QRC SURVEY: UNDERSTANDING THE REAL IMPACTS OF THE RESOURCE SUPER PROFITS TAX (RSPT)

SUMMARY OF FINDINGS
Welcome to this special ‘RSPT’ edition of the QRC’s State of the Sector report where we outline the findings of our recent survey of QRC full members covering coal and other mining, minerals processing, oil and gas production and exploration.

The objective of our survey was to gain a ‘first hand’ account of how the resource super tax will affect both current operations and the viability of future projects. We also asked members how the capital markets, both equity and debt, are responding to the government’s RSPT announcement.

Covering the length and breadth of the resources sector, from small exploration companies to large multi-national operations, the survey results from our respondents are damning of the RSPT.

Impact on current operations
The cumulative tax impost of existing taxes plus the RSPT will result in a substantial increase in effective tax rates. This additional tax burden will increase costs, squeeze margins, and will move companies’ current operations up their respective global cost curves.

Given that resource companies are price takers in global commodity markets, it comes as no surprise that as a result of this severe squeeze on margins, more than nine in ten respondents concluded that it would be ‘highly likely’ or ‘likely’ that their competitiveness in global markets would be adversely affected.

Furthermore, with lower margins, a clear majority of respondents indicated that it was either ‘highly likely’ or ‘likely’ that constraints on wages (69 percent) and expenditure on community infrastructure (73 percent), would occur.

Significantly, nearly half (46 percent) of respondents said that it was ‘highly likely’ or ‘likely’ the RSPT would cause operations to be scaled back and 16 per cent also said that it was ‘likely’ that shutdowns would occur.

Impact on future projects
Our survey found that the RSPT would have a crippling impact on future projects. The RSPT is a punitive tax because it applies a very high ‘headline’ rate (ie the 40 percent) on a very narrow capital base as the basis of the RSPT calculation.

The combination of the high headline tax rate, a very low uplift allowance (ie the long term government bond rate of about 6 percent), and normal depreciation of capital costs, means that future projects are liable for very high levels of tax early in the project mine life (and certainly much sooner than under the existing petroleum resource rent tax).

Large tax liabilities early in a project severely erode the value of a project both in Net Present Value and Internal Rate of Return terms. If project valuations fail to meet a company’s cost of capital and the internal ‘hurdle rate’, the project will generally not proceed.

Survey respondents supplied information on proposed (brown and greenfield) projects that were under study or under consideration before 2 May 2010. They reported that more than half (53 percent) of these future projects were either ‘highly likely’ or ‘likely’ to be under threat if the RSPT were to proceed as proposed.

The aggregated foregone socio-economic benefits to Queensland of these projects not proceeding would comprise:

- $25.3 billion in capital expenditure
- 10,400 full-time equivalent construction jobs
- 4520 full-time equivalent operational jobs.

Given the strong employment and economic ‘value add’ multipliers associated with minerals and energy construction and operational activities, coupled with foregone royalties and company tax contributions, the adverse consequences for the Queensland economy are immense.

The bad news does not stop there.
A further 41 percent of future projects covered by the survey responses remain under a cloud with respondents indicating that ‘it cannot be determined (yet)’ if they are under threat.

This may reflect the fact that these projects are close to internal hurdle rates and/or the impact of the RSPT is not clear. The value of these projects was $18.5 billion, involving 5150 construction jobs and 1000 operational...
Highly
36%
7.7%
3.8%
40%
23.1%
0%
16%
0.0%
0%
42.3%
8%
0.0%
53.8%
0.0%
46.2%
26.9%
46.2%
0%
26.9%
7.7%
26.9%
26.9%
Question 3
Are there any other impacts that a higher effective tax rate will have on your current operation/s?

- ‘Reduced capacity to undertake exploration activity. Difficulty raising external finance. Reduced ability to raise equity from investors’ (Mining company with a 2008/09 turnover of $0.7 billion and employing 1000 full time equivalent staff)
- ‘Significant potential for a decline in our ability to raise future capital’ (Exploration company with a 2008/09 turnover of $5 million and 8 full time equivalent staff)
- ‘Make much more difficult to obtain finance plus more likely to high grade project to maintain margins which will reduce project size and duration and leave behind medium and low grade resources’. (Exploration company)
- ‘Less likely to move from exploration to production’. (Exploration company with a 2008/09 turnover of $6 million and six full-time equivalent staff)
- ‘Capital raising potential slashed due to record low market capitalisation of explorers, new projects put on hold’. (Exploration company)
- ‘Likelihood of Australian operations having less access to capital in order to fund new operations or expand existing operations as capital may be given to operations in other jurisdictions as return on that capital is higher’. (Mining company with a 2008/09 turnover of $2.7 billion and employing 3462 full-time equivalent staff)
- ‘The higher tax rate reduces future cashflows making investment less attractive’. (Exploration company with 15 full-time equivalent staff)
- ‘Impact negatively on debt covenants, will need to renegotiate debt arrangements. Pass through costs (including taxes and royalties pass though) to domestic customers will also have to be reviewed [these are essentially government organisations]. Potential deferrals of major capital programs (stay in business capex) to maximise RSPT outcomes will delay decision making. Contractor mines and capital structures are at risk, due to the capital allowances not available on contractor capital’. (Mining company with a 2008/09 turnover of $2 billion and employing 1215 full-time equivalent staff)

IMPACT OF THE RSPT ON NEW PROJECTS

Question 4
Please complete this question if your company had a significant ‘new project’ (either brownfield expansion or greenfield) under study or under consideration (ie no final decision made) prior to 2 May 2010. Assuming the RSPT is passed as currently proposed, is your project under threat?

Respondents were asked to provide certain details of these projects, including commodity, proposed capital expenditure, expected full time equivalent workforce during the construction and operational phases, and all things being equal, the Net Present Value, Internal Rate of Return and Effective Tax Rate of the project pre and post RSPT implementation.

<table>
<thead>
<tr>
<th></th>
<th>Highly likely</th>
<th>Likely</th>
<th>Cannot yet be determined</th>
<th>Unlikely</th>
<th>Highly unlikely</th>
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<tr>
<td>11.8%</td>
<td>41.2%</td>
<td>41.2%</td>
<td>5.9%</td>
<td>0%</td>
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For those projects considered ‘highly likely’ and ‘likely’ to be under threat due to the RSPT, the aggregated foregone socio-economic benefits to Queensland would be:

- $25.335 billion in capital expenditure
- 10,400 full-time equivalent construction jobs
- 4520 full-time equivalent operational jobs

Question 5
Are there any other comments you would like to make in terms of the likely impact of the RSPT on new projects?

‘Uncertainty around this tax regime has raised the sovereign risk for Australia as a whole. Other projects around the globe are becoming more attractive. Locking in long lead time capital items for projects in this uncertain environment will be almost impossible. We will also have to review capital ownership structures especially around owner/contractor operator operations.’ (Mining company with a 2008/09 turnover of $2.1 billion and employing 1215 full-time equivalent staff)

‘A large Queensland mining company with multi-billion dollar turnover has 10 projects proposed for development to support export growth. The timing and economics of growth projects remain highly uncertain in light of the proposed new tax.’

INVESTMENT ATTRACTIVENESS AND THE CAPITAL MARKETS

Question 6
What will be the likely reaction of the debt and equity capital markets if the RSPT is passed as currently proposed?

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<th>Highly likely</th>
<th>Likely</th>
<th>Can’t yet be determined</th>
<th>Unlikely</th>
<th>Highly unlikely</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt capital may flow to other countries because of the perceived increase in sovereign risk</td>
<td>50%</td>
<td>35%</td>
<td>10%</td>
<td>5%</td>
<td>0%</td>
</tr>
<tr>
<td>Debt capital may flow to other countries because returns to capital are likely to be higher</td>
<td>55%</td>
<td>35%</td>
<td>10%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>
Highly likely | Likely | Can't yet be determined | Unlikely | Highly unlikely
--- | --- | --- | --- | ---
Debt capital may be more expensive - reflecting greater risk | 50% | 40% | 10 | 0% | 0%
Debt capital may be less expensive because markets will begin to 'value' the guaranteed tax credits when a project winds up | 0% | 0% | 0% | 50% | 50%
Equity capital may flow to countries instead of Australia due to expectation of lower earnings and lower dividends | 50% | 50% | 0% | 0% | 0%
Capital may flow to Australia as it did before the 2 May announcement | 0.0% | 0% | 10% | 50% | 40%

Question 7
Are there any other likely unintended consequences if the RSPT was enacted as currently proposed?

• 'Issues concerning the RSPT and existing financing arrangements, especially in connection to debt covenants. Diminished ability to generate franking credits which further reduce investment attractiveness.' [Mining company with a 2008/09 turnover of $0.77 billion and employing 1000 full-time equivalent staff]

• 'I think resource sector will be hit hard with investment flowing from Australian resource sector to other overseas resource sectors, and domestic sectors eg financial, plus super funds will be hit. Investors chase the best returns - the Australian resource sector having new RSPT providing total taxes of 57 percent is not attractive nor competitive.' [Exploration company with 12 full-time equivalent staff]

• 'It is the contractors that have to build the new projects. From the multinationals point of view they don’t really care whether an Australian project or outside Australia gets through their project approval hoops. It’s just hard economics. They don’t really have jobs and the company existence at stake. For the big guys it is ‘where will I invest? For local contractors it is ‘how can I exist if they don’t invest or even if they stall their investment?’ [Contract mining company with a 2008/09 turnover of $0.77 billion and employing 1000 full-time equivalent staff]

• 'The RSPT would negatively tinker with the whole DNA of mining investment across a range of ‘real world’ impacts that have not been understood by people that have no experience or understanding of how mining investment works.' [Exploration company with a 2008/09 turnover of $6 million and six full-time equivalent staff]

• 'These affects are already happening.’ [Exploration company with a 2008/09 turnover of $6 million and six full-time equivalent staff]

• 'Issues concerning the RSPT and existing financing arrangements, especially in connection to debt covenants. Diminished ability to generate franking credits, which further reduce investment attractiveness.' [Mining company with a 2008/09 turnover of $2.77 billion and employing 1000 full-time equivalent staff]

• 'The Australian mining community is a global hub of excellence. When third-world countries see what Australia is doing [if the RSPT becomes tax law] similar regimes will be introduced. This will erode margins on mining globally and have a negative impact on the whole industry.' [Exploration company with 2570 full-time equivalent staff]

• 'We note that one of the objectives of the Henry Review of the Australian tax system was to make it simpler. With several thousand mining operations in Australia due to conclude that this proposal is unlikely to achieve the objective of simplicity.' [Mining company with 2570 full-time equivalent staff]

• 'Impacts on major long-term contracts with state governments negotiated in 2004 and 2005 and running to 2025 and 2030 respectively, which were negotiated/price on the basis that only the states would collect resource rent.' [Mining company with a 2008/09 turnover of $2.4 billion and employing 1215 full-time equivalent staff]

• 'General nervousness amongst our shareholders on how this will impact growth prospects. Generally share prices have dropped by 20 percent as a result of the uncertain sovereign regime.' [Mining company with a 2008/09 turnover of $2.1 billion and employing 1215 full-time equivalent staff]