

QRC STATE OF THE SECTOR

DECEMBER QUARTER 2017



DELIVERING OPPORTUNITIES FOR LOCAL SUPPLIERS

The recent phase of mining investment spread its benefits widely. The Reserve Bank of Australia said nationally it raised average real wages by 6 per cent, raised real per capita household disposable income by 13 per cent and lowered the unemployment rate by about 1.25 percentage points¹. That's a pretty handy growth dividend!

It's common for industry opponents to say that after the resources industry's investment phase, all the jobs dried up. But that couldn't be further from the truth. The data says the benefits to local communities persist beyond the initial construction activity. Across Queensland, employment in the mining sector remains more than double pre-boom levels².

The Productivity Commission, late last year, said it's a similar story across Australia:³

“Mining regions continue to have high incomes and have substantially more people employed than prior to the boom. Many regions with a high concentration of activity based on mining have transitioned well from construction to production following large expansions in capacity during the mining investment boom”

Productivity Commission, 2017

The QRC's latest economic contribution data confirms that the resources industry is a major contributor to Queensland's regions. In 2016-17, the resources sector directly supported more than 16,400 Queensland businesses - with 56% of those businesses located outside of the greater Brisbane region. The sector continues to be a major employer in regional Queensland with 79% of the direct employees in the industry located outside of the greater Brisbane region.

The ongoing contribution to regional communities from the sector is not surprising. It's in the interests of resources companies to grow skills and suppliers locally and support the communities that you will call home for decades to come.

For this quarter's State of the Sector report, we asked our CEOs what they are doing to grow local suppliers in their area. And the results are promising. 50% of CEOs said their company ran programs to increase contracting opportunities and capabilities of local suppliers — such as pre-qualification programs, and training or mentoring programs for local businesses.

But some of our companies go further — 27% of CEOs said that they set internal targets for their company's share of spending on local businesses, with two major operators setting those targets above 50%. While 29% of CEOs said they provide alternative payment terms for local suppliers and indigenous businesses.

Outside of running specific programs, several CEOs outlined their commitment to local suppliers:

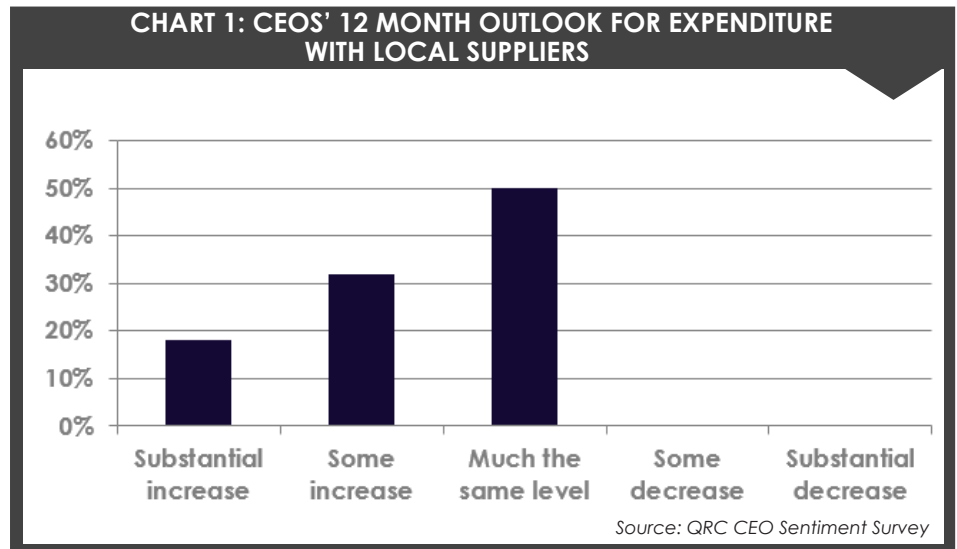
“We may not set targets but we have an overarching policy of buying locally and paying quickly”

“Local procurement policies are embedded in all of our major contracts”

QRC member CEO sentiment survey, December 2017

It's clear that investing in local capabilities builds opportunities. 41% of CEOs said that over the last 12 months, they had engaged more local suppliers as a direct result of the increasing capabilities of suppliers in their region. Furthermore, 27% of CEOs said that in the past year, there had been a noticeable improvement in the speed of local suppliers, while 23% said the quality of the goods or services supplied by their local suppliers had improved.

There's good reason to expect further gains for local suppliers in 2018. Not a single CEO expects to decrease their use of local suppliers over the next 12 months — while a staggering 50% expect an increase in the use of local suppliers over the same period (below). These results are particularly promising given the QRC's member CEOs already spent \$6.2 billion with 9,140 local suppliers in the regions last financial year — with a further \$9.9 billion spent with 7,277 suppliers in the greater Brisbane area⁴.



Clearly the message is getting out about local suppliers, with 36% of CEOs said their increasing awareness of suppliers was a key reason their use of local suppliers increased over the previous 12 months. Events such as the as the Gladstone Engineering Alliance Gladstone Resource Industry Supply Chain Expo, which is on again on 12 April, play a crucial role in getting the message out about the capabilities of local suppliers.

Despite the recent gains, local suppliers still face barriers to achieving further growth — 27% of CEOs said price competitiveness remains a key barrier to buying locally, while 23% said local supplier's compliance with health and safety requirements is also a major barrier.

Industrial relations is the highest cost area of Australian mining"

QRC member CEO sentiment survey, December 2017

More opportunities will build capabilities — and break down these barriers to growth. This is clear from the success stories identified each year in the QRC's annual Local Content Code Effectiveness Reports.

What can you do to support local suppliers? If you have a local supplier success story, we would like to know about them for this year's Code Effectiveness Report. You could also nominate one of your high-performing local suppliers for the Queensland Mining Awards 2018. The Bowen Basin Mining Club together with the QRC are proud to host the Queensland Mining Awards Gala on 25 July 2018 — with several award categories open for excellence and innovation of suppliers.

KEY INDICATORS

QRC PRODUCTION VOLUME INDEX

Industry bounces back

The QRC's quarterly Production Volume Index tracks changes in the total production of Queensland's major commodity exports - alumina, aluminium, bauxite, coal, copper, gold, lead, silver, zinc and LNG as of the December 2016 quarter.

The Production Volume Index is weighted by the value of each commodity. This means changes in the volume of coking coal (which is just over half the total index value) has a proportionately larger impact on the quarterly index result than, for example, changes in thermal coal volumes (representing approximately 10–15 % of total value).

The QRC's Production Volume Index for the September 2017 quarter (latest available data) has increased by 14 points, to 117 points, which is the highest level since the December 2016 quarter and the highest quarterly increase in the Index in over four years (June 2013 quarter).

Recovering coal exports drove much the bounce back in the QRC Production Volume Index. With Queensland exporting 32% more coal in the September quarter than the June quarter. An unsurprising result given the strongest impact of Cyclone Debbie was felt in the June Quarter of 2017.

Partially offsetting the coal volume recovery, lead production was down 49%, zinc down 20%, silver down 10% and gold down 4%. Planned mine changes across Mount Isa and Cannington mines were main driver behind these lower volumes.

As for the rest of the commodities in the QRC's index — LNG, aluminium, alumina, bauxite and copper were steady, each within 1% of the volumes from the previous quarter.

EXPORT OUTLOOK

The resources sector can expect to build ground on volumes over the next 12 months.

The Office of the Chief Economist forecast volumes of metallurgical coal to increase by 8.4% across 2017-18. The strong growth is driven by a mixture of higher prices and improving supply as miners recover from weather events and operational issues. Meanwhile for thermal coal, exports are forecast to remain steady over the same period, increasing by 1.3% over 2017-18.

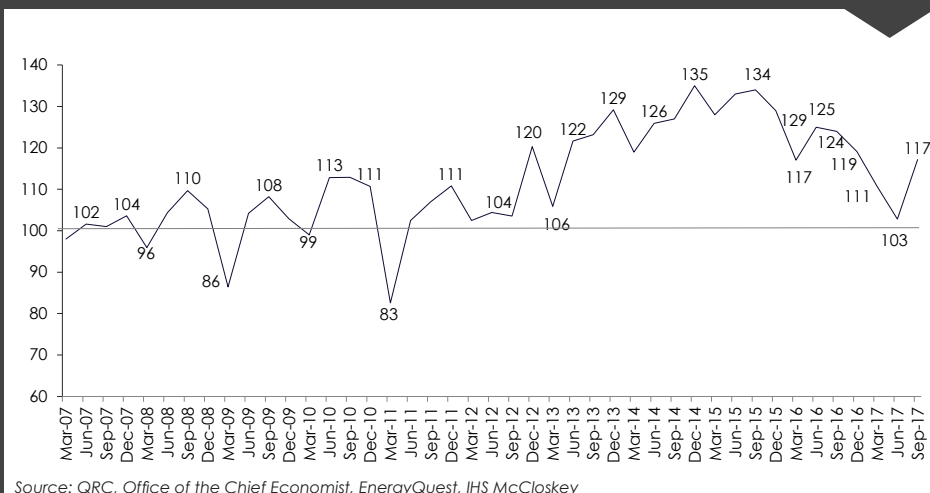
However, the forecasts above do not reflect the cyclone like impact of Aurizon's industrial "work to rule" campaign through maintenance changes in the central Queensland coal network. The damage to Queensland's reputation from deliberately sacrificing more than 20 million tonnes of coal exports is hard to calculate, but in terms of tonnes, "Cyclone Aurizon" is double the 10 million tonne impact of Cyclone Debbie and is the equivalent of nearly 10% of Queensland's annual coal exports.

According to QRC estimates, the lost tonnes from Aurizon's actions are worth \$4 billion in export revenue and around \$500 million in royalties — enough to pay the wages for 7,388 teachers, or 7,060 police constables or 7,430 registered nurses.

In brighter news, the outlook for base metals is positive on the back of strong growth in copper exports, which are forecast to increase by 4.5% annually. While bauxite production is expected to rise 2.4% across 2017-18 and then by a further 10% in 2018-19.

The Office of the Chief Economist expects LNG production in the Eastern Australian market to grow by 6% in 2017-18. But the real story is global demand, China's LNG imports forecast to increase by 21% to 2019, while Europe's LNG import are forecast to increase by 75% over the same period.

CHART 2: QRC PRODUCTION INDEX SEPT 2017 QUARTER (WITH LNG)
(A\$) (QUARTERLY) (INDEX BASE JUNE 05/06=100)



QRC STATE OF THE SECTOR

QRC VALUE OF PRODUCTION INDEX

Back to the podium

QRC's Value of Production Index reflects changes in the prices of the resources that Queensland produces. The weighted index reflects the same mix of commodities as the QRC production volume index and therefore now includes LNG production from the December 2016 quarter onwards.

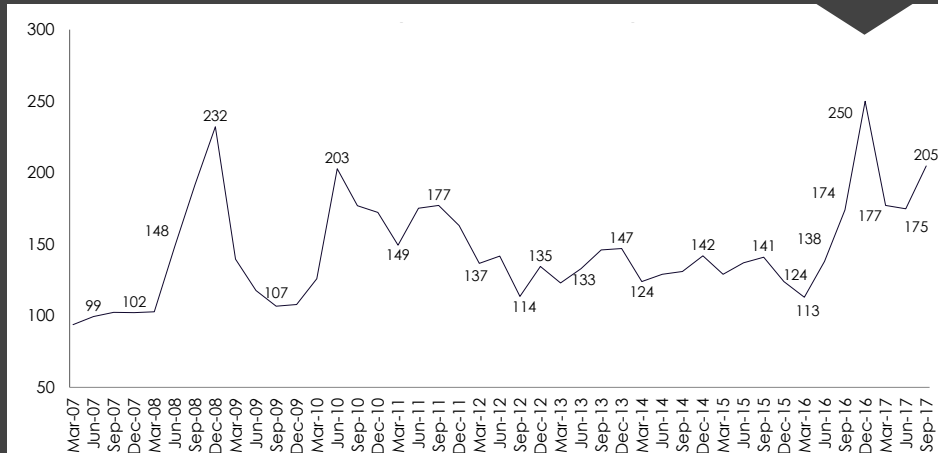
Over the September 2017 quarter, the QRC's Value of Production Index increased from 175 to 205 points — the third highest level since the Index began. The recovery in coal exports after Cyclone Debbie more than outweighed the small decreases in coking coal prices across the quarter. At the same time, the value of production index was supported by strong rises in thermal coal (up 18%), zinc (up 14%) and copper (up 12%).

In dollar terms, the value of the commodities produced by the sector reached A\$16.9 billion in the September 2017 quarter. This represents an A\$2.5 billion (or 17%) increase in value since the previous quarter—again, largely due to coal volumes recovering.

Outside of coal—zinc, copper and lead all saw large price increases, up 14%, 12% and 8% over the quarter as global industrial conditions continued to improve worldwide. Finally, bauxite prices decreased by 10% and LNG spot prices decreased by 4%. However, most of the LNG exported from Queensland is not traded at spot prices, but rather in oil-linked contracts, which include a cap and floor to protect the buyer and seller from extreme price variations. Chart 4 provides a breakdown of this quarter's average price changes for each commodity.

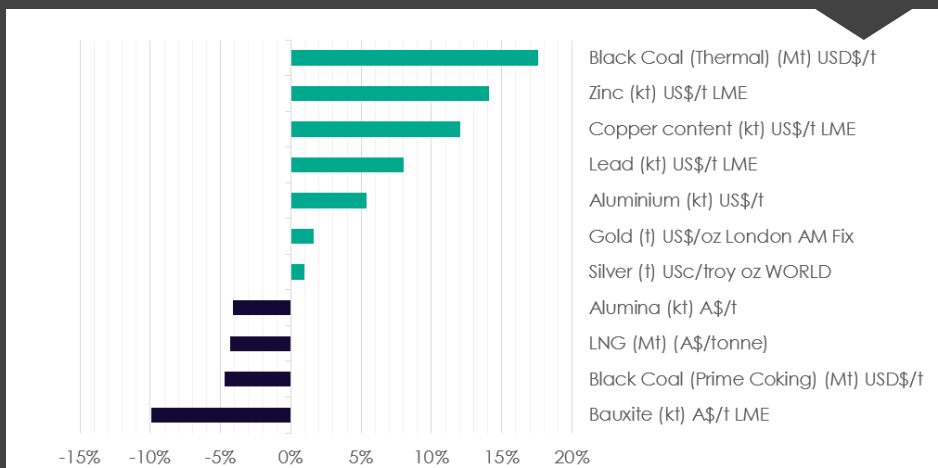
On a positive note, Chart 5 shows the volume of Queensland commodities exported and the value of those commodities both increased over the September 2017 quarter. Queensland export values remain well above long-term results—recording the second highest quarterly value since the index began in 2006. Furthermore, since the QRC's value of production index began in June 2006, the export value of Queensland's resources has more than doubled—from \$6.5 billion in June 2006 to \$16.9 billion in September 2017.

CHART 3: QRC VALUE OF PRODUCTION INDEX SEPT 2017 QUARTER (WITH LNG) (A\$) (QUARTERLY) (INDEX BASE JUNE 05/06=100)



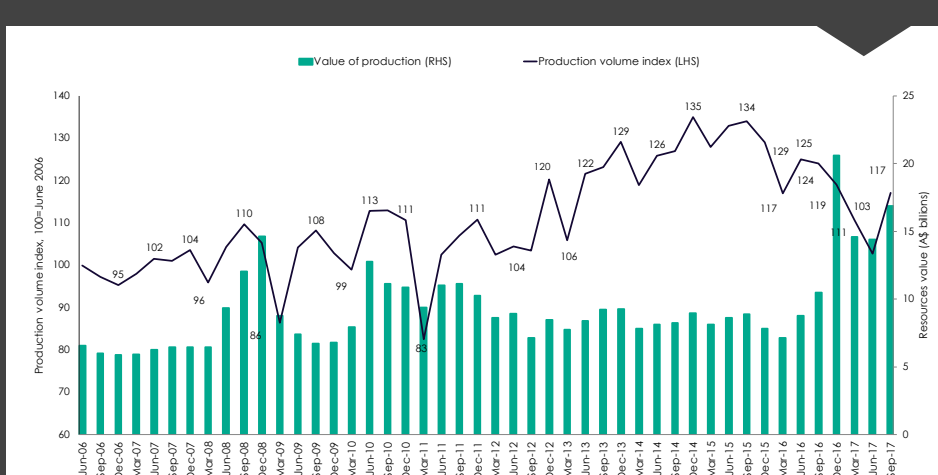
Source: QRC, Office of the Chief Economist, IHS McCloskey, EnergyQuest

CHART 4: AVERAGE QUARTERLY COMMODITY PRICES CHANGES - SEPTEMBER 2017



Source: Office of the Chief Economist, EnergyQuest, IHS Markit

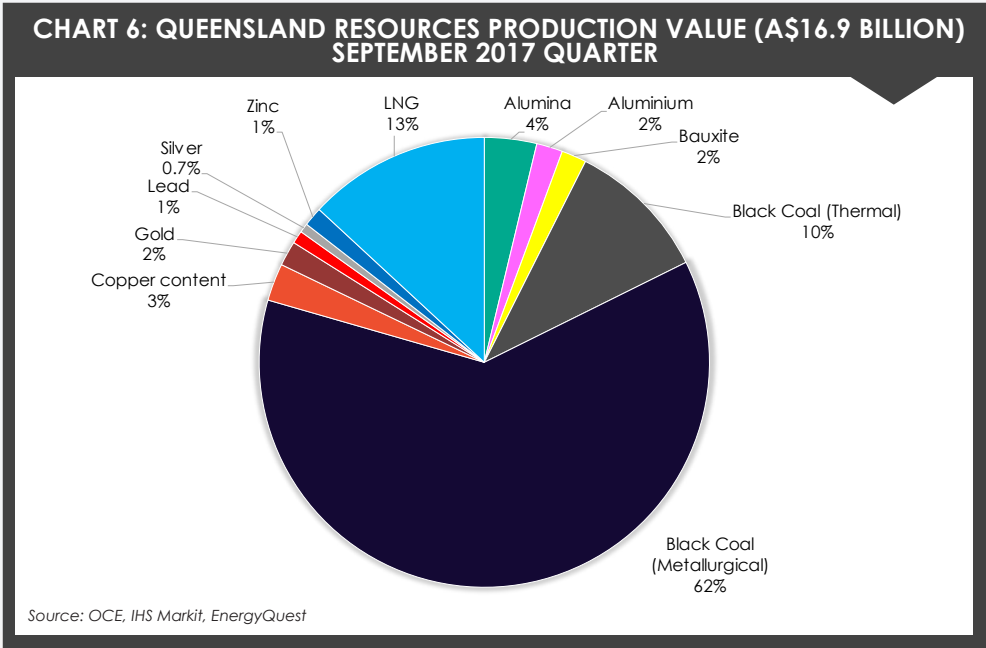
CHART 5: QUEENSLAND COMMODITY VOLUMES VERSUS VALUES



Source: QRC, Office of the Chief Economist, IHS McCloskey

KEY INDICATORS CONTINUED

Chart 6 below provides a breakdown of the value of Queensland's resource production in the September quarter. LNG has had a material impact on the value of Queensland's resource production—accounting for 13% of the sector's production value in the September quarter.



QRC CEO SENTIMENT INDEX

The QRC CEO Sentiment Index is collected through a quarterly survey of QRC's producer and explorer members with the typical response rates between 20-35 companies. The companies surveyed cover mining and energy, minerals processing, contracting, exploration, electricity generation and oil and gas extraction activity in Queensland.

Each quarter CEOs are asked to nominate to what extent they expect a series of eleven factors will impact on the objectives of their organisation over the next 12 months. All responses are weighted to arrive at a single sentiment value for that factor. The weighting means the factors generating the greatest concern receive the lowest scores and are lower down on the negative axis.

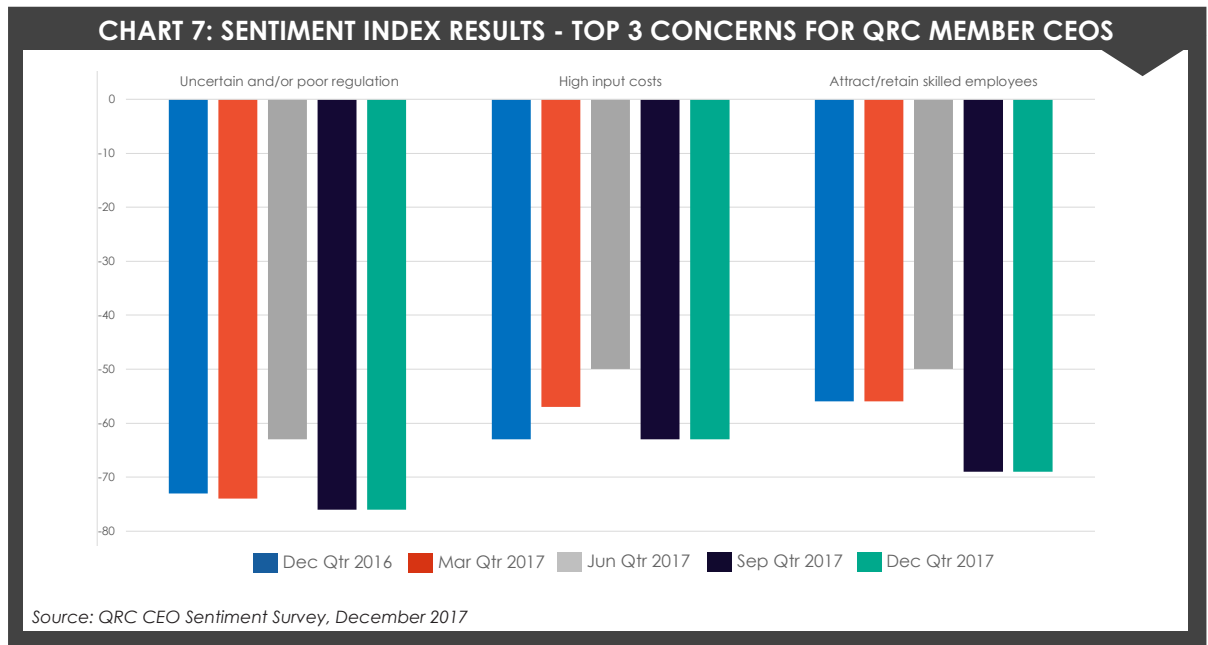
Across the board, CEOs' concerns elevated in the September and December 2017 quarters. Disappointingly, the greatest concern for our CEOs is again uncertain or poor regulation, eroding the gains achieved in the previous CEO sentiment Survey.

QRC STATE OF THE SECTOR

Meanwhile, rounding out the top three, *attracting and retaining skilled employees* came in at number two and *rising input costs* at number three (both were equal 5th in the last survey).

Perhaps most concerning, *attracting and retaining skilled employees* increased by 19 points since the last survey — reflecting the concern shown from all QRC member CEOs from exploration companies to electricity generators.

CEOs noted that increasing commodity prices is driving increasing supply, which leads to upward pressure on input costs in the short term. CEOs noted that regulatory burden isn't the only source of cost pressure:



“Competition for equipment and people and services is ramping up and costs are consequently rising with them”

“People are starting to throw money at labour and retention and attraction of appropriate skills is becoming more difficult”

QRC member CEO sentiment survey, December 2017

Chart 7 illustrates the change in sentiment over recent quarters for our member CEOs' top three concerns. It's clear that much of the positivity expressed by CEOs in the June 2017 quarter has eroded.

Beyond the top three concerns, one of the largest movers for this edition is industrial relations. The category achieved its highest negative score since the December 2014 quarter—reaching 6th position in terms of negative sentiment by CEOs.

Comments from QRC member CEOs support this concern:

“...productivity losses and industrial relations risk will drive up costs of production.”

“...Increasing regulation in project development and industrial relations will cause undue hardship in an industry that is slowly recovering from difficult markets.”

QRC member CEO sentiment survey, December 2017

However, as sign of the improving outlook for resources, the raising capital sentiment category improved by a further 2 points — making it 14 points better off than the category's sentiment lows in March 2016.



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