

AUSTRALIA - THE GLOBAL CONTEXT

Jac Nasser
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16 May 2012

INTRODUCTION

It is a pleasure to be here today and I am pleased to see so many friends from the Institute.

Addressing the Australian Institute of Company Directors is a long way from Northcote Boy's High School and Ford in Broadmeadows.

I think sometimes you have to go away from Australia for some time to fully appreciate the extraordinary opportunities that a sun kissed country at the southern tip of the world offered us and continues to offer all Australians.

I actually don't agree that we are a lucky country. I think everyone, including a country, makes its own luck and when the chips have been down; whether it's been a war, natural disasters or facing up to major economic changes, Australians have stepped up.

One of the major challenges we now face is that when good times have been part of everyday life for well over a decade, governments, companies and communities think it must be the norm and will go on forever.

I think this is why it is so hard to believe that the world has fundamentally changed since the financial crisis – that 2008 wasn't just a short-term glitch but a structural shift.

Let's take stock on where we are. Just think, in the past short period we have seen:

- the Prime Ministers of Greece, Italy and The Netherlands resign;
- incumbent governments voted out in the UK, France and Spain; and
- the Governor of the Bank of England declare an end to fifty years of rising living standards.

And as we sit here we are seeing the Eurozone change in ways that only a short time ago were almost unthinkable.

In Australia we have been fortunate that while the world has struggled with changes to arrest economic decline our banking sector withstood the turmoil of the liquidity crisis and our resources sector responded to the opportunities that China presented.

However today, as directors, we can't look in the rear view mirror at the last ten years hoping to get answers for the future.

Right now nine of the 20 largest economies in the world are what we used to consider emerging economies. In fact within the next 20 years over 60 per cent of the increase in global GDP is expected to come from the emerging economies.

And rather than the world settling down we will face increasing volatility and uncertainty. It really is going to feel as if the ground is shifting under our feet.

So in this context I thought I would stay close to home and look at actions that I believe Australia should focus on – actions that are within our control and would, in my view, immediately and positively improve public sentiment.

BUSINESS AND GOVERNMENT

As directors, every one of us has to make decisions that have the long term success of our companies at their heart.

And, as Australians, all of us want Australia to be successful and to give our kids and grandkids a better life.

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A few weeks ago I met with an old friend, a former Federal Minister. For the past few years he's been working closely with business and he said to me "I wish I knew then, what I know now".

What he was saying, which I think is true of business and government, is that he didn't fully realise the connections between what governments say and how company Boards think and react.

Those comments made me think that we need a better understanding of the connection between business success and Australia's long term prosperity.

More than 90 per cent of Australian Federal Government revenues come from taxes. The majority of that revenue comes from taxes like personal and company income taxes, capital gains tax and GST.

In addition, state governments receive substantial revenues from royalties and stamp duty.

So we all have a real interest in making sure business does well and pays a fair amount of tax.

The more successful business is, the more funds government has to invest and the more value we also create for our shareholders, employees, contractors, suppliers and everyone else involved with our businesses.

And, of course all Australians have a real interest in business doing well not just because of the jobs created but because it means that more Australians benefit through the value of their shares and superannuation investments. This is a very important driver of confidence in our country and our long term success.

But when there is a mismatch between the time horizon governments and business work to then we have a serious problem.

As I said earlier, Boards and nations have to make decisions for the long-term. In our case at BHP Billiton that long-term can be up to 50 years and sometimes longer.

That means we have to balance investing for the longer term with ensuring shareholders are adequately rewarded in the shorter term.

In some cases we don't see an investment break-even for up to ten years but we invest for the longer term because we believe our large, long-life assets can, and should, generate strong returns over time for shareholders. Getting the balance right is crucial in this environment.

For instance, construction in our Escondida mine in Chile began 34 years ago with the first copper concentrate leaving the mine three years later. That came after removing 180 million tonnes of waste to get to the ore body.

Today the Escondida mine is the world's largest copper producer. It has contributed to the economic well being of Chile and provided good returns to its owners over time.

Our Mount Whaleback mine in the Pilbara began production 44 years ago in 1968. In fact we shipped our first iron ore a year before Neil Armstrong walked on the moon.

For those of us who were around in the sixties the first man walking on the moon was a very big deal. For those of you who weren't born then it is the equivalent of New South Wales winning the State of Origin or the Melbourne Football Club winning the AFL Grand Final.

Anyway, this mine is now the biggest iron ore mine in the world. In terms of size think of a mine that stretches from here to Bondi Beach and back to Central Station.

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For over 50 years, BHP's board and management never lost sight of the big strategic picture of these iron ore investments.

As a result, in that time, BHP Billiton has gone from producing less than 7 million tonnes to almost 180 million tonnes on an annualised basis – employing 13 thousand people across the Pilbara.

DELIVERING RESULTS

This sort of continuing investment - together with new investment in resource projects - is one of the key reasons Australia has low unemployment, good economic growth and relatively low debt by world standards.

But how do we know if the right long term policies are being set for Australia's success?

Well, there are impartial reports that measure the effectiveness of nations.

The World Bank's "Ease of doing Business" index is one. According to the World Bank, Australia fell from 11th place last year to 15th this year.

Then there is the "Measure of Global Competitiveness" from the World Economic Forum.

When you look at these rankings, Australia dropped 4 places to number 20 last year – that's despite an increase in government spending of more than 80 per cent in the last ten years.

When you consider that over the same 10 years, tax revenues increased by 60 per cent to \$120 billion, it is fair to question how this happened.

All boards of directors and all governments have choices about where they put their capital. For BHP Billiton, these choices include different projects, products and geographies.

Equally, these days, every dollar of a company's cash flow has many claims on it – from shareholders, governments, communities and other stakeholders.

Let me slip in a small ad here and say that over the 11 years since the merger of BHP and Billiton – we have delivered a total shareholder return for our long term Australian investors of 353 per cent.

Our contributions to governments and communities are also significant. We are Australia's biggest taxpayer, contributing over \$6 billion in royalties and taxes to local, state and national governments last year.

Our effective tax rate in Australia including company tax and state royalties is 42 per cent.

We also spent around \$12 billion buying goods and services from suppliers in Australia – many of these are small to medium sized local businesses that depend on us and other miners for the majority of their income.

And for the last 10 years, we have committed 1 per cent of our pre-tax profits to community programs around the world – that is \$1.1 billion including almost \$200 million last financial year.

INVESTMENT FRAMEWORK

But coming back to how we invest – we all know that appropriate capital allocation is key to long term success.

Let me make it clear that I'm not suggesting we at BHP Billiton get it right all the time. However, given the size of the investments we make and the time frames we work to, I thought it might be useful if I shared the way we think about making investment decisions.

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In looking at where we invest, we prioritise our investments to where we see geopolitical and fiscal stability; where we have sustainable competitive advantage; and where we expect the best return for the risks taken.

And yes, over the last 11 years we have produced strong returns for shareholders – but it hasn't always been this way.

When the growth from China's development became evident in around 2001, resource companies were not in a position to respond quickly. After decades of a challenging business environment, the industry had no major projects ready to go.

What this meant was that companies and investors were slow to recognize and respond to the changed demand coming from Asia.

Once it was apparent that demand and higher commodity prices were sustainable in the medium term, the industry went ahead and started to make significant investments.

But having worked hard to generate investment options, producers like BHP Billiton now find the investment horizon has changed in 4 ways:

- First growth in development activity has driven higher operating and investment costs. While this is not restricted to Australia, it is true that Australia is increasingly one of the higher cost countries in the world.
- Second these cost increases have occurred at the same time as we have experienced a much more difficult industrial relations environment. It has not only affected productivity but has resulted in management being unable to operate its business in a fair and consistent way for all stakeholders.

Let me give you an example. Over the last year, in our Queensland coal business alone, we have faced 3,200 incidents of industrial action.

We have received over 1,000 notices of intention to take industrial action – and then approximately 500 notices withdrawing that action given on less than 24 hours notice.

The Global Competitiveness Report I referred to earlier highlights just this point. Restrictive labor regulations have quickly become one of the most problematic factors for doing business in Australia.

- Thirdly host governments have also responded to increases in short to medium term commodity prices by increasing taxes and royalties.

While governments have the right to make tax and royalty decisions, those decisions have repercussions.

Don't get me wrong we take seriously our responsibility to discover and develop the commodities owned by all Australians however that takes large amounts of shareholder funds over time.

- The final change is the continuing global volatility and uncertainty since the financial crisis.

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This has led shareholders around the world to lose confidence in the longer term health of the global economy and place a greater emphasis on cash returns and dividend yields.

As much as some wish it wasn't the resources business has always been and will always be a cyclical business.

The tailwind of high commodity prices has contributed to record growth in the sector and the country. Now we have a period where those tailwinds are moderating and we expect further easing over time.

It is critical that we appreciate the significance of these four changes as we think about our future.

Where the industry previously lacked investment opportunities and choice, it now has more projects than cash flows. All of us in the industry are having to make choices.

At BHP Billiton, our choices include in which product – iron ore, copper, uranium, shale, potash and so on – and in which country we choose to invest. We are fortunate to have a diversified portfolio of choices.

Given our range of options, if we can't meet our criteria in any one project, product or geography, we will redirect our capital somewhere else or we simply won't invest at all.

GOVERNMENT POLICY

I know that running a country is a serious and complicated matter and it's very different from running a business so I won't presume to say I have all the answers to the issues facing us.

I know some of you will remember President Bill Clinton saying that running a country is like running a cemetery - you've got a lot of people under you and nobody's listening!

And while we may not all run a country, I think sometimes all of us feel that way.

However given the uncertain global outlook and the fact that some of our own leading indicators are not encouraging I think there are two key levers in our control which, if we get right, will have an immediate impact on sentiment and confidence and help set up Australia for the next decades of growth.

These two levers have always been the basic pillars of confidence, long run investment, productivity and wealth creation but, when times are good, these are sometimes forgotten, or at least masked.

The first of them is a robust industrial relations framework with productivity and fairness at its core and suitable for the 21st century.

We need to recognise that an industrial relations system that pits labour against capital can never lead in the long term to an efficient and productive workplace.

In recent years, it's hard not to feel as if our industrial relations system has been like a pendulum, swinging from one approach to another.

I am not casting blame here, either at management, the government, unions or the workforce. I basically believe the framework is just not appropriate and doesn't recognise today's realities.

The success of a system that allows for direct employee engagement and alignment has been evident for many years and, even though it has been in different forms during the Hawke, Keating and Howard years, it worked.

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It carries with it the right for all employees to be represented but it also recognises the right of management to run the business without the constant threat of a veto over operational decision making.

It is imperative for companies to have the ability to manage and put in place fair and effective working arrangements that support a company's productivity, and by extension a nation's competitiveness.

BHP Billiton respects the role of unions in the industrial relations landscape. It is important to have a cooperative framework within which to engage employees who choose union representation.

But we do not believe that the influence of unions should be disproportionate to the level of union membership which today accounts for around 15 per cent of employees in Australia's private sector, although this of course varies across industries.

If we are to stem the fall in our relative competitiveness, as a nation we need an industrial relations framework that is fair but also builds a culture of continuous improvement and acceptance of change.

The Government's review of the Fair Work Act is an opportunity to move the pendulum back to a more appropriate balance.

The second lever is a stable, predictable and competitive tax framework.

It is the right of governments to set the tax regime but I cannot overstate how the level of uncertainty about Australia's tax system is generating negative investor reaction. People don't know where it's going.

What we have in Australia is not a perfect system and on a global basis we are at the upper end of overall taxation levels. That means we are not competitive - however what matters more at this point in time is stability.

In time we will need to address the complexity of our layered tax systems and ensure that they are competitive on a global basis.

But at this point in time constant discussion about change creates substantial uncertainty which in turn changes sentiment and the dynamics of long term investment.

If Australia doesn't get both of these policy levers right – industrial relations and taxation – we will not drive improvements in economic prosperity that we should expect for our country.

Last week, the Australian Government took a step towards de-leveraging by delivering a Budget which targets a surplus in 2013.

At this point in the economic cycle, it is a positive sign that the Government is committed to delivering a surplus as fiscal responsibility is at a premium today.

However, it is disappointing that the public comment is focused on taxation and wealth redistribution, not wealth creation.

That continuing debate is not helpful, particularly for the resources industry given the large expenditure and long term nature of our investment decisions.

The reality is that even in a fragile world, we have the opportunity to lift the wealth of all Australians – and I am talking about wealth in the broadest sense of the word – and to position future generations for a very different world.

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Yet, rather than focus on how to maximise the benefits of the resources sector and other potential growth sectors the debate has been mainly about which parts of Australia have been missing out, how to slow the industry down and how the government captures a greater share of the value – not how to create greater long term wealth for Australia.

So we need to look at today's costs, taxes, economic conditions and where we are in the cycle and think about where these could be heading. We have to think hard about taxing away future returns and consequently capping future investments and opportunity.

It's also personally disappointing to me that part of this debate has become one based on class divisions.

I am the son of a Lebanese man who worked side by side with the Australian armed forces in Lebanon during the 1940's. He admired them so much and what they had to say about Australia and meritocracy that he came here after the war.

Around 60 years ago my father packed up the family and left Lebanon. We docked at Port Melbourne and lived in a single bedroom in a house in the northern suburbs.

So Australia gave me a start, a great education and a life-long career that started at the bottom of the ladder at Ford.

Generally the people who have done well in Australia have done so by their own toil – they have created great companies, thousands of jobs and often led the world in what they've done – people like Lindsay Fox, Frank Lowy and newer entrepreneurs like Andrew Bassat and Greg Roebuck – and yes, so have Gina Rinehart, Andrew Forrest and Clive Palmer.

Attacking individuals and specific industries doesn't build confidence in our country – nothing good comes from this.

It is particularly troubling when these attacks are directed at the resources sector, a part of the economy that has the potential to continue growing, creating jobs for many more Australians.

We have a world class industry that all Australians should be proud of. But it is a global and very competitive industry in a fragile time.

We are not asking for government handouts or more favourable treatment. But when every day global investors question what is going on in Australia, as an Australian you start to worry.

I don't think it is good for Australia when global investors question openly whether Australia really wants a globally competitive resources industry.

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CONCLUSION

So in summary, what do we do? Well, in short, we have to “gear up” for it.

We can't dwell on the benefits of the last decade's record commodity prices. At this time we have to take responsibility for focusing on those things that make the difference for Australia.

I know there is a risk of being accused that as an industry we are banging on about stable tax and appropriate industrial relations frameworks - but having been privileged enough to spend my life working around the world, I personally think these are the two key issues that enable growth and opportunity in Australia.

I know we will make progress if we focus on getting these two issues right.

Let me finish where I started.

Australia is a land of extraordinary opportunities.

We have amazing natural resources; we have talented and enthusiastic people; we have a history of innovation; and we have a strong sense of fairness.

We have to once again face up to the challenges. We need to do it together. And we need to do it with a clear vision for what I really believe could be Australia's best century.

Thank you.