

## COMPETITIVENESS CONCERNS EXPOSED

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**With repair of the state's finances rightly at the top of the Newman government's agenda, it is clear that resources sector growth provides one of the best opportunities to increase government revenues sustainably.**

However, all governments need to be mindful of potential hurdles and roadblocks to growth.

Global competitiveness is the key, given that neither Australia

nor Queensland is guaranteed of supplying an increasingly crowded minerals and energy market.

The capacity of Queensland resources operations to remain competitive through operating cycles, including the severe downturn currently affecting the coal sector, will depend on governments and industry staying on the same policy page.

According to the QRC CEO Sentiment Index reported in this edition, rising input costs, the global macroeconomy, difficulty in raising capital, uncertain and/or poor regulation and climate change policies remain the higher order concerns for the sector.

The concern over input costs, be they regulatory or commercial, is confirmed by company data also reported in this edition showing a disturbing increase in costs that has pushed more than half of current Queensland resources operations into the upper third and fourth quartiles of their respective global cost curves. This compares to just 20 percent in 2008.

Against this outlook, we now have increasing speculation that the federal government will axe the sector's fuel tax credit scheme for a short-term revenue boost. Of course the long-term downside to such short-sighted revenue grabs is another blow to the global competitiveness of industries that operate in remote locations and for whom there are no alternatives to diesel-powered energy.

In a similar short-sighted context, the Labor state

government delivered a tiered coal royalty rate regime in 2008, with a rate of 10 percent applied to coal sold above \$A100 a tonne. The failure then to index this threshold meant that the royalty rate would effectively increase year on year.

In 2012, the LNP government lifted that 10 percent royalty rate by 25 percent (to 12.5 percent), while adding a further marginal rate of 15 percent for coal sold above \$AU150 a tonne. Once more, there has been no commitment to index royalty rate thresholds.

To restore our coal industry's global competitiveness and the state's attractiveness as an investment destination, royalty rate thresholds should be indexed to maintain their real value – recognising that over time, more coal production will move into the higher royalty thresholds.

While QRC appreciates the ongoing work of the Newman government's Resources Cabinet Committee to lower industry costs, boost productivity and drive new investment, the reality is that Queensland's unique tiered coal royalty regime (in the absence of indexed thresholds) with its embedded rising effective royalty rate, is stunting Queensland's appeal for new coal industry investment.

Meantime, we continue with the unedifying spectacle of state and federal governments squabbling over entitlements to the economic rents from resource extraction. Without a nationally binding agreement on preferential tax/royalty approaches or sharing arrangements, the current impasse between state royalties and the Commonwealth's resource rent taxes will remain 'harmful and unsustainable' (GST Distribution Review Final Report, October 2012).

As things stand, the states have an incentive to increase royalties as payments are credited against federal resource rent tax obligations. The time is ripe to end the feud and agree on a progressive national model to equitably distribute the proceeds of the nation's minerals and energy wealth, which are developed at no financial risk to taxpayers.

QRC will be urging the next federal government to work  
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- Feature articles Survey of CEO members – position of current and proposed resources projects on respective global cost curves
- QRC CEO Sentiment Index



with the resources states on a sustainable tax arrangement.

Heading towards the 2013-14 state budget, QRC is also reminding the state government that for a so-called resources state, Queensland remains surprisingly lightly explored. There are large swathes of Queensland unexplored by the latest technologies and the Geological Survey of Queensland funding has been neglected in recent years.

We can't keep relying on the discoveries of the past century to keep it viable in the 21st Century.

QRC's full pre-budget submission can be found here:  
[www.qrc.org.au](http://www.qrc.org.au)

## KEY INDICATORS

### QRC PRODUCTION INDEX

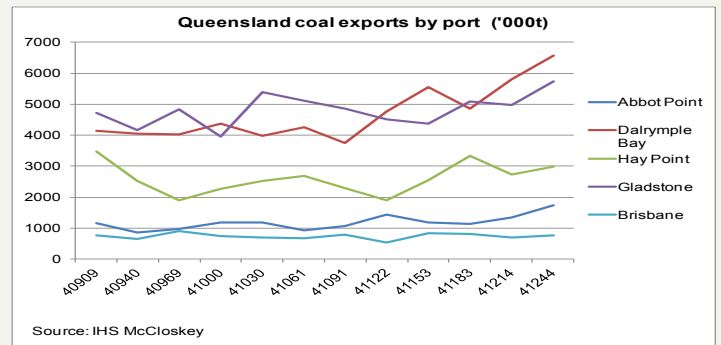
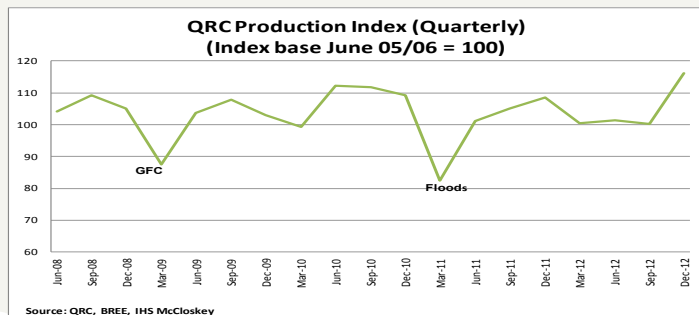
The QRC production index is a composite weighted index that tracks percentage increases and decreases in the total production of Queensland bauxite, alumina, aluminium, coal, copper, gold, lead, silver, and zinc quarter to quarter. Note – because Queensland is not yet producing significant quantities of additional coal-seam gas this output has not been included.

The index at the end of the December 2012 quarter (latest available data) shows an increase to 116 index points. This is an increase of 16 percentage points from the September 2012 quarter (June 2006=100) and the highest the index has been.

Queensland coal exports increased from 40.3Mt in the September quarter to 48.6Mt in the December quarter. Production volumes for thermal and metallurgical coal increased strongly, especially from the Dalrymple Bay and Gladstone ports.

This surge appears unlikely to be sustained in the full March 2013 quarter with bad weather causing closures at Hay Point, Dalrymple Bay and Abbot Point coal terminals, and rail disruptions on the Moura and Blackwater lines to Gladstone, and separately on the Townsville to Mount Isa line where a freight train carrying zinc concentrate derailed near Mingela. We estimate that coal exports in the March quarter will be approximately 6Mt lower to 42Mt.

A number of commodities including alumina (1464 kt), bauxite (6518/kt), copper (70/kt), lead (114/kt) and zinc (281/kt) also recorded higher production volumes during the December quarter. Only silver (290/t) showed a notable drop

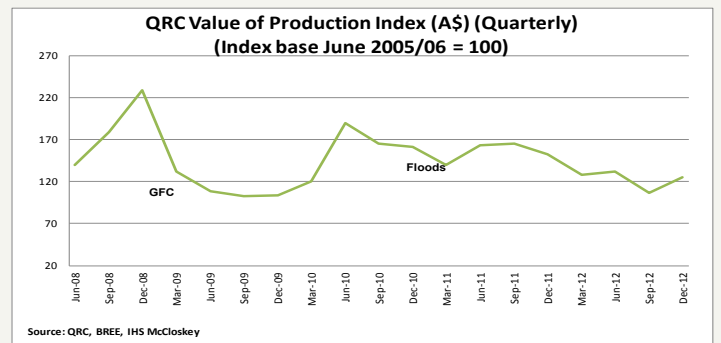


## QRC VALUE OF PRODUCTION INDEX

Comprising the same basket of goods as the QRC production index, the QRC value of production index 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 December 2012 quarter (latest available data) reached 125 index points, a strong increase from the previous quarter's low of 107. In aggregate, the resources sector recorded sales of \$8.3 billion in the quarter, up from \$7 billion in the September quarter.

Similar to the September quarter, thermal coal prices continued to stay very low at around \$US86-87/t (Newcastle FOB maker, high CV and 6000kc NAR basis). Other commodities showed healthy increases over the December quarter with aluminium (US\$1996/t), copper (US\$7909/t), lead (US\$2199/t) and silver (US\$32.61/troy oz) leading the charge whilst more moderate increases were recorded for alumina (\$A275/t) and gold (\$US1719/oz).



## PRICE OUTLOOK

The low prices for thermal coal will start to flow to expiring Japanese Power Utility (JPU) contracts. According to commentators, crucial Australia/Japan benchmark pricing for April-start contracts remains unresolved, with parties forced to operate on provisional pricing. A contract outcome in the 'mid \$90s' is now being looked on as likely by a number of shippers against the previous year's \$115/t, basis 6322kc GAR.

High quality metallurgical coal prices, as measured by the McCloskey Australian prime hard maker, also remain depressed with average prices staying below \$US160/t.

# STATE OF THE SECTOR

Benchmark hard coking coal prices for the April-June quarter (Q2) appear to have been settled between BHP Billiton and Japan's Nippon Steel at headline levels of \$172/t for premium Peak Downs brand and \$169/t for Goonyella.

Semi-soft metallurgical coal prices remain low but buoyant with coal producers starting talks with Japanese steel mills (JSM) about April-June quarter (Q2) pricing. According to commentators indicative pricing ranges from around \$122/t to \$129/t FOB. This compares with a January-March quarter benchmark price of \$117/t FOB. Semi-soft suppliers are generally favoured by recent market developments, especially an accelerated push by major steel makers to lower costs by increasing their proportional usage of lower ranked coals.

A number of commentators have suggested that base and precious metal markets are most likely at a turning point with moderating demand growth meeting steadily rising mine supply.

## COMPANIES CLIMB UP THE COST CURVE

**In response to concerns that domestic cost pressures are significantly affecting the competitiveness of the Queensland resources sector, the QRC recently surveyed the CEOs of full member companies to ascertain:**

- (1) For CURRENT operations that are comparable in profile then and now, in what global cost curve quartile did each operation sit in the year 2008 and today?
- (2) In what cost curve quartile will PROPOSED projects enter on their respective global cost curves?

In relation to current projects, 19 companies divulged (cash operating) cost curve information for 25 individual projects. These projects were a mix of mining, minerals processing, oil and gas production and 'other' activities.

Global cost curve analysis is very powerful as it helps to determine whether a nation's public policy settings are conducive to competitive resources extraction and investment attraction, and whether the sector is likely to stay globally competitive given that markets tend to set prices around the third quartile of cash costs. Operations that are in the upper third and fourth quartiles are unlikely to be

producing at costs less than prevailing market prices and are likely to be replaced by lower cost production over time.

The evidence is very clear that Queensland's resources operations and projects are no longer as cost competitive as they once were.

The results show that in the year 2008, 28 percent of operations were in the lowest quartile of their respective global cost curve, 52 percent were in the second quartile, 12 percent were in the third, and 8 percent were in the fourth or highest cost quartile. In effect 80 percent of operations were sitting 'safe' in quartiles one and two, with only 20 percent sitting in the higher risk third and fourth quartiles.

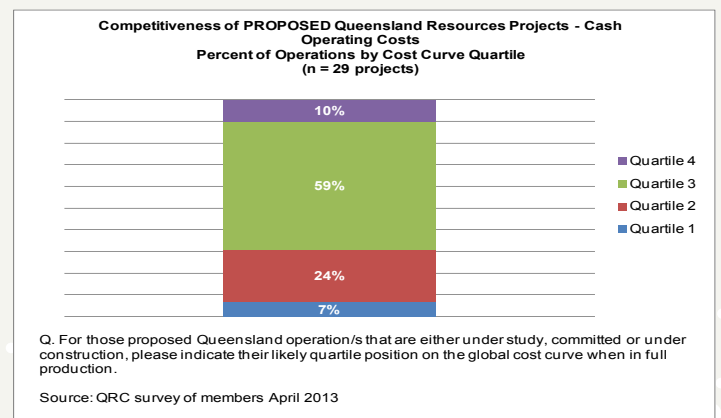
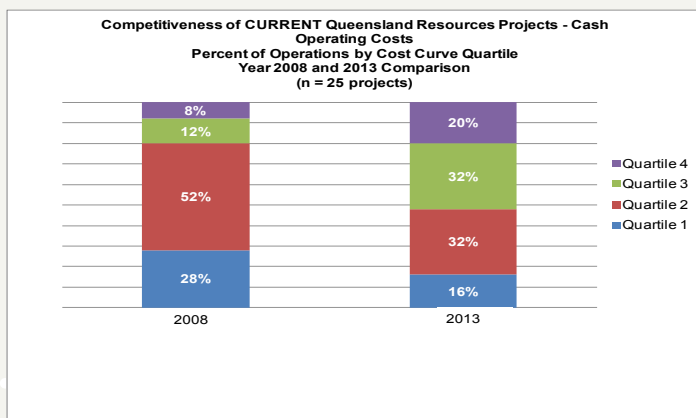
In 2013, these operations have moved significantly up their respective cost curves. Today, 16 percent of these operations are sitting in quartile one, 32 percent are sitting in quartile two, 32 percent sitting in quartile three and a very worrying 20 percent are sitting in quartile four. In effect, 52 percent of operations are under serious competitive threat if they cannot control costs and move down their respective cost curves.

Of note is that a number of companies which have embarked on significant cost cutting measures over the past 12 months have been successful in moving their operations from higher quartiles to lower quartiles. QRC expects to see more operations deliver such cost outcomes as cost reduction programs continue in earnest.

In relation to proposed projects, rising capital costs mean our new projects are also becoming less attractive. Globally, industry costs are rising for key inputs like labour, equipment, contracting services and raw materials. Yet capital costs for projects in Queensland are rising faster than elsewhere. Queensland projects are now at a distinct capital cost disadvantage relative to peers.

The survey results demonstrate that only a very low 7 percent of proposed resources projects will enter their respective cost curve in quartile one, 24 percent in quartile two, 59 percent in quartile three and a worrying 10 percent will start in quartile four.

Australian and Queensland projects are more prone to delays which contribute to cost escalation, as well as



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increasing perceptions of investment risk. These delays also inhibit our ability to compete for new market opportunities, an important factor in some commodities.

Competition for new resources investment is intense. Queensland's resource endowment alone will not guarantee market share or ongoing investment. We must also remain cost competitive to secure our share of new projects. Unfortunately, Queensland's competitiveness is declining, just as the number of our rivals is increasing. This is why the work of the Newman government's Resources Cabinet Committee is so important to keeping us 'in the game'.

## QRC CEO SENTIMENT INDEX

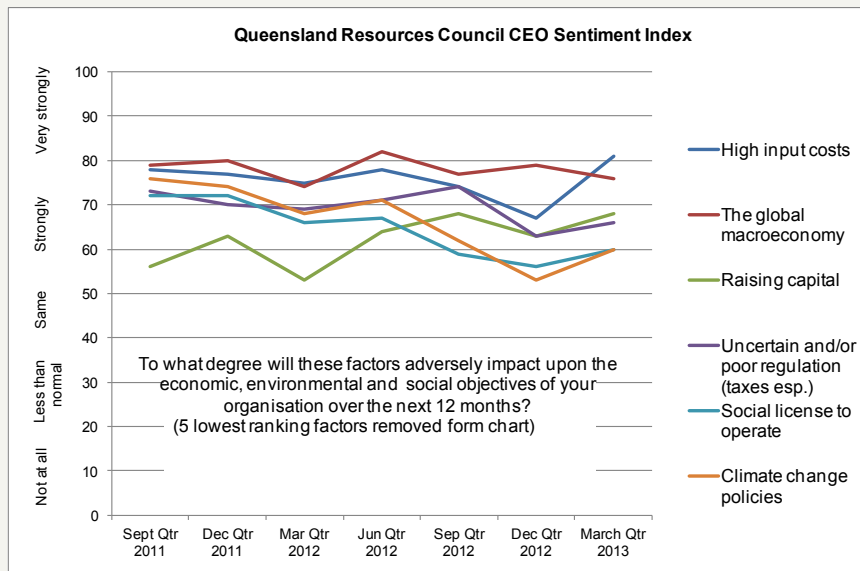
The QRC CEO Sentiment Index is a survey of the QRC's full member company chief executives.

These companies cover the majority of mining, minerals processing, contracting, exploration, electricity generation and oil and gas extraction activity in Queensland.

Issues that will 'more than normal' (score 60-79) adversely

impact operations over the next 12 months:

- 1 High input costs (81) = continued high AUD and conversion of costs to USD results in high 'paper' costs; labour, energy and taxation/royalty cost imposts not abating; and declining productivity (mainly from resources depletion). The high AUD is however improving the capital cost of mining equipment.
- 2 Global macroeconomy (76) = continued global economic uncertainty especially in Europe and the slowing of growth in China is depressing demand and prices, especially for coal.
- 3 Capital raising (68) = raising capital on the debt and equity markets remains difficult for some, especially for coal exploration given low prices.
- 4 Uncertain and/or poor regulation (66) = recent royalties increase, world's highest carbon costs with limited EITE assistance, potential abolition of the fuel tax credits scheme, proposed changes to the EPBC Act and lack of harmonisation between state/federal approvals processes the main concerns.



5 Social licence to operate (60) = NSW Government response to minority concerns over CSG extraction could spill over to Queensland; and uninformed commentary on potential impacts of ship movements and anchoring and dredge spoil on the health of the Great Barrier Reef.

6 Climate change policies (60) = world's highest carbon costs with limited Emissions Intensive Trade Exposed (EITE) assistance.

Of note is the significant softening of concerns related to growth – namely attracting and retaining skilled employees (39).

## 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 86 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](http://www.qrc.org.au)