

ECONOMIC DEVELOPMENT AND INFRASTRUCTURE COMMITTEE

Inquiry into Mandatory Ethanol and Biofuels Targets

Melbourne—20 August 2007

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Mr M. Jones, General Manager, Government Relations, CSR Ethanol.

The CHAIR—Welcome, Mr Martin Jones, to the public hearings of the Economic Development and Infrastructure Committee Inquiry into Mandatory Ethanol and Biofuels Targets in Victoria. All evidence taken at this hearing is protected by parliamentary privilege. Comments you make outside the hearings are not afforded such privilege. Could I ask you please to state your name, organisation, address and position within that organisation. Thank you.

MR JONES—Martin Jones, CSR Ltd, 9 Help Street, Chatswood. I am the General Manager of Government Relations, but I happen to be based in Melbourne.

The CHAIR—Thank you. Over to you, Mr Jones, to make some brief comments and then we will ask questions.

Mr JONES—I would like to make a few introductory remarks, if I may. CSR has been involved in the ethanol business in Australia for well over 100 years. We started out in Sydney. Today we have assets in Queensland at Sarina which is south of Mackay, and there we operate a distillery and we use C-molasses as our substrate. Last year we started up a new piece of equipment there called a molecular sieve that is used to manufacture the fuel grade. Our other assets are here in Yarraville. We have a distillery and what we call a polishing unit. That also has a fuel-making capacity, although we are not using it at the moment. We do not have enough substrate to keep both facilities at capacity but we do something like 90 different grades of ethanol in Victoria for pharmaceutical, food industry and so on.

The CHAIR—90 different—

Mr JONES—There are about 90 different grades, yes.

The CHAIR—Suitable for?

Mr JONES—Suitable for a range of industries. We service the pharmaceutical industries, the food industries. Obviously fuel is one of the big volumes today and it has been growing fast. CSR is strategically committed to ethanol. We have been in it for a long time and we would like to grow in that industry. To that end we have been studying new projects for a long time but in the last 18 months we have had a team really scouring Australia for opportunities. We have probably invested about \$2 million in studying various opportunities and we are struggling to come up with projects that would meet the hurdle rates and the risk that our shareholders would be prepared to accept. That is not to say we are not still looking at it but from our point of view we think it is quite difficult in Australia because agriculturally we are fairly poor and we do not have the water resources that other nations who are big in ethanol have—like Brazil and the United States.

We have opened an office in Brazil and it is public knowledge that we have aspirations about participating in the industry over there. From that point of view we understand ethanol quite extensively and in looking at any investment in Australia you do need to have that global perspective because from 1 July 2011 under the current policies the Australian market for fuel grade ethanol is completely open. Any investments that are made here have to be world competitive.

Mr DAVIS—Fully world competitive.

Mr JONES—Fully world competitive—and that is the issue for us in the longer term. That perhaps give you a bit of an overview of where CSR sees the situation.

The CHAIR—Thank you. My question relates to the Victorian biofuels and biofuel feedstocks market. From what you have stated would I take it that you do not think we are in a position at the moment to have a five per cent target by 2010?

Mr JONES—No.

The CHAIR—Thank you.

Mr DAVIS—I am very interested in the points you make about making ethanol from sugar in

Australia is value destroying today, and the section in your submission where you talk about Victoria being poorly placed to develop a large ethanol industry. What would be the effect on the Victorian economy of mandating, do you think—mandating a 10 per cent target for ethanol use?

Mr JONES—I do not think you would get there because—

Mr DAVIS—Or only through imports?

Mr JONES—Only through imports, that is right. We spend a lot of time studying grain and grain locations and drought. Our conclusion was that if you build a plant today—say our board approved the plant today we are probably not going to have it on stream for a minimum of two years, probably longer. We are probably looking at three years, maybe more. By that stage you are looking at not being able to take advantage of the existing Federal Government policy. You might as well forget about that and say today we have to compete internationally. World scale grain plants in the US are getting up around 400 million litres. Five years ago it was 100 million. To compete internationally you need to have scale. If you go for scale then you go to a grain region and you look at the drought impact. In a drought year—and that can be three years out of 10—you are having to move grain huge distances to get it to your distillery to get the scale. Then we said, 'Well, that does not seem to work because we lose our scale advantage. How about we put a distillery at a port,' so in those drought years you can import grain to keep it going because once you get into the fuel industry you have to be a reliable supplier. You are not going to be able to say, 'I'm sorry, we can't get enough grain this year. We're not going to fulfil our contracts,' because they are not going to write contracts like that.

When you move grain, you are moving carbon dioxide because when you ferment grain you release carbon dioxide. Taking a facility that might have been in Narrabri or Moree and moving it to Newcastle was highly value destroying. That was only 2c a litre cost. That gives you an indication of how sensitive the margins are around these businesses.

Mr DAVIS—With the carbon dioxide production is there some rule of thumb about how much you create with the distance?

Mr JONES—No, it is that you are carting grain that has carbon dioxide embedded in it. It is cheaper to cart ethanol.

Mr DAVIS—I understand but is there some rule—the difference between those two, the margin, as it were?

Mr JONES—Yes. I do not know the maths on it. Whatever the carbon dioxide that is released, it is essentially the freight you are saving.

Ms THOMSON—My question goes to what we hear from Agri Energy around drought resistant research into grains that may be used purely for the development of ethanol or fuels and not for grain for consumption, either by animal or by humans. You sat in on that, Martin. You were here for most of it.

Mr JONES—I heard some of it.

Ms THOMSON—What would you say about the arguments they were putting about the viability of the industry?

Mr JONES—We have not researched that aspect of it other than our preferred grain, which is sorghum. Sorghum is preferred because it is more drought tolerant; sorghum is preferred because the investment is lower; sorghum is preferred because it ferments faster and it does not foam, it is easier to process. The trouble is you cannot get enough of it. In drought years there are almost no exports. The percentage of what is produced in those years that goes to domestic is very high. You are going to have to buy it out of the domestic market at a time when everyone is wanting it again. Then we went down the path of, 'Well, you need to have a flexible distillery that can handle both, that drives your costs the wrong way.' Look, if an industry gets up all those things will follow. People will research. You will look at grains that have a higher starch content. You would look at sorghums that have a higher starch content and so on, but the basic

hurdles are difficult to meet and you are not going to invest on a promise of what might be delivered—well, we are not. We want proven technology.

Mr CRISP—Firstly, Martin, thank you for an excellent presentation because a snap of what the rest of the world is doing is an area where initially I did not think we were going, but what is happening in the United States and Brazil is certainly impacting on where Australia is going to have to fit in and then underneath that is where the state of Victoria fits. It is becoming a more complex problem than I first imagined. Thank you for that. It is a very good submission from my reading. Do you have a view on second generation? One of the things that is beginning to tempt my mind is that we will do what we can with the current biofuels but will we be better off to go into a holding pattern and wait for cellulosic, but given the way your company has a very wide view of Australia and cellulosic is something that you are currently evaluating—

Mr JONES—It is definitely on our radar screen. The fellow who runs our ethanol business is going to the US to screen what is going on there with the technology. There are varying views. I was at the Crawford Institute conference in Canberra last week and there were some views put that it is still 10 years away. We have heard other views that it is closer, that it could be five years. Certainly CSR is interested in being positioned for that, particularly with our sugar interests because there is an awful lot of biomass from a sugar crop that is not fully utilised today. If this technology really works and it is competitive then that it is an enormous opportunity for us. I will comment on sugar—and I know it is not very interesting to Victorians—but we are—

The CHAIR—You can expand upon it as much as you like because I want to understand from your perspective the benefits of producing ethanol from sugar as opposed to grain feedstocks.

Mr JONES—CSR is also doing research through the University of Queensland and we received a grant of \$5 million from the Federal Government for this work, so it is well under way. We were trying to produce something else with the sugarcane plant and we found that varieties exhibited significantly higher sugar yields. We found that when a sugar plant grows it gets to the point where there is a mechanism that turns off the production of sugar and we have found a way to keep that going. We are now doing field trials with hundreds and hundreds of varieties this year and we will be harvesting in September. They are the steps—we have an industry well established; we are in ethanol today and we are looking for ways to grow that, and this could change the economics of sugar based ethanol significantly if this technology works. These technologies take years and years to develop.

The CHAIR—From our Committee's perspective we do not have the hundred years of experience that CSR has. What would we be looking at in terms of the best guesstimate of the results of this R and D becoming known?

Mr JONES—The work that we are doing?

The CHAIR—Yes.

Mr JONES—Commercialisation is probably three, four years away, if it works.

The CHAIR—Thank you. I would really like you to expand as much as you would like on the benefits of producing ethanol from sugar, compared with grain feed stock.

Mr CRISP—I was surprised to read that using sugar was devaluing the sugar. Obviously world sugar prices are high but from time to time we hear about very low sugar prices.

Mr DAVIS—It is cyclical, isn't it, is really the question?

Mr CRISP—Obviously the ups do outweigh the downs because your company is looking beyond sugar for ethanol.

Mr JONES—The way we see it working—and there are other theories around, but this is the way we

see it working—is that Brazilian industry supplies 45 per cent of the world's sugar and they are if not the biggest will be the biggest ethanol producer in the world. The way they go about it in Brazil today is when they bring on new sugar plantations they invest in ethanol first and sugar second. When they do that they have the flexibility to move between sugar and ethanol and they have the flexibility to move by 10 per cent of their production, which is huge. It is the size of the Australian crop. If ethanol markets are more attractive they will switch their production to ethanol, which is what they are doing right now because the sugar price is down. If the sugar markets are more attractive they will reverse it. They play an arbitrage off their domestic market. No matter what they say, the motorist pays for the mandate in Brazil. There is a 60c excise differential between ethanol and gasoline. The motorist pays 26c a litre more than the Australian motorist, even though petrol at the wholesale level is cheaper in Brazil than here.

They will play that arbitrage and when you get into international markets, sugar and ethanol are pretty much at an equivalent price. If we were to take sugar that is going into a sugar market today at sugar prices, invest \$250 million to build a distillery to make ethanol that will be priced at the international sugar price, it has to be valued destroying. The Australian farmer can benefit off the Brazil arbitrage because they will fix it whichever shows higher value. Ethanol and sugar basically move pretty much in tandem. We have done correlations that demonstrate all that.

The CHAIR—If you wish that to be public—I do not know whether you do—

Mr JONES—Yes. We have shared that with our stakeholders.

THE CHAIR—Because that could be useful for inclusion in the way of detail for our report.

Mr JONES—The piece in our presentation that dealt with that we have reviewed with all the analysts.

The CHAIR—Good. I understand that pretty well. I feel like we are not giving you justification for coming in. We have not really pried deep enough.

Mr JONES—The follow-on from that of course is, if you take a grain-based distillery, you are taking a grain price that moves independently of the sugar price. You are taking grain to convert it into ethanol. It has to compete with sugar. It is a very simple way of looking at it.

Mr DAVIS—At the risk of two ends of the equation.

Mr JONES—Yes. I saw this last week where CSIRO got up and said, 'If the oil price is \$70 a barrel, it should be economic.' That assumes you can sell your ethanol at a gasoline equivalent, which you may not be able to do after 1 July 2011.

Mr CRISP—If CSIRO were not tempted to introduce the same flexibility as the Brazilians within your plant or it requires that \$250-million type investment you said.

Mr JONES—It means idling assets we have and building new assets.

Mr DAVIS—It does not seem that smart, does it, really?

Mr JONES—No.

Mr CRISP—It works in Brazil?

Mr JONES—It works in Brazil because they are growing by the size of the Australian industry every year. They are taking land, putting sugar cane in that land. What do we do with the sugar cane we have? We have to build something. It is a process. They can take that cane in at cost, add an investment that gives them the value add into the sugar or ethanol market. We are taking something out of a market and trying to add value, and the equation does not work. The early guys who get in—I believe, I have not seen it publicly, that the Dalby project got financial closure. They will get possibly four years or three years of operation under the

old policy where there is border protection, and that might be enough to get them enough capital recovery for that to work.

Mr DAVIS—Then they will be at the mercy of the markets.

Mr JONES—Yes. The issue is, you can probably compete on a variable cost basis but you cannot recover your capital. It costs half the price to produce ethanol in Brazil than it does here and it costs half the investment for the same capacity.

Mr DAVIS—Is that because of the scale of the plant's—

Mr JONES—They put them on the back of a semitrailer and roll them out, and they are doing it all the time. It is a cookie cutter, almost mass production. Here it is a unique, individual design. We have different standards in Australia and our capital costs have escalated 30 per cent in the last three years, particularly in North Queensland.

Mr DAVIS—What is behind that escalation in capital costs?

Mr JONES—They have had some escalation too but not as much. All the contractors are busy. The raw material prices have gone up and it is hard to get people to work in refining in regional Queensland because they are all busy with all the mining infrastructure. You do not get the A team.

The CHAIR—Yes. Mr Jones, thank you very much. That was short but the succinctness of it was absolutely clear for us. Thank you very much and thank you for the submission, which was great.

Witness withdrew.

Hearing suspended.