

QRC STATE OF THE SECTOR

JUNE QUARTER 2016

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Feature: The coal story: it's all about productivity

QRC CEO Sentiment Index

Key indicators: QRC Production Index and QRC Value of Production Index

BACK RESOURCES AND BE A WINNER



By Michael Roche, Chief Executive Queensland Resources Council

During the recent federal election campaign, the Queensland Resources Council called on the 60,000 workers across the state's resources sector, and the additional 300,000 workers

whose jobs depend on the sector, to support political candidates at the federal election that were committed to supporting their jobs.

We made this call as evidence came to light of political candidates demonising the resources sector on social media, with one even comparing coal to heroin. On national television, one of the supposedly rising stars of the parliamentary Labor Party, Terri Butler the Member for Griffith, said she did not support the Adani Carmichael mine project. Coming from the Shadow Parliamentary Secretary to the Leader of the Opposition, her comments about the Adani project, fossil fuels and transitioning from 'old industries' to 'green jobs' sent shockwaves through our resource communities. It was an interesting position for her to take given that more than 1,000 resource industry workers live in Griffith.

While some candidates were trying to out-green the Greens, others took a very different tack. Take the example of Michelle Landry, the MP for Capricornia, an electorate that covers Rockhampton and many mining communities and was set to fall to Labor with a swing of just 0.8 percent. While not uncritical in her support of the sector, Michelle has not been afraid to talk positively about mining. She campaigned strongly in support of protecting mining jobs and in favour of the long-awaited development of the Galilee Basin.

Instead of being swept out in the general swing to Labor, Michelle's two-party vote fell by a mere 0.15 percent. This once safe Labor electorate stayed with the candidate who stood up for mining.

And how did Ms Butler fare? Her LNP opponent out-pollled her by some 7,000 votes and her two-party vote fell by 1.5 percent. In the neighbouring seat of Moreton the Labor MP increased his two-party vote by 2.2 percent.

Also of note was the Senate vote for the Greens in Queensland - which was just 6.7 percent - the lowest

Greens vote of any state or territory except in South Australia, where the Xenophon factor was in play.

No doubt the Queensland political parties will be studying the implications of these federal results as they position themselves for the next state election.

For a start, perhaps the Greens will work out that steel has two major ingredients – iron ore and coking coal. During the election campaign their national leader said this on national television: "No one is suggesting we shut down the iron ore industry... that's a ridiculous proposition." This from the party that wants to end all coal mining and of course in Queensland that means mostly coking coal mining. It's not clear how the Greens think that wind turbines will be made without steel because no coking coal means no steel. A one megawatt wind turbine needs 220 tonnes of coking coal.

As we demonstrate in this edition, global demand for Queensland coal continues to grow with a record 222 million tonnes of coal exported in 2015-16. We also demonstrate that our coal industry has responded to some of the most challenging market conditions with a 170 percent lift in coal exports per coal worker. Productivity is the name of the game.

Our resource industry does though need a return to a supportive policy and regulatory framework. Our CEO Sentiment survey this quarter again shows that the biggest concern by far amongst industry leaders remains "poor and uncertain regulation". It is for the second quarter in a row outranking the global macro-economy as their biggest concern. When asked to rate the Queensland reforms that are most pressing, 70 percent nominate environmental policy/regulatory reforms.

One lesson for our political leaders from the federal election results is that standing up for jobs and standing up for our resources sector is not a vote loser. We know from our public opinion research that seven out of 10 Queenslanders support the mining and resources sector, while just seven percent strongly oppose the sector – which coincidentally - is roughly the Senate vote for the Greens in Queensland.

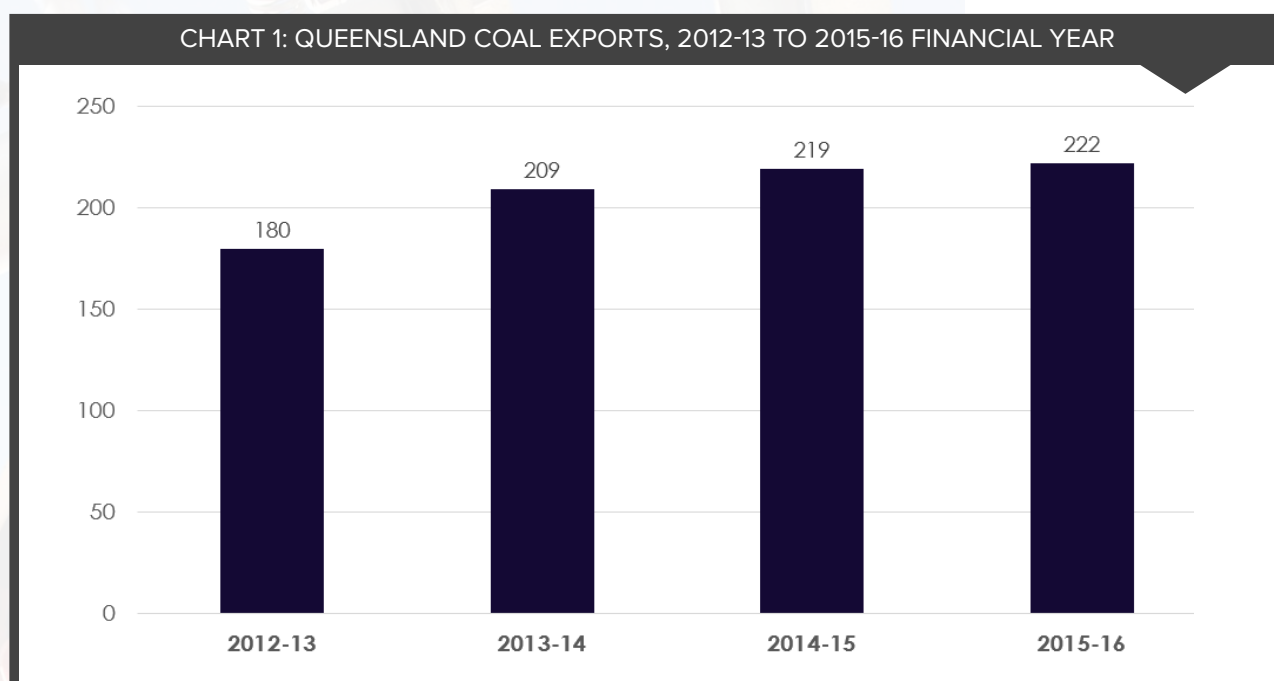


FEATURE ARTICLE

THE COAL STORY: IT'S ALL ABOUT PRODUCTIVITY

Record production volumes are not a signal of triumph in the resources sector, particularly not for coal producers. The strategy of increasing throughput deliberately spreads high fixed costs over more tonnes and reduces the unit cost of production.

It's widely known that many global commodity markets are oversupplied and economic theory would expect that in the current market conditions, producers would reduce production which would in turn push prices higher once demand begins to exceed supply. But in fact what we've seen is despite the oversupply, Queensland coal producers have again exceeded the record for tonnes of coal exported in the last financial year. A total of 222 million tonnes of Queensland coal left our ports during 2015-16 which is about 2.3 million tonnes more than in the same period last year. Gladstone was the leading export port, accounting for a third of all coal exports. The biggest increase in volume was Hay Point with throughput up 11% year on year.



It's no wonder the average punter is confused with the mixed messages coming from industry about new export records yet many producers are still making a cash loss ([March quarter State of the Sector](#)). What kind of pertinacious market are we operating in?

The answer is straightforward: it's all about productivity. Industry's strategy is to increase outputs with lower levels of inputs. This is not a strategy unique to coal – it is being pursued across virtually all resource commodities. Coal though provides a good case study given the availability of up to date data.

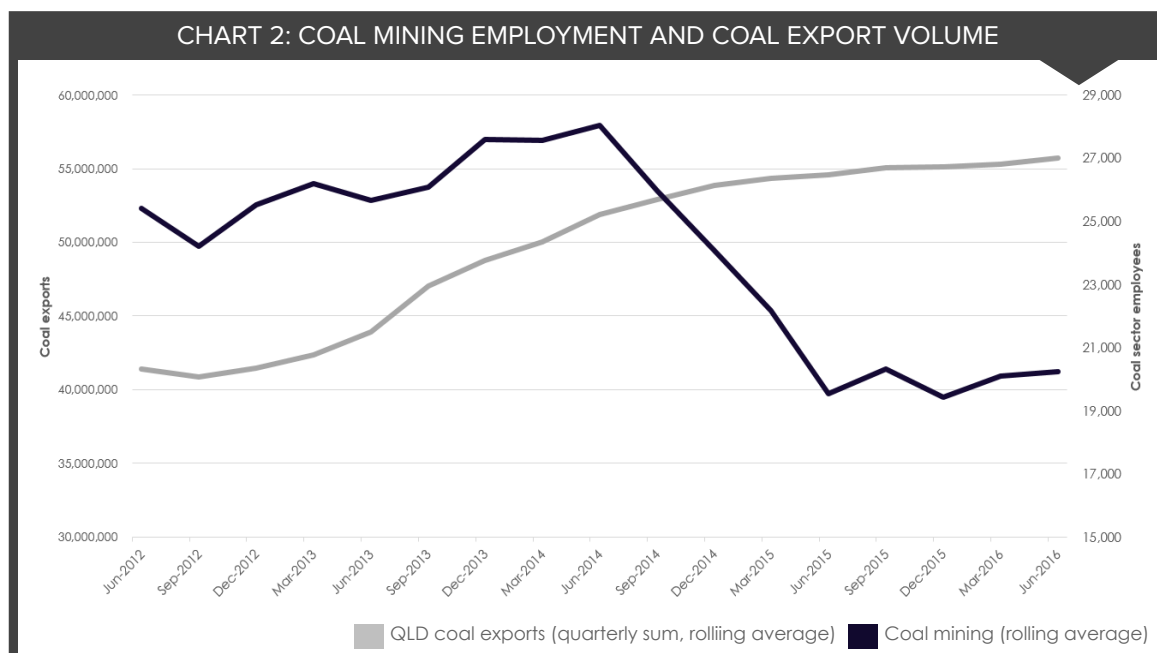
Key inputs for any resource operation include capital, equipment and labour. Costs have been slashed, machines pushed harder and we've seen a significant number of staff reductions across the sector. One in every four mining jobs have been lost since the peak employment level two years ago – that's close to 20,000 fewer jobs. For an industry like coal with high fixed costs such as port, rail and energy contracts that cannot easily be renegotiated, increasing production can spread these fixed charges over more tonnes and therefore lower the per unit cost of production. This scenario of high fixed costs, particularly for rail charges, is somewhat unique to the Australian coal industry and is a large barrier to responding to market changes, such as lower commodity prices.

A closer look at employment levels and the export volumes over the last four years demonstrates that productivity story. Chart 2 clearly shows the decline in direct coal mining employees while exports have steadily increased. This publically available data is taken from the latest (May 2016) ABS labour force statistics (ABS 6291) for coal mining in Queensland and the total tonnes exported are summed over the same period.

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To take this analysis one step further, an interesting way to measure productivity in the coal sector is to calculate the number of tonnes exported per employee. We can see from Chart 3 that the coal industry has been remarkably successful at increasing productivity.

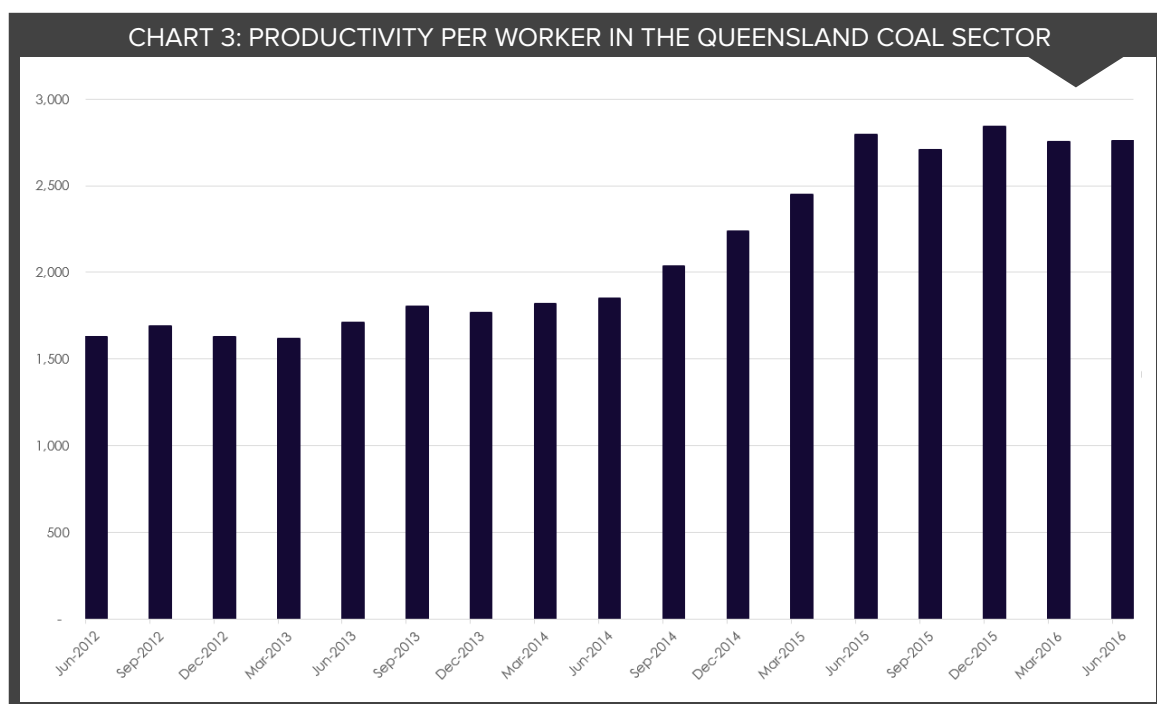
Between the June quarter of 2012 and the June quarter of 2016, Queensland coal exports per employee increased by a whopping 170%.



What can we expect from the coal sector in 2016-17? We'd like to say no more job losses and maintained levels of production but the reality is that in the current operating environment with heightened levels of policy uncertainty in Queensland, we can't be confident that the cost cuts and job losses are over. While there has been some semblance of price recovery recently, seeing more coal businesses achieving some positive net cashflow, to return their businesses to positive earnings before interest and tax (EBIT) coal companies are not relying on salvation through price or the exchange rate.

Instead, they continue the quest for smarter ways to run their businesses, and in turn reducing costs and increasing productivity.

The sector would like to see infrastructure providers being prepared to play a stronger role in working with their customers to get through this prolonged downturn. Parts of the coal workforce do not seem to have recognised that the era of generous annual increases in pay rates have to be consigned to the past. That will have to change.



Finally, the sector awaits the outcomes of a number of QRC-initiated State Government policy reviews which could see some tangible cost relief to the coal sector and the resource sector more generally.

This feature article was prepared by QRC Manager of Economic Policy, Amy Greene



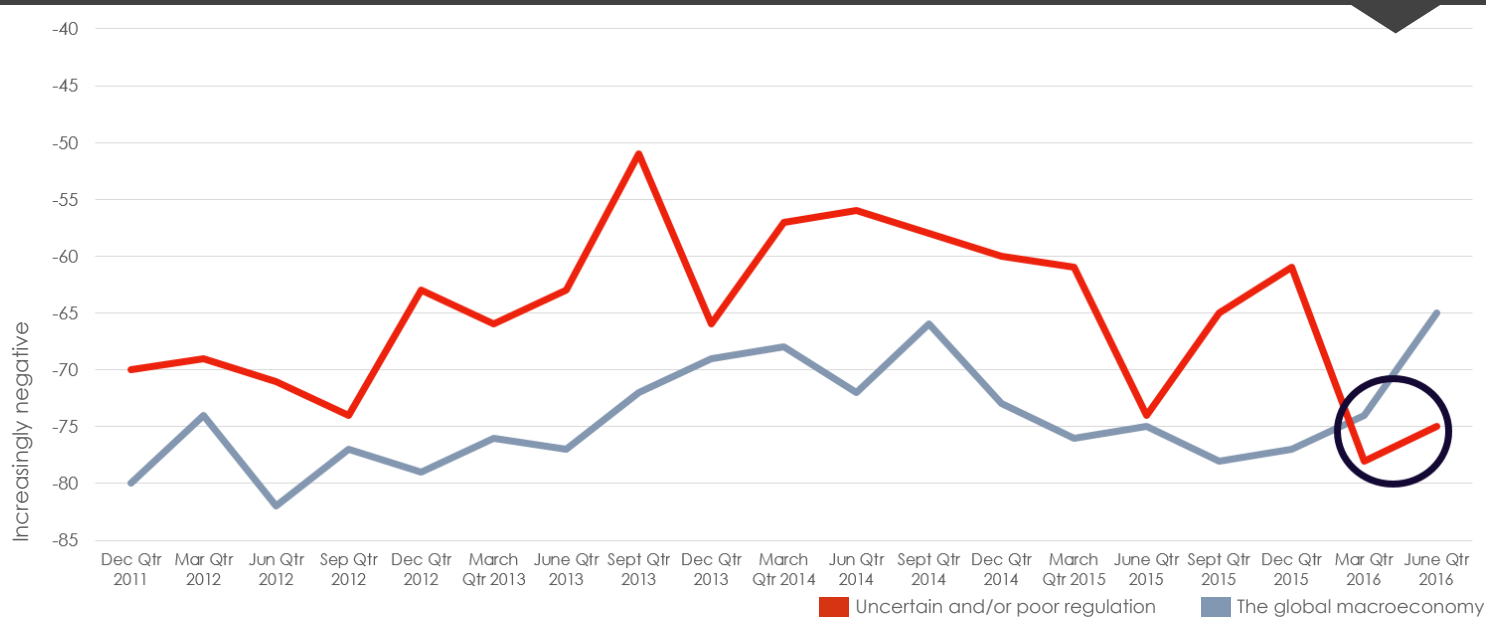
QRC CEO SENTIMENT INDEX

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

Each quarter the respondents are asked to nominate to what extent eleven factors will impact on the objectives of their organisation over the next twelve months. All responses are weighted to arrive at a single value reflecting the sentiment for that factor. The response options include very strong impacts (-1), more than normal (-0.75), the same (-0.5), less than normal (-0.25) and not at all (0). Therefore the most concerning factors receive the lowest scores and are lower down on the negative axis.

In the 19 editions of the QRC CEO Sentiment Survey, the global macroeconomy has ranked the worst in 15/19. The latest results (Chart 4) reveal that sentiment towards policy uncertainty is worse than the sentiment towards macroeconomy for the second quarter in a row.

CHART 4: SENTIMENT INDEX RESULTS



QRC's survey allows CEOs to provide comments, which help understanding of the issues that have driven the further deterioration in sentiment around regulation. Issues CEOs called out include:

"Government regulation/instability and the influence of the Green/activist vote is becoming a huge issue in terms of risk and cost..."

"Uncertainty around Financial Assurance and the moveable feast of mine closure regulations are currently having an impact on business confidence and may impact future investment decisions..."

"It is increasingly difficult to attract capital where there is an open ended legal path to disruption through legal challenges to progress in the development of resources projects..."

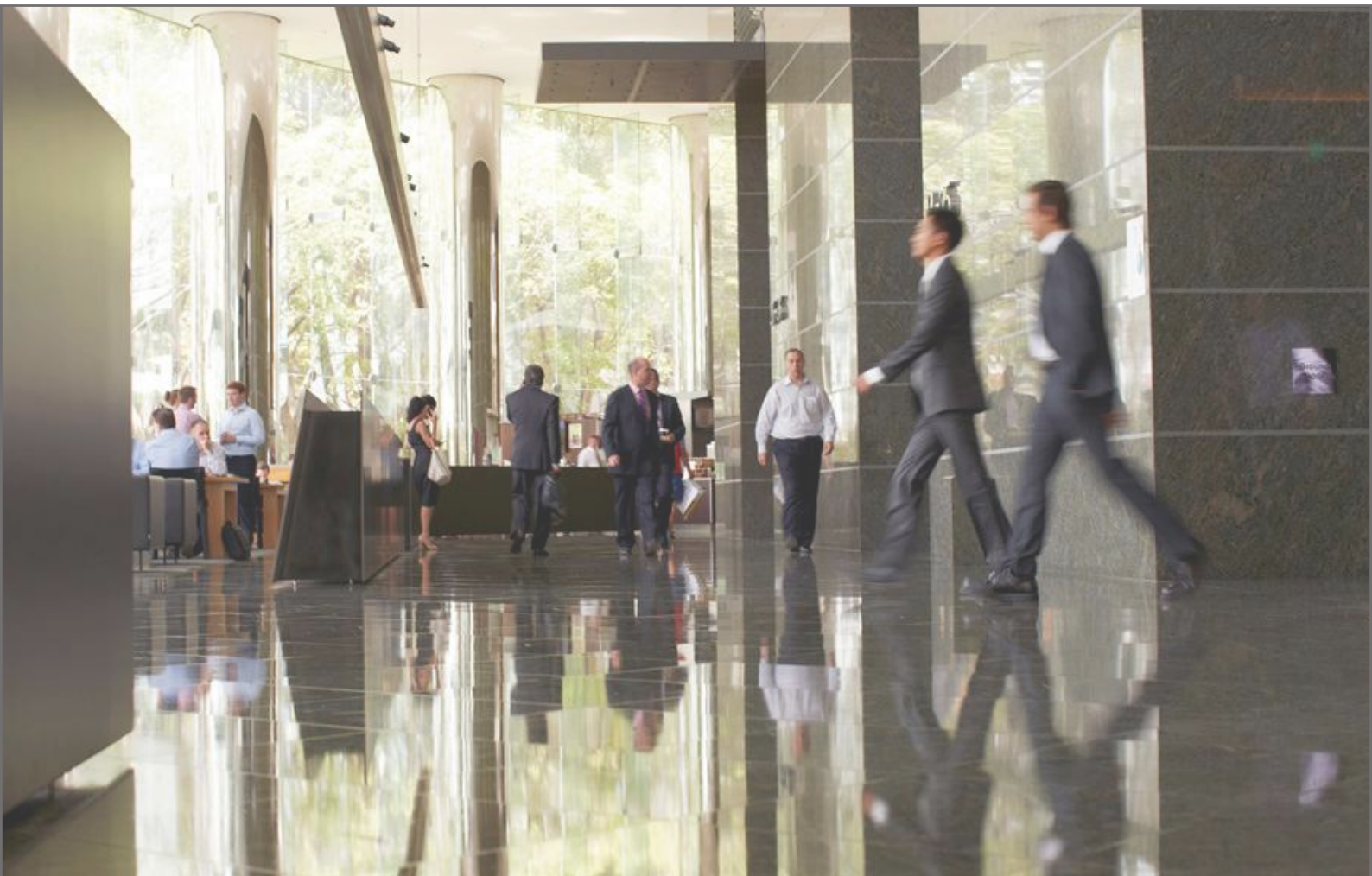
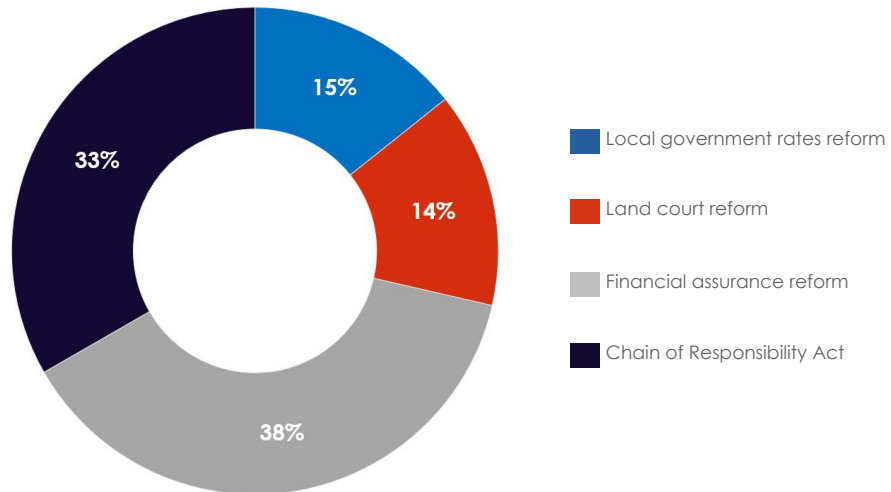
"The fragmented nature of both State and Federal Govts has the potential to provide adverse policy outcomes due to trade-offs with independents and minority parties..."

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Chart 5 shows that more than 70% of member companies have identified that urgent environmental policy reform is needed.

This category is dominated by concerns with Financial Assurance and the Chain of Responsibility Act. Many members also noted the urgent need for reforms in the areas of Local Government Rates and Land Court processes.

CHART 5: WHICH OF THE FOLLOWING IS THE MOST PRESSING REFORM FOR YOUR BUSINESS OVER THE BALANCE OF 2016?



KEY INDICATORS

QRC PRODUCTION VOLUME INDEX

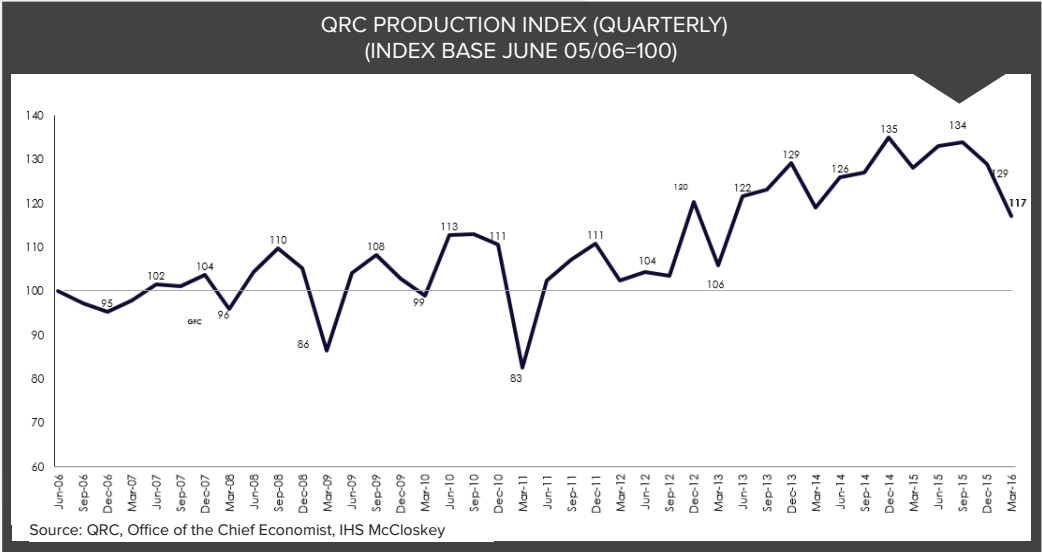
QRC's quarterly production index tracks changes since 2006 in the total production of Queensland's traditional commodity exports – alumina, aluminium, bauxite, coal, copper, gold, lead, silver, and zinc. Please note, due to limited pricing data, we are yet to integrate LNG prices and volumes into the index.

The production volume index is weighted by the value of the commodity. This means changes in the volume of coking coal produced (which is more than half the total value of Queensland resources production) has a proportionately larger impact on the index than, for example, changes in thermal coal production (representing approximately 10-15% of total value).

Total production volume decreases

The index at the end of the March 2016 quarter (latest available data) dropped from 129 points in the previous quarter to 117 points. This equates to the lowest index result since March 2013. The index base is June 2006 = 100, so overall the total volume of production has grown 17% since that time.

Over the March quarter all commodities recorded decreased production volumes. The greatest decreases in production were in zinc (which almost halved from 205 kt to 103 kt) due to curtailed production and closures.

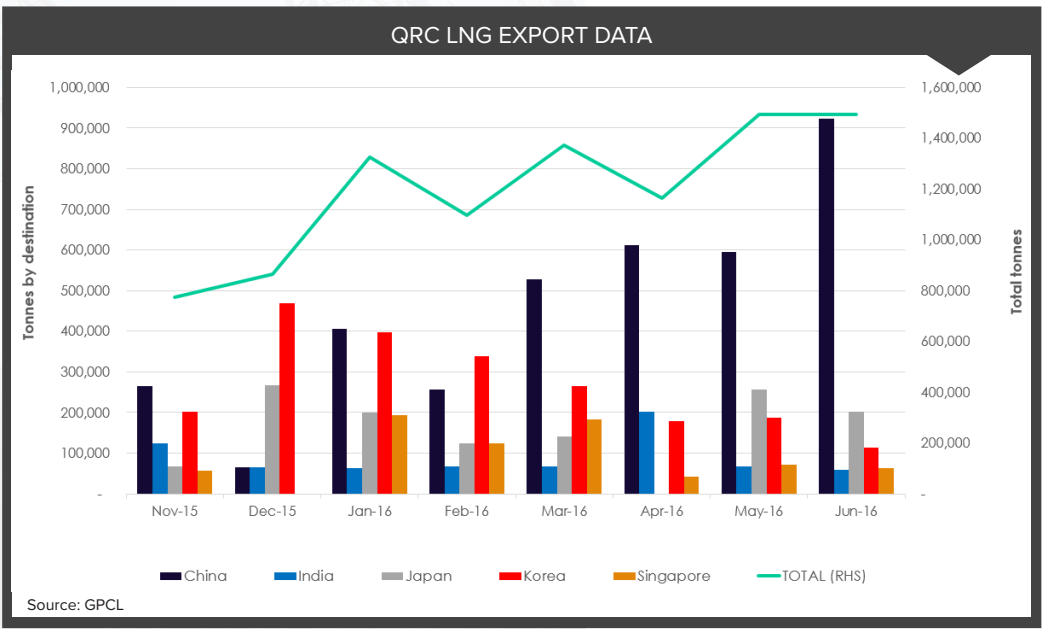


Consequently the global zinc market tightened faster than anticipated in the first half of 2016. Lead production also declined (97 kt to 73 kt) and coal exports in the March quarter totalled 53 million tonnes which is approximately 5% lower than the previous quarter of 56 million tonnes. The cumulative result of these decreases in production volumes, weighted by value, generates the 12 point decrease in the QRC Production Index over the March quarter.

In addition to the commodity production above, the most recent LNG export volumes for the June 2016 quarter totalled 4.1 million tonnes. The greatest volumes of LNG were exported to China (2.1 million tonnes) and Korea (0.5 million tonnes) during the June quarter of 2016. As compared to the March quarter, this equates to a 9.4% increase in exported volumes.

9.6 million tonnes of LNG has been exported via the Port of Gladstone to date (Nov 15- June 16). In total, 13 countries have received exports of Queensland LNG. 38% of total tonnes exported was destined for China and 22% or 2.2 million tonnes was destined for South Korea. Exports to Japan totalled 1.3 million tonnes.

Together exports to China, South Korea and Japan equate to three quarters of all LNG exports.



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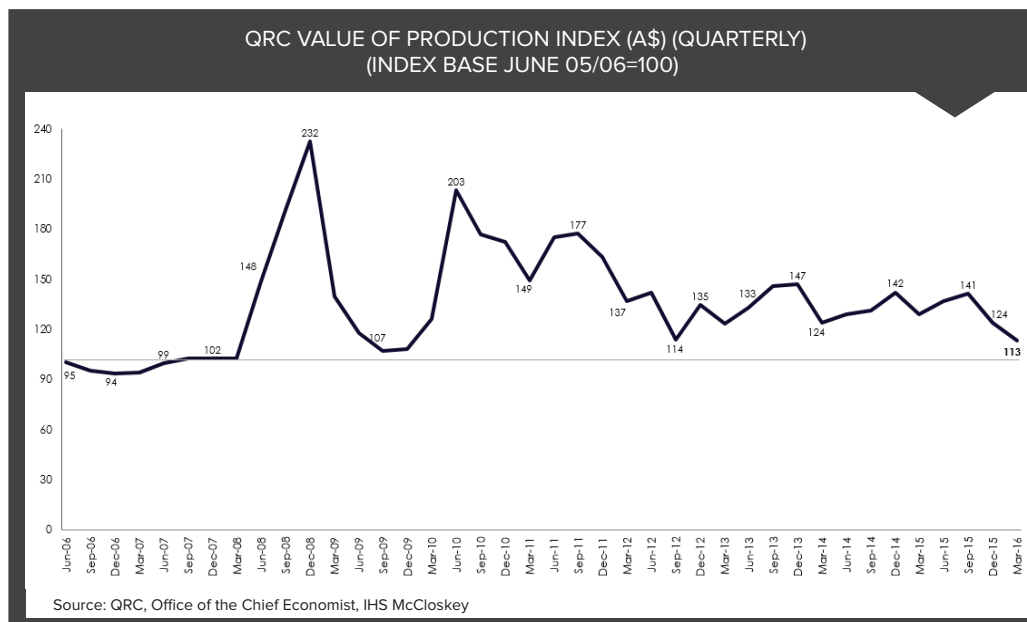
QRC PRODUCTION VALUE INDEX

QRC's production value index reflects changes in the prices of the resources Queensland produces. The weighted index reflects the same mix of commodities as the QRC production index. Once again, limited price data means LNG export values are not yet included in the index. Please also note that an exchange rate error in previous editions of the index has now been corrected.

The index at the end of the March 2016 quarter (latest available data) fell from 124 points to 113 points due to price reductions for most

commodities including thermal and metallurgical coal. The largest price

decrease was for silver, falling approximately 30% over the quarter. In aggregate, the resources sector produced goods valued at \$A7.1 billion in the March quarter, down from \$A7.8 billion in the December quarter.





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