occurred reduced them from $1 down to 7.2 cents. Therefore the difference was moved from share capital and charged against the deficit, and that is the reason for that particular change. That left a balance—if you take 7,154,000 shares at 7.2 cents, that gives you a value of $515,088. The $249,998 that we redeemed does in fact come out of the $515,088 and when you review the 1990 financial statements, that category will read $265,000-and-some which is the balance left in the category. That will obviously change again should the board pass a resolution to redeem more shares in 1991.

**Mr. Leonard Evans:** Thank you, I appreciate that explanation. One gets the impression from the newspaper headlines and so on that suddenly, and I do not criticize the Minister or the company for the newspaper's reporting, suddenly now we are able to make this repayment process as though all of a sudden this has happened. This has happened, but there have been substantial monies paid year after year for five years by the company. The company has been successful enough that it has been able to find the cash to make these payments, and this is a continuation. It is a difference, but it is still a continuation. The company has had that ability to have this cash to be able to make these payments, first on the loan; now that that is tucked away, now on writing down the capital. I am not trying to put words in anyone's mouth, but that I believe is the summary of what has been happening.

**Mr. Downey:** I am not going to disagree with the Member. The company has been able through the management and the direction to repay funds to the province, to the Manitoba Development Corporation, as well as through some of the work that was done previously, started by the previous administration and carried on by this Government. It is now able to pay back a capital portion of its shares to the province.

That we are pleased with, and I would just say to the Member that we look forward to even better performance out of the company with this kind of activity taking place and the stronger base. Hopefully the Member reads it in that light, that the work that has been done will give it a better opportunity to excel in the future, creating a better bottom line and job creation for people of the City of Brandon.

**Mr. Leonard Evans:** Of course, if you reduce the debt, you are reducing your interest burden. Obviously that makes it easier no matter what kind of business you are in. -(interjection)- Well, talking about the province, now that you have mentioned that, I see that there is now some reference on page 6 of the statements I have to some imputed interest cost information. This is something relatively new I guess in the last year or so. The Minister of Finance seems to want to have some kind of a note here showing the borrowing cost to the Government for investment in these shares. What this note tells us is that beyond all this, the Government is undergoing a burden of roughly $1.2 million per year.

**Mr. Robinson:** Yes, if you simply look at the investment that the Government put into McKenzie Seeds, that is a correct statement. This particular imputed interest cost information section does not specifically make reference to any deficit that is part and parcel of the net investment that the Government has. This particular section does not address the deficit that the company had for past operations, but you are correct.

**Mr. Leonard Evans:** I suppose it depends on how you want to look at it. You could say this is a cost to the Government, it is an annual borrowing cost to the Government of $1.2 million approximately, and that is true, but on the other hand it is an investment. The fact is you cannot have any company, you cannot have any firm, any organization without an investment. The money has to be put into it. I guess then the real question is: How do you calculate whether it is a worthwhile investment, whether you are getting a return on the investment?

* (1110)

We talked about the returns on the loan, we talked about the returns now on the shares, but I have always argued that as a province, as a provincial Government, you have a bigger balance sheet, a much broader balance sheet. You have to look at the returns to the provincial economy, and there is certainly a substantial return to the provincial economy, because I believe it was Mr. West who said 86 percent of the product was sold outside of Manitoba.

What we are doing, what the company is doing is bringing revenues into the province, employing the equivalent of 165 full-time staff with a multimillion dollar payroll. I have forgotten what it was—$4 million, on which the Province of Manitoba collects income tax and sales taxes from the McKenzie Seeds employees who buy their merchandise in Brandon or Westman or wherever they buy it.

From the broader perspective, in my opinion this is a very sound investment. If you want to take a narrower perspective you may not be as charitable. I think taking the broader perspective this company has proved to be a very positive asset to the people of this province and certainly to the Westman-Brandon area over the years, so unless the Minister wanted to say, make some additional comments or have some questions or—

**Mr. Downey:** Mr. Chairman, as the Member for Brandon East (Mr. Leonard Evans) knows, this is the day for him to question my—

**Mr. Leonard Evans:** No, I meant—I really cut myself short. Do you want to generate some more questions on my part?

**Mr. Downey:** Mr. Chairman, if that is an indication the Member is prepared to pass, I will say pass.

**Mr. Leonard Evans:** I just wondered, I thought the Member for Osborne (Mr. Alcock) might have had a question or two, and I do not know whether my colleague from Swan River (Ms. Wowchuk) has a question or not.

**Mr. Alcock:** The Member for Assiniboia (Mrs. McIntosh) says I must be stimulating or I cannot ask a question, but the Member for Brandon East has asked a number of the questions on the financial statements that I think needed to be asked. I do have a general question though, and I am not certain which one of the two gentlemen who spoke first in the opening statements made the comment but—no, no unfortunately it was not, I said the two gentlemen at the table.

**Mr. Chairman:** Order, please.

**Mr. Alcock:** You asked for that one. The comment was made, and it was a serious comment, that the position of the company is stronger and that profitability has improved, but it had not improved to the level that the company was comfortable with. That obviously makes some sense as you are trying to grow a company, hopefully you are always looking for a better performance than you are getting.

You also talk about a new program of trying to expand into the United States and front-end cost of that. Those are all logical and make sense if you are going to suffer losses, particularly in the mail order business. Your reference was losses at a time—and you are also attempting to pay back funds to the Government. At the same time you are undertaking an expansion, and as nationally we are going into both a recession and a serious drop in consumer confidence which presumably will be reflected in future sales. The only question I have is: I think we should all be very pleased with the position of the company and the work that has been done in the past while. One would be a little frightened about what is coming, just in the sense that if you are going to incur some exceptional costs, do you have deep enough pockets to handle it?

**Mr. Downey:** I want to make it just a short concluding comment after this question about the general overall comments made. I will let the general manager, the president, answer that comment. I guess if I have learned something about the company over the last couple of years, it is that consumer buyer habits, as you get into what we consider tougher economic times, sometimes tend to buy from the company which we are talking about, so you may say that it is an ill wind that does not blow someone some good. That would be my general comment, but I have no difficulty with the president responding or any one of the Members.

**Mr. Alcock:** My question is by no means meant to be critical or dig for some sort of nefarious problem. It is a query, given the many things the company is trying to do at a time when the rest of the country is feeling a little tentative.

**Mr. West:** Mr. Chairman, there was a time not too many years ago that the executive committee would have been concerned about our ability to do some of these things, because as you put it "how deep are our pockets?" I can only tell you that we do not have that concern anymore.

We have ventured into some situations, and as we indicated earlier, we intended to not be successful profit-wise the first year in that venture, but we knew it was not enough to put the company into a serious kind of situation. The company and its employees feel very good about the future for McKenzie. I think we will be able to, as I indicated earlier, impact the bottom line positively each and every year we carry on, and that takes into consideration the risk in growth situations and things of that nature.

**Mr. Alcock:** I am interested in the Minister's comment about ill winds and presumably that people would begin to grow more "victory" or some garden by another name as a result of lower purchasing power in the supermarkets. Was that what you experienced in the '80-81 recession? Did the company's sales go up?

**Mr. West:** Mr. Chairman, I would only be guessing. I do not think we were seriously hurt in that period of time, but the records were such in those years that we really did not have the kind of control on our business that we should have had, and I cannot positively state that was the case. I think today we are in control of McKenzie's. There was a time that we were not in control, and in the early '80s that was one of the situations.

**Mr. Alcock:** Just a final comment again out of interest, reading the notes in the statement: Your sales do go up significantly, given that you have excluded $1.1 million in sales through the outlets you operated directly. In this extraordinary item that is referenced here, they do talk about the results that you display here exclude the write-down of good will. Did you assign yourself any value for good will?

**Mr. West:** Mr. Chairman, I think the good will was written off in '88, and it is reflected in the statement that the Member for Brandon East (Mr. Leonard Evans) was referring to earlier. It was $60,000 which was related to the retail store that we discontinued in Edmonton.

**Ms. Rosann Wowchuk (Swan River):** You have talked about expanding markets, and I wanted to ask a question on an insert into newspapers I have seen quite often that you have in the Western Producer and other newspapers, where you have this circular promoting your products. Has this been successful? Is it used to expand your mailing lists? How successful has that been?

**Mr. West:** The one to which you refer is probably one of the better ones that we use in Canada. It is a newspaper insert that goes into weekly newspapers and things of that nature to the rural community, and it has been very successful, and we do it. We also insert the same type of material into magazines like Harrowsmith and places like that, and that also is very successful.

**Ms. Wowchuk:** Is it successful in sales or is it successful in expanding the lists? Most of these products are books that you are advertising quite often, and you are selling a lot of books through those advertisements?

**Mr. West:** Mr. Chairman, we do sell a lot of books, but they are successful inasmuch as it is cost effective in getting prospective new customers. When we then mail those customers a second time it becomes extremely cost effective, because the reply rate on our catalogues, the second mailing is significant. Without divulging the exact level, it is a very, very good program for building our lists and market or names of customers to whom we can send our catalogues.

**Mr. Leonard Evans:** One question: What would you say has been the most significant financial arrangement or rearrangement between the Government and the company in the past 10 years?

(1120)

**Mr. Downey:** Probably the money that they received to start with, and the manner in which it has been able to be managed to write it down and keep the company going and being solvent.

**Mr. Leonard Evans:** Because, as you recall in the '70s, there was concern about insolvency in the company. Mr. Banman was then the Minister. I remember him making statements to that effect, having big meetings in Brandon and so on. I would say therefore that what the Minister is referring to is what we talked about before, virtually an investment of $12 million by the province, turning the debt into share-equity shares. As I said, I think that was a wise decision, and I am very pleased that the company has shown the strength and the ability to pay back as it has over the years.

I think it is a credit to the company and everyone associated with it, the board, everyone. I believe over the years particularly board members have always given of their time and of their efforts and dedication to making the company as successful as possible, and it has not always been easy. It is a very competitive world out there I would imagine, from my brief little knowledge of it, where you are always not only competing with the regional companies, but you always have the foreign companies who can come in at any one time, some pretty big boys from south of the border, who can make life very difficult.

It is a credit to this Crown corporation that it has been successful in competing in a very competitive situation. Again, I think a lot of people in Manitoba do not realize that we are talking about the No. 1 national, the only national package seed company in the country. Mr. Chairman, I guess that pretty well winds up my questions.

**Mr. Chairman:** There being no further questions, the Minister has a closing statement I believe.

**Mr. Downey:** It will be very brief because I just want to acknowledge the positive approach which Members brought to the committee this morning and the capable way in which Mr. Robinson, Mr. West and Mr. Smeltz have dealt with the report, very open.

I say very seriously I look forward to the tabling of the next annual report. It would be less than fair for me to say today that there will be some announcements very shortly of a positive nature dealing with McKenzie's, which I am not able to talk about because of the time and the sensitivity of what has taken place, but I want the committee to know that there will be some good news to Government in the not-too-distant future.

**Mr. Chairman:** Thank you, Mr. Minister. Shall the October 31, 1989-88 Auditor's Report and Consolidated Financial Statements of A. E. McKenzie Co. Ltd. be passed—pass. Committee shall rise. Thank you very much, gentlemen.

**COMMITTEE ROSE AT:** 11:24 a.m.