GFC Impact on Mining, Engineering and Construction

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NEGOTIATING THE DOWNTURN:
EMERGING STRONGER
Ai GROUP NATIONAL FORUM 2009

Outline

- Global Outlook
- How the GFC is impacting the mining, engineering and construction industry
- Challenges facing the industry

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Thank you for the opportunity to talk to you today.

My address will cover the following three issues:

- The global economic outlook, particularly as it applies to construction, mining and engineering.

- How the global downturn is impacting our industry.

- Ongoing challenges facing the industry as we emerge from the downturn.

Leighton Group

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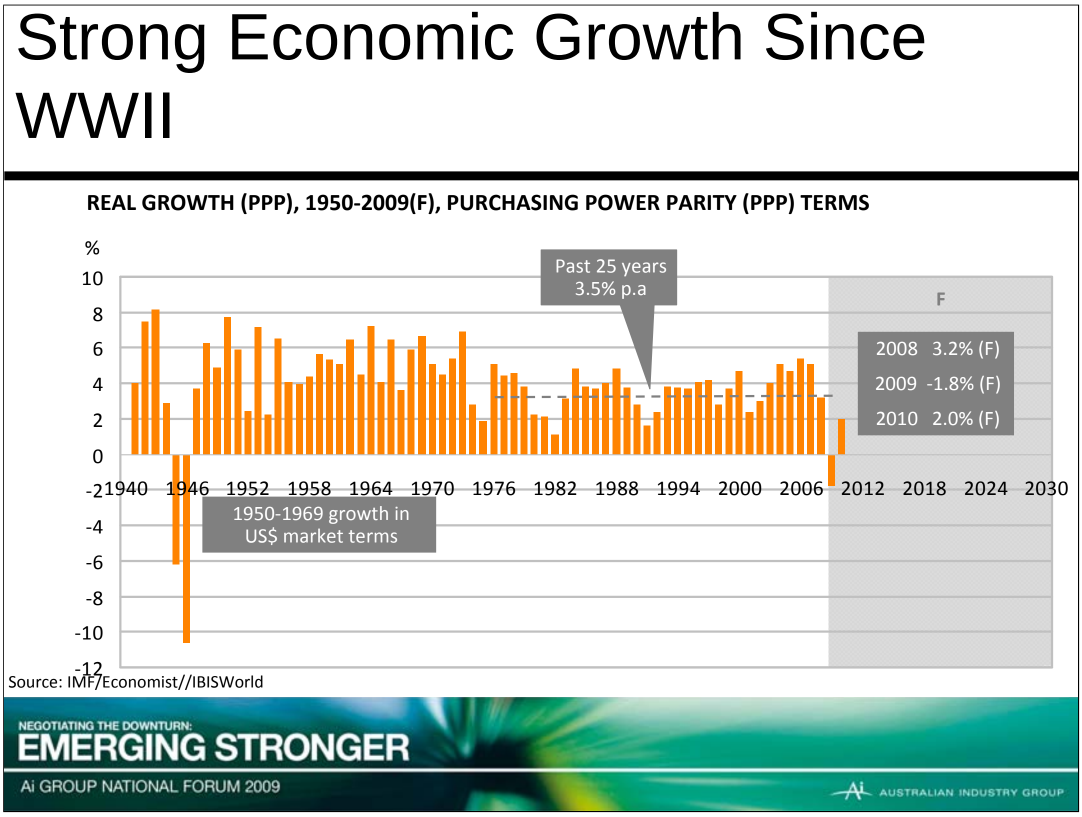
The Leighton Group is one of the world's major project development and contracting organisations and world's largest contract miner.

We operate in more than 20 countries from headquarters in Australia, Hong Kong and Dubai.

Work in hand last year was $37 billion.

We directly employ more than 40,000 people worldwide, including 23,000 Australians.



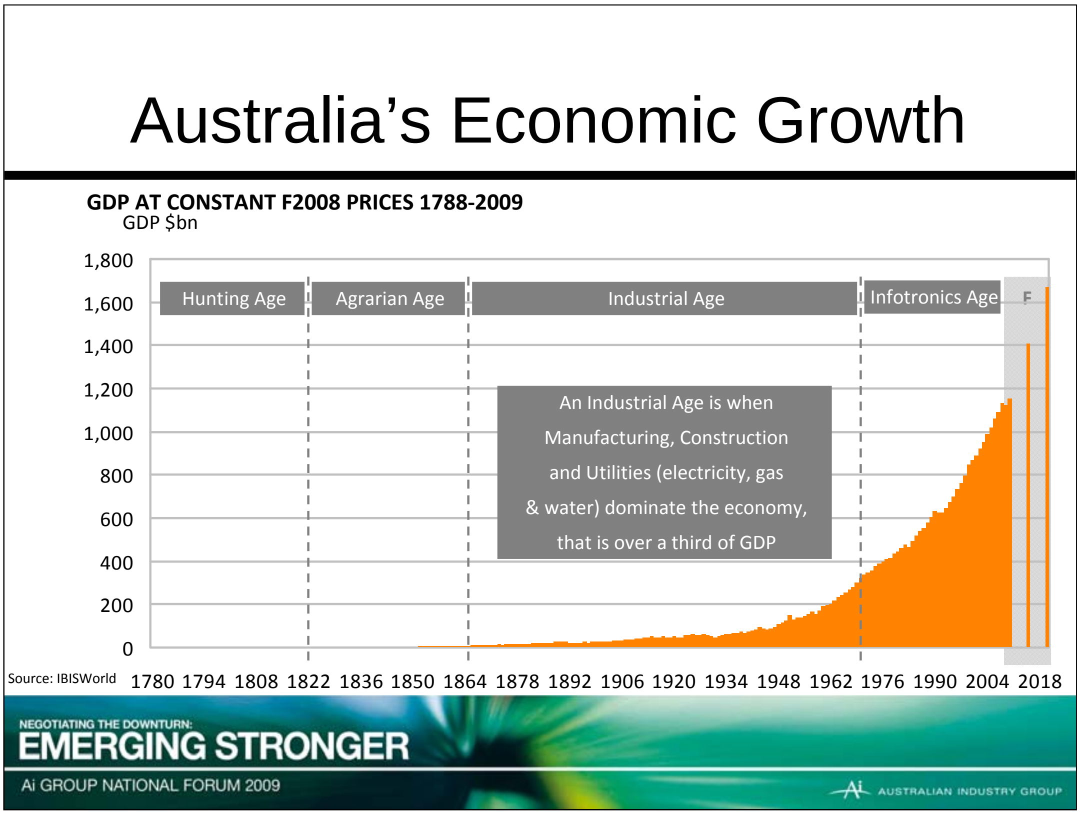
GLOBAL OUTLOOK

To appreciate where we are at in ‘negotiating the downturn’, I think it is important to take a long term perspective.

It is a natural human tendency to be more influenced by recent events, but it is not necessarily the best way to make informed decisions for the long term.

Everyone knows we have been going through the most serious global downturn in 60 years.

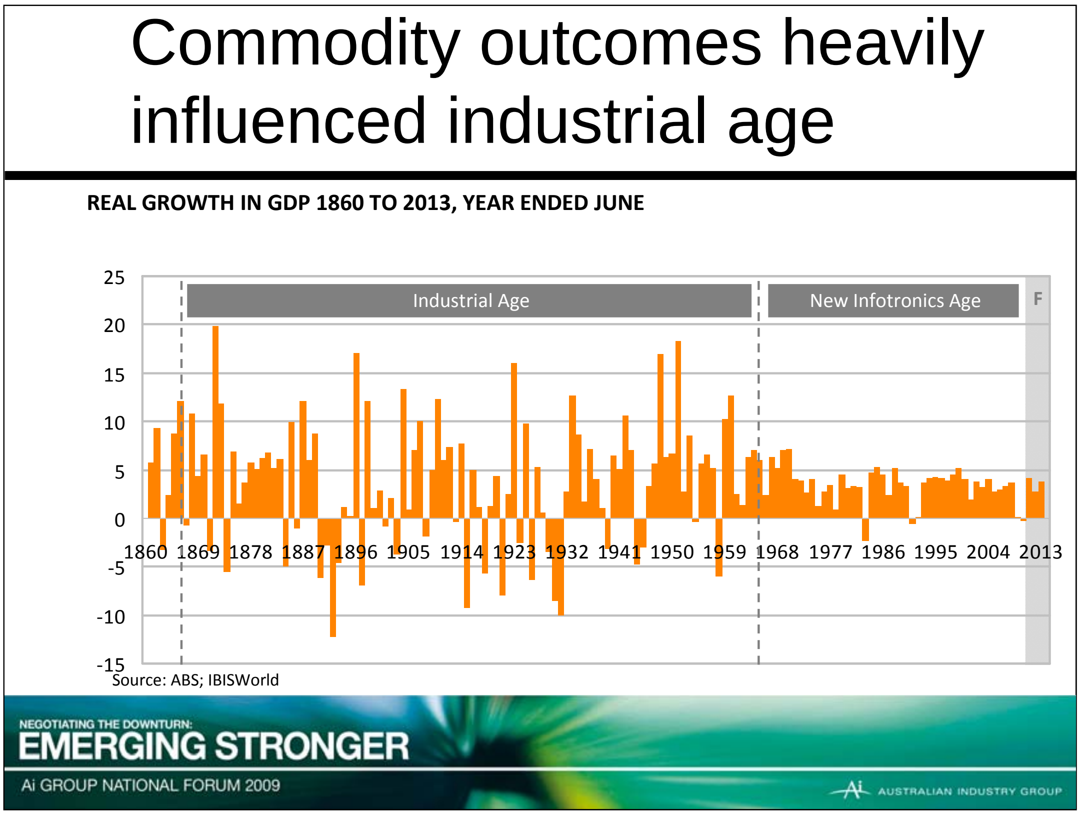
But this downturn is in the context of almost continuous strong growth since WWII.



If you take an even longer perspective, Australia’s economic growth has been significant over our short modern history, both in real GDP terms and in Standard of Living terms (real GDP per capita).

In Australia and in the developed world, we have better social safety nets and faster reaction times to lessen the impact of any dips.

And as technological change continues to drive productivity improvements, our GDP growth and standard of living is forecast to continued to increase.

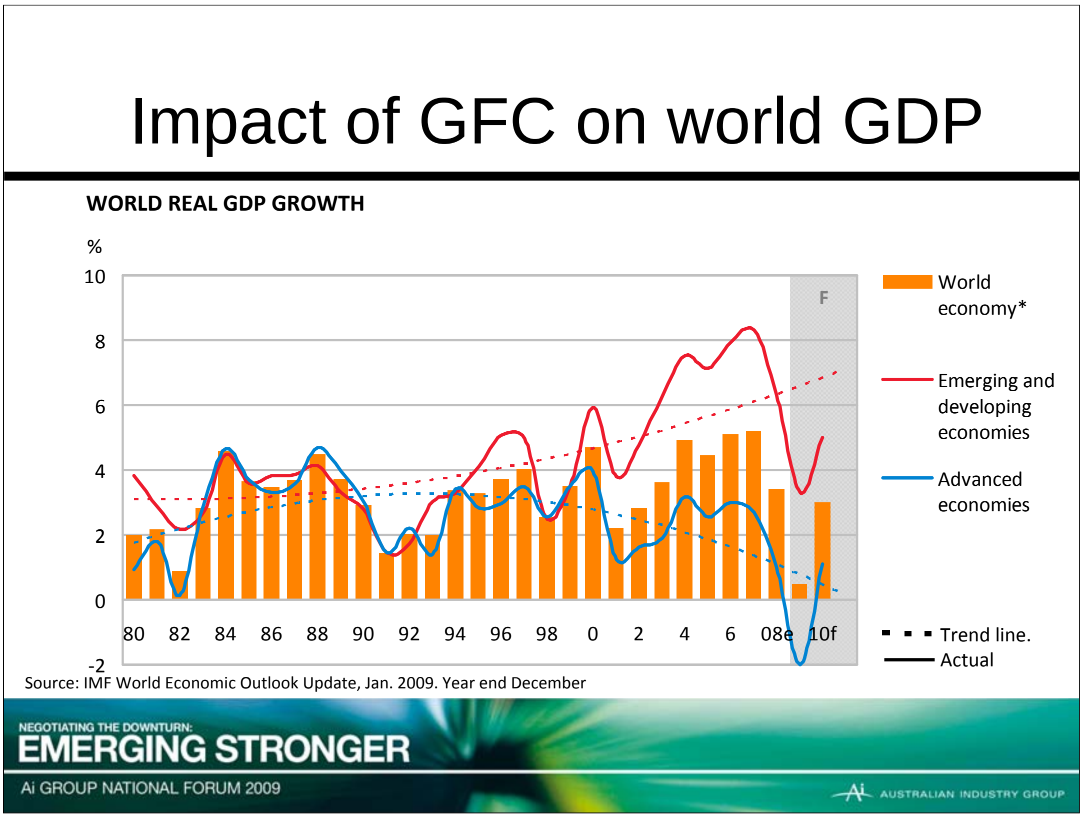


As impressive as our modern growth story is however, the overall growth figures mask significant setbacks at least until the end of the industrial age.

Historically, major falls in real GDP growth have been due to poor commodity outcomes caused by climatic factors in Australia (floods, droughts) and global demand factors impacting on prices.

Australia is now relatively less dependent on resources as part of our overall GDP mix, although they are still our biggest exports.

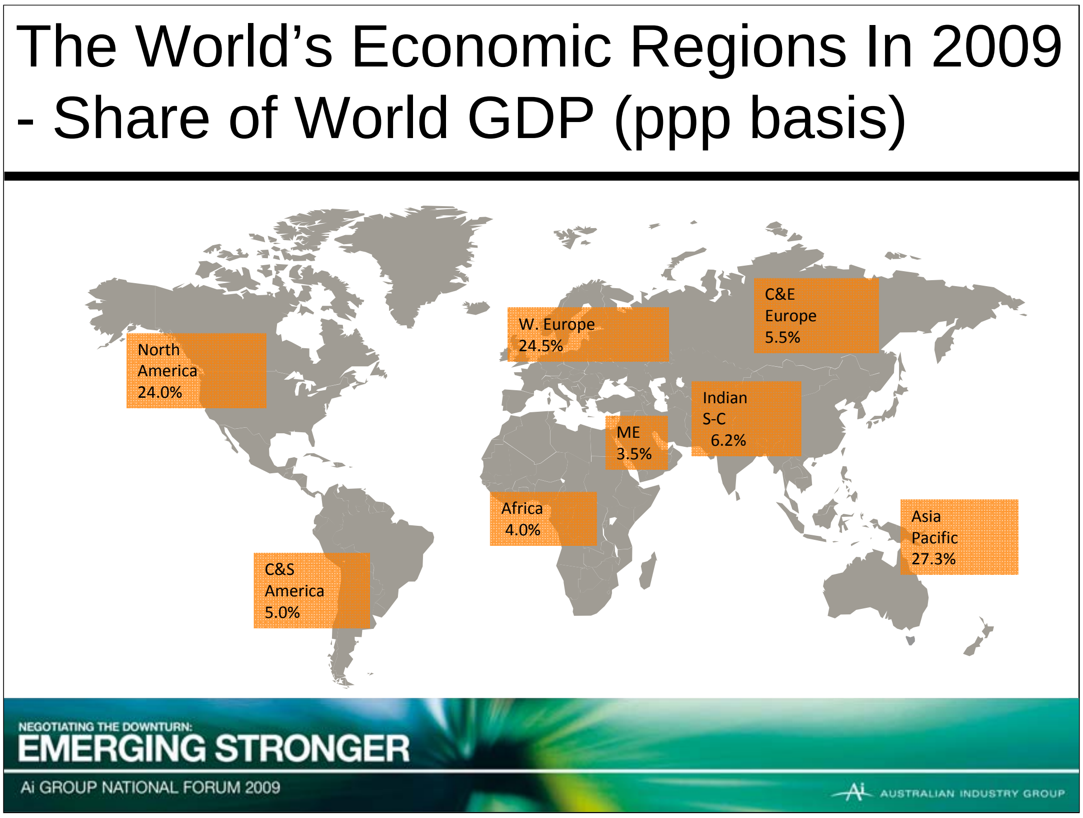
As the graph shows, whilst we may be going through a rough patch over the last 18 months, if you take a longer term perspective and look back to our grandparents and great-grandparents generations, we've been in a remarkably stable and prosperous period for nearly 50 years.



The Global Financial Crisis has obviously had a major impact on the world economy. For example, in the mining sector during the crisis, the value of the world's 40 largest mining companies dropped by around 60%.

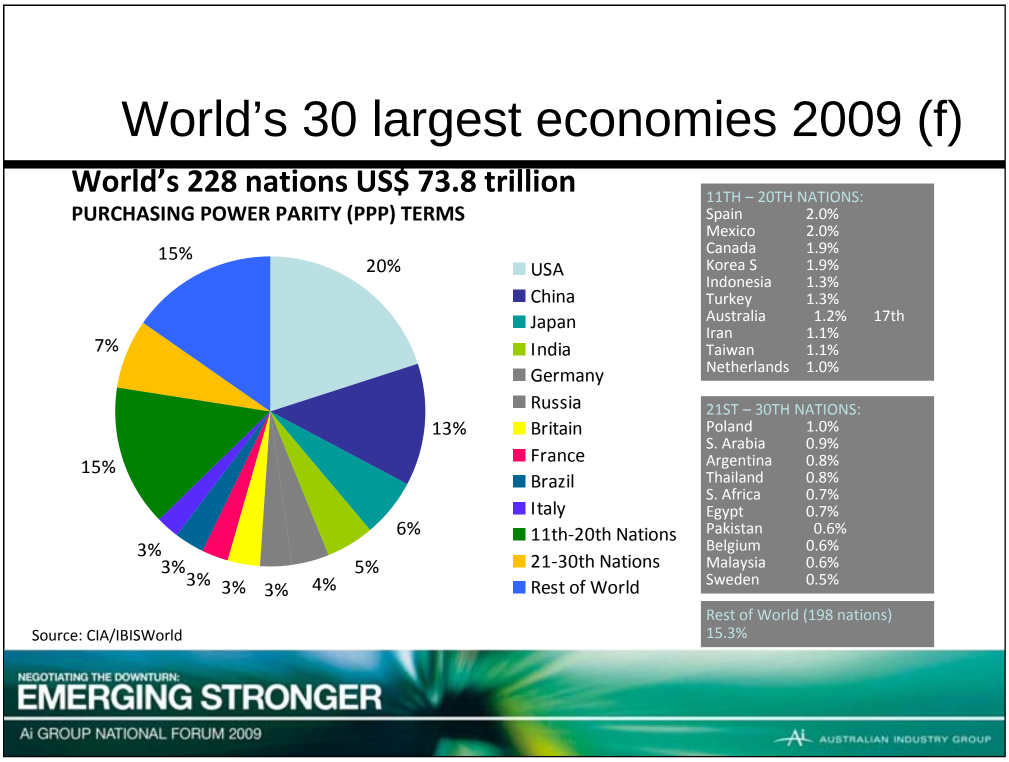
However as the chart shows, the impact on the advanced economies has continued a longer term decline in relative GDP growth.

The emerging and developed economies, including the powerhouse economies of our region, China and India, whilst affected by the GFC, are still on strong long term growth paths.



In Australia, we are fortunate to be part of the Asia Pacific Region, which accounts for over 27% of global GDP.

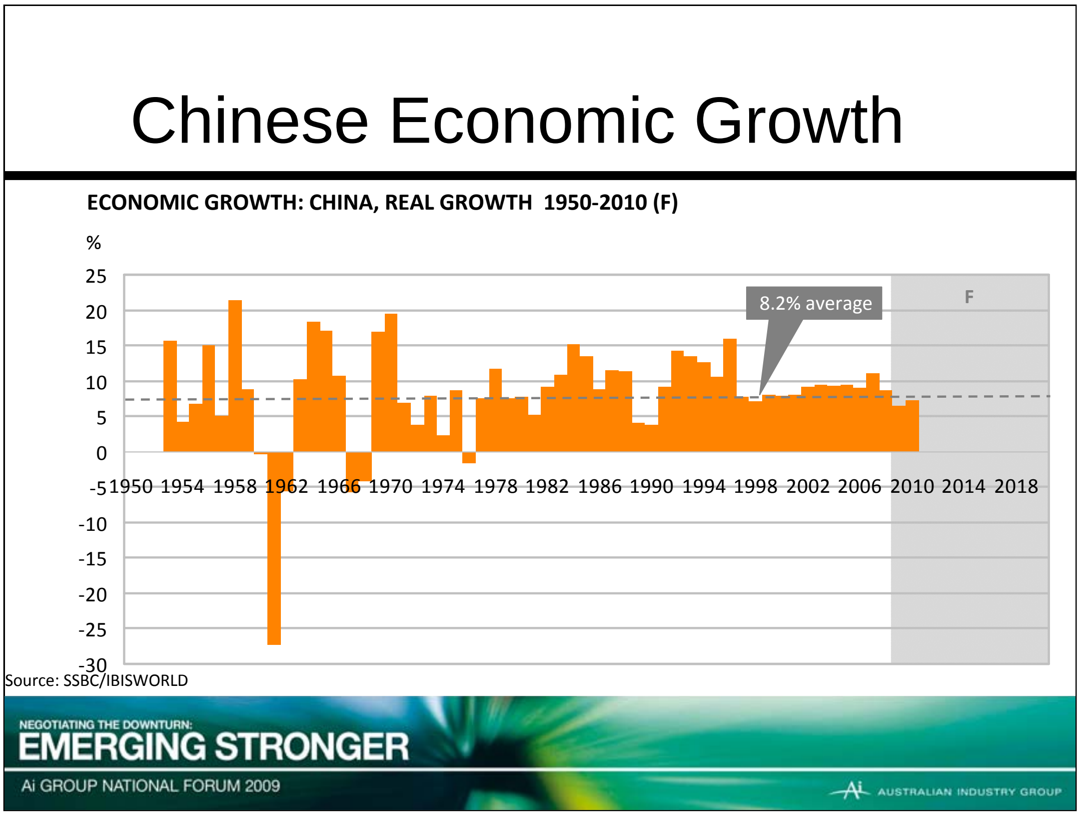
And this share is increasing, primarily due to continued high growth in China and the emergence of India as one of the world's leading economies.



To put this in historical perspective again, China has been the world's largest economy for most of the last two thousand years.

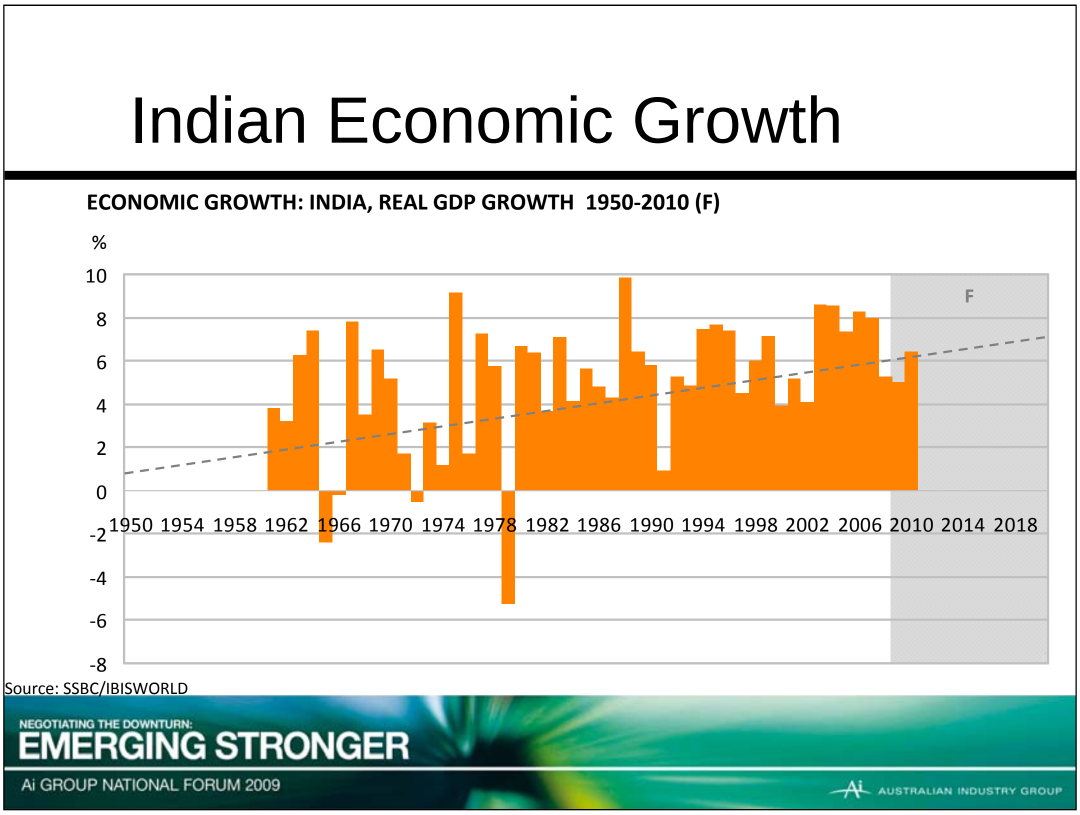
China is currently the world's second largest economy, currently accounting for around 13% of the global economy on purchasing power parity terms.

China is forecast to again take its place as the world's largest economy somewhere between 2025 and 2035.



The World Bank and the International Monetary Fund both recently raised their forecasts for China's 2009 growth, with the World Bank now forecasting growth of 7.2%, while the IMF expects 7.5% growth.

China looks set to meet the Government’s target of 8% growth in the near future, in line with its long term average.

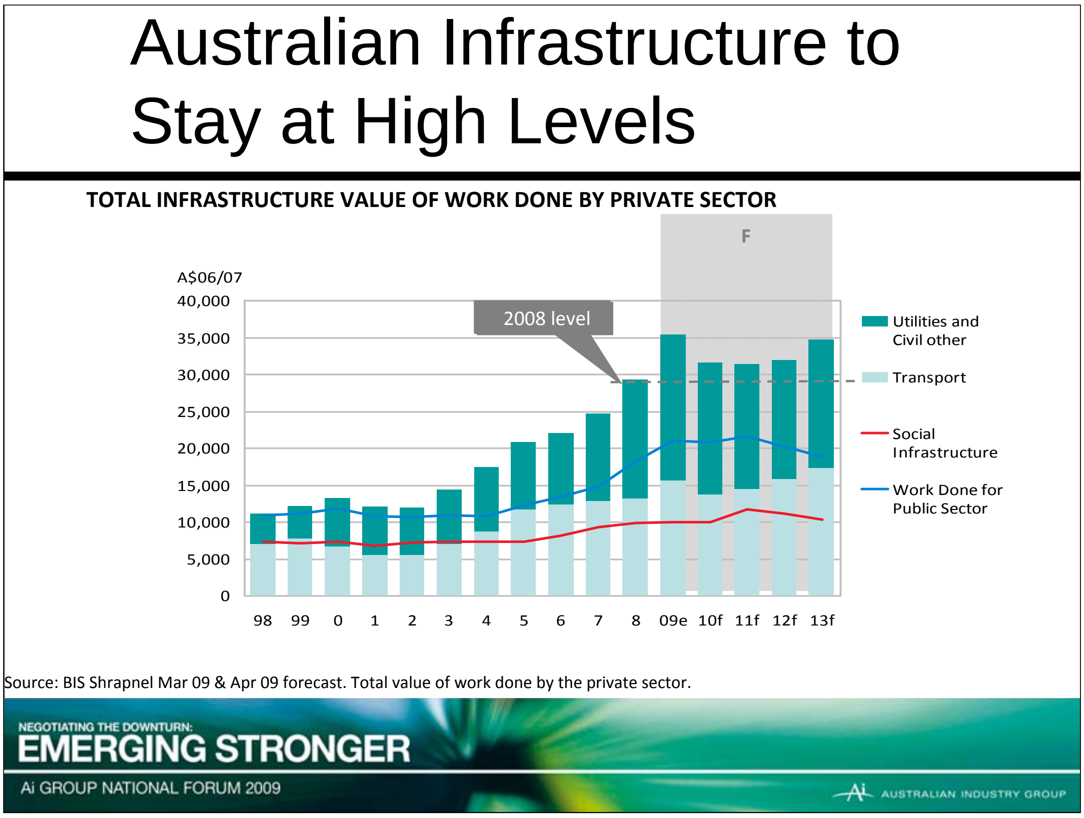


India is also increasing its demand for Australia's resources and has a large infrastructure construction program and mining prospects to underpin demographic changes and growth.

Growth forecasts for India are around 5.4% for 2009, expanding to around 7% next year, continuing on its impressive long term improvement of its standard of living.

So the drivers of growth in our region remain fundamentally strong.

Which is good news for our resources industry, and for the Australian economy more generally.



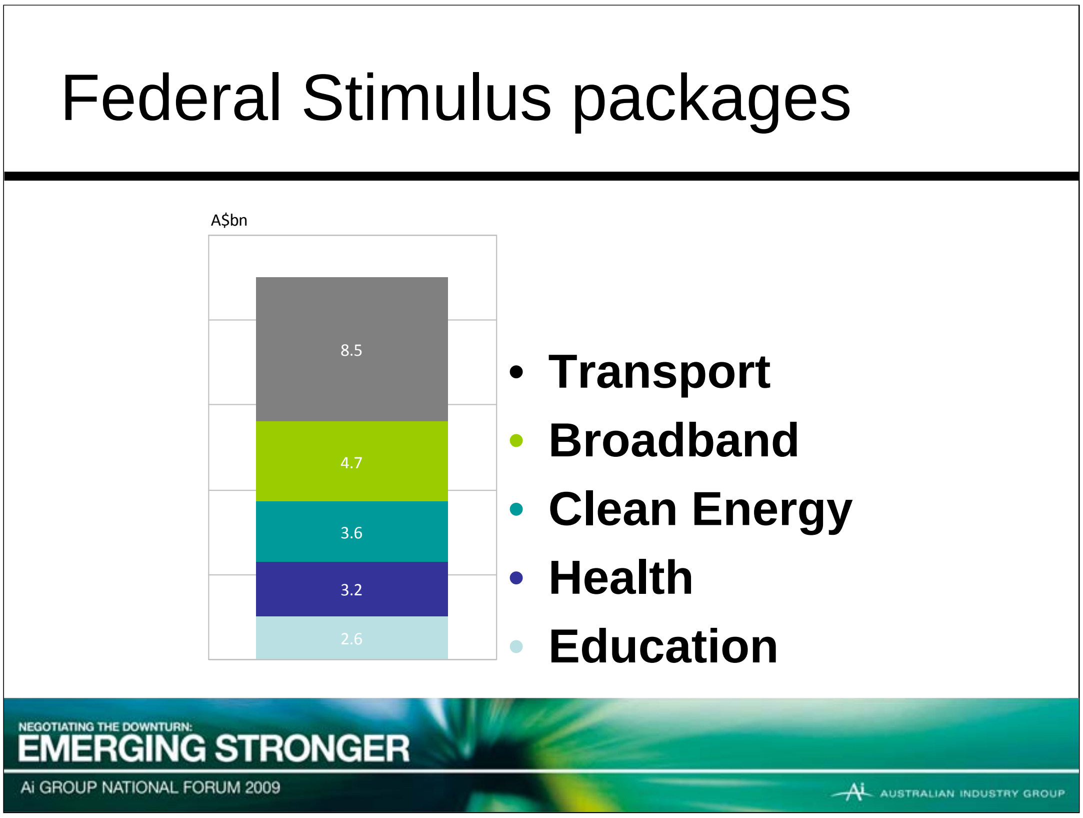
<u>Impact of GFC</u>

Despite the impact of the GFC on asset values and the availability of capital, the total value of infrastructure work done by the private sector is expected to remain at a high level overall.

Total infrastructure expenditure by the private sector will be more than $35 billion, almost triple the expenditure of a decade ago.

Investment in infrastructure has historically followed the business cycle, dropping off as the economy dips into a recession. However the need to invest in infrastructure to improve our productivity remains as important as ever.

As demand picks up, we need the infrastructure - roads, rail and port - to get our goods to market. And we need to continue to invest in our social infrastructure - schools and hospitals - to improve our human capital and to maintain our standard of living.

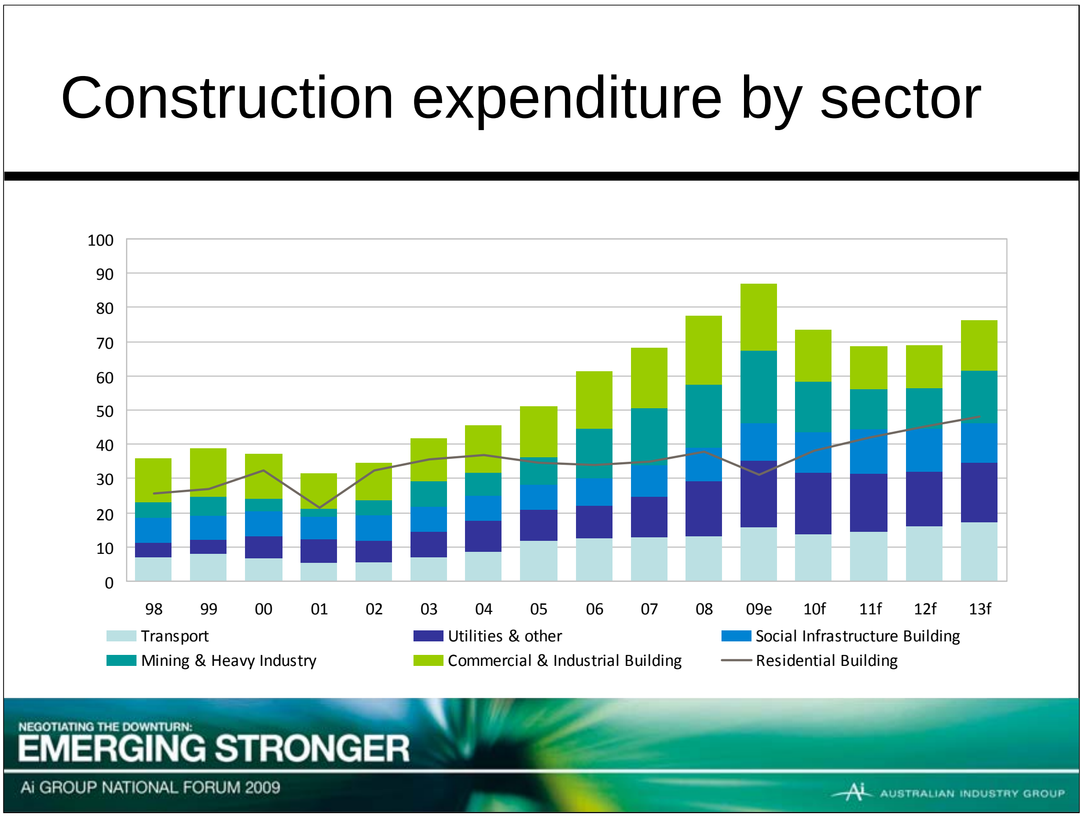


I congratulate the Federal Government for moving decisively to establish Infrastructure Australia and for rolling out its stimulus packages totalling $22 billion, with major expenditure plans in transport, telecommunications, clean energy, health and education.

This follows on from the Nation Building Plan announced earlier this year which focussed on schools, social housing and defence housing.

The challenge now is to improve the procurement systems, generally administered by the States, to bring those projects to market in a timely and efficient way.

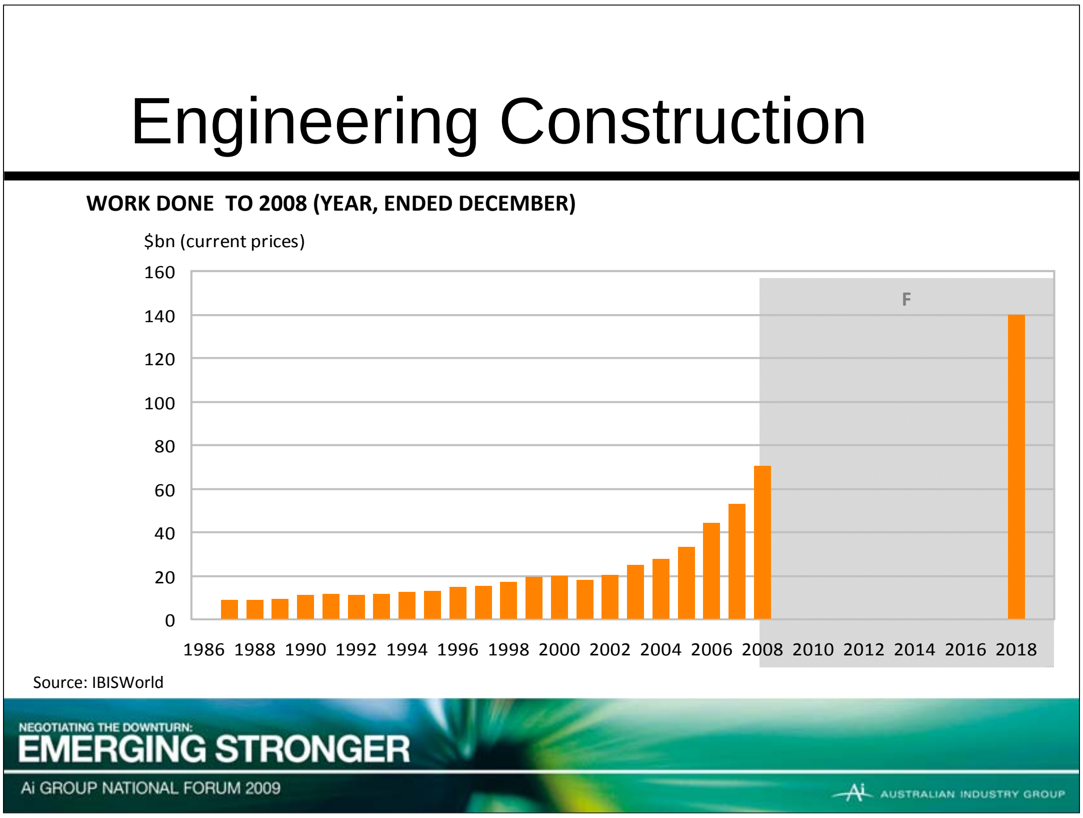
The availability and cost of project finance also still remains an issue and requires Governments to engage in a genuine partnership with the private sector to get these projects moving.



Overall, infrastructure work levels are expected to decline in 2010 from a peak in 2009, then resume steady growth, in part due to the large government ‘Nation Building’ agenda.

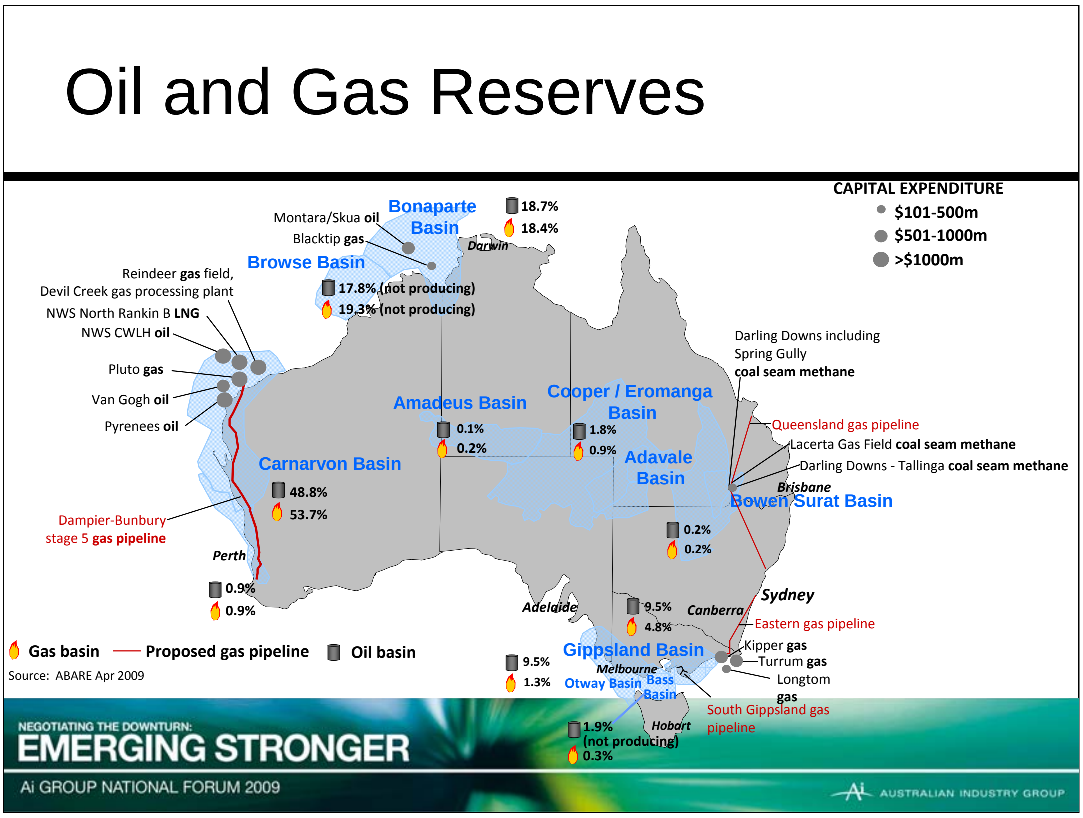
Within the heavy industrial construction market, growth is expected to be mainly centered on the oil and gas processing sector. An overall fall of 2.4% is expected in 2010 driven by a reduction in heavy investment in the resources sector and declines in mining-related infrastructure projects.

However, as the chart shows, we are still at historically high overall construction expenditure levels.



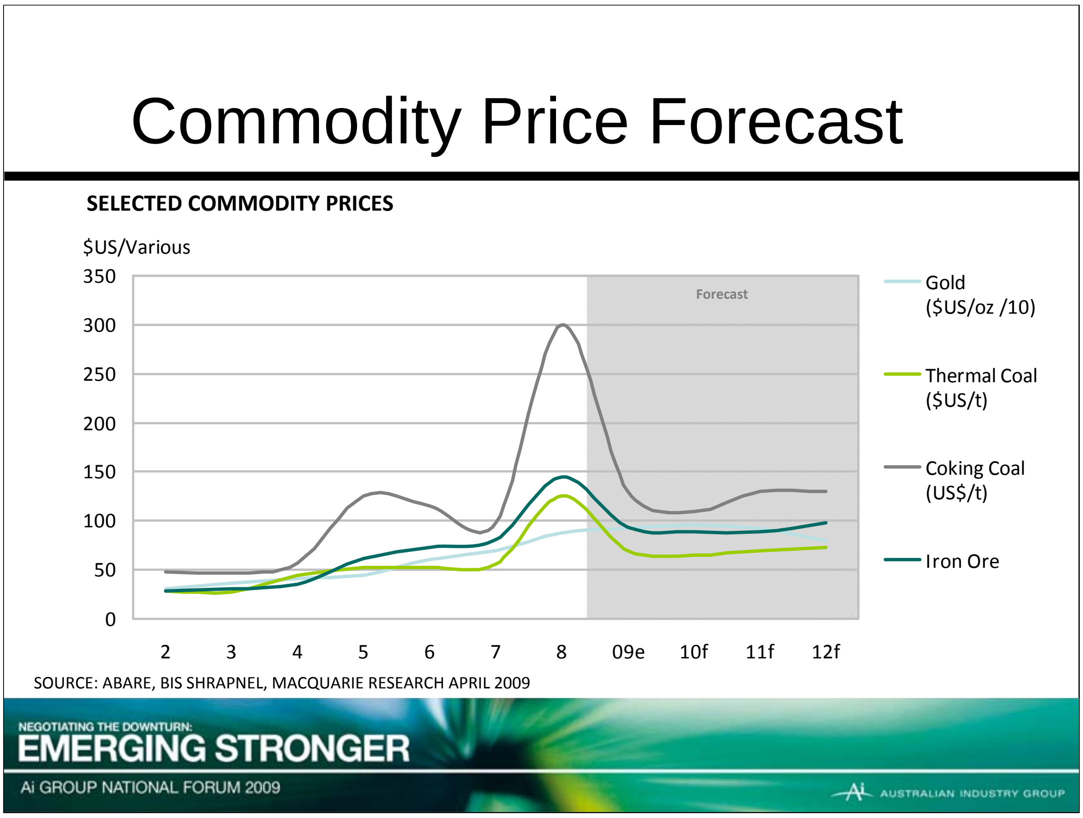
Looking forward, engineering construction is expected to grow to around $140 billion by 2018 – more than doubling within a decade, after tripling in the previous decade.

This growth will be supported by continued growth in the oil and gas sector, transport infrastructure, electricity generation and supply, sewerage and water supply projects.



The oil and gas sector in Australia has very strong prospects, particularly in LNG, with over $32 billion worth of projects committed and another $86 billion 'in the pipeline' as it were.

So I remain positive for the outlook for engineering construction in the longer term.



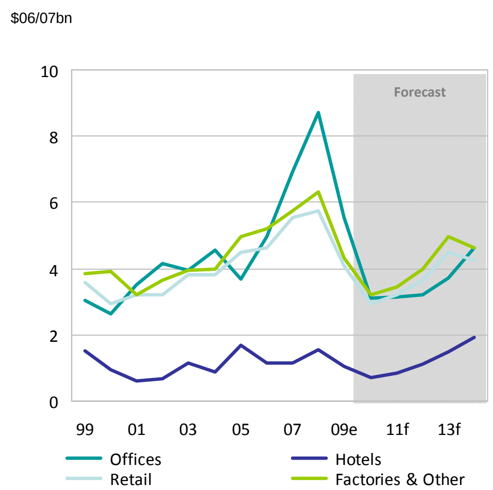
The continuing growth in Asia continues to support the Australian mining sector.

As the chart shows, commodity prices have fallen from their record highs in the past few years, but they still remain at levels significantly higher than those of the last decade.

Whether or not you believe in the commodity supercycle, the longer term outlook for volumes remains strong despite the substantial reduction in commodity prices.

ABARE forecasts that the value of mining production in Australia will increase by 2.7 % in real terms in the coming financial year.

Commercial and Industrial Property



Source: BIS Shrapnel, Value of Commencements, Building in Australia July 2009. Year end June

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Commercial and industrial property development remains fairly weak. This graph shows commercial and industrial commencements by sector.

The ACA/AIG construction outlook for non-residential building is expected to post marginal growth for 2009 of 1.3%.

This is due to the negative impact of a forecast 5.1% fall in private building activity, which contrasts with a 16.2% rise in public sector building.

The downturn in global credit markets and economic conditions has led to a sharp reduction in projects in all states, affecting all sectors, especially offices.

A lack of finance and challenges in securing pre-commitment levels, combined with increasing pressures to sell assets in the current market, is further weakening prices.

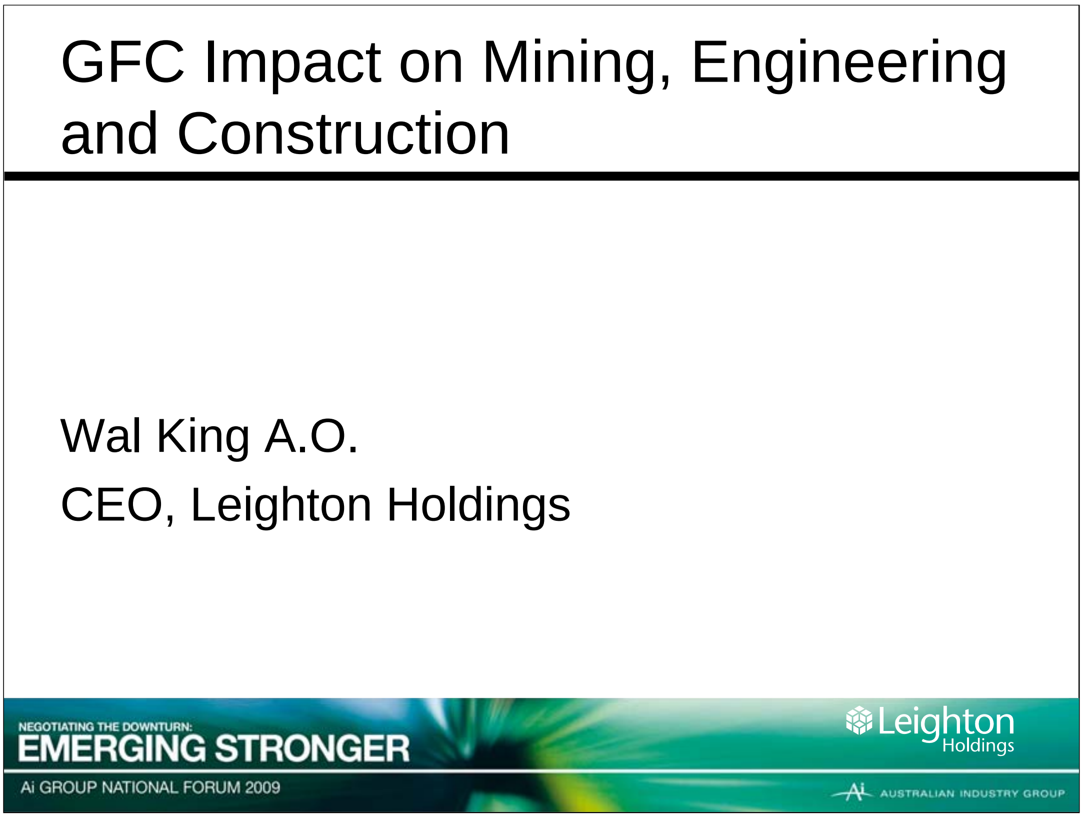
Outside the general market conditions, one of the main challenges facing the industry now will be industrial relations. The Fair Work regime has now commenced and we welcome a number of concessions including extending the powers of the BCII until it is transitioned into the Building Inspectorate of Fair Work Australia in January 2010.

The Building Inspectorate must be properly resourced. Everyone talks about maintaining a ‘tough cop on the beat’ – but that only works if the cops aren’t tied up doing paperwork.

And the curious provisions allowing projects to ‘opt out’ of some of the powers of the BCII Act will be interesting to watch - there is no real justification for these provisions.

The new workplace laws also introduce ‘good faith bargaining’- an American concept - where an employer can now be compelled to negotiate with union representatives, even where there is majority employee support for an agreement and the union has only one representative at a workplace.

This will lead to more complex industrial relationships and will also increase the risk of demarcation disputes.



CONCLUSION

We have been going through the most serious global downturn in 60 years. But that is coming from a long period of stable growth and improvements in our standard of living.

Australia remains in a strong position to benefit from the return to long term growth in our region, driven by demand from countries such as China and India.

Infrastructure investment is easing, but from historic high levels, and Government plans to further invest in nation building infrastructure are necessary and will help drive future growth.

And the Leighton Group is pleased to be helping to deliver that infrastructure.

Thank you for the opportunity to talk to you today.