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<u>**Australia-Latin America Business Council: Latin America Infrastructure Forum**</u>

Keynote address by Alberto Calderon, CEO, Orica Limited

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Good evening everyone, and I would like to acknowledge the many representatives from the governments of Australia, Victoria, Peru, Colombia, Argentina, Brazil, Ecuador, Chile, Mexico, and of course, the representatives of the Australia-Latin America Business Council. I thank you all for your company tonight.

It is a pleasure to be here this evening.

I'm particularly pleased to be among this gathering as a proud Latin American, born and raised in Colombia. But also as a Latin American who has had the privilege of working across a number of geographies, including Colombia, North America, the UK and Australia.

Introduction: Orica in Latin America

I've been CEO of Orica for just on two years now, and it's the most geographically diverse organisation of any I've seen, serving customers across around 100 countries.

We also have a substantial Latin American footprint. We employ around 2,500 people across Brazil, Chile, Cuba, Colombia, Venezuela, Panama, Peru, and Argentina, in manufacturing centres and on customer sites. We work with customers in the copper, thermal coal, gold, iron ore, and quarrying and construction industries.

In the last financial year, our Latin American business accounted for around 17% of our global explosives volumes and 18% of Orica's revenue, so it is a significant part of our global business.

Latin America and Australia

My career has introduced me to experiences across the globe and I have come to appreciate points of similarity and advantages of and across all the different economies and cultures in which Orica operates. In particular, given my personal heritage and my life here, I have come to appreciate the similarities and advantages shared by Latin America and Australia.

I have also gained an ever increasing understanding of how the criticality of the resources industry is often both under- appreciated and misunderstood, despite resources being the lynchpin of economic and social development.

For example, what do Chile, Colombia, Peru and Australia all have in common? Firstly, in each country, resources account for more than 50% of their exports[1]. Secondly, there is a general understanding that mining and related industries support the economy, whether by way of jobs, royalties and taxes, the flow on effect to local suppliers, as well as the introduction into the economy of increased skills, foreign investment, and expertise. In fact, you could argue that *without* the significant contribution of the resources sector in these countries, the respective current account balances would likely become unsustainable, host currencies would come under significant pressure, and government deficits would almost certainly grow. So across these nations, it is undeniable that the resources industry is a positive contributor to standards of living.

Now we all know that China's industrialisation led growth from the early 2000s until the end of 2011 created an unprecedented commodity price boom that we all benefited from, particularly in Australia where iron ore and coal are abundant and high in quality. Those record high prices are now over of course, as the demand and supply fundamentals for bulk resources like iron ore and coal moved toward equilibrium.

While the pricing outlook for metals and mining globally remains subdued, as China moves from the industrialisation phase into one of consumption-led growth[2], the next phase marks an opportunity for Latin America, given its substantial endowment of middle-income commodities, in particular copper.

This optimism for the long term copper outlook sits on the back of China's economic progress and the increasing movement of its populace into the middle class. In fact, you can reliably track the peaking demand from steel making commodities such as iron ore and coking coal, to more consumer product inputs such as copper and aluminium, by looking at GDP per capita. Demand for copper plateaus much later in the industrialisation cycle, compared with the bulk commodities.

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[1] Australia: https://industry.gov.au/Office-of-the-Chief-Economist/Publications/Documents/res/ResourcesEnergyStatistics2014.pdf;
Chile: https://www.cia.gov/library/publications/resources/the-world-factbook/geos/ci.html;
Peru: https://www.cia.gov/library/publications/resources/the-world-factbook/geos/pe.html
Colombia: http://www.worldstopexports.com/colombias-top-10-exports/

[2] PwC Mine 2015 report

Steel intensity tapers off when GDP per capita reaches around the US$15,000 level (on a Purchasing Power Parity basis), while copper demand keeps growing until GDP per capita hits between US$30,000 and US$40,000.

China accounts for around 45% of global refined copper demand, and by the end of 2015, its GDP per capita was around US$14,450[3]. Gold has similar market dynamics to copper.

So while the last phase of the mining cycle was a boon for Australia, the future for mining in Latin America is probably the brightest in the mining industry globally.

Like Australia, the Latin American mining nations are sophisticated, world class resources leaders. Australian and Latin American mining companies have partnered and collaborated successfully for decades. Outside of mining, Latin America and Australia share similarities that make natural business partners. Of course I am speaking generally about Latin America, knowing that there are many differences across particular countries in the region.

But – in general – like Australia, the nations of Latin America have been generally welcoming and understanding of the importance of foreign direct investment as an economic accelerator.

Similarly, both Australia and our major Latin American trading partners are committed to free trade and open markets. In fact, Latin America has played a fundamentally important role in driving global free trade – an agenda that is critical to Australia's economic health and wealth. This includes the development of a number of bilateral agreements Australia has with Latin American nations. Like Australia, most Latin American nations have open investment regimes, stable and pro-business governments and, of course, the abundance of natural resources that make the region an attractive investment destination for the extractive industries.

Shared challenges

With the good we also share industry challenges. Australia and resources capitals like Chile, Peru, Brazil and Argentina are grappling, to varying degrees, to compensate for the impact falling commodities prices have had on mining royalties and national balance sheets. Governments across the mining globe ignored warnings that resources will ever be a cyclical business and they allowed boom time revenues to become baked into forward budget estimates.

In mining specifically, declining ore grades, resources that are increasingly more difficult to access, labour productivity, industrial relations issues and higher expectations from host

[3] World Bank data: http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD

communities and governments are increasingly challenging issues shared by Australia and Latin America, and indeed, by any country with a rich resources endowment.

In a lower commodity price environment, productivity growth is essential. A recent McKinsey Global Institute discussion paper on Latin America's growth opportunities found that while in developing countries overall, productivity grew at 3.9 per cent annually and per capital GDP at 4.2 per cent between 2000 and 2015, Latin America's equivalent figures were 0.6 per cent and 1.6 per cent[4]. And Australia's Multifactor Productivity Growth is only slightly better, at 0.9%.

The figures are telling, and show a critical need for the region to focus on productivity initiatives. In my experience, while the burden of increasing productivity has to be borne by industry, governments have a role to play in ensuring the right industry-friendly structures are in place to ensure both the attraction of long term investment (based on having the confidence that business will be internationally competitive), and that businesses are free to take productivity actions. This particularly relates to labour laws that enable flexibility.

There are other, emerging challenges in the Latin American region. The United States remains the region's biggest trading partner and there is no doubt that U.S. international trade policies still require clarification under its new government. A border tax, if enacted, would certainly be difficult for the region, as would any moves towards more protectionist, domestic policies. These two issues alone would be significant for the region.

Encouragingly however, both Australia and the Latin American nations have governments and industry who are highly experienced at managing through complex issues. And despite the challenges, I remain optimistic about Latin America's resilience in the near term, and its growth opportunities over the medium to longer term.

Rising above the challenges

As I mentioned earlier, China's transition to a consumption-based or middle income economy will drive demand for base metals, such as copper and aluminium, to the benefit of those countries that hold the resources, such as Chile and Peru.

China has developed a voracious appetite for commodities. It has overtaken the US as the world's biggest commodities importer, despite the fact that US imports grew threefold over the last 20 years. China now consumes almost half of the world's refined copper, and is the

[4] McKinsey Global Institute: Where will Latin America's Growth Come From?, April 2017

world's largest copper importer, with a 45% share[5]. China is also a major trading partner of Australia, Brazil, Peru and Chile[6], so its fortunes and ours are strongly correlated.

As China's GDP per capita signals a move to the middle class, demand grows for middle class – or lifestyle – products, such as cars, air conditioners, mobile technology and household electronics, that require copper and other base metals as core components. This is now happening in China.

In addition, the global rise in renewable energy and electric vehicles provides massive opportunities. To illustrate, the rapid uptake of electric vehicles has been boosted by faster than anticipated developments in lithium ion batteries. While there are around 1 million electric vehicles on the roads today, Wood Mackenzie estimates this to grow to around 100 million electric vehicles by 2035. Why is this good for copper? Copper intensity for electric vehicles is far greater than in standard vehicles, with transmission, charging and manufacture consuming 80 kilograms of copper per electric vehicles, compared to just 20 kilograms of copper for standard vehicles. This could rise even further if there is additional demand for renewable energy charging stations.

In fact, we know that Renewable energy will be a growing component of our energy diets. And this is also good news for copper, because copper is a highly efficient conduit that is also a key input into renewable energy systems that generate power from solar, hydro, thermal and wind energy. In many renewable energy systems 12-times more copper is used than in traditional systems to ensure efficiency[7]. This provides an incredible opportunity for the Latin American nations that are exporters of copper ores and concentrates, including Chile, Peru, and Argentina[8].

The short term

But all that is over a longer, 5 plus year's horizon. What of the immediate future?

Orica's customers on either side of the Pacific are pursuing essentially the same strategies to rationally extend the productive life of their mature assets.

The key point of focus is productivity improvements that serve to defend and enhance returns from legacy assets in these times of low commodities prices.

[5] BTMU focus Latin America, MUFG Union Bank Economic Research (New York), January 2016
[6] BTMU focus Latin America, MUFG Union Bank Economic Research (New York), January 2016
[7] Copper Alliance: http://copperalliance.org/societal-benefits-landing-page/renewable-energy-3/
[8] The World Copper Fact Book 2013, slide 29, http://www.icsg.org/index.php/press-releases/finish/170-publications-press-releases/1188-2013-world-copper-factbook

The Latin American extractive industries will continue to look for innovative and proven ways to strengthen the sector's resilience, efficiency and profitability throughout the cycle. Counterintuitively perhaps, the lower commodity price environment presents opportunities for Australian businesses with the right skills and experience to work with Latin American companies in this effort.

Orica, for example, is increasingly focused on working with our customers to develop better outcomes in productivity, costs and safety, and in minimising environmental impacts through advanced blasting.

The real positive here for mining companies seeking to improve their productivity, is that the cost of explosives as a percentage of ore value is low, but an improvement in blasting outcomes can be leveraged into significant productivity benefits through improved mill throughput, maximising recovery, reduced energy usage, among other benefits. Blasting represents less than 4% of total mine costs, but it can positively impact 60% of costs, through improved fragmentation, vibration, increased throw, et cetera, which can be leveraged for significant productivity benefits[9].

The actions being taken by our customers in Latin America mirror those across our Australian customer base, essentially because both are world class mining regions that are looking for innovative ways to increases mining productivity. This also means we are able to easily and effectively share experiences and lessons across the Pacific, for the benefit of Australian and Latin American customers.

Orica has operated in Latin America for around 30 years, and my whole career in resources has bridged Australia and Latin America. Both my and Orica's experiences have been the same. In short, while there are language and cultural differences between the Latin American nations and Australia, in business and in attitudes towards business, in welcoming foreign investment, and in the skills and expertise of its workforce and enterprise leadership, the similarities outweigh all else.

Let me end this speech with some personal reflections about Australia. Since 2010 I've been very happy to call Melbourne home. Melbourne is a long way from Colombia and Latin America, but its tradition for welcoming foreigners is well known. It has actually welcomed South Americans since the beginning, Australia's third Prime Minister, John Christian Watson, was born in the Chilean port city of Valparaiso, immigrating to Australia as a 21 year old in 1886[10].

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[9] Orica FY15 Results Presentation, slide 33 (http://www.orica.com/News---Media/orica-2015-fy-financial-results-laying-the-foundation-for-long-term-performance#.WQf2iOn7VaQ)

[10] Chile Country Brief, DFAT: http://dfat.gov.au/geo/chile/Pages/chile-country-brief.aspx

When I arrived in Melbourne seven years ago my first major speech was here, with ALABC. So of course the opening lines had to do with footy, and what team had I chosen. I made then the joke that I would not make today. I said, I followed the advice of a good friend, “anyone but Collingwood”. And I say that I would not make it today because through the years I have come to understand the intricate and profound role that footy plays in society. Some of my best friends are Collingwood supporters and, yes, they have teeth…

They didn’t have a choice, it comes with the blood, it is deeply engrained in the family. I live close to the MCG and I still marvel at the size of the crowds, the roars of the fans, but mostly I marvel at how the families exit with a smile, peacefully, win or lose. I probably have to add that I couldn’t make the joke today after the thrashing that my team, Geelong, suffered some weeks ago at the hands of Collingwood.

Anyway… I also touched in my speech about my first impressions of this vast land of opportunity. How the mining boom was elevating the economy and touching so many lives for the better. This country, rich but still young in the industrial sense, vibrant, felt so pleasantly distant to the European continent I had left. Seven years have passed, and the easy charm of Melbourne and Australia has bewitched me and, if the government doesn’t keep changing the rules, I plan to apply for permanent residency next year.

Unfortunately, something else has changed in the past decade. The two engines of growth in the past decade, mining and housing, are not what they used to be. China is still growing at relatively high rates, but they have moved on into the second stage of development, which means that the commodities that Australia has, iron ore, metallurgical coal etc, will still be important contributors but will not see again the boom of the first years of this century. Nor will investment in these sectors keep pulling the economy along. The same can be said about housing. The largest sector in the GDP accounts, Ownership and Dwellings, contributed 10% of the growth in 2015. Construction came a strong second.

The most common theme of conversation in Melbourne, housing prices, leads to passionate debates. Maybe we will see some correction, maybe they will stagnate.

What is clear is that with a world record household debt over income of more than 200%, with the highest housing stock valuation to GDP in the world (3.5), with banks with 30% to 50% of their loans using the financially intriguing “interest only loans” that can only be repaid if the market keeps going up, with all of these factors the growth in real estate prices will not be the source of wealth creation that it has been during the past twenty years, nor will it be a pillar of growth.

There is another silent sign that things are not like they used to be. The underemployment rate, those who want to work full time but can’t find enough work, has reached almost 10%, the highest level since they began tracking this statistic – 1980. The highest hit cohorts, the under 24 and the over 45, are a particular worry. This is the main reason why real wages are not growing, nor will they grow at the 3% rates that for example the Government's budget estimates.

So what has to be done? The conditions need to be created for the private sector to invest, to innovate, to grow. Corporate taxes are the highest in the OECD, consumption taxes the lowest. This punishes investment and rewards consumption. We need to do the opposite. Make this boundless country as competitive as possible, and incentivise productivity to unleash its undoubtable potential. Unfortunately, we seem to be following the path of France and other developed low growth countries. Higher taxes on investment, higher government spending, crowding out of the private sector. One of the doyens of Australian journalism, Paul Kelly, wrote a column last week that I would like to quote: "The edifices of Australia's aspirational politics and market based reforms are being torched in an end of generation bonfire. Occasionally in a nation's history you can identify a point of transformation and it is likely that this week is such a marker…Politics is now a contest about the nature of tax increases, the scope of monumental social spending initiatives and the type of government intervention".

Daily life is enormously pleasant and easy in Melbourne. The economy is still growing and we have now the world record for the longest years without a recession. Maybe we will extend this for many years. But let's not fool ourselves. The dynamic, vibrant economy that I saw when I first came is not present any longer. Our economy will look more and more like France, not like Singapore. But this is not inevitable; this can be changed. My words have the hope that we can all commit to not giving up, to keep dreaming and fighting for that country that we know we can be. Thank you very much.