24 August 2016

Mr P Lindwall
c/- Regulation of Australian Agriculture
Productivity Commission
Locked Bag 2
Collins Street
MELBOURNE VIC 8003

Dear Paul,

RE: Productivity Commission - Draft Report on Regulation of Agriculture in Australia

The recent draft report released by the Productivity Commission has drawn a wide range of commentary from numerous parties, some within a particular agricultural industry and others external to a particular industry and it really does depend on what side of the fence one sits, as to how the Commission's report is received.

North Queensland Bio-Energy Corporation Limited (NQBE) has received Federal and Queensland State government Development Approval for the construction of a new "state of the art" sugar cane based renewable energy Facility in Ingham, North Queensland, Australia.

The Facility will process up to 3.1mt of sugar cane per annum to produce up to 420,000 tonnes of raw sugar crystal, have the capacity to produce 200,000 litres of ethanol per day (60ml per annum) AND have an installed renewable power generation capacity of 150MW per hour.

The NQBE Facility represents a significant "step change" for the sugar industry, an industry that has (both from a miller and grower representative perspective) predominately focused on raw sugar crystal production only, with very little appetite or vision for diversification.

The submissions by the QLD CANEGROWERS organisation, CANEGROWERS Herbert River and Wilmar Sugar Australia (Wilmar) provide interesting reading on the sugar industry background and the marketing arrangements up to the end of the 2016 sugar crushing season, as well as providing an insight as to where the millers (Wilmar Sugar, Mitr Phol and (Cofco) see the potential for increasing their own profitability, not only by marketing their own Economic Interest in sugar, but also by marketing the economic interest of the growers (which represents approximately two-thirds of the total sugar volume produced).

Interestingly enough, both miller and grower representative bodies submissions concentrate on the marketing arrangements for raw sugar crystal AND NOT on the other aspects of diversification that the industry could pursue to improve the revenue stream from the waste produce of the raw sugar produced, over which they are arguing about marketing rights!!

NQBE fully understands the issues surround transparency, particularly when one company is potentially the miller, the marketer and the transporter of raw sugar to particular destinations, as well as possibly a refinery owner. There is the issue of arbitrage sharing within the marketing of the sugar and growers having a degree of confidence in a system that provides the required confidence and transparency in relation to what was the "actual" selling price of the raw sugar.

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The Wilmar Sugar Australia submission to the Productivity Commission dated 9 October 2015 raised a number of concerns for NQBE.

The points of concern are as follows:

- Wilmar states in its submission summary on page 3, that forcibly removing a miller's ability to market and sell the product it makes is an "extreme proposal". It must be remembered that the mill only owns about one-third of the revenue value from the total sugar marketed. The other two-thirds of the value (which is set out in the cane pricing formula) belongs to the growers.

  If the grower believes that they can make more money by having a third party market their grower interest in the sugar, then that option should be available to the growers.

  If the miller could demonstrate that the checks and balances for a transparent marketing program were in place and could in fact do a better job than their competitors, the miller would win the marketing rights from the growers, over any other competitor.

- Wilmar estimates that the lost opportunity cost of the Queensland invoked Sugar Marketing Bill to be $46m per year. How does Wilmar arrive at this annual loss figure? They go on to state that this Bill could have a potential impact on the industry of as much as $1.0bn. Where is the justification and supporting evidence for this statement??

- Wilmar raises the $23m in annual transportation cost to take the raw sugar from the mill to the relevant ports which they pay. The cost of transportation was carefully considered and taken into account when the cane pricing formula was initially created and agreed to by the millers and then subsequently inserted into the Cane Supply Agreement (CSA).

  Yes, there is a cost to the miller, but they know that this cost was taken into account in formulating the cane payment formula. The millers were a part to that formula discussion and negotiation and agreed with the formula. (The transportation cost of raw sugar from the mill to the port **IS NOT** something new).

  If Wilmar are now suggesting that the growers should bear their share of the transportation costs (approximately 66%) then the cane payment formula needs to be adjusted to deduct that component (percentage), which was applied to the transportation costs when incorporated into the original cane payment formula.

- Wilmar talks about capital investment loss (quoting a capital investment of $78m in 2015 alone), but fails to mention the many years when Wilmar and its predecessor Sucrogen (formally CSR) invested very little or no capital in "staying in business". The strategy of low or no capital investment is used by major corporation Boards to ensure that sufficient cash is available to maintain a particular dividend policy, but is detrimental to the business in the long run.

- Capital investment, which in turn affects mill processing efficiencies, was also taken into account when formulating the cane payment formula.

  If Wilmar wishes to spend less capital, thereby impacting on its milling efficiency and hence profits at the end of the day, then that is a commercial decision that the miller, as a business entity, makes. That decision obviously impacts on the growers as well, if in fact, the miller cannot crush the cane in an efficient way or within the designated time perimeters to maximise the sugar make.

- Wilmar states that the determination of the "Grower Economic Interest Sugar" as defined in the Bill would make the miller effectively a "toll crusher". The mill owner (currently Wilmar) and previous owners have been crushing sugar cane in the Herbert River district for over one hundred and twenty five (125) years under the existing cane payment formula and that payment formula was put together on the basis of the cost associated within the industry. That is, growers capital and cost of operation and millers capital and operational costs.

  We must stress that the sugar revenues, no matter whether marketed individually or collectively, are divided approximately one-third to the miller and two-thirds to the grower. Wilmar's suggestion that the grower's returns would fall from $40 per tonne to $22 per tonne is absolute rubbish.

  Wilmar are in fact suggesting that over and above the operational costs and capital, which are taken into account in the cane payment formula, they will need to charge somewhere up around $18 per tonne of cane to toll crush.

  Again, I make the point that if this is the argument Wilmar wish to advance then the whole cane payment formula would need to be rewritten and adjusted for that argument. The cost of crushing the cane supplied by growers has always been borne by the miller. This **IS NOT** something new created by the Sugar Marketing Bill. You cannot have your cake and eat it to.

- Wilmar refers to mill availability and the graph on page 11 of Wilmar's submission clearly shows that Wilmar and its predecessors have not invested the capital required in their milling facility to efficiently "stay in business". The graph clearly shows that mill availability dropped from about 90% in the mid to late 90's and to as low as 80% in about 2008. Typically, efficient sugar mills should be providing mill availability in excess of 95%, if the capital invested to "stay in business" was actually spent on a year in, year out basis.

I would like to move onto Wilmar's commentary about the "toll crushing" model and the comments on page 26 and 27 of Wilmar's submission to the Productivity Commission are relevant.

Please note my comments above relating to the costs of crushing already being incorporated in the division of sugar revenues cane payment formula.

NQBE has a number of issues with the "Illustrative Toll Crushing data" on page 27, in particular:

Firstly: Wilmar paid in the vicinity of $1.7bn for the Sucrogen (formerly CSR Sugar) sugar assets (which includes the shares in Sugar Terminal Limited {STL}) which they are currently using in the business. Whilst the replacement cost of the assets **might** (AND I stress might) be $5.0bn, it is unrealistic to undertake the toll charge calculations based on what the mills cost to replace the asset might be versus the actual price paid in the market place for those assets. Wilmar are "reverse engineering" using the estimated replacement value to justify a higher "toll charge".

Secondly: The weighted average cost of capital (WACC) of 8.6% is ridiculous in this current financial market. Corporate Australia (and Wilmar is an Australian corporate) can borrow at the bond rate plus a small margin. The directors of NQBE are well aware of cane farming operators who are borrowing at around the 4.5% to 5.0% pa (total WACC including margin) and Wilmar certainly has significant more clout from a financial perspective than any cane farmer growing cane in any Wilmar region. In a nutshell, they have the financial capacity to borrow funds cheaper.

Thirdly: Wilmar has used (without consultation or any agreement whatsoever from NQBE) the published capital cost of $520m for a 2.5mt capacity (new greenfield) Facility, for which NQBE has received all of the Federal and Queensland State government Development Approvals for.

A **major flaw** with Wilmar's capital cost assumption is that Wilmar representatives who prepared the submission to the Productivity Commission **did not** understand what the $520M incorporated. The $520m capital or CAPEX (cost for the NQBE project) includes the construction of a 3.1mt per annum sugar cane processing Facility **plus** a 200K litres per day ethanol distillery **plus** a power generation facility with an installed generation capacity of 150MW per hour. This information is published and freely available on NQBE's website.

In relation to the NQBE Facility, the Commission should note that a rough breakdown of the CAPEX includes a 15% contingency component, working capital and a reserve account, a power generation unit with an estimated CAPEX of approximately $180m and an ethanol production facility with an estimated CAPEX of approximately $60m.

The NQBE Facility is more than just an ordinary sugar mill.

One can quite clearly see that by taking out the working capital and reserve account component, the contingency component and the CAPEX cost of the ethanol distillery and power generation units, means that the assumed capital replacement cost used by Wilmar with reference to the NQBE project to calculate their "toll charge" is not only flawed but significantly incorrect.

One would have to challenge and question not only the reasons for Wilmar using the $520M number on an ill-informed basis, but also for not questioning or seeking out more information from NQBE about the project and the breakdown of the quoted CAPEX.

I would suggest that not seeking out this information and using the $520M NQBE CAPEX to calculate a "toll charge" figure simply enhances Wilmar's argument and distorts the actual toll charge figures, and lends insight to Wilmar's self-serving agenda.

Wilmar's submission to the Productivity Commission is designed to destabilise the sugar industry further in an attempt to move the sugar revenues of the industry, which are currently shared, via the cane payment formula, more towards the miller.

Overstating the weighted average cost of capital (WACC), overstating the current market value of Wilmar's sugar milling assets and using incorrect CAPEX figures to calculate the "toll charge", without understanding that there is a power station and an ethanol distillery involved in the Capex cost, should send a clear message to the Productivity Commission, to be wary about relying unduly, or in fact at all, on Wilmar's submission.

The writer is available and more than happy to discuss and explain further the comments outlined in this submission.

Yours faithfully

Robert M Carey
Chairman
NORTH QUEENSLAND BIO-ENERGY CORPORATION LIMITED

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