Q.C.T. MANAGEMENT LIMITED

An address by

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General Manager, To The Securities Institute of Australia,
New South Wales Division, Sydney, March 6, 1986.

The Joint Ventures which comprise QCT's only investment encompass 6 large open pit coking coal mines and a trial underground colliery in the Bowen Basin. Nameplate capacity of these properties is 25.9 million sales tonnes.

The first mine, Blackwater, was established by Utah alone, at the south of the Basin. It ships through Gladstone.

Four were established by Utah and Mitsubishi as the original Central Queensland Coal Associates. These commenced from Goonyella in the north in the late 1960's, working south to Norwich Park in the late 1970's. Norwick Park is the farthest from the CQCA Joint Venture's port of Hay Point near Mackay.

The last mine, Gregory, was established at the south relatively recently by BHP. It also ships through Gladstone.

The trial underground colliery, Harrow Creek, reports with Peak Downs in Central Queensland Coal Associates.

There are two as yet undeveloped properties at Daunia and Isaac River.

Historical Background

In discussing the Queensland Coal Trust, it is probably essential to sketch the history of joint venturers since 1970, and in particular the history of Umal Consolidated Limited, the forerunner to the Trust.

Utah Mining Australia Limited was set up as an Australian company to own 10 per cent of Utah Development Company in the early 1970's. In the mid 1970's it increased this holding to 10.8 per cent, and purchased a 4 per cent direct interest in the four CQCA mines at the same time as the AMP acquired 7.75 per cent. In 1979 the company adopted the name Umal Consolidated Limited (UCL). Throughout 1983 the company was pivotal in the BHP negotiations for the takeover of Utah. The reason for this was two-fold:

1. BHP wanted the UDC shares owned by UCL, so as to own 100 per cent of Utah. These were obtainable through negotiation or by takeover.
2. UCL as an existing joint venturer had certain rights along with other joint venturers to approve or disapprove of BHP plans for the old CQCA joint venture. BHP was after all the new entrant.

The possibility of changing UCL to a unit trust was considered in late 1982 but one reason this was not practically achievable was that translation of the shareholding in Utah to direct interest in the joint venture would involve large taxation consequences. The whole game changed when BHP and GE agreed in principle to a sale of GE's interest in early 1983. The outcome is a matter of history, BHP, by agreement with UCL on a concept developed in July 1983 set up the Queensland Coal Trust in January 1984. This vehicle made a takeover bid for UCL offering fully subscribed trust units in exchange for Umal shares. UCL still exists as a BHP company.

The Queensland Coal Trust in April 1984 comprised 352 million units via the takeover route and 100 million units via new public issue. In addition the Trust borrowed US$182 million. All of the funds were used to purchase a 21.75 per cent interest in two joint ventures:

- The "new" CQCA Joint Venture, comprising Blackwater and the four "old" CQCA mines. Joint Venturers are the BHP group via the Utah Division being the Manager and Sales Agent, Mitsubishi, QCT, AMP, Bell and Pancontinental.
- The Gregory Joint Venture, comprising the Gregory mine only. This became a separate Joint Venture in 1984 as Mitsubishi chose not to take an interest.

QCT as at 28 February 1986 had issued approximately 480 million units, increasing from 452 million 2 years ago because of distribution reinvestment.

Joint Venture Operations

These highly competitive operations have the following hallmarks:

(a) A wide spectrum of coal types allowing for great flexibility in marketing over the whole range of coking coals, and also thermal coal.

(b) Costs are low, reinforced by the low value of the $A, enabling competitive tendering anywhere in the world.

(c) Utah management of the operations has a name for performance and reliability, (although any industrial stoppages do nothing for the reliability reputation with customers).

(d) Spare capacity exists now within name plate capacity of 25.9 million tonnes per year. Marginal capacity increases make sense in today's climate, being low in establishment cost per tonne and low in overall incremental outlay.

On this basis, one incremental investment is being made in Goonyella ("Cleanskin") recently announced to take name plate capacity to a total of 27 million tonnes per year, up 1.1 million tonnes per year.

(e) Reserves are adequate to support long term operations, and long term infrastructure agreements are in place to achieve that.

(f) There are two undeveloped properties, at Daunia and Isaac River for future investment.

Markets

The steel industry faces slow demand growth overall, although today's growth looks better than average. Coking coal around the world is generally in oversupply, but this varies for different coal types. The low-volatile coals are in particular oversupply and this affects Norwich Park's ability to find coking markets. Goonyella coal an the other had has always been in strong demand, and there are further sales opportunities for coal of this type. It is this factor that led to the "Cleanskin" pit expansion being commenced now, at a capital cost of $80m, plus establishment cost of an operating nature.

The new mines in Canada, Queensland and USSR are abtaining access to the Japan market at the expense of traditional suppliers like ourselves as the Japanese demand is fairly static. Diversification of sales has been pursued to the extent that within a couple of years Japan now accounts for about 47 per cent of sales, down from more than 60 per cent. Loss of 1 million tonnes into Japan last year was more than offset by an increase of 1.9 million tonnes in shipments to other countries. Part of this increase in shipments is due to sales of thermal coal.

The present sales outlook is for increased shipments against intense competition. In this context, US$ prices which are steady or have fallen, are not expected to strengthen in the short to medium term.

Sales of thermal coal are expected to continue to contribute towards a strong performance, although reduced oil prices will place these prices under pressure. However reduced oil prices if they persist might also stimulate steel and therefore coking coal demand.

Taxation, Government Charges, Industrial Relations

There is inadequate recognition generally from unions, government and the population at large that the coal industry is unsubsidised, and locked in competition with the world.

(a) Government charges overall show no signs of abating. Major costs like rail freight (which contains a substantial profit element — say about 7 cents/QCT unit/year) were freely entered into.

However in 1975 a Coal Exports Duty was unilaterally introduced to apply to selected types of high quality coal. In effect it taxed Queensland operations. This discriminatory Duty has now been so amended and specialised in its discimination that the $3.50 per tonne of applicable coal is charged *only* on coal exported from Joint Ventures. This is clearly inequitable, as it dampens the Joint Venturers' ability to compete in diversified markets, on which we are dependent for growth, or even for stable sales.

Now a fringe benefits tax is to apply which hits employers of remote area operations and in particular mining. Costs to the Joint Venturers could be up to $10 million per year, depending on deemed rental value of housing.

The industry is a very large export earner, but it cannot stand unlimited growth of government share of income. Again, distant markets suffer first, and apart from being our livelihood, they are closer anyway to our competition.

(b) Industrial relations have been relatively quiet in the coal area until the recent productivity claim. A shut down of operations with consequent loss of sales will do more to jeopardise the growth and prosperity of the coal industry than almost any other factor. Our customers depend on us for a vital raw material. When denied reliable supplies they naturally look to reliable supplies elsewhere. They do not owe us a living.

(c) The September 1985 announcement by the Treasurer of company tax to apply to public trading trusts is even nearer to QCT's heart. The Trust commenced operations less than two years ago, after careful attention to obtaining a Treasurer's favourable ruling, published in the prospectus. The plan to tax public trading trusts is discriminatory in that it leaves almost all public trusts untaxed. It is also retrospective given the basis for setting up the QCT. As one investor was quoted, it was the only retrospective part of the tax package.

Strenuous representations to all parties including Government and Opposition, while meeting pockets of sympathy, failed to obtain support for a "grandfather" clause to operate, probably as aggregate unit holders of those affected was too small at 80,000 to be a political factor.

It would be interesting to know how many institutional investors supported our position?

The result is now that we expect to be taxed from 1988. Directors are examining what this means for the future of QCT. The tax status of various types of owners will be explored and taken into account. It could be for example that tax exempt institutions on balance would favour some capital growth from retained earnings as opposed to maximum distributions.

Distribution Reinvestment Plan

This plan was instituted in 1984 and support by unit holders has been most gratifying to Directors. Units were issued at a 7.5 per cent discount to unit holders who elected in February and August 1985, and February 1986, to reinvest 26.5 per cent, 27.1 per cent and 29.2 per cent respectively of the total distributions at those dates. Capital so raised by the Trust amounted to $37.6 millions, and has contributed towards capital needed for investments discussed elsewhere in this talk.

Purchase of 3.25 per cent Interest

Papers have recently been mailed for a 17 March meeting of unit holders to vote on this acquisiton. It has been a drawn out affair because the purchase of the Blackwater Mine had to be excluded for this present exercise on the basis of excessive transaction cost to the Trust.

Borrowings

The Trust participates with the BHP Group and Pancontinental in Production Loan & Credit Agreements arranged by BHP for the purchase of Joint Venture interests in April 1984. Within the total facility of US$ 785 million, the Trust borrowed US$ 182.3 million with capital repayments commencing in May 1985. Principal outstanding at 31 December 1985 was US$ 173.2 million. Details are included in the financial statements. Expressly to provide for purchase of a further 3.25 per cent interest in Joint Ventures, a mandate was awarded for arrangement of a US$ 45 million unsecured facility for the Trust, unconnected with the earlier borrowing. This will only be drawn for purchase of this additional Joint Venture interest.

Currency

It would not surprise you if the average exchange rate for 1985 shipments were marginally below US$0.70 whereas in 1984 it was US$0.84. This further significant weakening of the Australian dollar again increased A$ revenues over the period, as practically all the Trust's coal revenues are in US dollars. Despite higher A$ interest costs on US$ borrowings, and a weakening of US$ coal prices, the net effect on profits was favourable. Changes in A$/US$ exchange rates are not fully reflected in Trust revenues as some contracts, notably into Japan, have a proportion of revenue tied to fixed exchange rates. However the dampening effect of this factor diminishes with a diminishing share of shipments to Japan. At present about 80 per cent of exchange rate changes flow on to QCT. It could move towards 100 per cent in time if more contracts move to annual pricing.

The Trust is vulnerable to a unilateral increase in the value of the A$. This is considered unlikely to happen.

If the US$ unilaterally devalues against other currencies, including the A$, there could be an offsetting increase of US$ coal prices, lessening the impact on the Trust.

Summary

So to summarise, we have coal resource without equal in the world, on quality, price and reserves which is well managed by Utah and has a good reputation in the marketplace.

QCT sees expanding market share for the Joint Venturers, against fierce competition.