AJ Lucas Group Limited

2009 Annual General Meeting

Chairman's Address 27 November 2009

AJ Lucas listed on the Australian Securities Exchange just over 10 years ago. During that time, Lucas has grown and diversified significantly. Annual revenue has increased some 25 fold to approximately $500 million and the Company has been admitted to the ASX200.

An investor purchasing a share in AJ Lucas in the IPO would have earned an approximate 17.5% compound annual return on their investment assuming non-reinvestment of 62 cents in dividends paid over this period.

Lucas has now entered the next major phase of its corporate existence in which the Company plans to consolidate and exploit the strategic position which it has placed itself in, in the key sectors of oil and gas, water and waste water and resources. Much planning and investment during this calendar year has gone into seeing that this major phase of growth during the next 2-3 years will be successful.

2009 Financial Result

The 2009 financial year can be viewed as one of mixed fortune for the AJ Lucas Group. Notwithstanding the very considerable progress made in growing the Company and executing its strategic plan, the financial result can only be viewed as disappointing.

The financial year was really one of two halves; a very good first half to end December 2008 but followed by poor second half to end June 2009. The reasons for this variable performance can be broadly summarised as a lack of confidence in the market place (largely as a result of the global financial crisis), the impact of an attempted group restructuring during the middle of the year which produced totally unsatisfactory results, margin erosion, delayed commencement of projects and some bad luck. Fortunately, the majority of these events can be viewed as 'one-off' and largely behind us.

While Mitchell Drilling was a sound acquisition from a strategic point of view – rounding out our drilling portfolio and consolidating Lucas as the pre-eminent coal seam gas and coal drilling operation in South East Asia – the cultural fit has been a challenge. As a consequence, it has proved a time consuming and difficult exercise to integrate within the Group. This has been particularly manifest in the areas of safety, OHS&E and plant maintenance.

A return in business confidence and therefore, a more regular and sustainable order book and better plant utilisation, should see the Drilling Services division produce the type of financial results anticipated at the time that the acquisition of Mitchell Drilling was undertaken.

The performance of the Construction & Infrastructure division has been profoundly impacted by a deterioration in business confidence, as a direct consequence of the global financial crisis. Project delays, capital expenditure deferment and much tougher contracting conditions have all been experienced by this division. These factors have been compounded by a poor performance in our project management in the field. The standard of construction has been first class, the standards in safety and OHS&E have been best practice but the financial performance of some of our projects has been disappointing. This, I believe, is a direct consequence of the Company's growing pains and a failure by the Division to mature with the increased scope and scale of its operations. This is currently being addressed.

If 2009 financial year was one of mixed fortunes, 2009 calendar year has been a year that the Company would much rather forget. Business conditions are difficult. The Company is very busy at the moment but the requirements of the market place and lack of sustained business confidence is making it difficult to consistently achieve expected margins. Deferment of projects and stop start drilling operations does not allow us to defer the fixed operational costs of personnel and equipment and this is impacting margins substantially. In addition, considerable expense is being incurred in responding to market enquiries for projects which may or may not take place and, if they do, are not likely to take place until the next or succeeding financial years.

Executive Remuneration

Much has been said in the Australian financial press in recent times on the subject of executive remuneration. This includes Lucas' Remuneration Report which has also received press comment.

Lucas is unapologetically a company which rewards success. At Lucas people are expected to step up, take responsibility and perform. That is the culture. In which instance those executives are entitled to expect reward for performance and effort over and above that for which they are remunerated on an annual basis. As far as base annual remuneration is concerned, Lucas management employees are remunerated at the median level according to the market, with a number of senior management paid substantially under market.

The remuneration levels are independently assessed by expert third party consultants every year. In relation to middle managers and above, this process is undertaken by a sub-committee of senior management, reporting to a non-executive director.

This practice is designed to achieve the Company's policy of setting remuneration at a level that will attract and retain qualified and experienced personnel and motivate and reward them to achieve strategic objectives and improve business results. As a consequence, Lucas believes that its employees are fairly paid. However, in some cases it can be said that some of the senior executives of Lucas receive considerably less than their market worth. Incentive schemes and non-financial criteria such as quality of work, working environment and career paths, attempt to compensate for this.

Turning specifically to the 2009 Remuneration Report, it can be seen that a number of one-off bonuses were paid to certain executives, including myself as CEO, relating to the disposal of the Company's interest in PEL 285, the Gloucester Basin. This investment was sold for $259 million, equivalent to approximately 10 times our investment over the 6 years we owned the asset. These payments were made to executives connected with the exploration and development, financial and commercial management and stewardship of Lucas' interests in the Gloucester Basin. They were necessary to attract and motivate the personnel with the requisite experience and commercial acumen to commercialise the project. This they were spectacularly successful in achieving.

Accordingly, at the time that the Gloucester Basin asset was acquired in 2002 from Pacific Power for $500,000, it was decided to set aside up to 5% of the equity in the asset to be made available to relevant executives connected with the development of the asset. This was a direct response to the dictates of the employment market.

Lucas is not embarrassed by the amount of the reward earned by those executives responsible for the generation of its capital gain because of the magnitude of the value uplift. This is entirely consistent with our historical approach of empowering executives, motivating them and encouraging them to achieve superior performance for the benefit of the Company and its shareholders. As Chairman, I sincerely hope that there are many more millionaires created by Lucas as, every time, this can only produce manifestly more wealth for the shareholders of this Company.

Energy Investments

Lucas' strategy includes making investments in selected energy and water projects using cash flow generated from our services business.

This strategy is designed to increase shareholder returns by leveraging off our knowledge of the sectors. The success of this strategy is most evident from the realisation of our investment in Gloucester Basin during the year for $259 million generating an internal rate of return of in excess 100% per annum over its six year holding. The Company's investment in Sydney Gas was also sold during the year realising a profit of $5.4 million or 19% over the period the investment was made.

The Company has reinvested some of the sale proceeds in new energy prospects, some in European shale gas through a company called Cuadrilla Resources Corporation Limited, and some in an oil and gas play in East Texas.

As at the date hereof, the Company's involvement with Cuadrilla has a book value of $50.6 million including loans of $24.0 million, with Lucas holding 57% of Cuadrilla's ordinary equity. Cuadrilla has a requirement for further funding of approximately US$50 million and, in the absence of alternative financing arrangements, Lucas has indicated to Cuadrilla that it would be prepared to provide such funds. On the other hand, it is Lucas' intention to attract a suitably qualified and value adding third party or parties to provide such funding. In this connection, Lucas has been holding discussions with a number of interested parties and we would hope that a successful conclusion can be reached in the first quarter of 2010.

Cuadrilla is a considerable financial exposure for Lucas but one which we believe is justified. Naturally, we have not invested all that money because we think we are going lose it. However, the answer only lies in the secrets that the rocks themselves reveal and this can only come from drilling and fraccing; an exercise which is scheduled to commence at the beginning of the second quarter in 2010. Until such time as we have definitive data and results from this exercise, the Cuadrilla European shale gas play must be considered by the market to be highly speculative and carry a very high degree of risk but, at the same time, a commensurate degree of reward if successful. Lucas believes that the Cuadrilla science and management team is world class, its selection of acreage and strategy to be very superior and the timing ahead of the game.

We have also invested considerable sums in an oil and gas venture in East Texas and a CBM play known as 'Grisly' in British Columbia.

East Texas is an unconventional deep fracture system situation in a known oil and gas province and which, in order to develop successfully, will require sophisticated drilling techniques (largely horizontal) and of which Lucas is conversant. The Lucas strategy is to act as a seed capitalist, build and consolidate an attractive asset, generate wealth and then refinance; leaving Lucas with little or no capital outlay and a small residual interest. Given the very significant upside potential for this asset, this was considered a relevant and appropriate strategy. This remains the case however, the originally anticipated timing for execution of this plan has not eventuated. We originally expected to achieve this plan well before year end but, due to circumstances beyond Lucas' control, the timing for execution has slipped and we are actively involved in managing our investment.

Attention is drawn to the Company's announcements on 27 August 2009 and 1 October 2009, which more particularly expand upon the Cuadrilla and East Texas assets. Lucas considers these assets highly prospective but remains in no doubt that they are high risk/high reward.

Further work has been undertaken on the Grisly prospect, with unfortunately not the results that we expected at the beginning of the exercise. While the play remains interesting, the combination of continuing involvement from afar (as the initial drilling has not produced what we had hoped it would), the depressed price of natural gas in North America and the requirement for further capital expenditure, make this prospect currently unattractive. Decisions will be made regarding Lucas' future involvement in the Grisly prospect before year end.

Lucas' sole remaining Australian asset, ATP651 in the Walloons in Queensland's Surat Basin and in which we hold a 15% interest, continues to be developed. Much work is being undertaken by the Operator (QGC) on this prospect and we remain very hopeful for its outlook given its location and the expected FID date for the BG project.

Outlook 2010

While the general market outlook seems to be improving, the first four months of this financial year have been below expectations. Although revenue levels have been much as expected, margins have been disappointing, a continuing legacy of last year's downturn and periodic stand-downs by our clients.

World macro-economic forces will undoubtedly influence the Australian situation, particularly in oil and gas prices and the availability of capital, although China's desire for natural resources will continue to underpin the downside from a national point of view. Lucas does not share the apparent ebullient prospects for the economy that some commentators and the stock market appear to be forecasting. While it is fair to say that confidence is returning, it is clear that this is only tentative and not necessarily sustained and in depth. Access to capital, particularly debt, remains tight and clients appear to be deliberating long and hard before committing to significant capital expenditure programmes.

Lucas has high expectations of benefiting from the LNG export facilities slated at Gladstone as well as from the North West Shelf. The recent award of the shore crossings contract at Barrow Island is evidence of this. Lucas is also hopeful of securing considerable work from water projects planned to progressively drought-proof the country.

While much work is being undertaken with respect to the development of Queensland's coal seam gas fields for LNG, we remain to be convinced that all developments will take place, and certainly if they do, whether they will occur within the timeframe currently indicated to the market. Capital expenditure of this magnitude requires a great deal of thought, planning, engineering and risk assessment prior to committing and it remains to be seen whether market forces play a part in the timing of these decisions. There has been a significant increase in tender activity but this has yet to translate into firm orders.

Much has also been said about the Government stimulus package however, we have yet to see a material impact as far as Lucas' business is concerned. Thus far, it appears that most of the expenditure has been on words rather than dollars or meaningful projects. This is expected to change when firm decisions are made regarding the National Broadband Network as well as water and waste water initiatives. Lucas has formed an association with Groupe Marais, one of France's leading trenching companies, to provide services for the NBN rollout but so far, apart from a small project in Tasmania, we are yet to see the benefit of this association.

On account of these delays, the 2010 financial year like 2008/09, is likely to be one of two halves, this time a very poor first half but followed by a much improved second half as work commences in earnest at Gorgon. This trend is expected to continue in following years as confidence returns in a more sustained manner than we are experiencing at present. Lucas remains confident for the oil and gas, water and waste water and resources sectors during the medium term although, we expect competition to increase.

Lucas is thus cautiously optimistic for calendar 2010 and beyond. However, we are mindful that business conditions are likely to remain tough with exacting standards expected from our clients. This will require the Company to remain nimble, able to respond quickly to changing circumstances while at the same time managing its cost base in response to the variability of the market.

This will require first rate people and superior ICT systems, including best practice, international standard, systems and procedures. Lucas is undertaking a great deal of work in this area, the benefits of which we expect to commence to be seen during calendar 2010.

In summary, the Group faces a difficult year but with conditions progressively improving. Having regard to the poor start, the Company now expects its underlying EBITDA for 2009/10 in the range of \$50 - \$55 million, predominantly arising in the second half. Whilst we might have hoped for better, at least the outlook beyond this financial year looks much brighter as infrastructure works commence, the LNG projects ramp up, the Government funded infrastructure projects commence and business confidence returns.