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# Incitec Pivot long-term American bet pays off

**Diversification** Incitec Pivot chief executive James Fazzino visits the US chemical plant the firm is spending \$1 billion on and explains why he ignored "short-term" shareholder pleas to cancel the project, writes **John Kehoe**.

**I**ncitec Pivot chief executive James Fazzino vividly remembers the negativity and scepticism he copped from local investors in April 2013, soon after announcing the explosives and fertiliser maker planned to invest almost \$1 billion building an ammonia plant in the United States.

Rather than Incitec doubling down on the then booming Chinese economy by constructing a plant at Newcastle, NSW, to feed Asia's voracious demand, the industrial chemical company diversified into an American economy still struggling to recover from a deep recession.

Standing at the 90 per cent complete ammonia plant among construction workers in hard hats in the deep south of the US 2½ years later, Mr Fazzino said he had to "stick my neck out" when local investors resisted the large capital outlay.

"The investors said 'we'd like some cash back'," Mr Fazzino said, in an interview with *The Australian Financial Review* at the Waggaman, Louisiana site. "But you can't run a business for the short term.

"I spent a lot of time with our sharehold-

ers and said 'we're going to go ahead and do this'."

Globally, many investors are yearning quick returns via financial engineering such as share buybacks and special dividends, while pressing company management not to commit to big investments.

Yet shareholders who backed the \$US850 million Incitec project, particularly US institutions that understood the revolutionary potential of shale gas feeding the ammonia plant, are on the cusp of reaping handsome rewards.

The development on the outskirts of New Orleans is on budget and on schedule to open in the September quarter next year. But the really good news for Incitec shareholders is a big financial windfall from the collapse in the Australian dollar.

Earlier, Incitec took advantage of the historically strong currency, financing the 800,000 tonne a year ammonia plant at an average of US96¢. The subsequent dive in the exchange rate means the US dollar earnings to be repatriated back home will be worth about 30 per cent more than when the project was commissioned.

"I call that the cherry on top," Mr Fazzino

The decision to move into the US when others were heading towards China has been vindicated, James Fazzino says.

said. Incitec is yet to hedge against a rising Australian dollar, betting it is likely to fall further.

The drop in the price of shale gas, the key ingredient in producing ammonia, has also delivered a bonus.

The project is tipped to deliver more than 50 per cent above the cost of capital and analysts estimate the plant will return more than \$US200 million in profit a year from 2017-18.

"If you have a project that makes its money back in less than five years, I can assure you they don't fall out of the sky," Mr Fazzino said.

Justin Hance – analyst at Chicago-based fund manager Harris Associates, which is Incitec's largest shareholder, controlling 9 per cent – was one of 50 analysts and investors on a tour of the construction site this September.

"It does look like things are going well when you walk around the plant, and financially it looks better than when they approved the project," Mr Hance said.

Incitec's share price has risen just over 30 per cent since the project was announced on April 17 2013.

US shareholders account for about 25 per cent of Incitec's register, up from just 10 per cent when the project was unveiled.

Fidelity portfolio manager Kate Howitt said many companies around the world were finding it challenging to generate growth in their base business and eschewing reinvestment.

"Australian investors have a love affair with yield, but that's not sustainable if companies don't reinvest eventually," she said.

"So in today's world of low-growth options, if a company can find an opportunity to reinvest at reasonably low risk, it's a good way to invest capital."

Speaking next to a huge 35,000 metric tonne ammonia cooling tank, Mr Fazzino acknowledged the plunges in the currency and gas price came at a fortuitous time for the company.

Gas, the key feedstock accounting for 75 per cent of the plant's operating costs, was fetching \$US9 per mmbtu when the investment was committed.

The company spent two years studying the long-term supply potential of shale gas that is now fuelling a US manufacturing renaissance. Incitec was betting on gas



falling to about \$US6 thanks to revolutionary horizontal drilling flooding the US with gas.

Incitec's optimism proved too pessimistic. The Hub gas price fell below \$US2.60 last week and Incitec is starting to hedge some of the low gas costs.

UBS forecasts there is 98 years of US gas supply at current consumption levels and that it is economic to produce at \$US3 to \$US4.

Leslie Palti-Guzman, director of global gas at The Rapidan Group, agreed there would be more shale gas drilling for decades to come, thanks to improvements in technology, productivity gains and the potential for gas producers to sell more of the commodity overseas.

"We are at a low point in pricing and production, but there will be more drilling for gas, which really helps supply," she said.

Mr Fazzino said the company gained a "first mover" advantage by recognising the "dislocation" created by the US shale gas revolution.

"US investors understand the supply of shale gas, but a lot of Australians don't get it," he said.

Mr Fazzino is a vocal critic of Australia's energy policy failing to open up more gas supply to local manufacturers and instead prioritising the export of liquefied natural gas at higher prices overseas.

He also laments that the anti-fracking movement has limited the supply of new gas for industry in NSW and Victoria, where the company also has chemical plants.

Mr Fazzino said the US environmental regulator is the "most aggressive in the world" and that "fracking is safe if you do it right".

At the time of the counter-cyclical investment, many analysts were urging companies to "double down" on fast-growing China, as the US was staggering out of its worst eco-

nomic downturn since the 1930s Great Depression. Some investors leaned on Mr Fazzino not to pursue a US strategy that, he said, opted for "some balance in the business portfolio".

Incitec had already spent \$3.4 billion acquiring Dyno Nobel in 2008 and soon after paid about \$1 billion to upgrade the ammonium nitrate plant at Moranbah in the Bowen Basin, Queensland.

Today, fears are growing that China is slowing more abruptly than forecast and quiet optimism is building that the US economy is picking up.

"It's quite interesting how the world turns. When we did the investments, everyone was talking about 'stronger for longer' China," Mr Fazzino said.

"We already had a good exposure to that through our [existing] Australian business.

"People forget the US economy is the largest in the world and I think people get a bit myopic in Australia."

Ammonia is a compound of nitrogen and hydrogen, and a key ingredient used to make fertiliser, explosives and chemicals used in airconditioning systems and furniture coatings.

Incitec is wagering the US will remain a net importer of ammonia. The country currently produces 16 million tonnes a year, short of the 21 million tonnes of demand. Macquarie Securities notes the "key fundamental risk" to the plant's economics is a build-out of North American ammonia production capacity, beyond the 2.3 million tonnes of ammonia projects likely to come on-stream by 2019.

All of the plant's scheduled production is already contracted for sale. Energy and fertiliser trader Transammonia will take 350 kilotonnes annually over 10 years, Incitec's US subsidiary Dyno Nobel will receive 250 kilotonnes each year and Cornerstone Chemical Company is locked in for 200 kilotonnes a year over 25 years.

Cornerstone operates the adjacent site and is leasing the ammonia plant property to Incitec for 99 years.

Once cash begins to flow from the plant, Incitec will earn about 70 per cent of its profits in US dollars, including revenue from existing American operations such as its industrial explosives and blasting services to the mining, quarrying, seismic and construction industries.

Every 1¢ move in the dollar shifts Incitec's bottom line by \$9 million.

As well as an abundance of gas, Mr Fazzino said there were other key reasons for picking the Louisiana site, rather than building on its existing fertiliser distribution centre at Newcastle as was originally intended. A streamlined regulatory approval process by the Louisiana state government and local Jefferson Parish Economic Development Commission (JEDCO) working closely together, concessions on state payroll tax and local government land tax, an abundance of skilled workers along the Mississippi petrochemicals hub and cheaper construction costs, ticked all the boxes.

"We wanted to provide the incentives to make it attractive for the company to do business here because this was a competitive worldwide selection process to bring jobs and investment to the Parish," JEDCO executive director Jerry Bologna said.

JEDCO estimates the local Jefferson Parish population of about 440,000 will receive about \$US45 million in tax revenue over a 20-year contract signed with Incitec's Dyno Nobel. The income will likely be dwarfed by taxes paid to the state and federal governments.

About 1000 construction workers rostered on day and night shifts are building the plant, fitting pipes, welding and driving trucks. Seventy staff will man the plant once it is up and running and every three years 1000 workers will be called in to conduct maintenance turnaround.

The major tanks, cooling tower and buildings are complete, 85 per cent of the piping installed and 70 per cent of electrical equipment finished. Insulation, paving and painting, as well as pre-commissioning of the plant and equipment, will occur in coming months.

In the 3½ years it will take to approve and construct the plant ready for production by next September, Mr Fazzino estimated it

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James Fazzino, Incitec Pivot CEO

would only be at the approval stage in Australia due to state and local government red tape.

Incitec believes it would have cost about \$2 billion to build the Newcastle plant, compared with the \$US850 million financed at \$US96¢ in the dollar.

In the end, Incitec wrote off \$30 million on a feasibility study into the Newcastle site, after being frustrated by regulatory delays and reluctance of customers to sign long-term contracts.

"I've got kids in Australia and I would have much preferred to invest there," Mr Fazzino said. "But we eventually realised the project economics weren't going to stack up."

He said the firm also benefited from first-mover advantages it seized on at the low point of the US economic cycle, which are not available today.

The \$US600 million fixed-price "turn key" contract signed with KBR to build the plant would now cost about double.

A huge construction boom in petrochemicals in the past couple of years has pushed up demand and pricing for construction services and labour.

Incitec's leasing of the abandoned methanol and ammonia brownfield site – complete with power, natural gas infrastructure and an ammonia pipe – as well as rail, barge and truck access, also saved the company considerable costs compared with a greenfield location.

As for the short-termism that could have derailed the project: if some shareholders got their original way, Mr Fazzino lays the blame finger at the underlying superannuation members pressuring funds to deliver results every quarter.

"You've got this horrible short-termism and we blame the investors, but we should blame it on ourselves," he said.



## Hunter Region Business Profile

**Also included: Business Counts by Employment size ranges as at June 2016. Page 6**

### **Employment by Industry – ABS Census 2016 – Working Population Profile (WPP)**

Place of Work data used for the Working Population Profile provides information on where employed people over 15 years of age worked in the week prior to Census Night.

<b>Industry Sector / Sub-sector</b>	<b>Newcastle &amp; Lake Macquarie SA4 No.</b>	<b>Hunter Valley excl Newcastle SA4 No.</b>	<b>Mid- Coast LGA No.</b>	<b>HUNTER REGION No.</b>
<b>Health Care &amp; Social Assistance</b>	<b>29,559</b>	<b>10,455</b>	<b>4,988</b>	<b>45,002</b>
Hospitals	9,600	2,232	1,247	13,079
Medical & Other Health Care Services	7,616	2,758	1,220	11,594
Social Assistance Services	6,733	2,901	986	10,620
Residential Care Services	5,084	2,351	1,449	8,884
Health Care & Social Assistance, nfd	520	214	82	816
<b>Retail Trade</b>	<b>16,448</b>	<b>10,399</b>	<b>3,685</b>	<b>30,532</b>
Other Store-based Retailing	8,841	4,844	1,844	15,529
Food Retailing	5,221	3,941	1,309	10,471
Motor Vehicle & Motor Vehicle Parts Retailing	1,443	893	254	2,590
Fuel Retailing	431	418	154	1,003
Non-store Retailing & Retail Commission-based Buying &/or Selling	92	35	9	136
Retail Trade, nfd	419	262	105	786
<b>Education &amp; Training</b>	<b>14,697</b>	<b>7,324</b>	<b>2,337</b>	<b>24,358</b>
Preschool & School Education	8,396	6,187	1,972	16,555
Tertiary Education	4,910	468	167	5,545
Adult, Community & Other Education	1,146	556	159	1,861
Education & Training, nfd	253	105	32	390
<b>Accommodation &amp; Food Services</b>	<b>12,227</b>	<b>8,893</b>	<b>2,703</b>	<b>23,823</b>
Food & Beverage Services	11,153	6,949	2,111	20,213
Accommodation	1,049	1,907	587	3,543
Accommodation & Food Services, nfd	32	35	6	73
<b>Construction</b>	<b>11,616</b>	<b>7,342</b>	<b>1,864</b>	<b>20,822</b>
Construction Services	6,534	4,081	1,085	11,700
Building Construction	2,806	1,904	540	5,250
Heavy & Civil Engineering Construction	1,722	1,018	144	2,884
Construction, nfd	547	343	98	988

Source: Australian Bureau of Statistics - 2016 Census of Population and Housing – Working Population Profile (WPP). NB: Count of employed persons aged 15 years and over.

Industry Sector / Sub-sector	Newcastle & Lake Macquarie SA4 No.	Hunter Valley excl Newcastle SA4 No.	Mid-Coast LGA No.	HUNTER REGION No.
<b>Manufacturing</b>	<b>9,303</b>	<b>7,266</b>	<b>1,512</b>	<b>18,081</b>
Food Products	2,128	1,115	556	3,799
Primary Metal & Metal Products	1,586	1,439	47	3,072
Machinery & Equipment	965	982	54	2,001
Fabricated Metal Products	1,109	452	147	1,708
Transport Equipment	687	516	120	1,323
Basic Chemical & Chemical Products	339	480	21	840
Beverage & Tobacco Products	70	727	23	820
Wood Products	367	265	184	816
Non-metallic Mineral Products	333	301	64	698
Furniture & Other	245	126	81	452
Textile, Leather, Clothing & Footwear	204	127	18	349
Polymer Product & Rubber Products	129	170	22	321
Printing (including Reproduction of Recorded Media)	216	46	25	287
Petroleum & Coal Products	110	31	8	149
Pulp, Paper & Converted Paper Products	32	8	-	40
Manufacturing, nfd	789	485	131	1,405
<b>Public Administration &amp; Safety</b>	<b>8,940</b>	<b>8,197</b>	<b>1,124</b>	<b>18,261</b>
Public Administration	6,513	3,305	858	10,676
Public Order, Safety & Regulatory Services	2,208	1,512	257	3,977
Defence	185	3,362	4	3,551
Public Administration & Safety, nfd	36	13	3	52
<b>Professional, Scientific &amp; Technical Services</b>	<b>9,766</b>	<b>3,739</b>	<b>938</b>	<b>14,443</b>
Professional, Scientific & Technical Services (except Computer System Design & Related Services)	8,582	3,222	855	12,659
Computer System Design & Related Services	1,160	488	79	1,727
Professional, Scientific & Technical Services, nfd	26	24	3	53
<b>Mining</b>	<b>2,246</b>	<b>9,450</b>	<b>215</b>	<b>11,911</b>
Coal Mining	1,674	8,436	128	10,238
Exploration & Other Mining Support Services	213	315	7	535
Non-metallic Mineral Mining & Quarrying	48	173	56	277
Metal Ore Mining	74	107	3	184
Oil & Gas Extraction	19	18	4	41
Mining, nfd	221	403	13	637
<b>Other Services</b>	<b>6,273</b>	<b>4,475</b>	<b>1,057</b>	<b>11,805</b>
Repair & Maintenance	2,748	2,653	541	5,942
Personal & Other Services	3,478	1,809	520	5,807
Private Households Employing Staff & Undifferentiated Goods & Service-producing activities of households for own use	37	12	-	49
Other Services, nfd	10	6	-	16

Source: Australian Bureau of Statistics - 2016 Census of Population and Housing – Working Population Profile (WPP). NB: Count of employed persons aged 15 years and over.

Industry Sector / Sub-sector	Newcastle & Lake Macquarie SA4 No.	Hunter Valley excl Newcastle SA4 No.	Mid- Coast LGA No.	HUNTER REGION No.
<b>Transport, Postal &amp; Warehousing</b>	<b>6,744</b>	<b>3,605</b>	<b>875</b>	<b>11,224</b>
Road Transport	2,369	1,918	480	4,767
Postal & Courier Pick-up & Delivery Services	1,128	464	181	1,773
Rail Transport	1,457	238	74	1,769
Transport Support Services	1,108	255	47	1,410
Warehousing & Storage Services	267	118	27	412
Air & Space Transport	69	301	6	376
Water Transport	68	39	8	115
Other Transport	43	68	3	114
Transport, Postal & Warehousing, nfd	247	206	42	495
<b>Administrative &amp; Support Services</b>	<b>4,438</b>	<b>3,225</b>	<b>831</b>	<b>8,494</b>
Administrative Services	2,568	1,585	312	4,465
Building Cleaning, Pest Control & Other Support Services	1,867	1,632	516	4,015
Administrative & Support Services, nfd	9	8	3	20
<b>Financial &amp; Insurance Services</b>	<b>5,956</b>	<b>1,221</b>	<b>364</b>	<b>7,541</b>
Finance	2,450	746	215	3,411
Insurance & Superannuation Funds	2,290	182	37	2,509
Auxiliary Finance & Insurance Services	1,154	263	97	1,514
Financial & Insurance Services, nfd	66	24	10	100
<b>Agriculture, Forestry &amp; Fishing</b>	<b>906</b>	<b>3,534</b>	<b>1,466</b>	<b>5,906</b>
Agriculture	765	3,163	1,229	5,157
Agriculture, Forestry & Fishing Support Services	69	173	41	283
Aquaculture	6	93	95	194
Fishing, Hunting & Trapping	43	53	56	152
Forestry & Logging	13	27	34	74
Agriculture, Forestry & Fishing, nfd	10	35	9	54
<b>Wholesale Trade</b>	<b>3,320</b>	<b>1,847</b>	<b>402</b>	<b>5,569</b>
Machinery & Equipment Wholesaling	947	756	91	1,794
Basic Material Wholesaling	887	555	125	1,567
Grocery, Liquor & Tobacco Product Wholesaling	493	151	80	724
Other Goods Wholesaling	442	137	64	643
Motor Vehicle & Motor Vehicle Parts Wholesaling	353	166	23	542
Commission-based Wholesaling	74	40	13	127
Wholesale Trade, nfd	131	47	7	185

Source: Australian Bureau of Statistics - 2016 Census of Population and Housing – Working Population Profile (WPP). NB: Count of employed persons aged 15 years and over.

Industry Sector / Sub-sector	Newcastle & Lake Macquarie SA4 No.	Hunter Valley excl Newcastle SA4 No.	Mid- Coast LGA No.	HUNTER REGION No.
<b>Rental, Hiring &amp; Real Estate Services</b>	<b>2,338</b>	<b>1,512</b>	<b>512</b>	<b>4,362</b>
Property Operators & Real Estate Services	1,853	1,053	449	3,355
Rental & Hiring Services (except Real Estate)	471	450	60	981
Rental, Hiring & Real Estate Services, nfd	12	13	-	25
<b>Electricity, Gas, Water &amp; Waste Services</b>	<b>2,327</b>	<b>1,510</b>	<b>454</b>	<b>4,291</b>
Electricity Supply	1,394	920	105	2,419
Waste Collection, Treatment & Disposal Services	397	348	150	895
Water Supply, Sewerage & Drainage Services	489	183	193	865
Gas Supply	31	47	8	86
Electricity, Gas, Water & Waste Services, nfd	18	7	3	28
<b>Arts &amp; Recreation Services</b>	<b>1,882</b>	<b>1,020</b>	<b>368</b>	<b>3,270</b>
Sports & Recreation Activities	1,282	709	248	2,239
Creative & Performing Arts Activities	333	126	56	515
Heritage Activities	88	143	56	287
Gambling Activities	140	36	7	183
Arts & Recreation Services, nfd	40	10	-	50
<b>Information Media &amp; Telecommunications</b>	<b>1,685</b>	<b>442</b>	<b>202</b>	<b>2,329</b>
Telecommunications Services	643	147	51	841
Motion Picture & Sound Recording Activities	282	95	28	405
Publishing (except Internet & Music Publishing)	253	101	45	399
Broadcasting (except Internet)	309	27	30	366
Internet Service Providers, Web Search Portals & Data Processing Services	124	28	13	165
Library & Other Information Services	32	32	27	91
Information Media & Telecommunications, nfd	37	5	7	49
Internet Publishing & Broadcasting	9	-	-	9
<b>Inadequately described</b>	<b>3,907</b>	<b>2,689</b>	<b>636</b>	<b>7,232</b>
<b>Industry of Employment not stated</b>	<b>1,530</b>	<b>1,055</b>	<b>400</b>	<b>2,985</b>
<b>Total</b>	<b>156,101</b>	<b>99,196</b>	<b>26,930</b>	<b>282,227</b>

Source: Australian Bureau of Statistics - 2016 Census of Population and Housing – Working Population Profile (WPP). NB: Count of employed persons aged 15 years and over.

## Employment by Industry – Residential Population vs Working Population - Census 2016

Place of Work data used for the Working Population Profile provides information on where employed people over 15 years of age worked in the week prior to Census Night.

Place of Residence data used for the Residential Population Profile provides information on where employed people over 15 years of age lived in on Census Night.

Employed Persons by Industry Sector - 2016 Census	Resident Population Profile No.	Working Population Profile No.	Difference Working v Resident Population No.	Difference Working v Resident Population %
Health Care & Social Assistance	46,197	45,002	-1,195	-2.6
Retail Trade	30,974	30,532	-442	-1.4
Construction	26,827	20,822	-6,005	-22.4
Education & Training	24,897	24,358	-539	-2.2
Accommodation & Food Services	23,984	23,823	-161	-0.7
Public Administration & Safety	18,974	18,261	-713	-3.8
Manufacturing	18,924	18,081	-843	-4.5
Professional, Scientific & Technical Services	15,321	14,443	-878	-5.7
Mining	13,916	11,911	-2,005	-14.4
Other Services	12,626	11,805	-821	-6.5
Transport, Postal & Warehousing	12,288	11,224	-1,064	-8.7
Administrative & Support Services	10,292	8,494	-1,798	-17.5
Financial & Insurance Services	7,746	7,541	-205	-2.6
Agriculture, Forestry & Fishing	6,054	5,906	-148	-2.4
Wholesale Trade	6,006	5,569	-437	-7.3
Electricity, Gas, Water & Waste Services	4,640	4,291	-349	-7.5
Rental, Hiring & Real Estate Services	4,498	4,362	-136	-3.0
Arts & Recreation Services	3,590	3,270	-320	-8.9
Information Media & Telecommunications	2,629	2,329	-300	-11.4
Inadequately described / Not stated	11,038	10,216	-822	-7.4
<b>Total</b>	<b>301,445</b>	<b>282,227</b>	<b>-19,218</b>	<b>-6.4</b>

Source: Australian Bureau of Statistics - 2016 Census of Population and Housing – General Community Profile (GCP) G51 and Working Population Profile (WPP) W12. NB: Count of employed persons aged 15 years and over.

# **Hunter Region - Business Counts by Employment Size Ranges, June 2016**

<b>Industry Sector</b>	<b>Non employing No.</b>	<b>1-4 No.</b>	<b>5-19 No.</b>	<b>20-199 No.</b>	<b>200+ No.</b>	<b>Total No.</b>	<b>Total %</b>
Construction	4,456	3,314	761	116		8,606	17.4
Professional, Scientific & Technical Services	2,339	2,122	496	85	3	5,063	10.3
Rental, Hiring & Real Estate Services	4,179	549	207	41		4,962	10.1
Financial & Insurance Services	3,900	692	116	20		4,737	9.6
Agriculture, Forestry & Fishing	3,687	672	118	44	3	4,501	9.1
Health Care & Social Assistance	1,715	1,025	433	95	6	3,290	6.7
Retail Trade	1,139	1,152	689	114		3,164	6.4
Transport, Postal & Warehousing	1,381	871	252	38		2,583	5.2
Other Services	907	1,170	370	43		2,505	5.1
Accommodation & Food Services	554	731	773	223	3	2,239	4.5
Manufacturing	764	628	437	139		1,942	3.9
Administrative & Support Services	892	625	269	103		1,882	3.8
Wholesale Trade	642	397	263	47		1,323	2.7
Arts & Recreation Services	384	149	71	24		656	1.3
Education & Training	252	199	126	45	3	638	1.3
Information Media & Telecommunications	157	73	18	3		232	0.5
Mining	73	58	18	15		165	0.3
Public Administration & Safety	33	83	30	15		128	0.3
Electricity, Gas, Water & Waste Services	64	30	30	6		124	0.3
Currently Unknown	407	113	42	3		606	1.2
<b>TOTAL</b>	<b>27,925</b>	<b>14,653</b>	<b>5,519</b>	<b>1,219</b>	<b>18</b>	<b>49,346</b>	<b>100</b>
<b>Total %</b>	<b>56.6</b>	<b>29.7</b>	<b>11.2</b>	<b>2.5</b>	<b>0.0</b>	<b>100</b>	

Source: ABS Cat. 8165.0 Counts of Australian Businesses, including Entries and Exits, Jun 2012 to Jun 2016, Businesses by Industry Division by Statistical Area Level 2 by Employment Size Ranges, June 2016