QUEENSLAND RESOURCES COUNCIL
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ELECTION OPPORTUNITY TO ADDRESS KEY CHALLENGES

MICHAEL ROCHE - CHIEF EXECUTIVE

At the start of a new financial year, many Queensland resources sector industries are staring down the barrel of the toughest operating environment in more than a decade.

Despite a softening of the $A against the $US, it appears our global coal customers are factoring those benefits into price negotiations as global coal prices continue to fall sharply. Coupled with high structural costs, the added burden of carbon costs and the likelihood of an oversupplied global coal market well into 2014, coal companies will continue to take prudent cost cutting measures to ensure their viability.

We know that the flow-on from these measures is being felt across the industry's supply chain. Our valued suppliers are having to adapt to the new market conditions and look to engage producers with a focus on efficiency and productivity.

In an all-out effort to spread high fixed costs over more tonnes, the Queensland coal sector as a whole is delivering some extraordinary uplifts in production and exports that will be confirmed at the end of the June quarter. In June 2013 Queensland coal exports were one-third higher than in June 2012, and for the first six months of 2013, coal exports were up by 15 percent on the same period in 2012. New production capacity has come on line (for example Kestrel, Daunia) but we will inevitably see more job cuts and more mines or parts of mines put on care and maintenance.

One piece of good news is that the diversity of our state's resources sector is providing some buffer against the coal downturn. Quarterly data from the Australian Bureau of Statistics (ABS) shows that mining and resources sector full-time employment has remained steady over the past 12 months at around 73,000 persons. Coal employment is down but sectors such as gas have been on the rise.

While petroleum/gas sector exploration remains strong, coal and mineral exploration has fallen off the cliff, according to March quarter 2013 ABS data. This reflects the very difficult fund raising environment for junior explorers, with the majors also reducing their exploration to the necessary minimum.

As we move into the federal election season, we are looking to the major parties to put down markers in four key areas:

Carbon emissions reduction: A globally competitive approach to emissions reductions is currently lacking. The Rudd government proposes an accelerated move to the floating carbon price, said to be $6/tonne on current parameters. We need to hear more about fair treatment of emissions intensive trade exposed industries (EITI) and the preparedness to either include coal as an EITI or bring Australia into line with the rest of the world by not applying the carbon price to coal mine fugitive methane emissions. The Coalition's plan involves no carbon price, a fund to purchase lowest cost abatement, establishment of baselines for emissions and a White Paper process commencing shortly after the election.

Taxation: Industry craves fiscal stability. No further tax increases, no more surprises, no fiddling with the fuel tax credit and an open and consultative dialogue with industry and the states around a long-term, sustainable framework for resource taxation. The Coalition is committed to repealing the MRRT and a comprehensive taxation White Paper.

Environmental approvals: An end to the current duplication and inefficiencies besetting project approvals under a system of bilateral agreements between the Commonwealth and the states. This means restarting the process abandoned by the Commonwealth in December 2012. Mr Rudd recently acknowledged the need for action but the detail was lacking. The Coalition has committed to a single entry point for project approvals, delegating more responsibility back to the states under its one-stop-shop policy.

Exploration: Government must recognise the headwinds confronting the exploration industry given the market weakness and difficulties in accessing equity markets. This issue is increasing in significance as confirmed by our CEO Sentiment Index findings this quarter (see page 4). The inability to raise capital rates today is the second most significant impediment facing the resources sector.

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- Feature article: Community views towards the Queensland mining and resources sector
- QRC CEO Sentiment Index

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There is no better time for the next federal government to revisit a much-promised but so far undelivered 'flow through shares' (FTS) or exploration tax credit (ETC) scheme to allow unused deductions to filter back to exploration companies to be spent on eligible exploration activities. In the absence of an ETC scheme, and in an effort to conserve cash, we anticipate a continued slowing in exploration and development expenditures across a number of commodities.

Despite challenging times ahead, Queensland's resources sector is drawing comfort from overwhelming public support. The latest public opinion polling for QRC by Crosby-Textor (see further reporting in this edition) shows community support for mining and resources at 82 percent statewide.

This high level of support includes both voters who are yet to decide who to support at the next election (so-called soft voters) and voters in marginal electorates.

From the QRC's perspective, we remain confident about the longer term demand fundamentals for Queensland's resources, and the prospects for continued wealth creation under the right commercial and policy settings (see CEO Sentiment Index findings on page 4 for areas of concern).

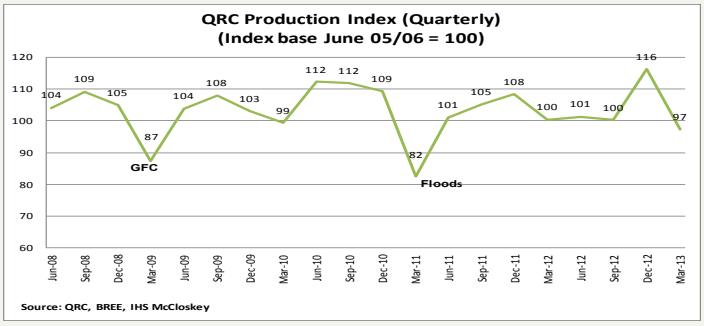
KEY INDICATORS

QRC PRODUCTION INDEX

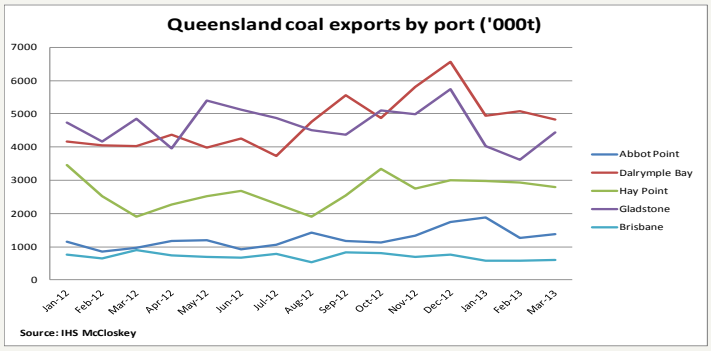
The *QRC production index* is a composite weighted index that tracks percentage increases and decreases in the total production of Queensland bauxite, alumina, aluminium, coal, copper, gold, lead, silver, and zinc from quarter to quarter.

Weightings are on a value of production basis; hence changes in coal production (representing 70 percent of the Queensland resource sector's total value of production) have a proportionately larger impact on the index than changes in silver production for example (representing just five percent of total value of production). As Queensland is not yet producing significant quantities of additional coal-seam gas, this output has not been included.

The index at the end of the March 2013 quarter (latest available data) showed very large volatility with a substantial decrease to 97 index points. This is a decrease of 19 percentage point from the December 2012 quarter (June 2006=100).



Coal exports fell from 48.6 Mt in the December quarter to 41.9 Mt in the March 2013 quarter. The largest downturns were experienced at the Gladstone, Brisbane and Dalrymple Bay ports (see below). This reflects a combination of market factors as well as scheduled maintenance and bad weather. We know from prelimiary data that volumes once again increased in the June quarter.



A number of commodities including alumina (1,464 kt to 1,116 kt), bauxite (6,518 kt to 5,783 kt), lead (114 kt to 102 kt) and zinc (281 kt to 219 kt) also recorded lower production volumes over the March quarter. Only copper (70 kt to 75 kt) and silver (290 t to 350 t) showed a notable increase in production. Production for gold and aluminium remained relatively static.

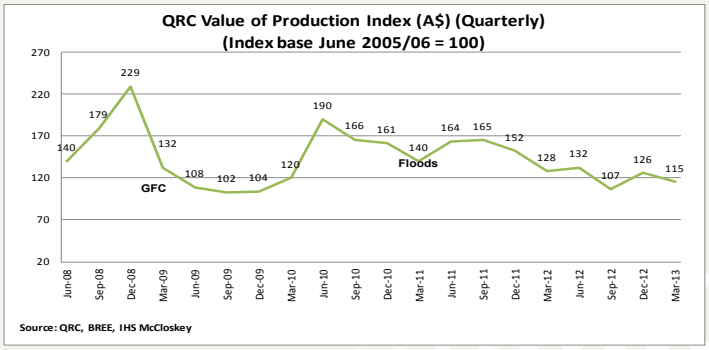
QRC VALUE OF PRODUCTION INDEX

Comprising the same basket of goods as the *QRC production index*, the *QRC value of production index* is also a weighted index. It combines domestic production and average global benchmark prices to track percentage increases and decreases in the Queensland resource sector's total value of production.

The index at the end of the March 2013 quarter (latest available data) reached 115 index points, a decrease from the previous quarter's high of 126. In aggregate, the resources sector recorded sales of A$7.6 billion in the quarter, down from A$8.3 billion in the December 2012 quarter.

The decrease was primarily on account of the temporary lower coal export volumes and decreasing coal prices. Spot thermal coal prices continued to stay very low at around US $88/t (Newcastle FOB maker, high CV and 6,000kc NAR basis) while Australian prime hard coking coal traded in the spot market for around US$166/t by the end of March 2013.

Gold ($US1,719/oz to $US1,631/oz) and silver (US$3,261/troy oz to US$3,009/troy oz) also recorded decreases while alumina ($A275/t to $A293/t), aluminium (US$1,996/t to US$2,003/t), copper (US$7,909/t to US$7,928/t), lead (US$2,199/t to US$2,303/t) and zinc (US$1,949/t to US$2,033/t) recorded increases at the end of March.



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PRICE OUTLOOK

While traded volume growth rates for coal remain high as countries like China and India take advantage of weak prices, global prices for thermal and coking coal continue to trend downwards due to significant oversupply as new supply enters the market. The problem is exacerbated by lock-in infrastructure agreements in Australia.

With thermal coal, Australian producers appear to have settled June-expiry 2013-2014 Japanese Power Utility (JPU) contracts at around $90/t FOB. This is a step down from a $95/t benchmark for larger tonnage March-expiry JPU contracts, finalised earlier this year, but remains significantly above current spot levels for similar spec product which fell below the $80/t in early July (basis is 6,000kc).

Japanese and Korean benchmark hard coking coal prices for the July-September quarter (Q3) appear to have been settled at $145/t for premium Peak Downs brand. This is a significant $27/t reduction on Q2 prices. ULV PCI Q3 benchmark pricing appears to have settled at around $115/t with poorer PCI and semi-soft brands settled around $105/t FOB.

Australian producers continue to keep a close eye on China, where a plethora of new policy and regulation announcements have been made. For example, a proposed ban on low rank coal imports and production would benefit Australian producers and disadvantage Indonesian and US producers. Steel producers in our traditional coking coal markets in Japan and Korea continue to struggle to compete with China which is well endowed with their own coking coal.

Metals prices are expected to weaken given the anticipated slowing of the Chinese economy and lower than anticipated global growth. Prices for domestic gas are also expected to continue to increase in the face of tight supply.

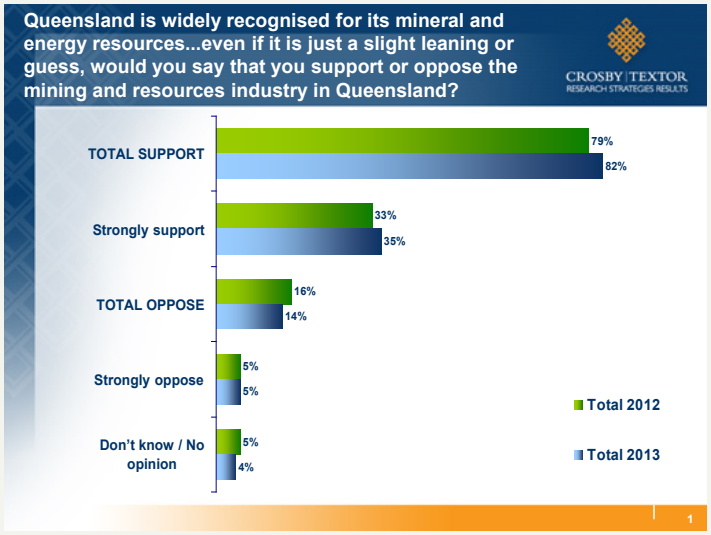
COMMUNITY VIEWS ON THE SECTOR

The QRC recently engaged respected pollsters Crosby-Textor to undertake quantitative research to measure community attitudes towards the sector.

Conducted in April-May 2013, 1000 randomly selected residents from the Darling Downs (DD), Central Queensland (CQ), South East Queensland and North Queensland were interviewed by telephone. Where feasible the 2013 results were compared with research conducted in August 2012.

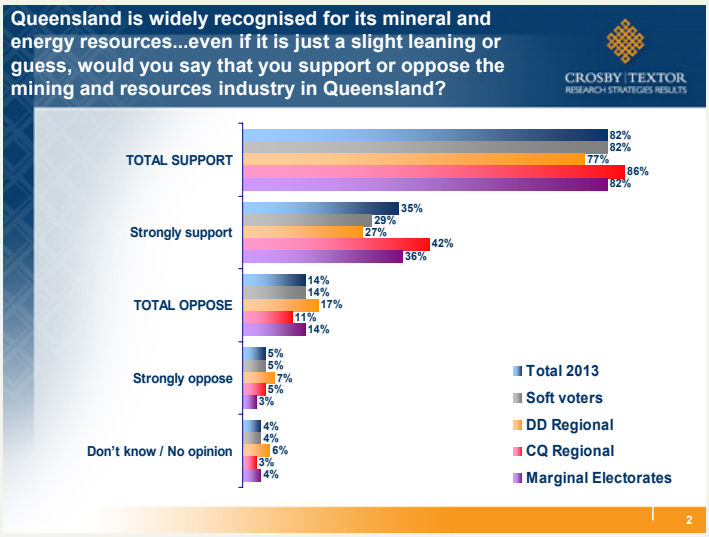
Support for the Queensland resources sector remains very high at 82 percent (up from 79 percent in 2012) (see below). This 82 percent consists of 35 percent who 'strongly support' the sector and 47 percent who 'somewhat support' the sector.

When the data is broken down, total support for our sector in the Darling Downs is 77 percent (up from 74 percent in 2012) and 86 percent in Central Queensland (up from 83 percent in 2012). These findings are particularly relevant in the context of the proposed statutory regional plans for these regions currently out for public consultation. These plans have been proposed by the state government to address perceived land conflict issues between the agricultural and resource sectors. The findings would suggest that the conflict is potentially not as strong as thought, requiring a measured policy response.



Of significance also are the reasons why the Queensland community supports the sector. Overwhelmingly, employment and the economy/exports are the main reasons, with support for these factors increasing between 2012 and 2013.

This increase reflects increasing concerns about job security as the Queensland economy reaches the very high peak of the resource sector investment cycle and a desire to ensure the sector continues to grow and invest to create further employment opportunities.



Finally, the survey asked people to either agree or disagree with various statements about the mining and resources sector. Again of high relevance to the finalisation of the regional plans for Darling Downs and CQ is the fact that the statement scoring the highest net agreement (77 percent) was that 'mining and resources can co-exist with agriculture if the relationship is managed better.' There was also very high net agreement (64 percent) to the statement that 'mining and resources is needed as agriculture is not enough to sustain the economy.' A net 75 percent of people agreed that mining and resources was needed to power homes and businesses.

The Crosby-Textor survey can be accessed here.

QUEENSLAND RESOURCES COUNCIL

LEVEL 13, 133 MARY ST, BRISBANE QLD 4000
T (07) 3295 9560 F (07) 3295 9570 E INFO@QRC.ORG.AU WWW.QRC.ORG.AU

QRC CEO SENTIMENT INDEX

The *QRC CEO Sentiment Index* is a survey of the QRC's full member company chief executives. These companies cover the majority of mining, minerals processing, contracting, exploration, electricity generation and oil and gas extraction activity in Queensland.

Issues that will 'strongly' (score 60-79) and 'very strongly' (score 80-100) adversely impact operations over the next 12 months:

1 Global macroeconomy (77) = continued global economic uncertainty, especially in Europe and the slowing of growth in China, coupled with oversupply in some markets is depressing prices.

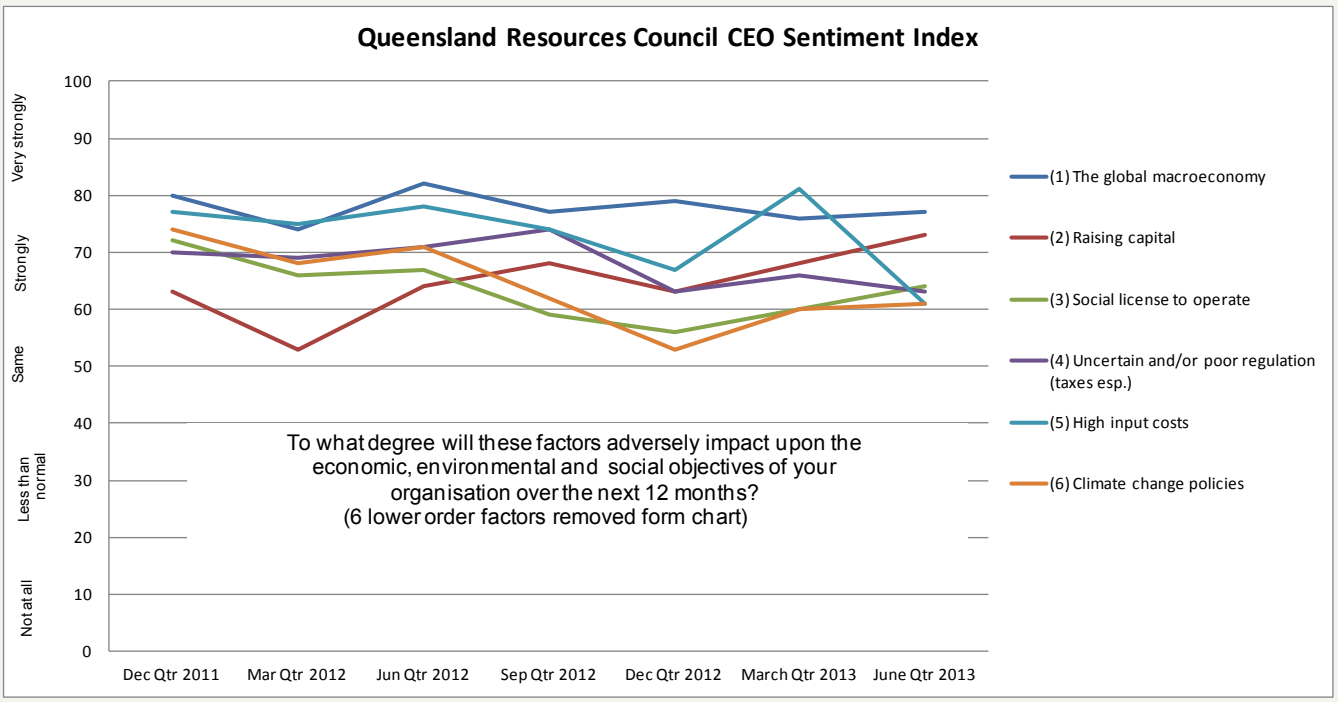
2 Raising capital (73) = raising capital on the debt and equity markets is becoming increasingly difficult, as is securing internal funding within the larger corporates as shareholders request larger dividends.

3 Social licence to operate (64) = Mobilisation of the environmental activist groups, including unfounded claims re the potential impacts of resources extraction (eg ship movements and anchoring and dredge spoil on the health of the Great Barrier Reef).

4 Uncertain and/or poor regulation (63) = increasing taxation and royalties burden; world's highest carbon costs with limited Emissions Intensive Trade Exposed (EITE) assistance; potential abolition of the fuel tax credits scheme; recent changes to the EPBC Act and lack of harmonisation between state/federal approvals processes the main concerns.

5 High input costs (61) = whilst softening, continued high AUD against the USD results in high historical costs; high labour costs as a legacy of the 'boom'; energy costs increasing mainly on account of high network and green costs and domestic gas scarcity; and declining productivity (mainly from resources depletion).

6 Climate change policies (61) = world's highest carbon costs with limited EITE assistance.



QRC PROFILE

The Queensland Resources Council is the peak representative body representing more than 300 companies with interests in the state's minerals and energy sector. The QRC's 84 full-member companies comprise explorers, miners, contractors, mineral processors, oil and gas producers and electricity generators. QRC service companies cover the gamut of professional services provided to the resources sector in the four corners of Queensland.

Written and prepared by the QRC. The data for this publication is sourced from a number of public sources–notably the Australian Bureau of Agricultural and Resource Economics and the Australian Bureau of Statistics. For more information, contact the QRC on (07) 3295 9560 or www.qrc.org.au

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