QUEENSLAND RESOURCES COUNCIL

STATE OF THE SECTOR

SPECIAL RSPT EDITION

QRC SURVEY: UNDERSTANDING THE REAL IMPACTS OF THE RESOURCE SUPER PROFITS TAX (RSPT)

SUMMARY OF FINDINGS

Welcome to this special 'RSPT' edition of the QRC's State of the Sector report where we outline the findings of our recent survey of QRC full members covering coal and other mining, minerals processing, oil and gas production and exploration.

The objective of our survey was to gain a 'first hand' account of how the resource super tax will affect both current operations and the viability of future projects. We also asked members how the capital markets, both equity and debt, are responding to the government's RSPT announcement.

Covering the length and breadth of the resources sector, from small exploration companies to large multi-national operations, the survey results from our respondents are damning of the RSPT.

Impact on current operations

The cumulative tax impost of existing taxes plus the RSPT will result in a substantial increase in effective tax rates. This additional tax burden will increase costs, squeeze margins, and will move companies' current operations up their respective global cost curves.

Given that resource companies are price takers in global commodity markets, it comes as no surprise that as a result of this severe squeeze on margins, more than nine in 10 respondents concluded that it would be 'highly likely' or 'likely' that their competitiveness in global markets would be adversely affected.

Furthermore, with lower margins, a clear majority of respondents indicated that it was either 'highly likely' or 'likely' that constraints on wages (69 percent) and expenditure on community infrastructure (73 percent), would occur.

Significantly, nearly half (46 percent) of respondents said that it was 'highly likely' or 'likely' the RSPT would cause operations to be scaled back and 16 per cent also said that it was 'likely' that shutdowns would occur.

Impact on future projects

Our survey found that the RSPT would have a crippling impact on future projects. The RSPT is a punitive tax because it applies a very high 'headline' rate (ie the 40 percent) on a very narrow capital base as the basis of the RSPT calculation.

The combination of the high headline tax rate, a very low uplift allowance (ie the long term government bond rate of about 6 percent), and normal depreciation of capital costs, means that future projects are liable for very high levels of tax early in the project mine life (and certainly much sooner than under the existing petroleum resource rent tax).

Large tax liabilities early in a project severely erode the value of a project both in Net Present Value and Internal Rate of Return terms. If project valuations fail to meet a company's cost of capital and the internal 'hurdle rate', the project will generally not proceed.

Survey respondents supplied information on proposed (brown and greenfield) projects that were under study or under consideration before 2 May 2010. They reported that more than half (53 percent) of these future projects were either 'highly likely' or 'likely' to be under threat if the RSPT were to proceed as proposed.

The aggregated foregone socio-economic benefits to Queensland of these projects not proceeding would comprise:

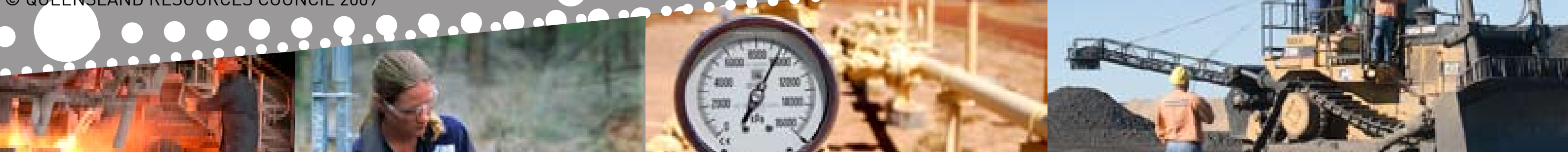
- $25.3 billion in capital expenditure
- 10,400 full-time equivalent construction jobs
- 4520 full-time equivalent operational jobs.

Given the strong employment and economic 'value add' multipliers associated with minerals and energy construction and operational activities, coupled with foregone royalties and company tax contributions, the adverse consequences for the Queensland economy are immense.

The bad news does not stop there.

A further 41 percent of future projects covered by the survey responses remain under a cloud with respondents indicating that 'it cannot be determined (yet)' if they are under threat.

This may reflect the fact that these projects are close to internal hurdle rates and/or the impact of the RSPT is not clear. The value of these projects was $18.5 billion, involving 5150 construction jobs and 1000 operational



jobs.

A mere 6 percent of projects were 'unlikely' or 'highly unlikely' to be under threat.

Impact on capital markets

The final measure that the survey looked at was the impact of the RSPT announcement on the capital markets.

There is no denying that the rapid industrialisation and urbanisation of much of the developing world will require significant volumes of minerals and energy resources in the years to come and Queensland is well positioned to meet this burgeoning demand.

In order to supply this demand, resource companies operating in Australia will be required to mine deeper than ever before, and often further away from infrastructure such as ports. These projects will require tremendous levels of capital that must be sourced from the debt and equity markets.

The issue then becomes one of whether these markets will be willing to lend to Australian companies, and will it be at lower 'risk free' levels because of the design feature of the RSPT which is for government to underwrite losses if they occur. On this latter point, all respondents indicated that it was 'unlikely' or 'highly unlikely' that the markets would begin to provide capital at a risk free rate.

Eighty-five percent of respondents said that it is 'highly likely' or 'likely' that debt capital would flow to other countries because of the perceived increase in sovereign risk in Australia.

Ninety percent said that it was 'highly likely' or 'likely' that debt capital may flow to other countries because returns to capital are likely to be higher. The same percentage of respondents said that it is 'highly likely' or 'likely' that debt capital might be more expensive - reflecting greater risk.

All respondents said that equity capital might flow to countries instead of Australia due to the expectation of lower earnings and lower dividends, and 90 percent said that it is either 'highly unlikely' or 'unlikely' that capital would flow to Australia as it did before the 2 May announcement.

Conclusion

The RSPT is a very punitive tax and will adversely affect the short, medium and long-term viability of the Queensland resources sector if not amended.

The most significant impact on current operations is that it will push proponents up on their global cost curve.

This will impact upon competitiveness and viability and may have a short-term employment impact.

For those commodities that are produced and consumed in domestic industrial and manufacturing processes that are then exported, input costs will inevitably rise, placing further pressure on those companies' ability to compete globally.

The most significant impact on new projects is that it will push up effective tax rates.

High tax liabilities, especially early on in a project, negatively impact upon the value of projects (net present values). A consequence is that projects will fail to meet expected rates of return and will not attract the necessary capital.

The RSPT's fundamental problem is that it fails to take into account that whilst Australia's resources are immobile, the global capital that brings them to market is highly mobile. This survey provides very clear evidence that the RSPT as proposed will place Queensland's resource sector on a much lower growth trajectory than that assumed before 2 May 2010.

In terms of the likely impact on the debt and equity capital markets, it is clear that parties will not value the guaranteed tax credits when a project winds up and capital costs will not decrease as a result. It is also clear that the 2 May announcement may have done irrevocable damage to Australia's reputation as a stable investment destination, and that the sector expects both debt and equity capital to bypass Australia for the time being.

The damning results of this QRC survey lead to one clear conclusion: the federal government must immediately withdraw the RSPT proposal and begin a new process of genuine industry consultation.

Detailed survey results

The objective of this survey was to assess the impacts of the proposed RSPT on the current operations and proposed new projects of the QRC's full members against a variety of measures.

A 38 percent response rate was recorded (30 of 79).

Main activity of respondents

Companies involved in mining, contract mining, oil and gas production and exploration responded to this survey.

Average effective tax rate of respondent's pre RSPT

39 percent

IMPACT ON EXISTING OPERATIONS

Question 1

What will be your company's total effective tax rate once the RSPT is introduced?

58 percent (average across all respondents)

Question 2

Assuming a higher effective tax rate will be payable, what will be the likely effect on your operation/s?

	Highly likely	Likely	Can't yet be determined	Unlikely	Highly unlikely
Reduced competitiveness in global markets	65.4%	26.9%	7.7%	0.0%	0%
Constraints on wages	23.1%	46.2%	26.9%	3.8%	0%
Constraints on community infrastructure expenditure	19.2%	53.8%	26.9	0.0%	0%
Constraints on the research, development and deployment of technologies	23.1%	42.3%	26.9%	7.7%	0%
Scaled back operations	23.1%	23.1%	46.2%	7.7%	0%
Shutdowns	0.0%	16%	40%	36%	8%

Question 3

Are there any other impacts that a higher effective tax rate will have on your current operation/s?

• 'Reduced capacity to undertake exploration activity. Difficulty raising external finance. Reduced ability to raise equity from investors' *(Mining company with a 2008/09 turnover of $0.7 billion and employing 1000 full time equivalent staff)*

• 'Significant potential for a decline in our ability to raise future capital' *(Exploration company with a 2008/09 turnover of $5 million and 8 full time equivalent staff)*

• 'Make much more difficult to obtain finance plus more likely to high grade project to maintain margins which will reduce project size and duration and leave behind medium and low grade resources'. *(Exploration company)*

• 'Less likely to move from exploration to production'. *(Exploration company with a 2008/09 turnover of $6 million and six full-time equivalent staff)*

• 'Capital raising potential slashed due to record low market capitalisation of explorers, new projects put on hold'. *(Exploration company)*

• 'Likelihood of Australian operations having less access to capital in order to fund new operations or expand existing operations as capital may be given to operations in other jurisdictions as return on that capital is higher'. *(Mining company with a 2008/09 turnover of $2.7 billion and employing 3462 full-time equivalent staff)*

• 'The higher tax rate reduces future cashflows making investment less attractive'. *(Exploration company with 15 full-time equivalent staff)*

• 'Impact negatively on debt covenants, will need to renegotiate debt arrangements. Pass through costs (including taxes and royalties pass though) to domestic customers will also have to be reviewed (these are essentially government organisations).

Potential deferrals of major capital programs (stay in business capex) to maximise RSPT outcomes will delay decision making.

Contractor mines and capital structures are at risk, due to the capital allowances not available on contractor capital'. (*Mining company with a 2008/09 turnover of $2 billion and employing 1215 full-time equivalent staff)*

IMPACT OF THE RSPT ON NEW PROJECTS

Question 4

Please complete this question if your company had a significant 'new project' (either brownfield expansion or greenfield) under study or under consideration (ie no final decision made) prior to 2 May 2010. Assuming the RSPT is passed as currently proposed, is your project under threat?

Respondents were asked to provide certain details of these projects, including commodity, proposed capital expenditure, expected full time equivalent workforce during the construction and operational phases, and all things being equal, the Net Present Value, Internal Rate of Return and Effective Tax Rate of the project pre and post RSPT implementation.

Highly likely	Likely	Cannot yet be determined	Unlikely	Highly unlikely
11.8%	41.2%	41.2%	5.9%	0%

For those projects considered 'highly likely' and 'likely' to be under threat due to the RSPT, the aggregated

foregone socio-economic benefits to Queensland would be:

• $25.335 billion in capital expenditure

• 10,400 full-time equivalent construction jobs

• 4520 full-time equivalent operational jobs

Question 5

Are there any other comments you would like to make in terms of the likely impact of the RSPT on new projects?

'Uncertainty around this tax regime has raised the sovereign risk for Australia as a whole. Other projects around the globe are becoming more attractive. Locking in long lead time capital items for projects in this uncertain environment will be almost impossible. We will also have to review capital ownership structures especially around owner/contractor operator operations.' *(Mining company with a 2008/09 turnover of $2.1 billion and employing 1215 full- time equivalent staff)*

'A large Queensland mining company with multi-billion dollar turnover has 10 projects proposed for development to support export growth. The timing and economics of growth projects remain highly uncertain inlight of the proposed new tax.'

INVESTMENT ATTRACTIVENESS AND THE CAPITAL MARKETS

Question 6

What will be the likely reaction of the debt and equity capital markets if the RSPT is passed as currently proposed?

	Highly likely	Likely	Can't yet be determined	Unlikely	Highly unlikely
Debt capital may flow to other countries because of the perceived increase in sovereign risk	50%	35%	10%	5%	0%
Debt capital may flow to other countries because returns to capital are likely to be higher	55%	35%	10%	0%	0%

	Highly likely	Likely	Can't yet be determined	Unlikely	Highly unlikely
Debt capital may be more expensive - reflecting greater risk	50%	40%	10	0%	0%
Debt capital may be less expensive because markets will begin to 'value' the guaranteed tax credits when a project winds up	0%	0%	0%	50%	50%
Equity capital may flow to countries instead of Australia due to expectation of lower earnings and lower dividends	50%	50%	0%	0%	0%
Capital may flow to Australia as it did before the 2 May announcement	0.0%	0%	10%	50%	40%

Question 7

Are there any other comments you would like to make in terms of how the investment community is likely to respond if the RSPT is introduced as proposed. You may like to comment on the affect already.

• 'Issues concerning the RSPT and existing financing arrangements, especially in connection to debt covenants. Diminished ability to generate franking credits which further reduce investment attractiveness.' *(Mining company with a 2008/09 turnover of $0.8 billion and employing 1000 full-time equivalent staff)*

• 'I think resource sector will be hit hard with investment flowing from Australian resource sector to other overseas resource sectors, and domestic sectors eg financial, plus super funds will be hit. 'Investors chase the best returns-the Australian resource sector having new RSPT providing total taxes of 57 percent is not attractive nor competitive.' *(Explora tion company with 12 full-time equivalent staff)*

• 'It is the contractors that have to build the new projects. From the multinationals point of view they don't really care whether an Australian project or outside Australia gets through their project approval hoops its just hard economics. They don't really have jobs and the company existence at stake. For the big guys it is 'where will I invest? For local contractors it is 'how can I exist if they don't invest or even if they stall their investment?'(*Contract mining company with a 2008/09 turnover of $0.77 billion and employing 1000 full-time equivalent staff)*

• 'The RSPT would negatively tinker with the whole DNA of mining investment across a range of 'real world' impacts that have not been understood by people that have no experience or understanding of how mining investment works.' *(Exploration company with a 2008/09 turnover of $6 million and sic full-time equivalent staff)*

• 'These affects are already happening.' *(Exploration company with a 2008/09 turnover of $6 million and six full-time equivalent staff)*

• 'Issues concerning the RSPT and existing financing arrangements, especially in connection to debt covenants. Diminished ability to generate franking credits, which further reduce investment attractiveness.' *(Mining company with a 2008/09 turnover of $0.77 billion and employing 1000 full-time equivalent staff)*

• Many of the major shareholders in mining companies are Australian superannuation funds. This will be unlikely after the introduction of the RSPT as no franking credits will be allowed for RSPT paid and the deduction will lower the company tax paid and hence the franking credit attached to those distributions. As such, mining companies may find it hard to raise new capital as other industries without such prohibitive taxes (and risk) would be favoured.' *(Mining company with a 2008/09 turnover of $0.7 billion)*

• 'General nervousness amongst our shareholders on how this will impact growth prospects. Generally share prices have dropped by 20 percent as a result of the uncertain sovereign regime.' *(Mining company with a 2008/09 turnover of $2.1 billion and employing 1215 full-time equivalent staff)*

Question 8

Are there any other likely unintended consequences if the RSPT was enacted as currently proposed?

• 'Transition base does not allow for recognition of price paid to acquire tenements - in our case, tenements account for approximately 85% of the value of recent transactions. Onerous compliance requirements including potential tax effect accounting and fixed asset register maintenance.' (*Mining company with a 2008/09 turnover of $0.77 billion and employing 1000 full -time equivalent staff)*

• 'The government says the RSPT will maximise the resource recovery of our resources for all Australians. This is not the case. Fewer deposits will be developed and established mines are less likely to expand or create new ones. In addition, companies will selectively mine the high grade to maintain margins and the medium and low-grade resources unexploited and once the best zones are mined the remaining resource will likely be stranded forever ie exact opposite to what the government has promoted. Also companies and projects will be stressed and overseas companies are in a position to gain product at cheaper price and not be intending to maximise profits in Australia - their resource security and supply is more important than profits in Australia.' *(Exploration company with 12 full-time equivalent staff)*

• 'Even if it was a to exist in the end, the stalled projects in the period of uncertainty will send a number of contracting companies broke as they continually get pressured for 'free consulting' pricing-up projects with no near-term revenue stream.'(*Contract mining company with a 2008/09 turnover of $0.77 billion and employing 1000 full-time equivalent staff)*

• 'The Australian mining community is a global hub of excellence. When third-world countries see what Australia is doing (if the RSPT becomes tax law) similar regimes will be introduced. This will erode margins on mining globally and have a negative impact on the whole industry. *(Exploration company with a 2008/09 turnover of $12 million and employing 25 full-time equivalent staff)*

• 'We note that one of the objectives of the Henry Review of the Australian tax system was to make it simpler. With several thousand mining operations in Australia and a determination of the taxing point in regard to Super Tax possibly required for each operation, it is not difficult to conclude that this proposal is unlikely to achieve the objective of simplicity.' *(Mining company with 2570 full-time equivalent staff)*

• 'Impacts on major long-term contracts with state governments negotiated in 2004 and 2005 and running to 2025 and 2030 respectively, which were negotiated/priced on the basis that only the states would collect resource-rent.' *(Mining company with a 2008/09 turnover of $2.4 billion and employing 1215 full-time equivalent staff)*