“Quebec Inc. in the Chinese Age”

Address by MR. RÉMI MARCOUX

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TRANSCONTINENTAL INC.

to the Board of Trade of Metropolitan Montréal

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www.transcontinental.com

Dear guests and friends,

When I received the invitation from the Board of Trade of Metropolitan Montréal to address its members, my first response was to re-read the speech I made here in 1996 on the occasion of Transcontinental's 20th anniversary. It was an interesting exercise because it made me realize that things have changed considerably since then.

Like your businesses, Transcontinental has grown a great deal in 10 years. In 1996, we reported $915 million in revenue; in 2006 we'll reach about $2.3 billion. We have also more than doubled our workforce, to about 14,000. Plus, we extended our operations into Mexico and have become a major player in the fast-growing direct marketing segment in the United States.

Many other companies have also grown and enriched Québec's economy. Behind high-profile successes such as Alimentation Couche Tard, there are a number of companies that are less well-known but are securely established in their respective niches, both here and internationally. They are the new Quebec Inc.

Another thing that has greatly changed is the economic environment in which we operate. In 1996, for instance, I talked about the globalization of trade. But at that time it was primarily a matter of Quebec companies dealing with competition from Japanese, U.S. or European companies in the Quebec market, and competing with them in their own countries, which mainly meant the United States. Globalization of trade is a much different and much more complex reality today.

Which brings me to my topic, which I have titled "Quebec Inc. in the Chinese Age."

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The past decade has been marked by the rise of what we call "emerging economies." This is not a new phenomenon. You will recall the Asian tigers of the 1980s such as South Korea and Taiwan, which became highly industrialized countries. What is different now, however, is that the emerging economies carry much more weight and have greater potential.

Take, for instance, the group of countries know as BRIC, that is, Brazil, Russia, India and China. These four countries account for 42% of the world's population and are a formidable counterweight to the United States and the European Union. A number of Western multinationals depend on them for their growth.

Another new feature is the growth of powerful multinationals from the BRIC countries. A recent study by the Boston Consulting Group compiled their top 100 companies; the list was published by *Business Week* in July 2006. Of those 100, 44 are based in China, 21 in India, 12 in Brazil and 12 others in Russia, Turkey or Egypt. Over the past four years they have grown at an average rate of 24% and are involved in just about every sector of activity.

To give you an idea of the scale involved, in 2005 these 100 companies had a combined income of 715 billion U.S. dollars, a combined operating income of $145 billion, and assets worth $500 billion.

These multinationals are spearheading the economic expansion of their countries of origin. Their domestic market gives them a solid industrial base, with cheap labour, and they have the active support of their governments in external markets. Plus, they have the financial weight to assert themselves on the global scene. We all followed the saga of the Brazilian company CVDR’s offer to buy Inco, the world’s largest nickel producer, for the mere sum of $19 billion cash. No U.S. or European company could match the offer. A major European newspaper called it “globalization in reverse.”

Because of its huge population and enormous potential, China is the leader among the emerging countries. It has grown at an average annual rate of 10% for the past 20 years. Its factories are being built or modernized at a rapid pace and its domestic market simply cannot absorb the excess production capacity. We even learned that China has begun exporting newsprint to the west coast of North America. That’s in addition to the durable consumer goods, raw materials, technology, telecom products and so forth that they already export.

And then there are the cultural goods. We have become major consumers of cultural products that have local content but are made in China. These include books, magazines, posters, postcards and paintings, to mention only the print-related items. From the time I last spoke to you in 1996, Canada’s trade deficit for the cultural industry alone has risen from $75 million to $278 million.

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So for our companies, the most urgent question is: are these emerging economies, led by China, a threat or a new opportunity for development?

I thought that you might be interested to hear more about how a Quebec Inc. company like Transcontinental is dealing with this new reality in its own industry. And, since it's a vast and complex subject, I thought I'd get some help to give you a more general picture. You'll see what I mean in a few minutes.

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Transcontinental is firmly rooted in North America. On the international market, the United States is our priority. In the U.S. market we have pursued a niche-based strategy: our goal is not to be the biggest, but to be the best in each of our markets.

That aside, when China first appeared on our radar screen we perceived it as a threat. Over the past several years, some of our customers in North America have started getting certain products printed in China. As a company with responsibilities to our employees and shareholders, we reacted quickly to the first warning signals.

First, we determined that China poses a maximum threat when the job involves print products that require a lot of labour and where delivery deadlines are not an issue. So we conducted an in-depth review of our activities in light of these criteria. On screen you can see the revenue for each of our main areas of activity, followed by the projected revenue for 2006 in brackets.

On screen:

- **Magazine, newspaper and book publishing ($500 million)**
- **Door-to-door distribution of advertising material ($100 million)**
- **Newspaper printing ($220 million)**
- **Flyer printing ($450 million)**
- **Direct marketing products and services in the United States ($275 million)**
- **Catalogue and magazine printing ($300 million)**
- **Commercial products printing ($280 million)**
- **Book printing ($150 million)**

At first glance, the threat does not seem that big for us.

(Note: as they are mentioned, the segments vanish from the screen.)

For obvious reasons, our publishing and distribution activities, which represent about a quarter of our revenues, are safe from this type of competition. Similarly, so are many of the products we print, because they have very time-sensitive production and delivery deadlines: newspapers, flyers and other retailer products that are printed every day or week. For its part, direct marketing, with integrated data management and the design and printing of complex items, and direct mail, are also safe. These activities account for three quarters of our revenues.

However, we are more vulnerable when it comes to printed catalogues and magazines, commercial products like posters or brochures, and books. But to different degrees. For example, there’s a big difference between a weekly magazine like *Time*, for which we print the Canadian edition, and a monthly or quarterly magazine.

But we wanted to find out more, so I went to China with two of our senior executives. We visited a dozen printing plants in several major cities, talked with their managers and their European or North American suppliers and met with observers of the Chinese economy.

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Overall, we found that our image of China was dated. China has a development plan for each of its sectors and its model is largely based on the approach adopted by South Korea.

15 years ago, Korean companies like LG Electronics and Samsung were producing low-end, fast and cheap electronic equipment. They were experts in low-cost production. Today they have reached and even exceeded the Sonys of the world in terms of quality, technology, design and brand management.

That’s the model that China wants to follow. By focusing on technology and innovation, China is trying to move from an economy based on cheap labour to an economy based on knowledge and added value. It therefore has much less need of our capital than it does of our know-how and technologies. China wants to end its technological dependence on the West. In 2005 alone, one of its flagship companies, Huawei Technologies, a direct competitor of Cisco in the telecom industry, spent $558 million on research and development. It has an R&D centre that employs 7000 engineers.

This is the backdrop to the development of China's printing industry and our positioning as a company.

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The printing industry in China has gone through a major transformation over the past several years. The small unproductive state-run outfits have been consolidated or closed; ultramodern plants have been built and specialized, and the government has allowed the creation of private companies or partnerships between the government and foreign companies. Plus, they have modernized existing plants. From 2002 to 2005, the printing industry grew at an average annual rate of 20%, double the rate for the Chinese economy as a whole, and it was one of the best-earning industries. China's official goal is to become a key player on the global scene by 2015.

We came back to Canada with two conclusions: that we would encounter increasing competition from China in some segments of our industry; and that the most vulnerable activity for Transcontinental is book printing, a segment that is part of our growth strategy. Note that Transcontinental is Canada's largest book printer and that 60% of our production goes to the U.S. market.

So, what's our plan?

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The biggest advantage Chinese printers have is their very low prices. They have the benefit of a very cheap labour force. A press operator, for example, earns about $1000 a year, whereas here the salary would be $60,000. In terms of raw materials, not only is the paper made in China less expensive than here, but the government also subsidizes exports by 12% to 15%. However, on the other hand, the biggest enemy of Chinese printers is time.

In other words, competition from China is greatest for books that are labour-intensive or for large format, high-priced fine-art books whose publication dates can tolerate turnaround times of more than a few weeks.

At Transcontinental, we have specialized in short and medium-runs, that is runs of a few hundred copies up to 200,000 copies for a bestseller like *Harry Potter*, with very short production cycles. This is the positioning we decided to strengthen in light of the threat from China.

For instance, for several years we've successfully developed short-run digital printing. We print about a hundred titles a month with an average run of 800 copies and a turnaround time of barely 10 days. This means publishers can do a market test and then decide whether they want to do a longer run afterwards. We've specialized our Sherbrooke plant in these very short runs.

Plus, we are investing more than ever to improve our efficiency and provide value-added services before and after printing. This past June we opened our ultramodern printing plant in Louiseville, an investment of $25 million. Not only will it reduce our costs, it will also cut our turnaround times by half, so our customers can get to the market much faster.

Our Louiseville plant also strengthens our positioning in the black-and-white book market in North America, particularly for short and medium runs. In this category, publishers gain few savings if they print their books in China.

Lastly, we have always been known for innovating with the latest technology. We now aim to be the world leaders in this area. That's why this past June, at our plant in Beauceville, we installed the first press in the world to use the new Goss autotransfer technology. This highly automated press cost $20 million and will decrease our costs, shorten turnaround times and improve product quality.

Our investments at Louiseville and Beauceville also reinforce Transcontinental's position in a niche where time is of the essence: issuing reprints of bestsellers. Publishers have to get the books out when the market is hot. We can now offer them the shortest production times in the industry, whether for books in black & white or in colour.

Those are some of our strategies for dealing with the competition from China. We also have competitive advantages that I call "permanent and sustainable." I'm thinking of the fact that our business model is based on being close to our customers, and of our ability to understand our customers' needs and to develop appropriate products and services. This category also includes our qualified and dedicated workforce, which has the ability to adapt quickly to new technologies.

I do not in any way wish to underestimate the competition from emerging economies, but I believe that Transcontinental is in a good position to face it.

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A few words now on the other aspect of the question: Is China a development opportunity?

At first glance, the printing industry looks attractive. Domestic demand for print products will grow exponentially in the coming decades. Indeed, in late September, the printing equipment manufacturer Heidelberg opened its plant in Shanghai and immediately announced the plant's expansion during 2007. Plus, foreign investment in printing is still low compared to other sectors: a bare 2% compared to 29% in the plastics industry or 37% in textiles. U.S. printers like Banta have announced plans to buy in to local companies as partners and private enterprise is more encouraged now than it used to be.

For Transcontinental, however, doing business in China is a medium-term prospect.

When we went to China, we discovered the other side of the coin. China remains a closed economy. It still has deep roots in a planned economy, a legacy of more than 50 years of communist rule. Industry sectors are still run by government corporations, which are all very powerful and independent. Plus, the printing industry faces an additional obstacle. Printed products are the country's primary method of disseminating information and the government is not ready to transfer control to a private corporation, and even less so to a foreign one. Even when partnerships are accepted, foreign companies are restricted to a minority share.

So the liberalization of the economy will be a slow process.

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From the beginning, I've spoken specifically about the printing industry. I thought you might appreciate having a slightly broader picture, so I've asked five other business people to talk about whether they view China as a threat or as an opportunity for development.

Let's first listen to Henri-Paul Rousseau, president and chief executive officer of the Caisse de dépôt et placement du Québec.

(Videoed statements:

- **Henri-Paul Rousseau, president and chief executive officer of the Caisse de depot et placement du Québec**
- **Pierre Fillion, the Canadian Plastics Industry Association's interim general manager for Québec**
- **Alain Com-Nougué, president of Aciflex**
- **Michel Tassé, president of Groupe Fertek**
- **Laurent Verreault, chairman and CEO of Groupe Laperrière & Verreault)**

Thank you, Henri-Paul, Pierre, Alain, Michel and Laurent.

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It's now time to wrap up.

When I founded Transcontinental in 1976, Quebec companies had started to play a significant role in our economy. In fact, the business community only needed a little help to get things rolling.

That help was provided in 1979 by the creation of the Quebec Stock Savings Plan. The famous QSSP! By encouraging Quebecers to invest in Quebec companies, the QSSP gave a generation of entrepreneurs like myself the leverage we needed to grow and thrive. Plus there was the invaluable role played by the Caisse de dépôt et placement du Québec and the Société générale de financement. All that was part of the first model for "Quebec Inc."

Since the early 1980s, our businesses have gone through two recessions, experienced radical technological change with the Internet and digital technologies, faced globalization and the creation of megacorporations such as AOL-Time Warner, and confronted the first stirrings of Third World emerging economies such as Mexico, South Korea, Singapore and Taiwan.

The new emerging economies will force us to adjust, of course, but will also offer us new opportunities to grow. In any case, we have no choice. From now on, to rephrase the message of Thomas Friedman in his book, *The World is Flat*, our market is the world.

I'm not worried, especially when I look at the next generation. In the family businesses that formed the first wave of Quebec Inc., including Transcontinental, we are seeing the rise of the second generation, which is very encouraging. As a society, we have to continue investing in education, stimulating entrepreneurship and being open to other cultures.

At the start of this presentation we talked about Centraide. That leads me to another type of second generation that's very important to me: those who will follow in our philanthropic footsteps. That's why I'm very proud that my daughter Isabelle has gotten involved with the Fondation du maire de Montréal pour la jeunesse which, among other things, encourages young professionals to help other young people get started in business.

In 1996, I ended my speech by making a date with you to celebrate the 40th anniversary of Transcontinental in 2016. I came back ten years early. At this rate, I should probably say: “See you in five years!”

Thank you for your attention.