JCP - Investing in Practice

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View on Resource Rent Tax

The proposed introduction of the new Resource Rent Tax (RRT) following the Henry Tax Review will have wide implications for the Australian resources sector, the economy and consequently, on many of the valuations in the JCP Investment Partners investment universe.

To help us better understand the impact of the proposed RRT, we have been in contact with a range of proprietary contacts in recent weeks. Below is a brief summary of our key findings we believe may be of interest to you.

RRT was a trade-off for increased 3% super levy

JCP Investment Partners monitored the progress and politics of the Henry Review. We spoke to members of the Henry Review committee along the way, as well as holding discussions with political contacts in Canberra. We knew the Henry Review would impact some of our resource valuations, but believed the timing of the resource-specific recommendations would be after the next Federal election. The “surprise” was in the form of the new 3% super levy not recommended in the Henry Review. In February, Wes Campbell (Head of Institutional Business & Portfolio Manager) attended the ACTU Investment forum where the Federal Minister for Finance and Deregulation, The Hon Lindsay Tanner said “the super levy would not be increased from 9% to 12%”. We strongly believe that with the introduction of the new super levy, coupled with the desire to bring the budget back into surplus, the RRT was fast-tracked.

The key parameters of the RRT are here to stay

post the announcement of the RRT, Michael Fitzsimmons (CIO) has spoken with the Prime Minister and we have established a new proprietary contact in Canberra. In addition to this, we have spoken with Treasury, BHP, RIO, NCM and WPL. The Prime Minster and Treasury firmly believe in their actions. With such high conviction there is little chance of significant horse-trading and whole-sale changes to the RRT. Betting against the implementation of the RRT is betting on government change, not a policy back-flip.

Deals will be done to water down some impacts of the RRT as well as other trade-offs

when the RRT was first announced Treasury was non-committal on some of the details. The Government is aware that investment uncertainty created by the RRT is untenable, particularly in The Prime Ministers home state of Queensland, where there is $80 billion of investment in coal seam methane to LNG at stake. From discussions with our proprietary contacts, we strongly believe concessions will be made on the rate of return allowable on capital expenditure, as well as the starting point for defining asset values. It is likely that concessions granted will be much smaller than the value lost. Deals will also be done on non-RRT related issues such as BHP and RIO securing more port and rail investment in NSW and QLD.

Despite Treasury predictions the RRT will decrease activity in the mining sector but help keep a lid on inflation and therefore interest rates

The Treasury believes the RRT will increase output and employment in the resources sector. We’re sceptical that employment and output can be increased while decreasing profits and increasing uncertainty. While high margin resource projects will go ahead, it is important to understand the implications of the increasing sovereign risk associated with the RRT, and the the difficulties in securing project financing. The uncertainty created by the introduction of the RRT will slow down project development and help keep a lid on inflation.

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Impact on JCPvaluations will vary depending on location, commodity and existing royalty

We have modelled the impact of the RRT with concessions. Changes to valuations vary depending on:

- Where a company derives it revenues – companies like EQN and OSH will not be impacted while IGO and WHC will.
- What the pre-RRT royalty was – oil and gas companies were already subject to the Petroleum RRT so they were less impacted compared to gold companies whom typically paid a small royalty pre-RRT
- Whether capital expenditure is to be spent or sunk

Changes to our large risks positions include - BHP down 11%, RIO down 10%, NCM/LGL down 7%, WPL down 5%, WHC down13% and IGO down 17%. OSH was unchanged due to its assets being held offshore.

We will continue to monitor developments with the RRT by speaking with our contacts in Canberra, as well as the large mining and energy companies, to ensure the our valuations accurately reflect the potential risks and impact on returns associated with the RRT, as well as other recent changes in energy policy announced in the Budget.

If you would like to discuss any of these issues in more detail, feel free to contact Wes Campbell or Peter Harris.

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JCP Investment Partners is a research driven investment manager that specialises in building tailored, risk controlled portfolios.

With more than ten years experience, we have managed money through bull and bear markets.

Our strategies

- Benchmark Based
- Benchmark Insensitive
- Long-short 150/50
- Absolute Return

For further information

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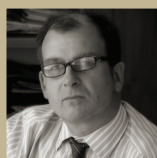

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