

QRC STATE OF THE SECTOR

MARCH QUARTER 2017

IN THIS EDITION:

Feature: Resources roar back to record values!

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

QRC CEO Sentiment Index

REGIONAL COMMUNITIES NEED JOBS



By Ian Macfarlane, Chief Executive Queensland Resources Council

High unemployment rates in regional capitals like Townsville will always grab the headlines and the attention of politicians - and rightly so.

In particular, youth unemployment in our regional communities reveal a slowly unfolding tragedy of wasted potential. Every community will struggle when as many as one in four of our young people is not learning or earning. Study, training, employment, these are the basic building blocks of an enduring prosperity – as individuals, as families and as communities.

The Palaszczuk Government is right to maintain a relentless focus on creating jobs, on creating opportunity in regional communities. Stable, secure, interesting employment is the first rung on the ladder of opportunity.

But there's a risk the Queensland government could miss the hidden message of unemployment. If you look at unemployment in regional centres like Mackay, Gladstone and Mount Isa, low rates can be deceptive, hiding a hollowing out of these communities.

When jobs are lost, the first to leave the region are often the most mobile workers – the highly skilled, the highly trained – and as families move out, our regional cities and towns lose vibrancy. There are less kids in the schools, homes stand vacant, there are less cars in the main street as the shopkeepers start to grumble about times being tough.

A new project in town, particularly a new resource project can reverse this cycle. Investment can bring new jobs, new infrastructure and revitalise communities with an influx of new people.

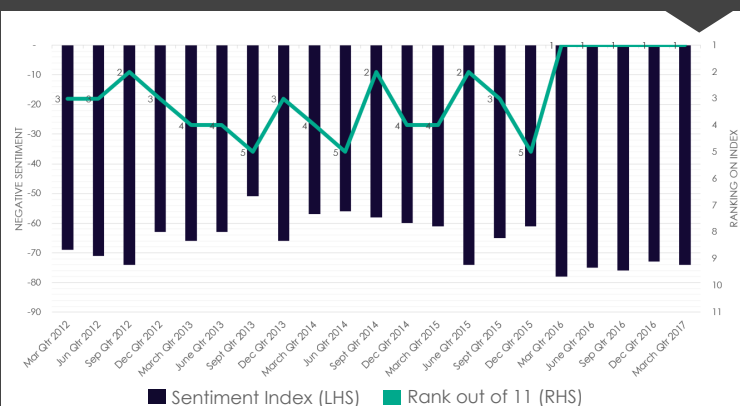
The recovery in resources is already starting to deliver new jobs. Premier Anastacia Palaszczuk has been quick to acknowledge that 9% growth in coal mining employment has delivered 1,800 new jobs for Queensland. Similarly, the Minister for Natural Resources and Mines Dr Anthony Lynham was pleased to note that an uptick in exploration and mining support services has delivered more than 13,000 new jobs. That's a great start for our regions.

Creating jobs is hard work and requires businesses to invest. While investors can cope with risk, nothing makes them turn tail and run faster than policy uncertainty. New laws, inconsistent approaches to compliance, new regulations and unclear processes all create uncertainty and kill investment opportunities.

'The best way to turn on the investment tap is to stop the policy churn'

The economic price of policy uncertainty is a very clear message from QRC's CEOs in this month's *State of the Sector* sentiment survey. For the fifth quarter in a row, they have nominated policy uncertainty as their key concern (see chart below and page 2).

CEO NEGATIVE SENTIMENT TOWARDS POLICY UNCERTAINTY VS RANK IN SENTIMENT INDEX (MARCH QTR 2017)



NOTE: A DETERIORATION IN SENTIMENT REPRESENTS A LOWER SCORE ON THE INDEX
Source: QRC CEO Sentiment Survey, March 2017

The sentiment index tracks the issues that CEOs see as most likely to impact on their business in the next 12 months, a larger score reflects heightened concern. While policy uncertainty has always been in the top five issues for the past 5 years, a ranking of the greatest concern is utterly unprecedented.

The precarious composition of the current Parliament makes governing Queensland a tough job. The Premier has to count votes on every single issue, but she has shown that she is up to the task. Now her challenge is to leave the policy levers alone and let the economy grow. No one wants to tell a generation of unemployed Queensland kids, that for want of policy certainty, we let opportunity slip through our fingers.

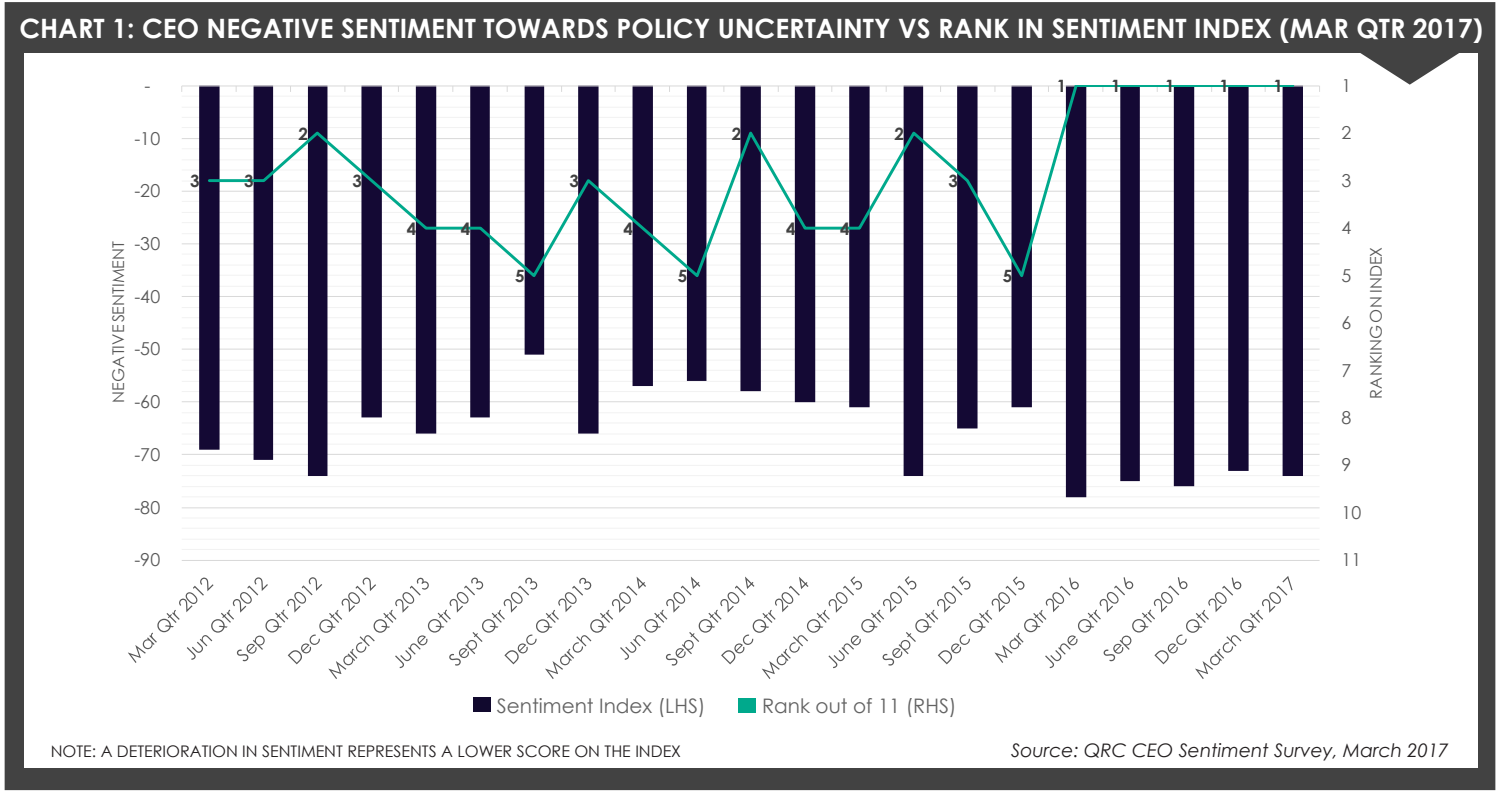
Queensland has a rich pipeline of resource projects that could be creating jobs and anchoring the future of regional communities. New resource projects need policy certainty to convince global investors that Queensland is a safe bet. To deliver regional jobs, Queensland needs to cement the policy goalposts into some deep footings, so they simply can't be moved.

QRC CEO SENTIMENT INDEX

The QRC CEO Sentiment Index is a quarterly survey of QRC's producer and explorer members with the typical response rates between 20-35 companies. The companies surveyed cover 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 they expect a series of eleven factors will impact on the objectives of their organisation over the next 12 months. All responses are weighted to arrive at a single sentiment value for that factor. The weighting means the factors generating the greatest concern receive the lowest scores and are lower down on the negative axis.

The CEO sentiment survey for the March quarter 2017 delivered mixed results. The strongly negative sentiment of member CEOs on the macro-economic outlook and access to capital has improved by 10% and 25% since the March quarter 2016. However, the impact of policy uncertainty continues to act as a wet blanket for industry. Chart 1 below illustrates this ongoing concern.



'Over regulation just imposes costs and delays and inhibits job creation.'
CEO sentiment survey



QRC STATE OF THE SECTOR

Uncertain or poor regulation has been the number one concern for member CEOs for five quarters in a row, extending its record run at the top for the sentiment category—but QRC member CEOs warn that the real pain from regulatory uncertainty is felt in the long-term:

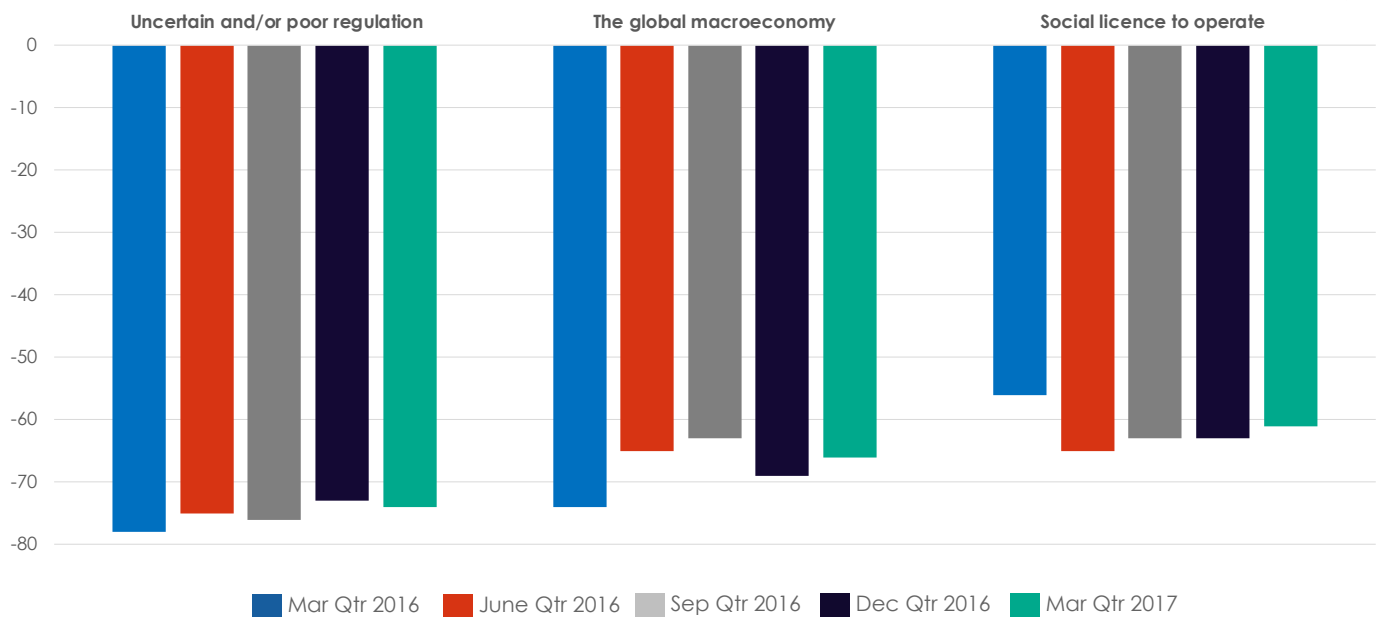
‘Government policy is very volatile at present and it is difficult to allocate long lead capital with any certainty the legislation will be the same when the projects are delivered.’

‘Resource industry companies need greater certainty with respect to regulation in order to commit to projects.’

‘The current regulatory environment in Queensland is dreadful – in particular the environment department is acting as “policeman” rather than collaboratively working with companies to identify and resolve potential issues.’

CEO sentiment survey

CHART 2: CEO SENTIMENT – TOP 3 CONCERNS IN MARCH 2017



Source: QRC CEO Sentiment Survey, March 2017

Apart from uncertain and/or poor regulation, the global macroeconomy and social licence to operate are also major concerns for member CEOs (see Chart 2 above).



RESOURCES ROAR BACK TO RECORD VALUES!

The most recent data shows that Queensland's resource industry is alive and kicking, as records tumble. QRC's *State of the Sector* value index soared a massive 78% in the December 2016 quarter to the highest level on record.

An extra \$8 billion is always handy

In the December 2016 quarter, the value of Queensland's resource exports grew by an extraordinary \$8 billion dollars. That performance was driven by strong price increases for coking coal, thermal coal, lead, zinc and copper. It's rare to see so many commodity prices flourishing all at once, so while we should enjoy the short-term sugar hit, we also know that the March 2017 figures will suffer from the effects of Cyclone Debbie.

Eight billion is a serious amount of extra money. That's enough to build 24 new stadiums for Townsville, or two and half times the amount needed to pay the Solar Bonus Scheme's stream of subsidies out to 2028. With Queensland's population just under five million people, \$8 billion is the equivalent of each of us getting a cheque for \$1,600.

Over the past decade, the value of Queensland's resources has tripled. That's an extraordinary achievement that should see the industry feted as the backbone of the state's economy.

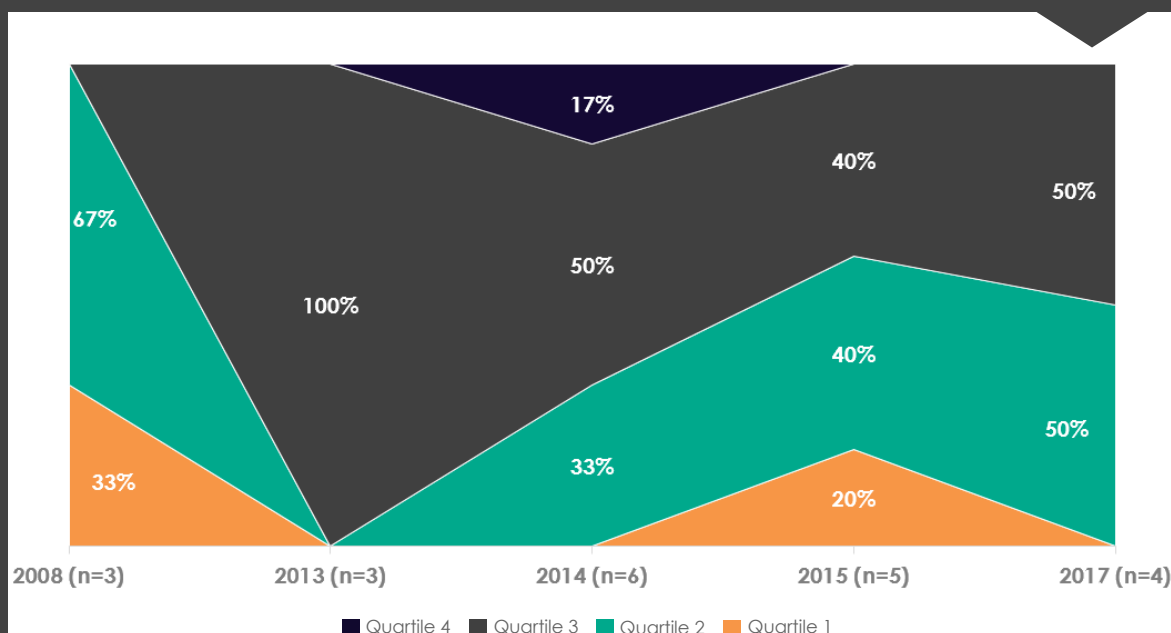
Queensland's record breaking last quarter shows how the combination of exchange rates and global commodity markets can deliver big swings in returns for Queensland's exports. However, despite this short-term volatility, the underlying outlook for Queensland resources remains sound. The consensus forecasts for the next two to three years suggest that we should see steady growth in demand for our coal, LNG, aluminum, alumina, copper, zinc and nickel.

How much has industry reduced costs?

QRC regularly asks the CEOs of our companies about how they rate their Queensland operations against their global competition.

Based on the survey results, it is clear oil and gas operators have lost some of the gains achieved in recent years (see chart 3). In 2015, 20% of oil and gas operators were in the first quartile of the cost curve (i.e. the lowest 25%) and 60% were in the lowest half of the cost curve. In 2017, none of the surveyed operators are in the first quartile and only 50% are in the lowest half of the cost curve. There is clearly more work to do for oil and gas operators to regain their competitive positions.

CHART 3: OIL AND GAS OPERATIONS COST QUARTILE COMPARISON
2008, 2013-15, 2017

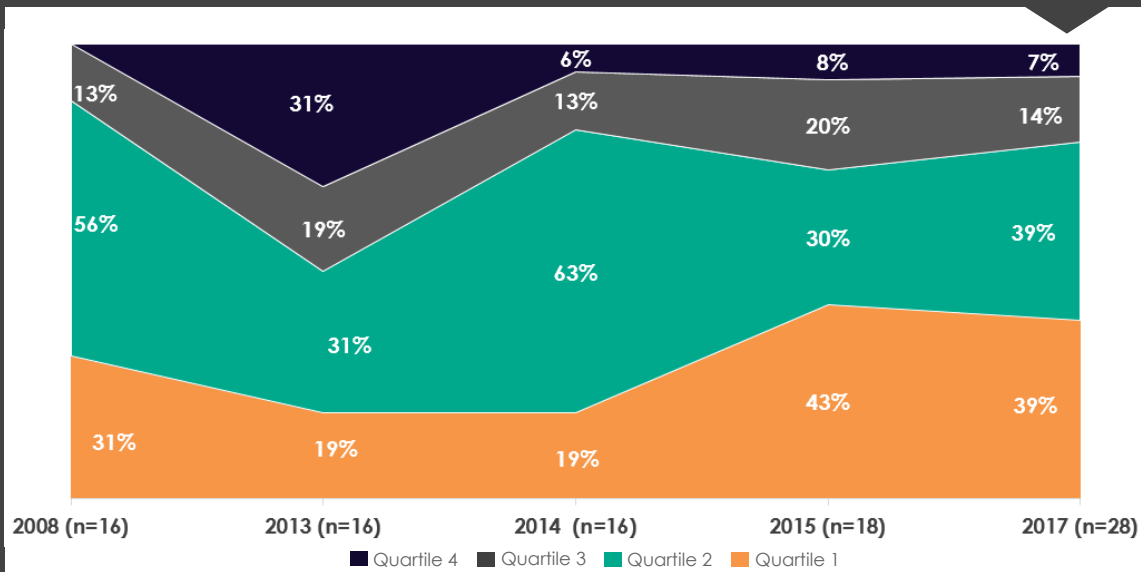


Source: QRC CEO Sentiment Survey, March 2017

In comparison, the relative positions of mining operators in the global cost curve are much brighter (see chart 4). The heavy cost cutting the mining operators achieved in 2015 has continued to pay off, with 39% of operators now in the lowest cost quartile and 78% of operators within the lowest half of the cost curve. Importantly, the number of operators sitting in the third and fourth quartiles—the higher cost operators—has decreased from 28 to 21%.

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**CHART 4: MINING OPERATIONS COST QUARTILE COMPARISON
2008, 2013-15, 2017**



Source: QRC CEO Sentiment Survey, March 2017

One of the key ways that operations have remained competitive is by working closely with local suppliers to contain costs. QRC members see a close relationship with local companies as an essential part of remaining globally competitive.

'We have a long term relationship with local suppliers and encourage them to remain competitive in terms of skills, safety and environmental processes, costs etc.'
CEO sentiment survey

While the resource sector has long had a focus on delivering opportunities to local suppliers in Queensland, there has been intense national scrutiny recently on payment terms. Australia's Small Business Ombudsman has described a national "slow pay" epidemic which has seen small businesses right across Australia wait for as long as 125 days to be paid for their work. Clearly, extended payment terms will affect their cash flow and place the business under pressure.

'We prefer to work with local suppliers and support local industry.'
CEO sentiment survey

Managing payment terms for small business is the focus of a new industry Code released by the Business Council of Australia (BCA). The Code aims to see BCA members reduce payment terms to 30 days for small businesses.

How do QRC members measure up against that new 30 day goal?

QRC's CEO survey shows that almost 80% of companies already pay suppliers in less than 30 days. CEOs say that an impressive 8% of members get payments processed in under two weeks. When you consider that many of the industry's suppliers are major businesses in their own right, not just small businesses, it is clear that Queensland has made a good start on addressing payment terms.

'...working with individual suppliers on terms acceptable to them.'
CEO sentiment survey

As the industry enjoys stronger prices, it provides some leeway for companies to revisit their payment terms. While they are BCA members, before the new BCA code was released, Rio Tinto announced that starting in July, it will ensure all small businesses are paid within 30 days.

While faster payment terms will be music to the ears of the industry's suppliers (and their bankers) in Queensland, the job is not done. A recent survey of regional suppliers to the resource industry shows plenty of room for improvements. A recurring complaint from suppliers was the need to improve the administration of payments. Suppliers clearly want the industry's administration of invoices to be much more efficient and consistent. Variations and changes in scope were called out as a basis for long delays.

One third of the suppliers surveyed said they still see half their revenue on extended payment terms. Almost three quarters of the suppliers said that the impact on their cash flow was having a material impact on their ability to supply the industry. This is not good news as operations look to work with their suppliers to identify the next wave of innovations to drive productivity gains.

It seems that the next challenge for the industry is to ensure that local suppliers share in the benefits that their belt-tightening has helped to deliver.



KEY INDICATORS

QRC PRODUCTION VOLUME INDEX

Building momentum in the December quarter

QRC's quarterly production index tracks changes in the total production of Queensland's traditional commodity exports—alumina, aluminium, bauxite, coal, copper, gold, lead, silver, and zinc. Please note, due to data limitations, we are yet to integrate LNG 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) has a proportionately larger impact on the quarterly index result than, for example, changes in thermal coal production (representing 10–15% of total value).

The QRC's Production Volume Index for the December 2016 quarter (latest available data) increased to 125, up one point from the September 2016 quarter—or a net increase of 25% greater volume since the index began in June 2006.

While Queensland's production of alumina (6.7%) copper (5.6%) and gold (3.3%) all increased when compared to the September 2016 quarter, these gains were almost entirely offset by reduced production of zinc (-15%) and bauxite (-7%). Thermal and coking coal exports, which represent approximately two-thirds of the index, increased by 1.9% across the quarter.

QRC PRODUCTION VALUE INDEX

Record dollars for Queensland resources

QRC's Value of Production Index reflects changes in the prices of the resources that Queensland produces. The weighted index reflects the same mix of commodities as the QRC production index and is also yet to include LNG production.

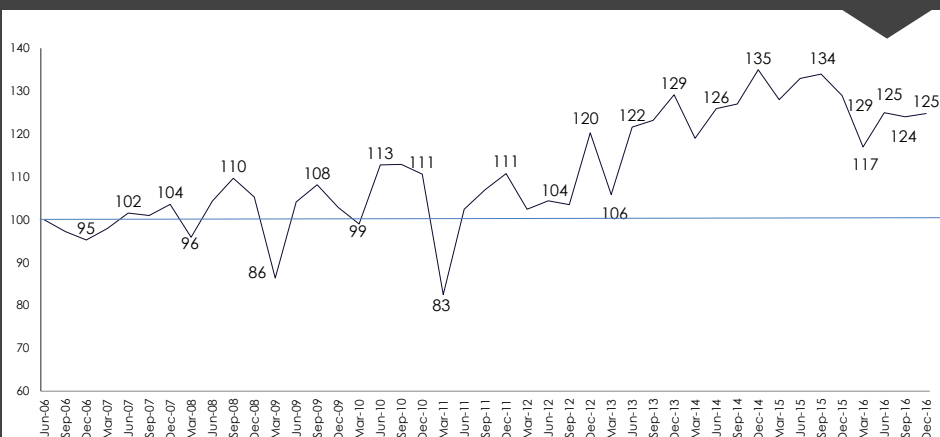
Over the December 2016 quarter, the QRC's Value of Production Index achieved a record quarterly increase, increasing from 174 to 296 points—which is also the highest ever result since the index began in June 2006. This latest record means that Queensland's resources production has nearly tripled in value in just over ten years.

In dollar terms, the value of the resources produced by the sector (excluding LNG) reached A\$18.6 billion in the December 2016 quarter. This represents an A\$8 billion (or 78%) increase in value since the previous (September) 2016 quarter.

Strong price growth in some of Queensland's key export commodities has fuelled this index record. The December quarter average price for thermal coal was US\$94/t, up 42% from the September quarter and the Australian prime hard coking coal average reached US\$266/t, up 104% from the September quarter. However, coal was not the only winner, with lead (21%), zinc (13%) and copper (11%) all seeing average price increases across the quarter. The only commodities to see average price reductions in the December 2016 quarter were silver (-14%) and gold (-9%).

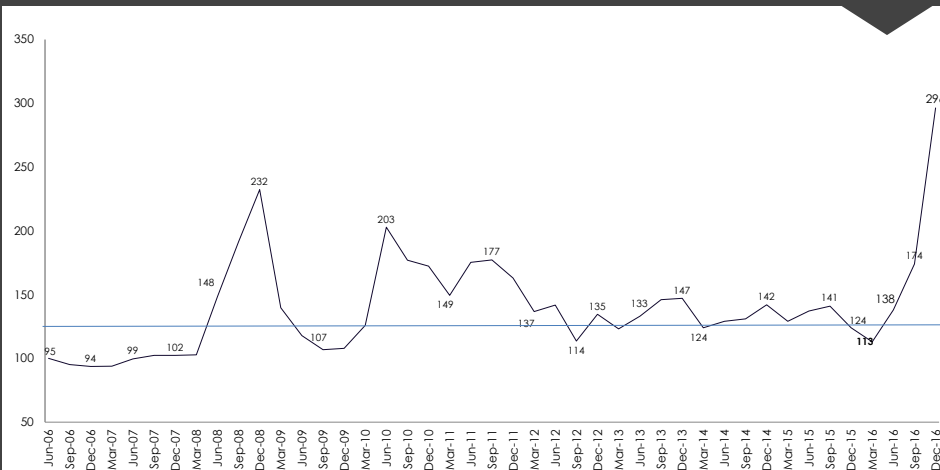
These improving conditions in the resources sector haven't gone unnoticed, with Premier Anastacia Palaszczuk telling state parliament in May that coal mining jobs are up 9% to 22,000. That's 1,817 new jobs. But there other signs of green shoots—according to the Australian Bureau of Statistics, the number of jobs in Queensland's exploration and mining support services doubled between February 2016 and February 2017, that's another 13,200 new jobs.

CHART 5: QRC PRODUCTION INDEX (A\$) (QUARTERLY)
(INDEX BASE JUNE 05/06=100)



Source: QRC, Office of the Chief Economist, IHS McCloskey

CHART 6: QRC VALUE OF PRODUCTION INDEX (A\$) (QUARTERLY)
(INDEX BASE JUNE 05/06=100)



Source: QRC, Office of the Chief Economist, IHS McCloskey

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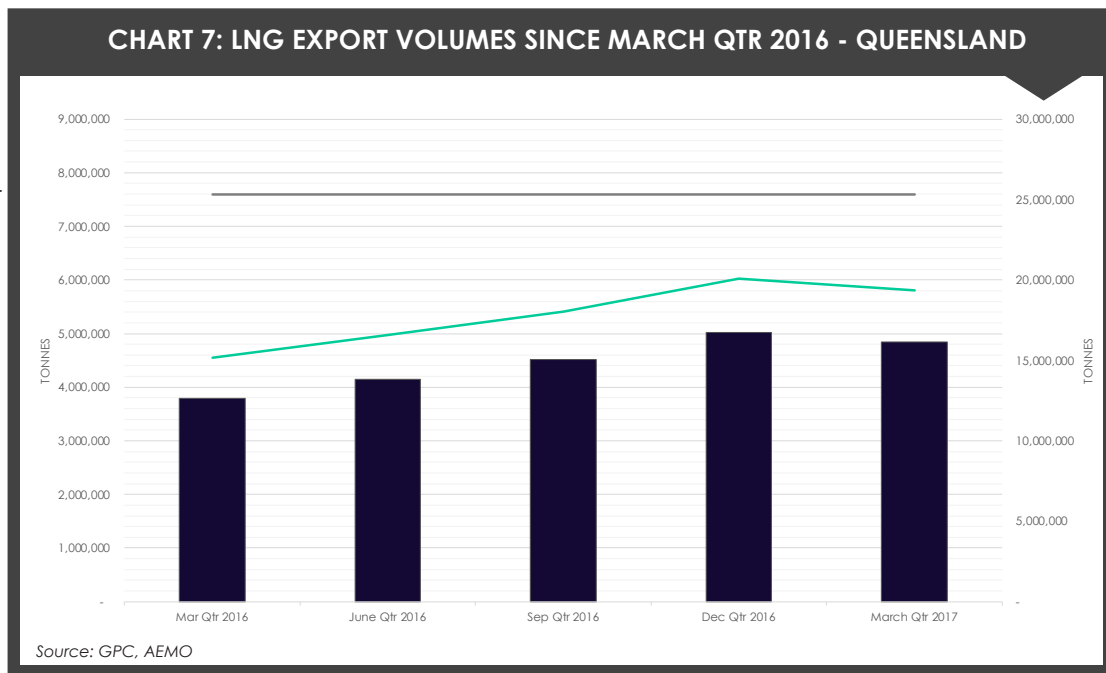
EXPORTS

Queensland coal exports for the December 2016 quarter reached 56.4 million tonnes, a small increase on the 56 million tonnes of coal exported in the December 2015 quarter. Throughout the 2016 calendar year Queensland exported nearly 221 million tonnes of coal, broadly in line with the 220 million tonnes exported in the 2015 calendar year.

While zinc volumes reduced by 14% over the December 2016 quarter, this reduction is consistent with forecasts from the Office of the Chief Economist, which noted the closure of MMG Century's mine and curtailed production at other mines would likely impact on 2016–17 exports.

In addition to the commodities recorded in the production index, Queensland also exported more than 5 million tonnes of LNG in the December 2016 quarter—a new LNG export record for Queensland. China received more than half of LNG exported over the quarter China (2.7 million tonnes), with 1.2 million tonnes destined for Korea.

Chart 7 illustrates the quarterly LNG exports since March quarter 2016.



INDUSTRY OUTLOOK

Looking to the medium term, Queensland's resources companies—and the estimated 309,577 employees that are supported by the sector—have reason to be optimistic. The Office of the Chief Economist, in its March 2017 *Resources and Energy Quarterly*, predicts continued export growth for base metals and coal, with particularly strong growth in Australian LNG export volumes, which are forecast to double in the next three years.

Furthermore, the Office of the Chief Economist's outlook for key commodity prices remains broadly positive. Metallurgical and thermal coal prices are expected to moderate from their heights of late 2016 but are still likely to remain above the lows of 2015. Furthermore, despite the doubling of Australian LNG exports, higher LNG prices are forecast over the period to 2021–22.

As for metals, the Office of the Chief Economist expects moderate growth over the medium term for aluminium, alumina, copper, zinc and nickel, while subdued price growth in gold is expected over the medium term.





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