

COAL, JOB LOSSES AND ROYALTIES: FACING FACTS

BY MICHAEL ROCHE CHIEF EXECUTIVE



With the dust still settling on a state budget that included a much larger than feared royalty hike for coal, all Queenslanders need to understand how our biggest export industry is faring.

Even before the royalty increases announced on 11 September, Queensland's coal industry had not been travelling well.

Prices have slumped by almost half over the past year and

the expected fall in the Australian dollar has not eventuated. Furthermore wage and materials costs have continued to soar.

Far too many Queensland coal mines are now in the higher production cost categories globally.

The combination of 30 percent company income tax and the new royalty rates (without indexation of the coal royalty thresholds) will mean Queensland will carry an effective taxation rate (ETR) of 50 percent on a typical coking coal operation. This will make us the highest taxing coal jurisdiction globally.

Furthermore, if bracket creep is not addressed by indexation the government's commitment of no further coal royalty increases for 10 years will be breached because the sector's effective royalty rates will continue to increase year on year (See feature article below).

In the face of a cost-price squeeze and intensifying competition, coal companies are naturally reviewing current and proposed projects. Job losses resulting from the reviews are in the thousands. In our special edition of the CEO sentiment index survey this quarter we asked both our coal and non-coal producer and developer CEOs for their views on how the royalty increase is likely to affect them. The full results are contained on pages 3-4.

In short, the decision to dramatically increase royalties at

this juncture will have a significant adverse impact on Queensland's coal sector, especially the pipeline of future projects. For a sector that must continually find new projects to offset depleting resources, a stalling of new projects may see us going backwards.

Canberra tax alert

There is mounting concern among resource companies that in a desperate bid for 'surplus-saving' budget revenue, the federal government will drop the axe on the diesel fuel tax credits scheme.

Mining and resources is just one activity in Queensland where fuel is an essential business cost.

Farming, fishing, rail transport, hospitals and construction are among a range of activities in usually remote locations that are eligible for the fuel tax credit.

Claims that the scheme is an 'industry subsidy' have been rejected categorically by the Australian Treasury, yet there is growing concern that this advice will be ignored, adding more than \$2 billion to the tax bills of resources companies in Australia.

New tack on uranium

Queensland's uranium industry has been left behind by the rest of Australia because the former state government was not prepared to talk about the issue.

It is therefore encouraging to see an invitation from new Natural Resources and Mines Minister Andrew Cripps to start a serious discussion.

The publication by two Queensland media networks of an editorial submitted by QRC and the Australian Uranium Association has been greeted with negligible adverse community reaction to date.

This reaffirms national polling that says Australians are more open to discussing uranium mining on its merits since the federal ALP's abandonment of its 'three mines'

IN THIS EDITION:

- Key indicators: QRC Production and Value of Production Indices
- Survey of CEO members – assessing the impact of the royalties increase
- Coal royalties: the indexation imperative
- QRC CEO Sentiment Index





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policy in 2007.

Previous QRC polling found that the overwhelming majority of Queenslanders thought that uranium mining in Queensland was inevitable.

The QRC and AUA are preparing a major report on uranium opportunities in Queensland to be released in coming weeks.



Queensland's Mary Kathleen Mine near Cloncurry operated from 1958-63 and again from 1976-82. About 9.2Mt of ore were processed yielding just under 9000 tonnes of U308.

KEY INDICATORS

QRC PRODUCTION INDEX

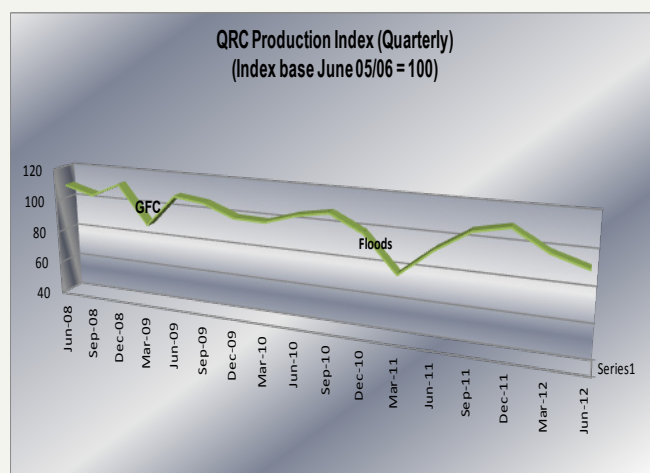
The QRC production index is a composite weighted index that tracks percentage increases and decreases in the total production of Queensland bauxite, alumina, aluminium, coal (all saleable), copper, gold, lead, silver, and zinc quarter to quarter.

The index at the end of the June 2012 (latest available data) reached 93 index points, six points below the March quarter of 99 (June 2006=100). This is another drop and the second quarter since December 2011 (110)

that showed the industry as a whole was just shy of the December 2008 peak of 112 percentage points.

Queensland coal production decreased significantly over the June quarter from 43 Mt to 38 Mt on the back of very weak global demand and oversupply in key destination markets.

More positively, bauxite, silver and zinc production increased, whilst alumina, copper and lead production decreased slightly over the June 2012 quarter.



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 resources sector's total value of production.

The index at the end of the June 2012 quarter (latest available data) reached 113 index points, another significant decline from the previous quarter and an enormous 62 points lower than the December 2011 quarter (June 2006=100).

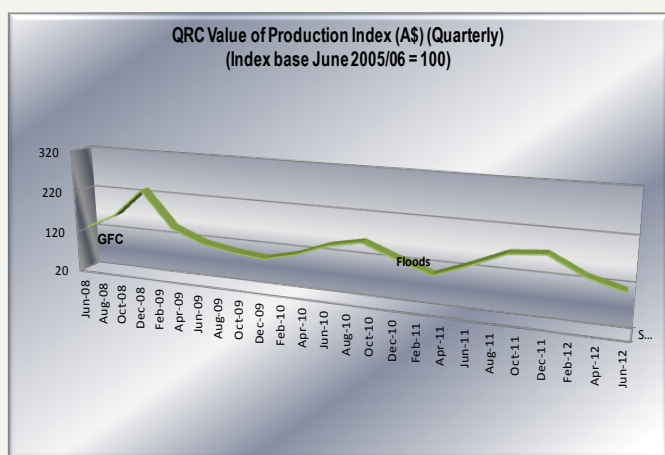
In aggregate terms, the Queensland value of production decreased from A\$9.8 billion in the March 2012 quarter to A\$8.1 billion in the June quarter.

Coal volumes and prices were still the major contributors to the decrease. In particular, average benchmark high quality coking coal prices decreased from A\$183/t in the June quarter compared with A\$216/t in the previous quarter representing a 15 percent decline. Lower quality product is trading significantly below these levels.

Thermal coal prices have also been depressed, with an official benchmark price of around A\$100/t reported, but in reality Queensland producers have been selling for much less to move product. Overall coal value of production was down 23 percent to A\$5.7 billion.

Whilst considered a cyclical downturn, China stimulus, improved global economic conditions, and a need to clear excess tonnages will be needed for price recovery to occur.

Most prices, including gold and base metals (lead, silver, zinc and copper) have dropped slightly, whilst the price for alumina increased.



SURVEY OF QRC CEOS – ASSESSING THE IMPACT OF THE ROYALTIES INCREASE

The proposed changes to Queensland's coal royalty regime are significant and would see the effective royalty rate at A\$175/t increase from 8.3 to 9.7 percent in the first year of implementation.

The changes are expected to raise an additional \$1.6 billion over the first four years. This aggregate royalty rate would increase even further if the coal royalty thresholds were not indexed.

The QRC recently surveyed the CEOs of our full member companies (coal and non-coal) for their views on how the recent royalties increase would be likely to affect their



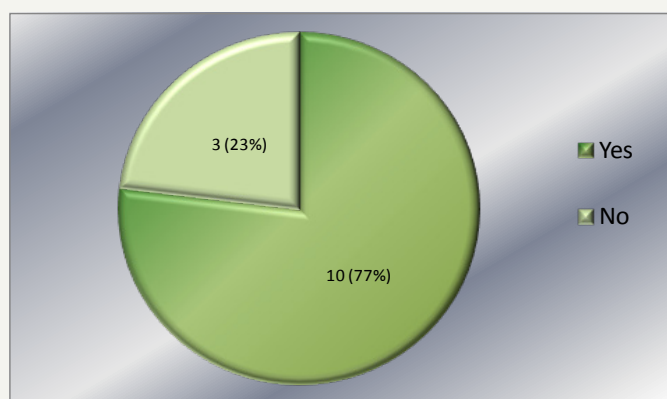
The new royalties will cost coal companies an additional \$1.6 billion over the first four years.

current and future operations, as well as Queensland's sovereign risk profile. A total of 37 company CEOs responded to the survey.

Question 1

For coal producers and developers: will the substantial increase in coal royalties in the recent state budget ...

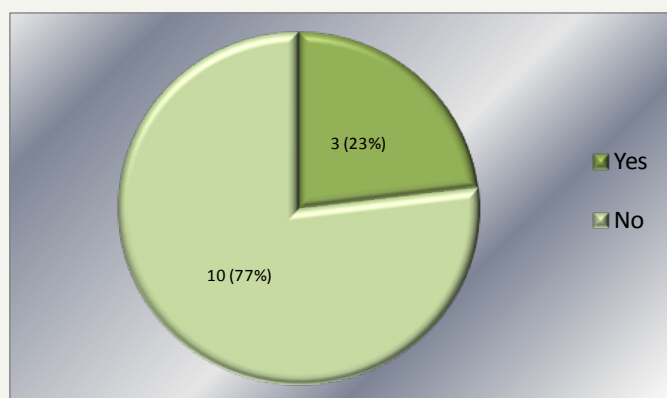
Necessitate measures to effect offsetting savings? (please specify)



Note - those who responded 'no' were coal explorers.

CEOs cited port and rail costs, labour requirements (employees and contractors), and exploration expenditure as likely areas to be reduced.

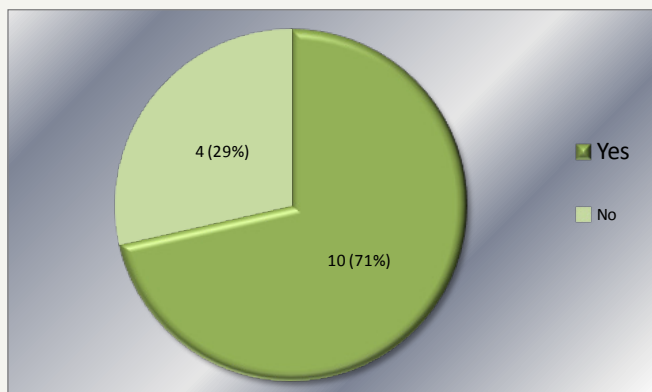
Risk premature closure of existing operations? (please specify)



Note - three of the respondents who answered 'no' were coal explorers and a number of coal producing CEOs who responded 'no' raised the concern that the increase would not be the sole catalyst, but would add to the burden of pressures that materially affect profitability and return on investment.

Harm the economics of proposed projects to the extent of rising project deferral/cancellation? (please specify)

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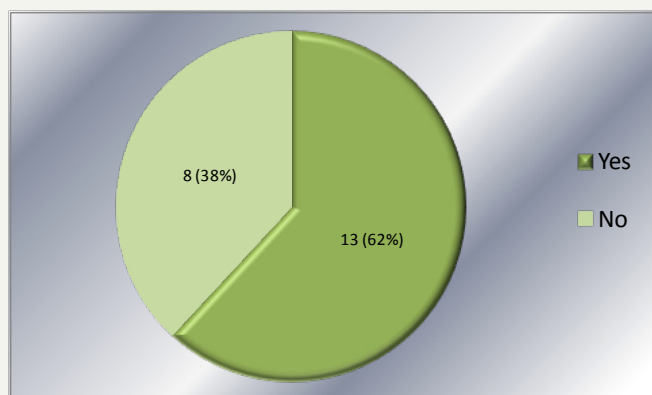


The common response was an unequivocal yes. The increase will considerably influence the economics of proposed projects.

Question 2

For non-coal (including gas) producers and developers: will the substantial increase in coal royalties in the recent State Budget...

Impact investment decisions as a result of concern re sovereign risk and future changes to non-coal royalties?



The common response was that this increase follows a continuing trend of uncertainty in Australia with regard to sovereign risk and uncertainty in planning new projects resulting in capital being directed offshore. Some CEO's expressed concern that the non-coal sectors would be targeted next for a royalties increase given the optimistic revenue forecast in the recent state budget.

COAL ROYALTIES: THE INDEXATION IMPERATIVE

The QRC has made a submission to the state government on the importance of coal royalty threshold indexation.

Inflation causes bracket creep within the royalty regime, increasing the effective royalty rate over time. Without

indexation, bracket creep on royalties due to CPI alone would cause the Tier levels to effectively halve over a typical investment period (\$100 becomes \$48), (\$150 becomes \$73) over 30 years. In effect, more and more revenue will be assessed at the higher 12.5 percent and 15 percent royalty thresholds.

Without indexation, the government would be effectively increasing the royalties every year. For example, without indexation, the effective royalty rate on \$175/t value coal would increase from 9.7 percent to 12.4 percent by the end of the 30-year project.

Increasing effective royalty rates will affect Queensland future coal investments and will have direct impacts on long-term project economics generating low or negative economic indicators such as net present values (NPV) and unsustainable internal rates of return (IRR).

As demonstrated in the example below, indexation has the potential to double the NPV of a typical metallurgical coal project, making it twice as attractive.

Indexation can be implemented by simply inflating the proposed royalty tiers annually by the Australian CPI.

The QRC has also argued that the revenue foregone from preventing royalty bracket creep could be recouped many times over by salvaging a number of new projects otherwise placed in jeopardy by the new coal royalty scale.

	Investment Size	Investment Metrics	NPV
No Royalties	A\$930M nominal (2.6Mt Product)	Price Received – A\$162/t Cost –A\$86/t	267
Current 7% / 10%			83
Proposed 7% / 12.5% / 15%			36
Proposed 7% / 12.5% / 15% with indexation			74

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 'strongly' (score 60-79) adversely impact operations over the next 12 months (September quarter 2012) (with June quarter comparisons):

1 Global macroeconomy (77) = continued global economic uncertainty is depressing demand and prices,

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especially coal (82 previously)

2 High input costs (74) = continued unsustainable wage levels and declining productivity (78 previously)

3 Uncertain and/or poor regulation (includes taxes and royalties) (74) = concern over increasing royalties and continued taxation uncertainties (71 previously)

4 Capital raising (68) = raising capital on the debt and equity markets remains difficult for some (64 previously)

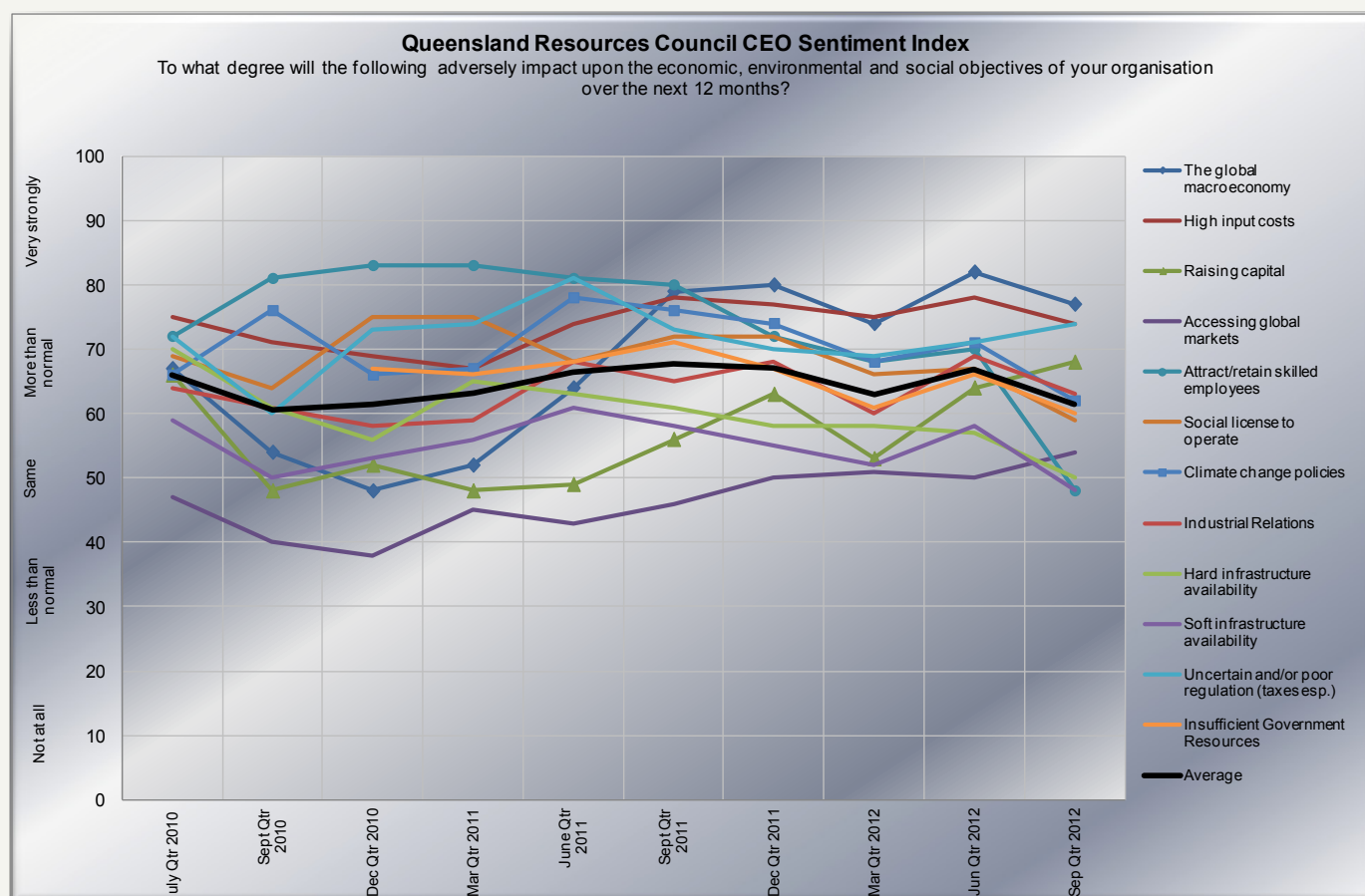
5 Industrial relations (63) = concern over potential industrial disputation over job losses and anticipated

federal election result (69 previously)

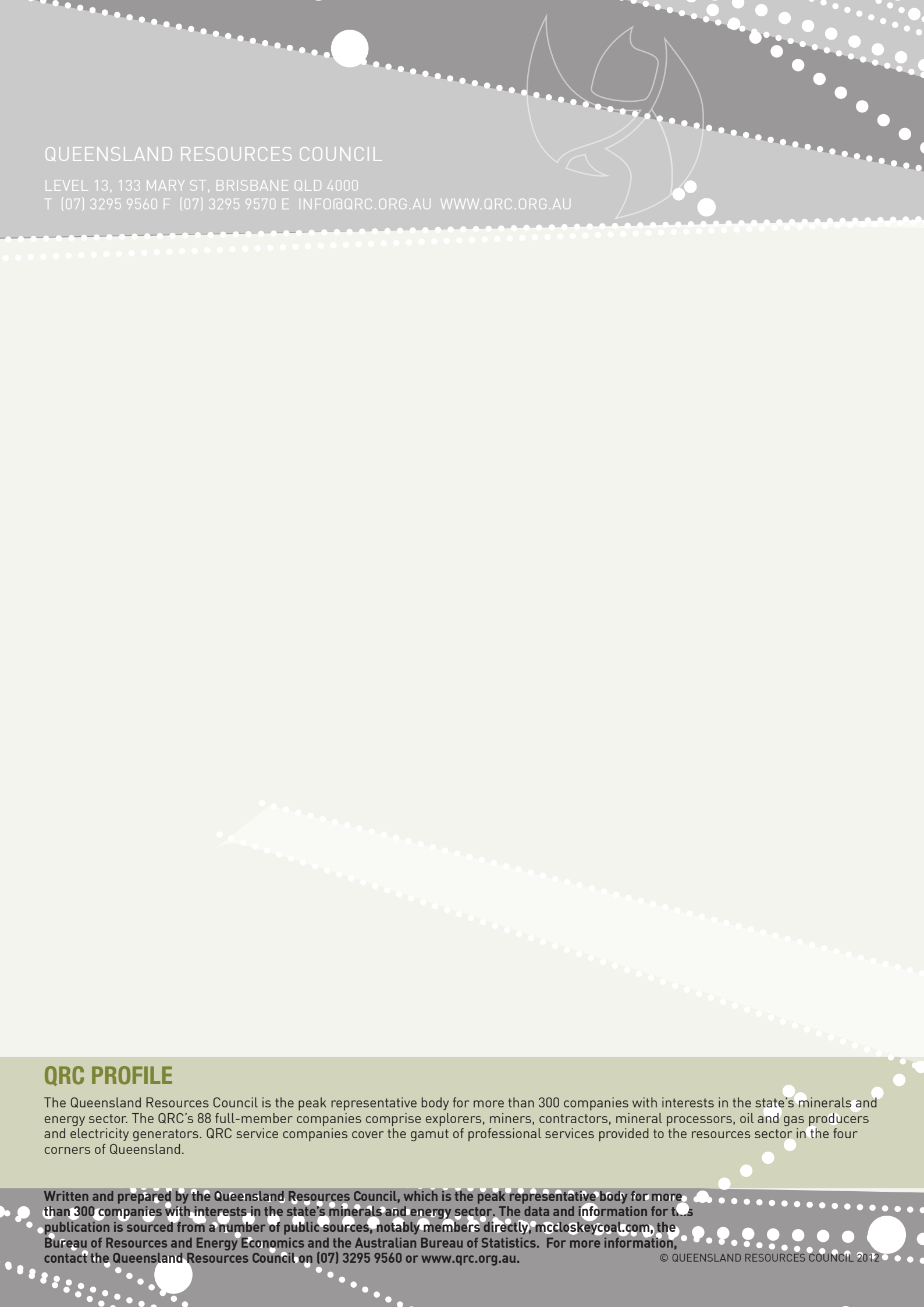
6 Climate change policies (62) = uncertainty about the impact of direct and indirect carbon costs on competitiveness (71 previously)

7 Insufficient government resources (60) = concern over pace of approvals processes (66 previously).

Of note is the significant softening of concerns related to growth – namely attracting and retaining skilled employees (48 from 70 previously) and hard infrastructure availability (50 from 57 previously).



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QRC PROFILE

The Queensland Resources Council is the peak representative body for more than 300 companies with interests in the state's minerals and energy sector. The QRC's 88 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 Queensland Resources Council, which is the peak representative body for more than 300 companies with interests in the state's minerals and energy sector. The data and information for this publication is sourced from a number of public sources, notably members directly, mccloskeycoal.com, the Bureau of Resources and Energy Economics and the Australian Bureau of Statistics. For more information, contact the Queensland Resources Council on (07) 3295 9560 or www.qrc.org.au.

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