



AJ Lucas Group Limited

2012 Annual General Meeting

Chairman's Address

30 November 2012

Introduction

Reflecting on the past few years, one could say that “Lucas put its foot flat on the accelerator just as the world was putting its foot on the brake”. While the timing was inauspicious, the thinking was and remains correct. Having embarked upon the chosen course of action, it was difficult not to follow it through and thereby risk losing a great deal of potential wealth, albeit then having to deal with the consequences and strains on the demands for capital. Dealing with the consequences has taken up a great deal of management time during the past two financial years but we now believe we are back on track.

Cuadrilla has involved twice as much time and money than was originally planned, East Texas has not yet drilled and we are not in a position to judge whether this was a wise investment or not, a very unfortunate acquisition of Mitchell Drilling, some ill judged senior appointments and, quite frankly, some management decisions both here and in the UK which were not up to the increased challenges presented by the market place, all combined to create a very challenging 2-3 year period. We have chewed through money instead of producing lots of it.

But where we are now I think justifies not only the strategy but the course of action we had to take to deal with it; notwithstanding the pain caused along the way. The political situation vis a vis fracking, the slowdown in the world economy, severe weather conditions, the state of the financial markets have all taken their toll and therefore, refinancing and restructuring in this market place has had to be gradual.

We would like to think that these are now behind us. The market has moved such that Lucas' operational strategy and the market place are now back to being realigned, our senior management has been completely restructured and we have returned to the “proprietor mentality” which previously operated. We now have first rate systems and procedures, including our Oracle ERP system. The final piece in the jigsaw puzzle is the last stage of the balance sheet restructuring/refinancing of the Group, which is currently in process and expected to conclude in the first quarter of 2013.

Over the last 18 months, we have substantially recapitalised the Company through the injection of \$215 million of capital into Lucas: \$87 million of equity, \$100 million in net new loans and \$25 million from asset sales. During this period, we have continued to develop our interests in our E&P assets and restructured our debt instruments. The maturity profile of our liabilities has been extended to better match expected cash flow and future asset sales. Kerogen, our new principal shareholder and financier, has been very supportive in this process and we thank them for their continued and meaningful support.

The new equity raised, including \$40 million since balance date, together with an agreed period for repayment of the monies owing to the ATO, has resulted in a substantially stronger balance sheet. Negotiations are continuing with the Company's financiers as well as other restructuring initiatives which will hopefully restore the Group balance sheet to a surplus net current asset position in the not too distant future.

2012 Financial Result

Turning now to last year's financial results, clearly these were very disappointing.

The headline result however, paints a worse picture than the underlying result. Much of the loss was of a non-cash flow nature, including nearly \$50 million of impairment charges. Refinancing costs accounted for nearly \$7 million. We also decided to provide \$10 million for some legacy contracts which we had been a long time in settling and we decided to take a cautious approach to accounting for these in order to expedite collection of the agreed amounts owing. Costs for discontinued business activities added another \$3.5 million. The quality of the underlying operating business is however, reflected in the cash flow from operations which amounted to over \$20 million, a substantial improvement over the prior year.

There is no doubt that the financial result was impacted by the drop in commodity prices, the Group's weakened balance sheet, senior management's time being diverted to other factors such as Cuadrilla and the balance sheet reconstruction as well as strains on the Group's liquidity position, with competition for funding between the Group's E&P investments and the Group's operating activities.

Both the Drilling and Engineering & Construction divisions experienced increased turnover. The Drilling operating result however, after a solid first half, fell away towards the end of the financial year as weaker commodity prices and unseasonal wet weather caused frequent business interruptions and stand downs. Engineering & Construction also experienced a weaker second half mainly due to provisions for contracts in dispute. These contracts are

currently subject to mediation and judicial proceedings which, should there be a favourable outcome, may result in recovery of some of the provisions.

To address the business environment, we have significantly rationalised and restructured the business to reduce overheads, particularly in our Engineering and Construction division. Overhead expenditure has been cut by approximately \$13 million on an annualised basis and we continue to look for further savings. We also continue to consolidate our operating facilities and implement margin improvement initiatives.

Senior management changes have also occurred as well as a new organisation and reporting structure introduced. Savings are expected to be found and made at all levels of the business. The restructuring of the business returns us to the organisation structure pre-2009 where we had a much “leaner and meaner” overhead structure and delivery mechanism. Significant emphasis on the cost base across the business includes many of the senior management voluntarily making salary sacrifices and curtailment of expenditure on plant and equipment.

During the year and continuing, the new Oracle ERP system was successfully rolled out and, while being a very significant investment thus far to the Group (approximately \$10.5 million in capitalised expenditure over a 3.5 year period), we expect this to result in a substantial improvement in not only the Group’s job cost and project management capabilities, but also operating discipline. We now have comprehensive and systemic procedures embedded across the businesses to ensure management discipline and quality financial and management information systems and procedures.

Cuadrilla / Bowland

The level of capital expenditure required to maintain our involvement in both the Bowland prospect and Cuadrilla Resources has been a major cause of our balance sheet strain and lack of liquidity. Only time will tell whether our continued faith in these assets will prove to be a wise investment but the lack of decision making regarding whether or not to allow fracking to resume is certainly frustrating, given that we have had to continue funding a much increased operating overhead structure to support Cuadrilla’s activities throughout this delay period. We are now three years later than where we wished to be and have invested a total of approximately \$100 million – twice the amount we originally planned.

Having said that, we are very encouraged that the Bowland shale is a super giant continuous gas accumulation which has the ability to transform the socio-economic landscape in the UK; much like has happened in the USA from the development of its shale gas reserves.

We are however, hopeful of receiving consent in the near future to resume hydraulic fracturing activities in Lancashire (and thereby prove Bowland as a major gas resource) by flowing the wells. (To date, we can only say that this is a major gas accumulation as no commercial production exists). The next stage of Bowland exploration and development has been carefully planned but, in reality, it is of little consequence in a value creation context until we can flow the wells, observe decline curves, and estimate the total recoverable resource etc which will allow us to formulate a detailed Development Plan. This cannot happen until we are given permission to recommence hydraulic fracturing activities.

To this end, we note that a number of authoritative reports have been issued during the year including, importantly, one from The Royal Society and The Royal Academy of Engineering in June 2012 entitled “Shale gas extraction in the UK: a review of hydraulic fracturing” which concludes, inter alia, that “the health, safety and environmental risks associated with hydraulic fracturing as a means to extract shale gas can be managed effectively in the UK as long as operational best practices are implemented and enforced...” We share this view.

Given the now overwhelming body of scientific data which supports the extraction of gas from shale and the potential favourable economic impact that development of this industry in the UK (and Europe for that matter) would have were it allowed to be developed, the tardiness of the UK government in allowing fracking to resume is mystifying, especially when one considers the prevailing economic circumstances in the UK. The Bowland resource alone could meet much of the UK’s domestic energy requirements for many years. In this regard, the UK Energy Bill, released last night, notes the expected continued importance of gas to the UK energy mix for the foreseeable future. We believe that the Bowland prospect has the reserves potential to support this thereby significantly reducing the UK’s reliance on gas imports. I also note recent comments made by George Osborne, the UK Chancellor of the Exchequer, regarding consideration being given to the introduction of a “generous new tax regime” to encourage shale gas exploration. There is speculation that this will be included in his autumn economic statement to be made next week and, at the same time, permission is granted for the resumption of fracking. We can only hope.

Outlook

There is no doubt that softening in commodity prices, the slowdown in China and reduced productivity and the increased cost of doing business in Australia relative to overseas are biting in the market place. New projects are being shelved, mine expansion is being curtailed and, generally speaking, there is an element of political risk now creeping into the decision making

process regarding further capital expenditure in Australia which was certainly not there 2-3 years ago.

In the coal sector, Lucas is seeing a number of its exploration rigs being stood down, planned capex from clients for resource projects is being deferred or delayed, the cost of doing business is increasing and many clients are demanding cost reductions, which in turn is impacting on service company margins. We have restructured the business to operate in this environment.

That being said, we are not all “doom and gloom”. The financial markets are over-reacting and, if the Government creates its foreshadowed nexus with business, business conditions should improve and a saner cost regime should prevail with a greater focus on productivity.

While the outlook for our drilling business in the immediate future is more clouded than this time last year, mines still have to be degassed, coal still has to come out of the ground and CSG is gaining more traction. We are therefore quite sanguine about this business and are planning to change our emphasis to focus more on directional drilling, forming closer delivery/turnkey relationships with clients as well as increasing our engineering and non-capital intensive related service offerings such as steering, engineering and the like. We remain confident in the underlying strength of and our prospects for the Drilling division, even if fewer new coal mines are being developed. We believe that the operating environment will get better; particularly around the end of FY13.

Our Engineering and Construction division is actively engaged in the construction of the Perth desalination project. We are very pleased with our performance on the contract; on time and on budget. This successful project delivery, at odds with the delivery of many other Australian desalination projects, has been recognised and applauded by the market – winning desalination plant of the year at the Global Water Awards in Rome earlier this year.

Our engineering expertise has also been recognised by the 2012 Environmental Engineering Excellence Award for the Gorgon Project shore crossing at Barrow Island. On account of this engineering expertise, we are being invited and are tendering on a significant amount of work. The works required to complete the roll out of the many energy and resource projects commenced in recent years is not expected to be completed for several years yet.

In summary, this year has been one of consolidation and establishing a solid platform to really motor the Group from the middle of CY13. Lucas expects to realise an asset or assets during the next 12 months; to eliminate debt and provide its final balance sheet solution. While the immediate outlook is weak, the Company has been rationalised and restructured to deal with it.

We believe market conditions and, in particular, Lucas' ability to perform in that market are quite positive from around the middle of next year. Upside will come from positive developments in the UK.

I now ask our CFO, Mark Summergreene, to address the meeting to explain more fully our achievements in restructuring our balance sheet and providing a solid platform from which to move forward.