

THE IMPERATIVE FOR WORLD-CLASS REGULATORY ENVIRONMENT

BY MICHAEL ROCHE



The 2009 September quarter showed signs that the global economy might have turned a corner.

Indeed, responses to this quarter's *QRC CEO Sentiment Survey* confirm that concerns about the global macroeconomy have eased since the June quarter (see page 4 for details).

While demand for coal in particular has improved over the past two quarters (see QRC production index), predicting the strength of the upturn is difficult as we don't fully understand how the private sector globally will respond to lingering credit constraints and the unwinding of large stimulus packages around the world.

More positively, our strongest trading region—Asia—has rebounded strongly and appears to be leading the global recovery.

Another important finding from our sentiment survey is a strong increase in concern over uncertain and/or poor regulation. This is now seen as the number-one issue with potential to adversely affect the economic, environmental, and social objectives of Queensland resource sector companies over the next 12 months.

This is both good news and bad. It is good news in the sense that the sector's CEOs are thinking about growth and expansion. The bad news is they see government as more of a hindrance than help.

The industrialisation and urbanisation of the developing world and associated increase in demand for resources should be forming the basis for enormous opportunity in the resources sector. However, having 'what the world wants' is no guarantee of new investment or that Queensland's comparative advantage in an increasingly competitive global resource markets will be maintained.

Governments must continue to implement reforms and commit the resources necessary to ensure Queensland's regulatory frameworks achieve their stated objectives while allowing the sector to capitalise on future opportunities.

In coming editions, we will look more closely at areas where

we feel reform is needed, but three broad areas are front of mind.

Firstly, the federal government's Carbon Pollution Reduction Scheme's (CPRS) failure to treat the coal industry the same as other emissions-intensive, trade-exposed industries (EITE) is an example of flawed policy design. For every Australian coal mine claimed by the new tax, another will open in competitor countries who are not contemplating putting a price on carbon in the foreseeable future.

Secondly, there are 40 'significant projects' under assessment by the Queensland Department of Infrastructure and Planning (DIP). Despite a 'state significance' label meaning that all government assessment is brought together under the Coordinator-General, efficiencies are lost with officers taking on increasingly larger case loads. The majority of these projects are mining or export-chain related, complex, and worth many billions of dollars to Queensland.

Thirdly, as at 31 August 2009, the Department of Employment, Economic Development and Innovation (DEEDI), which includes Queensland Mines and Energy, took 339 days to grant a coal exploration permit; 495 days to grant a minerals exploration permit; and 454 days to grant a mineral development licence. Such delays mean that a relatively small percentage of total applications are being processed, frustrating new employment opportunities and denying additional state revenues.

The QRC is looking to both the Queensland and Australian governments to deliver a world-class regulatory environment for its resources sector.

Improved regulation will boost the already significant socioeconomic potential of the sector, which in 2008-09 directly and indirectly contributed 200,000 jobs or 12 percent of Queensland's full-time-equivalent workforce; \$14 billion in wages and salaries (14 percent of Queensland total); more than 20 percent of Queensland's Gross State Product; \$6.5 billion in capital expenditure (30 percent Queensland total); and 65 percent of Queensland's total commodity exports.

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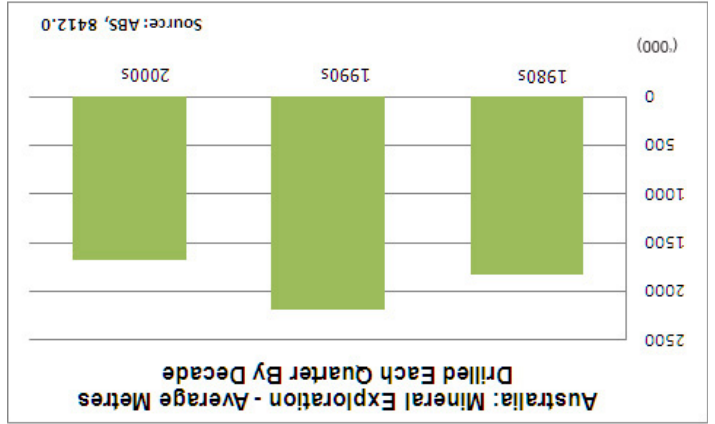


STATE OF THE SECTOR

WHY WE NEED FLOW-THROUGH SHARES

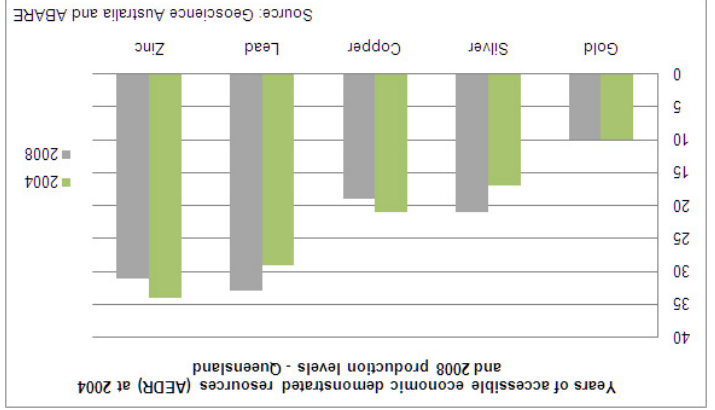
A disturbing trend in the Australian and Queensland resource sectors has been a decrease in exploration activity and the subsequent lack of new, large-scale mining projects.

As the chart below shows, an average of 1,824,000 metres was drilled each quarter during the 1980s, increasing to 2,195,000m in the 1990s, before dropping to 1,687,000m in the 2000s. This is despite demand for resources increasing significantly in the latter half of the decade and prices reaching record levels.



The effect of this has been particularly stark in Queensland.

Comparing 2004 and 2008 levels, the chart following shows that for Queensland's base and precious metals, years of economically demonstrated resources remain very low at 10-33 years. In some cases, levels are falling, which means inventory is not keeping pace with production.



The exploration sector is the engine room of the resources sector. Junior exploration companies are playing an increasingly significant role, accounting for approximately 70 percent of greenfield exploration and 50 percent of all exploration.

However, this sector is severely constrained because of the way the Australian taxation law treats tax losses. Currently, junior exploration companies who often have

little or no taxable income because they do not produce 'anything' are unable to immediately deduct exploration expenses. Without such deductions, exploration costs are higher, resulting in lower levels of activity. The immediate deductibility of eligible expenses is a key parameter of Australia's company taxation system and recognises the longer-term benefits of exploration and the associated risks of this activity.

The resources sector strongly supports the introduction of a flow through shares (FTS) scheme to address these structural impediments facing junior exploration companies in raising capital for new and increased levels of exploration investment. The long-term benefits of a FTS scheme have been recognised by the Australian Government. The development of a tailored FTS scheme was promised by the Australian Labor Party at the 2007 federal election. Based on Australia's dividend imputation system, the Australian exploration companies exploring in Australia are able to pass 'unusable' tax deductions on to their Australian shareholders. Exploration Tax Credits (ETC) would be available to shareholders at the Australian company tax rate of 30 percent. Eligible shareholders would be entitled to use their ETCs to offset tax liabilities.

By offsetting high costs associated with the non-deductibility of expenses, as well as stimulating the investment markets, it is estimated that a FTS scheme for Australian junior exploration companies would result in increased exploration expenditure of 10-30 percent compared with today's levels (Synergies Economic Consulting, May 2009).

This is based on the positive experiences of Canada, which introduced a FTS scheme more than a decade ago and has led to a significant increase in capital flows and net exploration and mining activity.

Coupled with high labour intensities, few impediments and significant spare capacity in exploration and supporting industries, the Synergies report concludes that an Australian FTS would deliver a significant short-term boost to the domestic economy during the current slowdown, as well as delivering significant longer-term benefits when more metres drilled is converted to more discoveries, and ultimately more mines in production.

The QRC has called on the Henry Tax Review to recommend the immediate implementation of a FTS when it hands down its report in December, and for the Australian Government to honour its 2007 election commitment and make allowances for a FTS in its 2010-11 Budget.

THE 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 (all saleable), copper, gold, lead, silver, zinc, oil, gas, and electricity (NEM) quarter to quarter.

The global financial crisis (GFC) reached its most severe point in the March quarter of 2009 when the production index fell 22 percent to 90 index points. However, the value of production (see commentary next page) remained relatively high due to continued high benchmark coal prices.

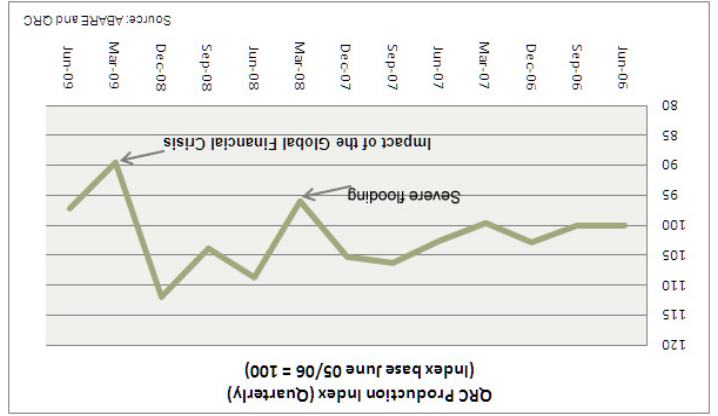
The March 2009 quarter was one of the worst experienced by the sector in recent years with a greater impact on production than severe floods in early 2008 when a 9 percent drop in production was recorded for the March 2008 quarter.

The global economy is showing signs of recovery on the back of massive stimulus spending by governments and a number of other factors. In particular, unusually strong demand from China for all types of coal has absorbed lower demand from traditional export markets such as Japan and South Korea.

The *QRC Production Index* at the end of the June 2009 quarter (latest available data) reached 97 index points. This is a 7 percent increase in output of Queensland's main resources compared with the March 2009 quarter. While data to the end of September is not yet available, indications are that production remains strong.

Strong increases in production and exports were recorded for both thermal and metallurgical coal during the June quarter, with moderate increases in demand and recorded for copper, lead, silver and zinc. Production of gold and aluminium remained flat.

Falls in the international price of coal and lower freight rates have increased the competitiveness of Australia's exports to China relative to domestic production. In addition, coal production at a number of small and medium-sized mines ceased as a result of safety issues, and Chinese companies have embarked on a concerted re-stocking program,



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THE QRC VALUE OF PRODUCTION INDEX

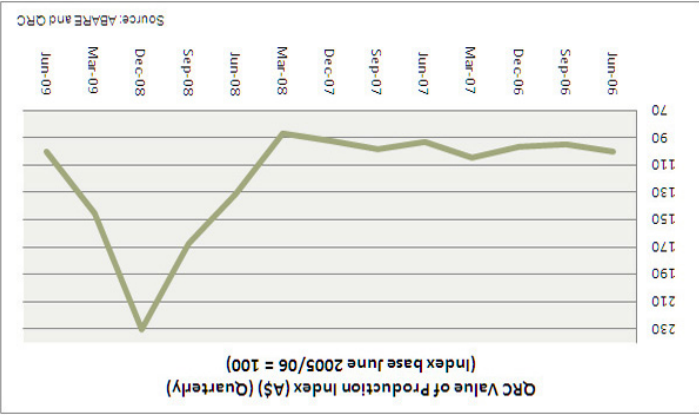
Comprising the same basket of goods as the QRC Production Index, the QRC Value of Production Index combines domestic production and average global prices to track percentage increases and decreases in the total value of production.

This index can be seen as a general 'health barometer' for the sector as it crudely approximates sector profit levels (assuming costs remain constant). The *QRC Value of Production Index* at the end of the June 2009 quarter (latest data) reached 101 index points (June 2005/06 = 100).

This is a 45 percent drop in the value of output of Queensland's main resources compared with the March 2009 quarter when production dropped strongly, but value was maintained because of buoyant contract prices for coal.

While global demand and domestic production improved in the June quarter (prices for metals improved slightly with the exception of copper), the overall value of production fell because of the strong weighting to coal in index calculations and the substantially lower coal prices settled for the period April 2009 to March 2010.

Reflecting increasing global demand for Australian resources and dollars, and high domestic interest rates relative to other large economies, the value of production would have been higher if not for the strength of the Australian dollar, which appreciated 20 percent between December 2008 and June 2009.



especially for metallurgical coal as underlying global demand for steel shows signs of stabilising. The sustainability of this new demand from China remains uncertain. It is expected that once re-stocking is complete and domestic production resumes, China's imports may start to fall back, exposing Queensland's vulnerability to the economies of our traditional trading customers, several of which remain weak.

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QRC CEO SENTIMENT INDEX

The QRC CEO Sentiment Index is a survey of the QRC's 72 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.

Each quarter, CEOs are asked:

Answering 'not at all', 'less than normal', 'same', 'more than normal', or 'very strongly', to what degree will the following adversely impact upon the economic, environmental, and social objectives of your organisation over the next 12 months?

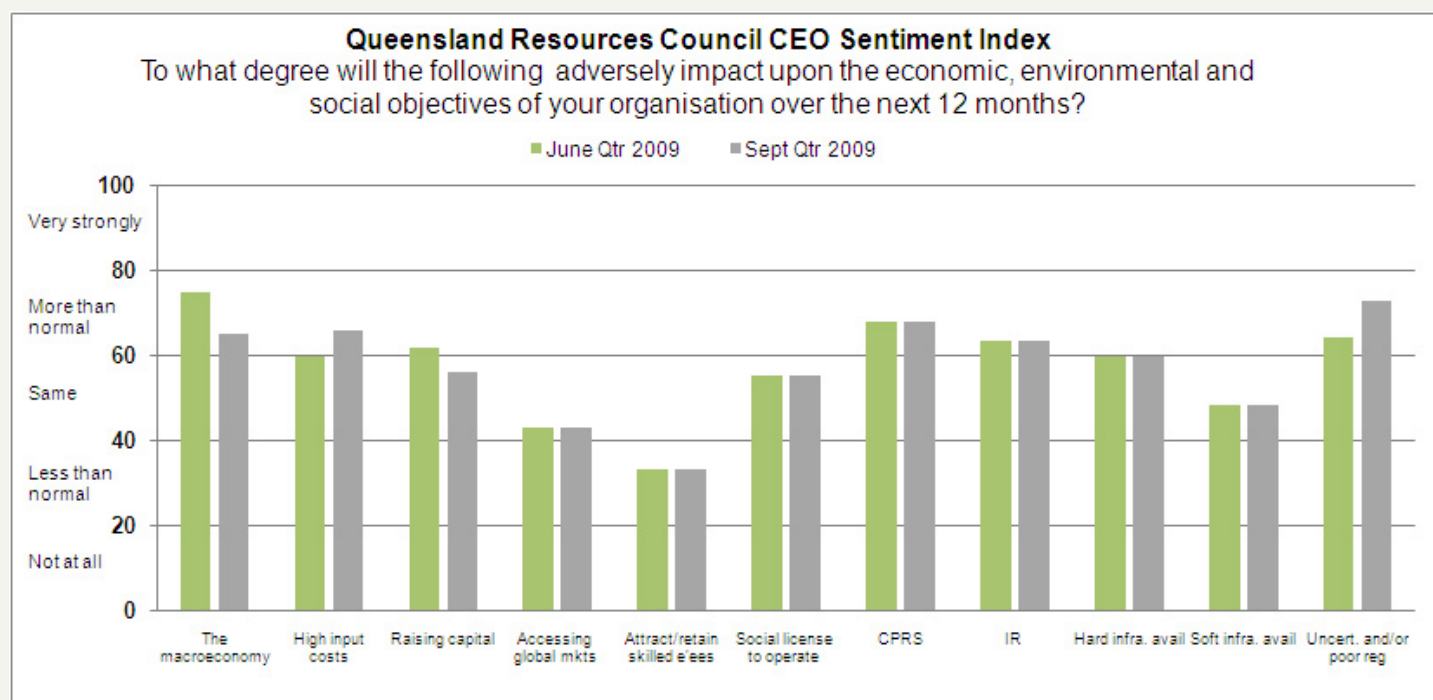
Summary of key findings September Quarter 2009 follow:

- In priority order, issues that will 'very strongly' and 'more than normal' impact on the Queensland resources sector over the next 12 months are uncertain and/or poor regulation, the CPRS, high input costs, the global macroeconomic environment, industrial relations, and hard infrastructure availability.

- Compared with the June Quarter 2009 findings, concerns about the global macroeconomy and raising capital have softened slightly, whilst concerns in relation to uncertain and/or poor regulation have increased.

- The level of concern with accessing global markets, attracting and retaining skilled employees, maintaining social licence to operate, the CPRS, industrial relations, and hard and soft infrastructure availability remained constant.

For more information, contact the Queensland Resources Council on (07) 3295 9560 or <<http://www.qrc.org.au>>.



QRC PROFILE

The Queensland Resources Council is the peak representative body for more than 150 companies with interests in the state's minerals and energy sector. The QRC's 72 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 <http://qrc.org.au>