

COVER STORY



King Copper

One-on-one with Codelco's Juan Villarzú Rohde

The president and chief executive officer of the world's largest copper producer will be in New York this week to receive accolades as one of the Copper Club's "Copper Men of the Year."

The award comes as Juan Villarzú Rohde prepares to stand down as president and chief executive officer of the world's largest copper producer after 11 years at the helm. With copper prices at all-time record highs,

Corporación Nacional del Cobre de Chile (Codelco), like many of its competitors, is enjoying good times. Under Villarzú, the company has made substantial strides so that it is better able to benefit from high prices.

But for all the progress, much is left to be done by Villarzú's successor if the company is to complete its transformation into an independent, business-focused copper industry leader.

By Paul Harris
Special to AMM

AMM: Chile recently elected a new president and your position is a political appointment. Would you like to stay on as executive president of Codelco?

Villarzú: I would prefer to leave—11 years is enough. I have pushed hard for a transformation (of Codelco) and I think the company is at the stage now where it is important that it implements the projects that are in the pipeline. Codelco has a strong portfolio of projects to put into action and this needs different types of skills to get into this new stage. At the same time, continuity is very important to strengthen the concept of the enterprise. It is important to signal that a change in government doesn't mean a change in the senior management of a company like Codelco. If you change management every few years you won't have the ability in the company to pursue a long-term business plan. I strongly suggest (the government) gives a strong signal that the company

is run as an efficient multinational. In general, you don't change management when you are doing well. In that context, I may stay a while to help smooth the transition, but I think for continuity it is a good idea to have a successor from within.

AMM: Do you have a candidate in mind?

Villarzú: Yes, but I am not going to tell you who.

AMM: You have been the head of the world's largest copper company for 11 years. What do you consider your main achievement?

Villarzú: Transforming the public's and industry's perception of Codelco from that of being a public agency or institution to that of an efficient and strong enterprise. That is why I am concerned about continuity. It is not easy to transform a company. There were major cultural changes, not only in the company but also in Chile's political circles. You have to look at the relative importance of Codelco

to the Chilean economy. Between 1994 and 2005 we transferred to the government \$17 billion, which is an average of 77 percent of total government revenue.

AMM: What were the most difficult challenges you had to face?

Villarzú: Politicians tend to look very closely at Codelco and the decisions we make, and they try to influence them. For example, in 2003, when we decided to create a strategic stockpile in a low-price situation rather than decrease production, this created criticism from influential politicians. But it turned out to be a profitable decision for Codelco and it helped to stabilize the market. These decisions are those a leading company in the industry has to be ready to take, and it is obvious that you cannot discuss this in congress. It is not the way you run a company. It was the same with the China Minmetals Corp. deal. The political leadership has to understand that Codelco is a

huge company and that it takes decisions that entail risk. This is an issue that Chile has not well understood. Fortunately, we have a special law and the legal power to act by ourselves. But a few months ago there was a bill aiming for Codelco to be treated like any government-owned company. This proposal would have taken away the majority of the special powers Codelco has to make autonomous decisions. We opposed this bill—not an easy thing when a state company opposes the government. Our major achievement was to gain back the trust of former presidents Eduardo Frei and Ricardo Lagos to run the company autonomously. We committed to strict targets and asked the government to hold us to them, to give us the backing we need and to leave us alone. This has worked well.

AMM: What other major challenges were there?

Villarzú: The change in the business model we implemented. We started a value-based management system in Codelco in 2002 and we have gone far in implementing this, but it is not complete. This was a top-down process and we have to consolidate the business model so that middle managers use it as a daily tool for decision making. This is still a challenge, but I don't think the resistance that exists will undo this. There is still work to be done to get the system established at the base level. There is a lot of value to be gained from doing this.

AMM: What would you have liked to have done but couldn't?

Villarzú: By nature I am never fully happy. I'm optimistic and I like to produce results, and we produced very good results, but I think we can do things better.

AMM: Codelco is now looking to spend \$12 billion during the next six years to increase production to 2.6 million tonnes a year from 1.75 million tonnes. That seems like a big challenge.

Villarzú: It is a management challenge, but we also had to convince the state that it made sense. We are now in a position to move quickly ahead. The Goldman Sachs Group Inc. evaluation (delivered in January) was important in this regard because it said that they believe we can do this, that we have the ability, the resources, the know-how and the management to really implement the investment portfolio and capture the value implicit in these assets.

AMM: Codelco does not have a lot of room to take on more debt without having a credit downgrade, so where will the money come from?

Villarzú: The total debt of the company can go up to \$6 billion by 2009. This implies a debt/equity ratio of 0.8, which given our strengths we will be able to raise in the market. Our credit rating would be reduced by a couple of notches and the cost of borrowing would go up a



A GREEN LIGHT TO GROW: Codelco expects to spend \$12 billion over the next six years to lift production to 2.6 million tonnes a year. "It is a challenge," Villarzú says.

couple of points, but we can manage that.

AMM: But isn't the problem that Codelco's credit rating affects Chile's credit rating, and a downgrade would make borrowing more expensive for the whole country?

Villarzú: The problem is a macro problem affecting the country. But we could increase the capital base of the company by using part of the capital stability fund to capitalize the company without paying the price of reducing other public expenditure. (Codelco delivers all of its surplus or profit to the state, but

with this mechanism it could effectively retain profits.) We have been working to come up with other kinds of financial arrangements, such as the China Minmetals deal. We also are talking with equipment suppliers and asking them to sell us a service, not the equipment, so that we pay to use a service rather than buy the equipment.

AMM: You have had considerable success at Codelco. Why do you think that is?

Villarzú: A key component was our ability to bring together the labor unions through a far-reaching agreement about what

we wanted to do. To put this in context, in 1994 Codelco was in a crisis. There was a scandal with futures trading; the El Abra deal almost got killed. There was talk in the country of the inefficiency of Codelco and privatization, and that if the company went ahead with the Radomiro Tomic Mine it would be a mistake. The previous administration in 1990-94 had seen a lot of confrontation between unions and management. It was a very complex situation. We got together with the unions and told them that to keep Codelco in state hands we had to demonstrate that we could be efficient and competi-

tive. We told the unions that they had to be flexible and change their working habits, that we had to reduce the work force because productivity was too low. This was an important restructuring of the company that we had to do in cooperation to convince the state and the country that the best proposition was to keep Codelco state owned.

AMM: What were your goals back then?

Villarzú: We promised to reduce operating costs by 10 cents a pound, increase produc-

(Continued on page 6)

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2006 Copper Club Man of the Year

(Continued from page 5)
tivity by 50 percent and reduce costs by 20 percent. We achieved even better results. We reduced employees by 10,000, increased productivity 80 percent in five years and became one of the lowest-cost and most competitive producers. This was Phase 1—to regain our competitive position.

AMM: And Phase 2?

Villarzú: In 2001 we had to prepare Codelco for a major expansion, given the high quality and large reserves it has. We have more than doubled the economic reserves the company has and we put the pieces in place for a major expansion. It was very ambitious to make the transformation and double the value of the company. When I look back, I think I was irresponsible to try to do this as I didn't realize the difficulty of what I was committing to do. But we finally made it and met our targets and more than doubled the value of the company and gave our shareholder—the state—a return on capital of around 27

percent, which puts Codelco among the most profitable companies, not just in the mining industry but in general.

AMM: You have a good relationship with the unions but you have said several times recently that labor costs have to go down and productivity has to increase. Will that strain the relationship with the unions?

Villarzú: All the effort we have made to increase production has coincided with a change in market conditions that has led to a huge price increase for all commodities that has put upward pressure on production costs. Between 1994 and 1999 productivity increased more than labor costs, but in the past five years wages have increased more than productivity so we are more or less in the same place. We cannot sustain this trend in the medium term so we have to put the brakes on this. We are working with the unions on Phase 3 to produce 2.6 million to 3 million tonnes a year. The unions know we need their support for our investment pro-

gram and we have to show that we can reverse the wage cost trend of the past five years.

AMM: Will that translate into a more extensive use of contractors? Codelco has had problems recently with its contract workers.

Villarzú: The target in the next five years is to improve productivity using our own workers and contractors. In any new mine you see the ratio of workers to contractors as 1:2 or 1:3. The normal relationship is 1:2. At Radomiro Tomic, we have 500 workers and 1,000 contractors. Gaby will be the same. In total, Codelco has 17,000 employees and 28,000 contract workers. Chuquibambilla and El Teniente are 100 years old and in those days you could not buy the services you can now so they were fully self-sufficient operations, and to dismantle that is complex and very difficult. That is why we have these tensions. We had to outsource because some people (nurses, cleaners, etc.) were paid miners' pay, more than their productivity.

AMM: The Ventanas division has agreed to a new collective bargaining agreement. Everyone wants to share in the bonanza of the high-price environment, but you want to control costs and increase productivity. It seems there is a conflict here.

Villarzú: That is a problem for the new Codelco administration. In June or July 2006 we will start collective contract negotiations for Andina and Codelco Norte. The Codelco Norte negotiations are very tough and they all want to share in the high price so it is going to be difficult to contain wages, but there is a need to contain wage increases.

AMM: What do you think Codelco's role in the copper market should be?

Villarzú: The major challenge is to increase production as much as we can due to the demand growth in China and the robust expansion of India and Asia in general. It is not an advantage that the price is at the level we are witnessing now because it will trigger substitution. The relative price of copper to aluminum is 1:1.3 normally but now it is 1:2, which makes it worthwhile to substitute copper with aluminum. The price is high because inventories are low, because production has not increased as fast as expected. There is very strong demand, supply is moving slowly and investment funds are becoming more active in commodities. To obtain a steady increase in stocks, large producers have to do all that is in their hands to increase production as fast as they can. Codelco is in a strong position to do this.

AMM: Several market analysts I have spoken with criticize Codelco for not having brought new production on-stream quick enough. Would you agree?

Villarzú: The responsible action for the industry is to invest and bring new production to the market as fast as it can.

There is the perception that the market has changed drastically. Two or three years ago, stocks were at record highs and there was a steady decline in the price. Now, almost everyone is saying that the growth of China and India will last a long time. We are witnessing a structural change as we are going into a long cycle of strong demand, and to really take advantage of this we have to increase production. This demand strength will last for 10 years or more.

AMM: How much metal will Codelco produce in 2006?

Villarzú: We will produce a little less than in 2005, just under 1.7 million tonnes. We sold 30,000 tonnes of molybdenum in 2005 and we are planning to produce 24,000 tonnes this year. We will produce less copper and molybdenum as the ore grades are falling, especially at Codelco Norte. There will be a slowdown in production in 2006 and 2007 but we will start to increase again in 2008, when Gaby comes on-stream, and in 2009, when Mansa Mina starts production.

AMM: You have commented a great deal in the past year about corporate governance at Codelco and the need to make Codelco a limited company.

Villarzú: The political leaders need to decide whether they want a strong, competitive and professional Codelco or a public agency that moves very slowly. To me, the best way to solve these issues is to transform Codelco into a Sociedad Anonima (limited company) in which 100 percent of the shares are owned by the state. This can be done in a way that avoids the privatization issue by requiring the state to obtain a special law to privatize the company, to put aside any doubt about the ownership of Codelco. Giving Codelco the same legal status as a limited company implies that it would be subject to the same conditions and requirements as any other limited company without being subject to the restrictions of public entities. This would also mean the company has a board with the power to run the company and solve the problem that most of the power is in the executive president's hands.

AMM: Do you think you have too much power?

Villarzú: No doubt I have too much power. The arrangement we have is reasonable if the board structure cannot play an active role and exercise the function of managing the company. Codelco's board comprises the finance minister, a representative of the military, two worker representatives and two additional members appointed by the president of Chile, which are usually the only two with business experience. As a limited company, the board would have the power but you need competent management.

AMM: So why is there so much resistance to this idea?

Villarzú: Chile is still very much an ideological country. Many politicians of the opposi-

tion distrust anything that is state related and they think that Chile would be better off if Codelco were privatized, and so it is difficult for them to accept that a company like Codelco can be run efficiently. This destroys their vision of the role of the state. Any small failure becomes a huge issue. To manage Codelco is very complex as everyone centers on any mistake. Chile has to agree on a way of governance and an institutionalization, and keep the management of the company away from short-term political debate. Chile should really treat Codelco in a very special way and not use it as a political football. One of my frustrations is that we have not been able to get political critics to respond to our invitation to come and look at our books. They are not interested in the opportunity to have a serious discussion about the company. But in London and New York, people are interested in what we do.

AMM: In 2005 there was a big fuss about contracts Codelco awarded that involved you personally. Given the sensitivity about Codelco, do you think it was a mistake for you to be associated with companies that won contracts?

Villarzú: In 2002 we changed the internal regulations concerning trading with related parties such that Codelco cannot do business with external companies in which senior staff have an economic interest. The criticism centered on contracts with companies related to think-tanks. The opposition said I was channeling funds to think-tanks close to the (government). We commissioned specific reports about what was happening in the European Commission about environmental issues... with people that were ambassadors to Europe and knew what was happening.

AMM: Was this another frustration?

Villarzú: I was disappointed because by doing this, by making claims with no basis, they were hurting the company. They got a lot of press, but when the investigative commission gave the all-clear the damage was already done.

AMM: What's next for Juan Villarzú? Does a position in the private sector appeal to you?

Villarzú: I will probably go back into the private sector. I had a consulting business before and I have a long experience in banking and finance, so I will probably go back into private consulting, but nothing related to Codelco or mining. I like to do things; I am very good at identifying opportunities. I am a good strategist and a good negotiator; those are my strengths, so I will see how I can combine these with opportunities in the market. I also would like to write a couple of books: one about the economic development of Chile and maybe one about what we have done at Codelco. It was a challenging process and there are many things to be told. Maybe I will take a six-month sabbatical at a U.S. university to write.

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