Incitec Pivot Limited

Incitec Pivot Limited submission to the Australian Competition & Consumer Commission's East Coast Gas Inquiry into the competitiveness of wholesale gas prices and structure of the gas industry in Eastern Australia.

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Introduction

IPL welcomes the opportunity to provide a submission to the East Coast Gas Inquiry and supports the objective of ensuring a functional east coast gas market which encourages both growing a LNG export industry and growth in value-adding domestic industries.

Australia's east coast gas market has undergone a profound structural change, caused primarily by the rapid development of a coal seam gas (CSG) to liquefied natural gas (LNG) export industry. This world first technology, aimed at commercialising Queensland's' extensive CSG resources, is on a scale of magnitude larger than any previous use for gas in Eastern Australia's history.

While there are significant benefits to Australia of a major new liquefied natural gas industry, this unprecedented rise in demand for gas for export to Asia has had and will continue to have a substantial impact on domestic downstream gas users.

As a whole, participants in the Australian CSG to LNG industry overcommitted to LNG sales based on their reserves positions. As a result, over the last five years, participants in the LNG industry have become significant purchasers of gas in the east coast market. The over commitment of current LNG reserves together with the associated acquisition of gas previously aligned with domestic supply has meant that the domestic market now faces significant supply uncertainty.

Recent modelling by Deloitte Access Economics[1] shows that supply constraints, market dysfunction and higher gas prices will have impacts across the economy including mining, agriculture, electricity and water, construction and trade, transport and commercial & services. In IPL's case, the result is a higher cost base reducing our competitiveness in providing products to Australia's agricultural and resources industries.

[1] Deloitte Access Economics '*Gas market transformations – Economic consequences for the manufacturing sector'* July 2014

About Incitec Pivot Limited

Incitec Pivot Limited is an ASX 50 company that manufactures, markets and distributes a range of explosives, fertilisers and related products and services through the Incitec Pivot Fertilisers and Dyno Nobel brands to customers in Australia, North America and a number of other countries across Asia, Europe and South America, employing approximately 5,000 staff worldwide.

Australian east coast manufacturing operations – gas intensive manufacturing

Mt Isa, Queensland: Sulphuric Acid – 1000kpta
Employees: 50

Phosphate Hill, Qld: ammonium phosphates – 950kpta
Employees: 450+

Moranbah, Queensland: ammonium nitrate – 330kpta
Employees: 100

Gibson Island: urea 280ktpa, ammonia 300ktpa, ammonium sulphate – 200ktpa kpta
Employees: 400+

Incitec Pivot Fertilisers

Under the Incitec Pivot Fertilisers brand, IPL is a manufacturer and distributor of fertilisers on the east coast of Australia, dispatching around 2 million tonnes each year for use in the Australian grain, cotton, pasture, dairy, sugar and horticulture industries. In addition IPL sells manufactured fertiliser into offshore markets including Asia, South-East Asia and Latin America.

In Australia, IPL operates urea and ammonium phosphate fertiliser manufacturing facilities at Gibson Island, Brisbane and Phosphate Hill in North West Queensland. It also operates single superphosphate fertiliser plants at Geelong and Portland in Victoria. The plants are strategically located to service key agricultural regions. The Queensland facilities are also uniquely positioned to support the future agricultural development of northern Australia.

Dyno Nobel Asia Pacific

IPL's Dyno Nobel Asia Pacific business is a producer and distributor by volume of industrial explosives and related products and services in the Asia-Pacific region. IPL operates a 330,000 tonne ammonium nitrate manufacturing facility in Moranbah, Queensland. The Moranbah plant is strategically placed to service the metallurgical coal mines of the Bowen Basin. On 8 July 2015, IPL made an ASX announcement advising of a gas supply reduction at Moranbah.

IPL's manufacturing plants are part of large value chains, delivering regional employment, distribution and services that support the Australian resources and agricultural sectors.

IPL and natural gas - a critical feedstock for our business

Natural gas is the basic feedstock in the production of ammonia, and therefore an essential ingredient for nearly all nitrogen-based fertilisers (such as urea and ammonium phosphates) and ammonium nitrate explosives. Natural gas accounts for up to 80% of the cost of ammonia manufacture.

IPL's annual gas consumption is approximately 31-33PJ, which equates to approximately 5% of the existing East Coast domestic gas market.

Gas costs substantially affect the cost of manufacturing nitrogen-based fertilisers and explosives. Gas for ammonia production cannot be substituted with any other energy source therefore IPL requires gas on terms that support a manufacturing operation, which maintains the ongoing economic viability of those plants.

IPL identified likely structural changes in the gas market several years ago and concluded that, as the LNG industry ramped up, domestic gas prices were increasingly likely to be based on an equivalent LNG netback price.

Further, over the past few years we have observed a change in the domestic market. Our view is that this change has been caused by the following factors: an increase in demand which can be seen by the ramp up of the LNG projects, the limited number of suppliers in the marketplace, the concentration or consolidation of gas reserves and the limited availability of new reserves for the domestic market. If we look at the LNG projects, these projects are estimated to require additional gas supplies of over 2000PJpa to meet their export needs. The significant increase in demand by the LNG industry has led to the LNG industry becoming an acquirer of gas for export and reserving acreages for future development to meet the LNG export demand.

As an example of the impact of the change in the domestic market, we have experienced increased gas costs for our Phosphate Hill fertiliser plant. Indeed, as previously announced to the ASX, in the 2015 calendar year, higher gas costs will increase IPL's manufacturing costs at the plant by $50 million.[2]

Creating a functioning gas market in Eastern Australia

For some time IPL has argued that Australia must seize the opportunity before it through the development of Federal and State Government policies which encourage both the growth of LNG exports and a competitive domestic gas market that fosters value-adding domestic industries.

Australia has a number of energy options, including abundant gas and the challenge is to create policies which respond to the national interest and provide for the management of Australia's gas resources for the greatest benefit of the "owners" of the resource, the people of Australia.

This can be achieved through the establishment of an efficient, competitive Australian domestic gas market as well as an LNG export industry.

[2] See IPL ASX Announcement dated 19 December 2013.

IPL concurs with the principal in the Eastern Australian Domestic Gas Market Study that:

> *"The purpose of gas market reform is to promote gas markets in the long term interests of consumers in accordance with the National Gas Objective (which covers residential, commercial and industrial users including making LNG)."*[3]

IPL believes that a functioning eastern Australian domestic gas market could be advanced by:

- The encouragement of competition by supporting new suppliers into the Australian market.
- Encourage new entrants into gas production by preferentially allocating new acreages to companies for domestic supply.
- Apply and enforce a "use it or lose it" policy for acreage to prevent companies from 'warehousing' reserves of gas.
- Establish mechanisms for greater transparency in gas pricing and supply.
- Encourage development of gas transport infrastructure and the development of new infrastructure such as the north east gas interconnector.

Australia and the USA – a stark contrast in markets

IPL has had recent experience in two gas markets – Australia and the United States of America (USA). The USA gas market is a benchmark for a competitive market. The USA has been able to capture a significant energy advantage through a combination of a highly competitive market place and supportive government policy.

This is in contrast to IPL's recent experience in procuring gas in Australia with significantly higher prices than previously experienced in the east coast market and increasingly onerous contract terms.

[3] Eastern Australian Gas Market Study, Australian Government Department of Industry – Bureau of Resources and Energy Economics, 2013, page 96.

Case Study: Phosphate Hill – part of a manufacturing value chain in north Queensland

IPL operates a world scale ammonium phosphate fertiliser manufacturing plant at Phosphate Hill (160 kilometres from Mount Isa) and a sulphuric acid plant in Mount Isa. Natural gas is essential in the manufacture of ammonium phosphate fertilisers and is the largest input cost of the manufactured cost of the finished product; therefore any rise in the price of natural gas has a significant impact on the economics of this operation.

In the 2013/14 financial year IPL employed more than 850 people in north west Queensland (at Phosphate Hill and Mt Isa together with operations in Townsville) generating a total of more than $97 million in wages and salaries. IPL's total employment contribution in north-west Queensland, both direct and indirect, is more than 2,500 jobs.

IPL's north Queensland plants form part of a broader manufacturing value chain which stretches across northern Queensland. This value chain includes the Mt Isa Mines (MIM) copper smelter as well as the Sun Metals refinery in Townsville (from which IPL purchases sulphuric acid), road and rail services and associated engineering and utilities services.

These plants operate through a symbiotic relationship. For example the MIM copper smelter provides affordable inputs, through the utilisation of a waste product of MIM's operations, into the IPL sulphuric acid plant at Mount Isa. The Mount Isa sulphuric acid plant in turn provides affordable sulphuric acid to the IPL fertiliser plant at Phosphate Hill. Each of these components is as important as the next and the success of one is vital to the success of all.

The ability of IPL to secure gas for the Phosphate Hill operation is a key part of ensuring this value chain continues to deliver employment and economic benefits to regional north Queensland.