

QRC STATE OF THE SECTOR

MARCH QUARTER 2016

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Key indicators: QRC Production Index, QRC Value of Production Index and Price Outlook

QRC CEO Sentiment Index

POOR REGULATION HITS CONFIDENCE



By Michael Roche, Chief Executive Queensland Resources Council

Around this time last year, in the wake of Labor's surprise election win in Queensland, QRC's quarterly State of the Sector survey found that, despite the change, industry leaders thought

that it was a 'business as usual' climate.

The results of our latest CEO sentiment survey reveal just how much things can change in 12 months.

While the Labor Government's commitment to royalty stability is very welcome, there has been anything but stability in the regulation of our sector. Whether deliberate or not, our sector has also been the target of a raft of regulatory changes – some enacted and many more proposed. Therefore, there's little wonder the sentiment survey results show that industry CEO confidence about regulation is at its lowest in nearly five years.

The CEOs listed a range of concerns, including the inflexible nature of royalties to adapt to changes in commodity prices, uncertainty around financial assurance, inability to control input costs and operational impacts and skyrocketing local government rates. One CEO said: **"see how long a mayor would last if they proposed a 500 percent increase on all ratepayers"**.

When asked how favourable it was to do business in Queensland – just 13 percent backed Queensland over the other states – while one in five CEOs said their companies suffer a cost disadvantage in Queensland. Some of the main concerns are directly quoted below:

"Chain of Responsibility Bill is a catastrophe" ... "Unstable federal and state leadership" "Raising capital for exploration is becoming increasingly difficult" ... "We want government to reduce its regulatory burden where there is no impact to safe production" ... "Poor federal and state government policy relation to energy" ... "Recent state government proposals and regulatory changes appear reactionary and populist" ... "The upcoming federal election introduces the risk of poor regulatory outcomes as political parties position themselves"

The majority of the company CEOs were confident that if the state government was able to reduce industry costs this would actually improve their business outlook.

"The Queensland Government must act to amend local government legislation and policy ... if they fail to do this ... this will further erode Queensland's national and international competitiveness"

While QRC is getting a good hearing from Treasurer Curtis Pitt and State Development and Mines Minister Anthony Lynham on important issues such as government taxes and charges and Land Court reform, elsewhere our state

government continues to deliver nasty surprises and poor policy.

The Chain of Responsibility legislation has been an absolute debacle. An unnecessary piece of legislation seemingly targeted at one person has instead become a Frankenstein monster, sweeping up many businesses into its scope and creating huge investor uncertainty. While the Act includes a two-year review, feedback flooding into QRC suggests that investors may have exited the state well before that.

Elsewhere we find resources companies swept up in the government's Vegetation Management legislation, with an attempt to deal with agriculture sector issues instead overturning tried and tested principles around environmental offsets. The government has also failed to undertake proper process with their legislation to shut down mining on North Stradbroke Island in just three years' time as there has been no Regulatory Impact Statement to assess the economic and social impacts.

The government is about to legislate open slather for objections to mining leases in the Land Court – under this legislation you can be living in Perth or indeed in Berlin and have your objection heard by our Land Court. To rub salt into the wounds, the Land Court has no time limits on its deliberations.

Politicians bemoan the losses in royalty revenue and cite the so-called 'end of the mining boom' as a reason for their financial woes, but the fact is, that our sector continues to provide billions in revenue, hundreds of thousands of jobs and provides the materials for just about every product we use in our everyday lives.

Our feature article this quarter points out that the \$2.1 billion in royalties paid to the state government last financial year by resource companies would have paid for about 35,000 state teachers or 30,000 nurses or about 32,000 police officers.

Our sector is also holding its own in the export markets, with the LNG exports ramping up now that all three plants are in production. Figures for the six months to April reveal the destination of the LNG shipments, with nearly one-third of LNG volumes heading to China (32%), followed by South Korea (28%), Japan (12%), then India and Singapore (each 9%). Not to be outdone, coal exports were up 5 percent in April 2016 compared to April last year, and the first four months of 2016 are 2 percent higher compared to the same period in 2015.

So instead of talking about how much the downturn in the prices of commodities has affected their revenue, why don't governments at all levels get serious about fixing the regulatory and cost burdens hampering the viability of current operations and holding back investor confidence?



RESOURCES - JOBS NOW, JOBS FOR THE FUTURE

Advance Queensland is the phrase the Premier uses to describe her government's philosophy for developing the state. It's an upcycled ethos drawn from Premier Beattie's *Smart State* tagline, which was so ubiquitous it even graced Queensland number plates at one point.

Advance Queensland is a slogan designed to rally support for a program of complex change. The recurring elements include biofuels, renewable energy, education exports, integrated tourism resorts, attracting investment and establishing Brisbane as a global innovation hub - the next Silicon Valley.

The government's *Advance Queensland* aspirations were on full display at two recent events – first the Queensland Jobs Summit and then the Queensland Innovation and Investment Summit. The government's focus is clearly on creating 'new economy' jobs in services and technology industries for Queensland. The challenge is to further diversify our state's economy – hence the focus on encouraging start-ups and fostering innovation. The government's aim is to deliver "jobs now and jobs for the future". These are all themes that are likely to be front and centre in the federal election too.

The very clear risk for the resource industry is that our massive ongoing economic contribution is taken for granted.

Green activists have been quick to administer the last rights to Queensland's traditional economic strengths as being in terminal structural decline. Worryingly, some leading politicians lend weight to the activists with the refrain that "we should be more than just a rocks and crops economy". They're right; we should, but they do a huge disservice to regional Queensland in trying to dismiss the unique structure of the Queensland economy that is the most decentralised in the nation.

Queensland's regional centres have grown on the basis of strengths in tourism, resources, defence and agriculture. The most resilient centres successfully combine different blends of these industries. What each of these regional centres have in common is a network of small to medium size locally-based service businesses that work across multiple industries, selling expertise in providing solutions. A small engineering services company in Paget (Mackay) or Dalby or Townsville won't necessarily see itself as 'in the resources sector', but will have customers in mining, in gas or in agriculture, who need equipment maintained and repaired.

These are real long-term jobs that the activists deliberately ignore and some politicians overlook. These are regional jobs, highly skilled, entrepreneurial jobs that sustain local businesses, regional communities and regional centres. These are the jobs that are not included in the official ABS headcount of almost 23,000 jobs lost from the resources sector from the peak in November 2013, but these are the jobs that are at risk if Queensland's traditional industries are taken for granted. As the [Queensland Treasury](#) describe it:

"In Queensland, manufacturing has traditionally supported our resources and agriculture sectors through activities such as minerals and meat processing."

The Queensland economy is unusual because our regional communities add value to our primary resources. Minerals and food are not brought to Brisbane to be processed and refined. This chain of value-adding in the regions is how the Queensland economy has grown and diversified. This is the regional reality that the green activists try to air-brush out of our state's economic story. These regional firms are the real powerhouse of the Queensland economy – they support their regional economies, not just a single industry. These firms don't try to pick winners, and governments likewise, should be careful about thinking they can pick winners. Their track record of doing so is pretty ordinary.

What are the facts about the resources sector right now in Queensland? The reality is that despite weak commodity prices and the ongoing tragedy of job losses, the sector continues to make a major contribution to the Queensland economy.

QRC STATE OF THE SECTOR

In November, the Queensland treasurer launched the latest figures for the resources sector, which show that in 2014-15, Queensland resources were responsible for injecting nearly \$30 billion into the state's economy, including purchases of goods and services from 24,400 different local firms. Sector spending generates one in five dollars of the Queensland economy, and one in six Queensland jobs.

These are big numbers and can be hard to fathom. Take royalties for example, last year the resources sector paid \$2.1 billion in royalties to the Queensland Government. Most people have never seen \$2.1 billion, so how do you put that figure in context? In 2014-15 it would have employed around 35,000 Queensland teachers or about 30,000 Queensland nurses or approximately 32,000 police officers.

Imagine a pretty full house at Lang Park with the crowd comprised entirely of these essential service workers – police, teachers and nurses. That's the resource industry's annual contribution to Queensland from royalties alone.

And guess what, there are no royalties for the State Government from an IT start-up, a bio-fuels refinery or a wind farm. To the contrary, governments seem happy to lavish subsidies, grants and regulatory leg-ups to such businesses.

Queensland resource industry workers are highly skilled and amongst the highest paid in the state. When a resource industry job is lost, the flow on impact to the economy is large, hitting businesses that relied on the purchasing power of that resource industry worker.

The loss of those high skill, high wage jobs also hits the Queensland Government's revenues. Take payroll tax, an important source of revenue to government. The loss of 23,000 resource industry jobs since November 2013 translates to \$148 million in payroll tax. That's revenue that could have paid for an extra 2,500 teachers, 2,200 police or 2,100 nurses.

A football stadium full of nurses, teachers and police officers wouldn't see themselves as working in the resources sector, but like the engineering firms in the regions, each of their jobs depend on the continuing success of the sector.

“Without royalties, there are fewer government services. Without resources, there are no royalties.”

An important part of a policy framework for advancing the Queensland economy – has to be recognising an existing sector that is already providing jobs now and jobs for the future – Queensland's resources sector.

In the face of extremely challenging global market conditions over the past few years, the resources sector has responded with sweeping self-help actions to remain competitive. Costs have been slashed and productivity has surged – but to remain competitive, government now needs to work in partnership with industry.

Government has to be prepared to reform our royalty system – our coal royalties are the second highest in the world.

A war on delays and inefficient regulations can only succeed with government's support in weeding out the wheat from the chaff. Regulations can be reformed, compliance made more focussed and approvals streamlined.

Global industries need world-class regulations and globally competitive government taxes and charges. The resources sector wants to work with government to deliver win-win reforms that drive down industry costs, while preserving jobs now, and delivering more jobs for the future.



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, LNG prices and volumes are not included in 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 increases

The index at the end of the December 2015 quarter (latest available data) dropped significantly from 134 points in the previous quarter to 129 points. This compares to an index of 135 during the peak December quarter 2014. The index base is June 2006 = 100, so the total volume of production has grown 29% since that time.

Over the December quarter most commodities recorded decreased production volumes. The greatest decrease in production were in silver (336 t to 240 t), lead (131 kt to 97 kt) and zinc (249 kt to 205 kt) while alumina production increased by 3 percent from 1,659 kt to 1,718 kt over the December quarter. Coal exports in the December quarter were 56 million tonnes, which is consistent with the September quarter volume. The net result of these changes in production volumes, weighted by value, generates the 5 point decrease in the QRC Production Index over the December quarter.

In addition to the minerals production above, the LNG export volumes for the March 2016 quarter totalled 3.8 million tonnes. The greatest volumes of LNG were exported to China (1.2 million tonnes) and Korea (1 million tonnes) during the first three months of 2016.

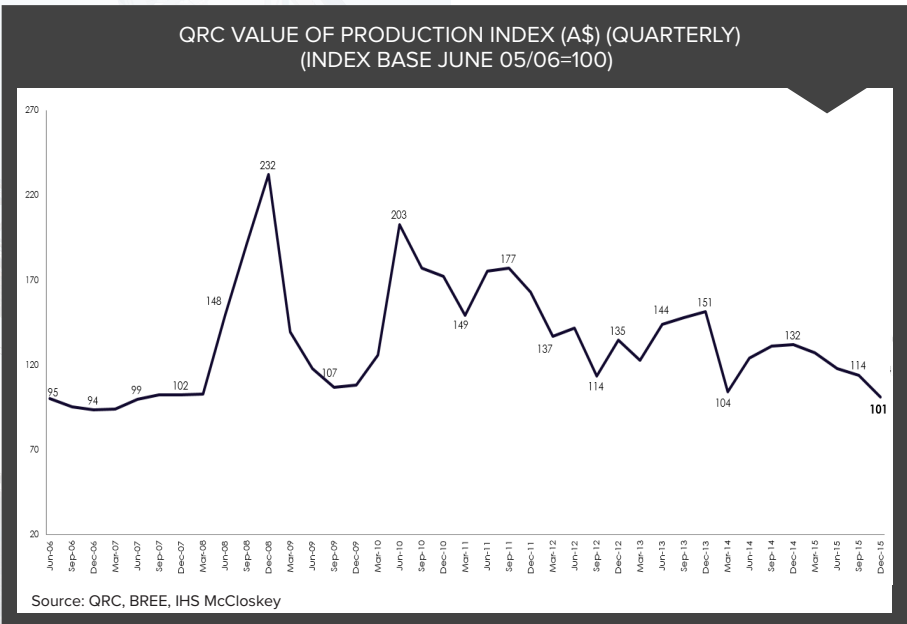
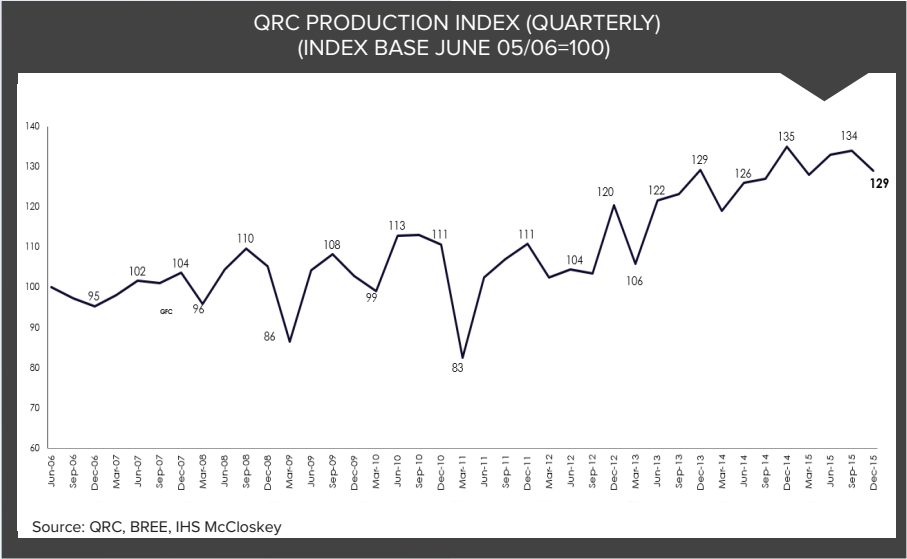
QRC PRODUCTION VALUE INDEX

QRC's production value index reflects changes in the quantities produced of Queensland's resources at average global benchmark prices. The weighted index reflects the same mix of commodities as the QRC production index. Once again, limited price data means LNG export values were not included.

Lowest value of production in eight years

The index at the end of the December 2015 quarter (latest available data) fell significantly from 114 points down to 101 points due to price reductions for all commodities except for lead (which rose 5 percent). In aggregate, the resources sector produced goods valued at \$A6.35 billion in the December quarter, down from \$A7.15 billion in the September quarter.

The largest price decreases were for silver and copper, both falling about 20 percent over the quarter. Alumina, thermal coal and zinc prices also fell by 12-14 percent, which cumulatively contributed to the significant fall in the value of production index this quarter.



INDUSTRY OUTLOOK

The following outlook information is largely drawn from the March edition of the [Resources and Energy Quarterly](#), produced by the Office of the Chief Economist, Department of Industry, Innovation and Science.

Overall, despite the current challenging market environment, the outlook for Queensland's resource and energy exports over the medium to long term remains optimistic. Increasing demand, particularly in highly populated, emerging economies in Asia, is expected to support an increase in Queensland's commodity export volumes over the medium term. There is no doubt that the current market conditions for resource and energy exports are challenging and likely to be so for the next few years.

Queensland producers have in the past demonstrated their resilience and ability to respond to changes in market dynamics and the industry has been able to change its cost structure and find efficiency improvements along the supply chain to ensure they remain competitive. Further, the Australian mining industry has a strong history of successful technical, process and cultural innovations, and has developed many specialised technologies to increase productivity. At a time where media and governments are using rhetoric that dismisses our industry in favour of innovation, QRC is working to put the spotlight on the sector's contribution to advanced technology and ideas. The first step was the recently commissioned discussion paper by innovation and capital markets expert Robert Bladier, which is currently being disseminated across thought-leadership platforms.

The Office of the Chief Economist makes the point that notwithstanding the recent reductions in employment, the resource sector's workforce is still more than twice the size it was before the mining boom. The sector remains as a large employer of indigenous Australians, pays high wages and employs large numbers of skilled workers such as engineers, geologists and surveyors and young apprentices.

The recent appreciation of the AUD against the USD in the first three months of 2016 has reduced the AUD benefit of price increases in commodity prices. It seems that the exchange rate is likely to remain stubbornly high. In its latest publication the Office of the Chief Economist forecasts the AUD: USD average exchange rate for 2015-16 to be US73 cents and remain relatively steady at US72 cents in 2016-17.

Thermal coal

The latest Resources and Energy Quarterly forecasts that over the medium term, thermal coal prices are projected to increase marginally as demand from India and Southeast Asia increases and offsets expected falls in demand in the OECD and China. It is important to note that although the rate of growth in global coal consumption is expected to slow over the next five years, it is projected to remain the dominant source of electricity over the medium term in most countries.

The development of cheap and reliable electrical generation capacity is essential for economic expansion and increasing living standards in emerging economies. There are around 370 gigawatts of new coal-fired generation capacity under construction or approved in non-OECD countries, which is almost equal to the investment across all technologies in new generation capacity in the OECD.

Metallurgical coal

According to the Office of the Chief Economist, the outlook for Queensland's metallurgical exports is broadly positive. Exports are forecast to increase over the medium term, supported primarily by an increase in imports from emerging economies such as India who are investing in infrastructure and residential housing. Prices are also projected to increase moderately from 2018, underpinned by an increase in global steel production.

Gas

LNG prices are expected to remain subdued over the next year, with oil prices remaining relatively low as a result of increased capacity coming online. The Office of the Chief Economist is optimistic of a strong demand growth for LNG from China, largely as a result of government policies directed towards increasing gas-fired electricity generation. Although China is also sourcing gas from domestic sources and international pipelines, its LNG imports are projected to increase at an average annual rate of 17 percent to reach 56 million tonnes in 2021. LNG from Australia will be a large contributor to China's overall LNG consumption. Australia's LNG exports to China are projected to account for 45 percent of China's LNG imports in 2021, compared with 22 percent in 2015.

Metals

The March edition of the Resources and Energy Quarterly notes that a divergence in prices between metal and bulk commodities is expected over the medium term with prospects for metals a lot better than for prices of bulk commodities. In the markets for metals, supply is projected to be constrained by the closure of capacity because of the exhaustion of economic resources or declining ore grades. Overall the medium to long term outlook for the metals sector remains strong due to the rising global demand by an increasing middle class for electronics and everyday conveniences that are made up of many minerals mined in Queensland. This concept is the focus area for the QRC campaign, "[Did you know?](#)".



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 12 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. For this edition the focus is on the sentiment towards regulation, input costs and government resources and the primary data was collected during the last week of April 2016. In addition to the standard questions, two additional questions regarding the cost of doing business in Queensland were also included.

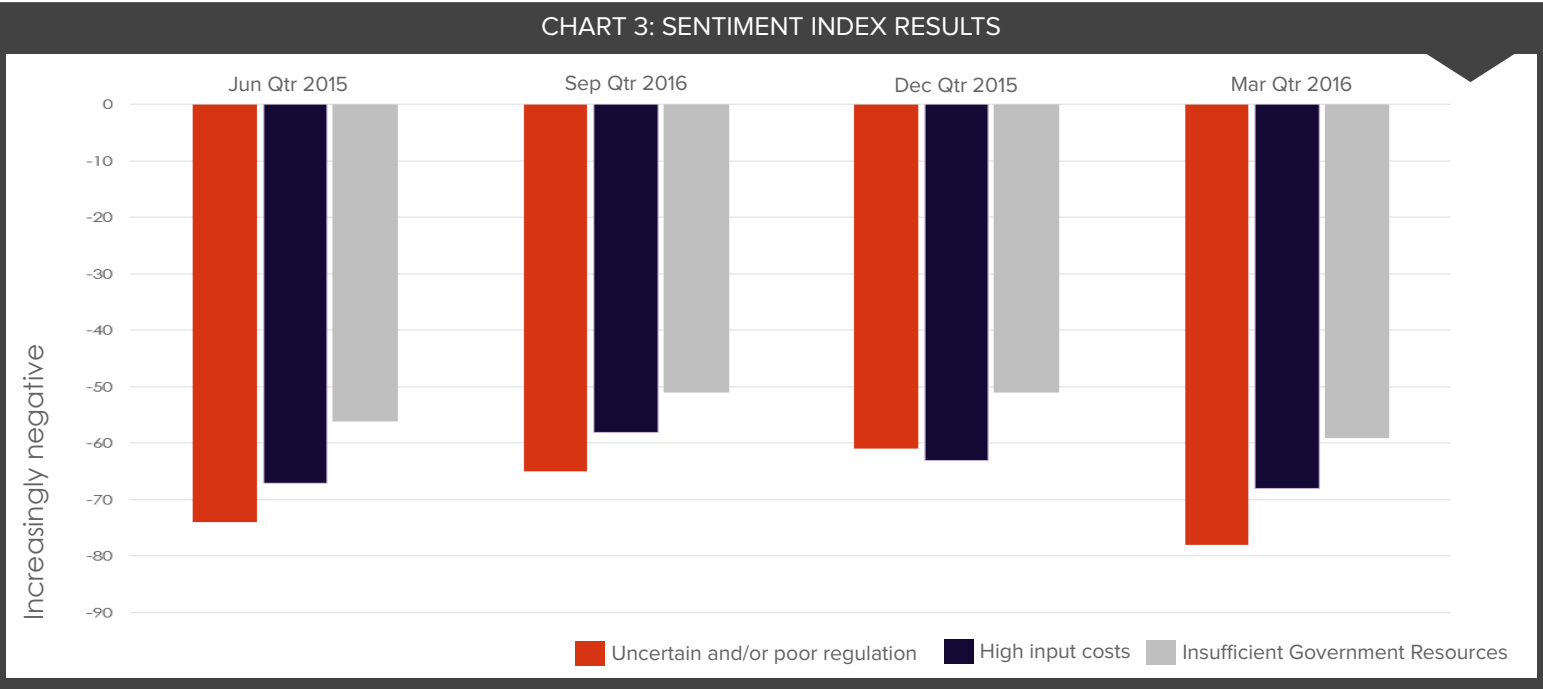


Chart 3 shows the deteriorating sentiment towards uncertain and/or poor regulation, high input costs and insufficient government resources over the last quarter as each factor scored lower than the previous quarter. To put these results in context, the highest result was sentiment towards attracting and retaining skilled employees at -41 down from -33 in the December quarter.

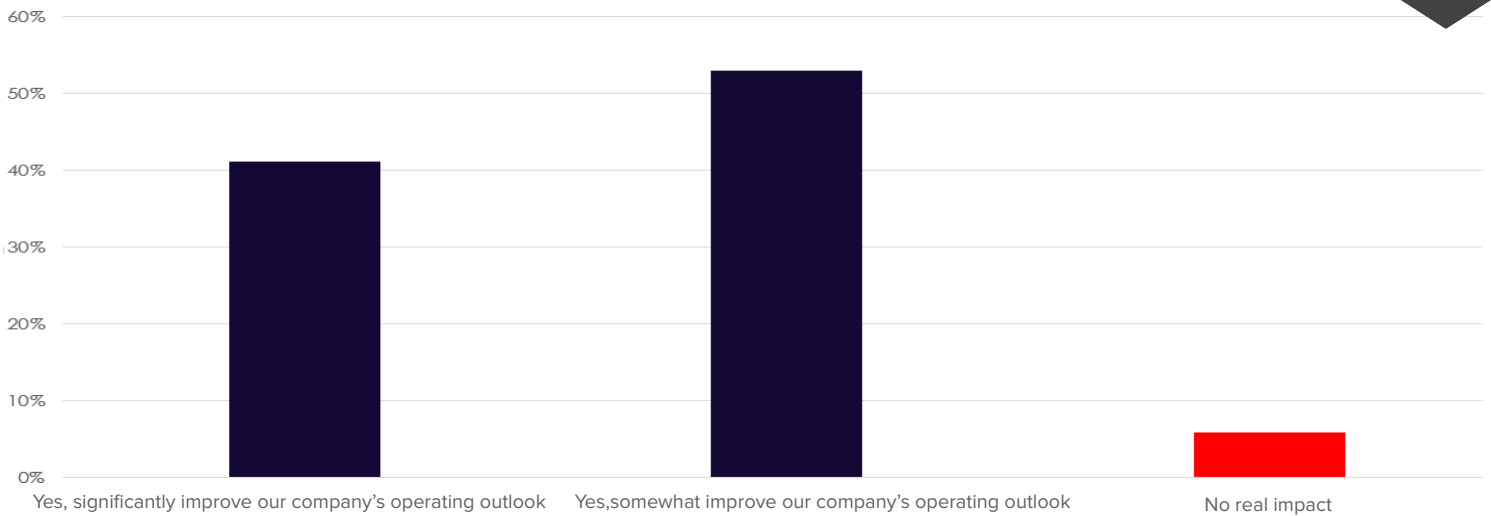
Negative sentiment towards regulation has not been this low since June quarter 2011 and the decrease in sentiment over the last quarter was 17 points.

Chart 4 shows the majority of operating companies are confident that any efforts by state government to reduce imposed costs would somewhat or significantly improve the operating outlook.

Question: Given the focus on cost reductions and productivity improvements in your organisation, would efforts by the state government to reduce imposed costs (including royalties, infrastructure charges and other taxes/charges) improve the outlook for your operations?

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CHART 4: STATE GOVERNMENT IMPACT ON IMPROVING OUTLOOK OF OPERATIONS



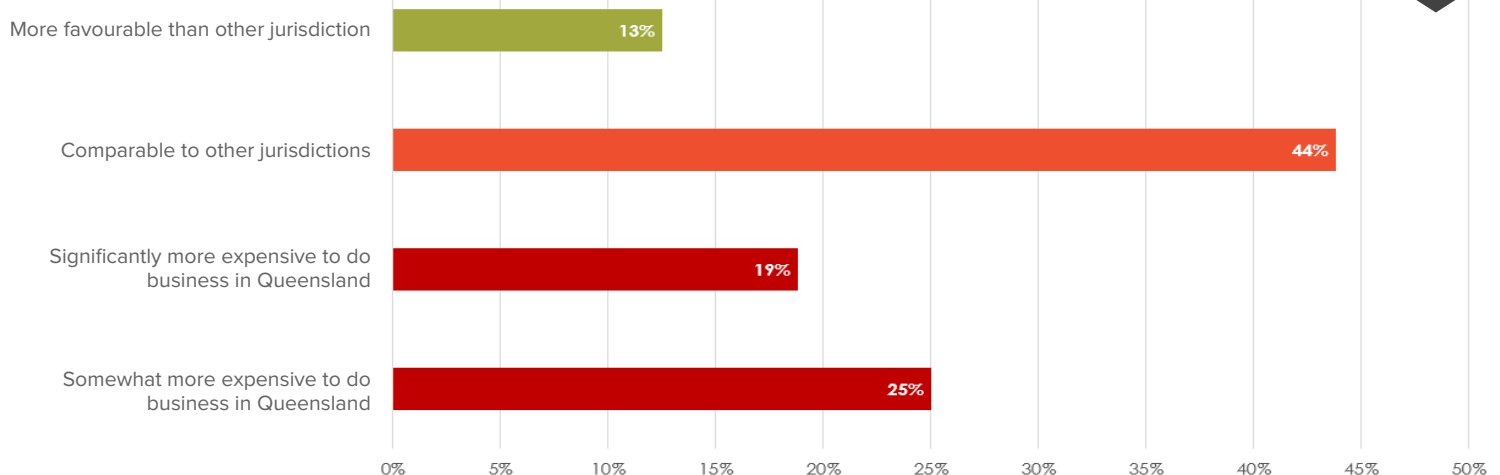
The results of the question in Chart 5 reveals that just 13 percent of respondents noted Queensland was a more favorable jurisdiction to do business. The majority of companies indicated that the cost of doing business in Queensland is comparable (44%) with other jurisdictions.

Interestingly, the same share 44% found that Queensland was more expensive than other jurisdictions – either somewhat more expensive (25%) or significantly more expensive (19%).

It is alarming that almost one in five resource companies CEOs describe Queensland as suffering from a significant cost disadvantage to other jurisdictions.

Question: *If your company operates in other jurisdictions outside Queensland, how do the fixed regulatory costs including take or pay, compliance, payroll tax and royalties in Queensland compare as a cost of doing business?*

CHART 5: FIXED REGULATORY COSTS COMPARISON



While the participating CEOs acknowledged the government's welcome decision to allow exploration spending commitments to be reduced, they also called out a number of concerns with fixed (or rising) regulatory costs.

CEOs listed a range of concerns including:

- inflexible royalty regime to reflect a low price environment,
- sharply growing costs and uncertainties associated with financial assurance,
- uncertainties created by local government's unfettered ability to charge differential rates: "see how long a Mayor would last if they proposed a 500% increase on all rate payers", and
- an inability to control input costs is starting to become a key factor in a company's operational decisions.





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