

Abterra wheels and deals, elicits queries from local exchange

BY ANGELINE CHEONG |

Investors were excited to learn in 2006 that Abterra, a contractor-turned-iron ore trader, had been sold to General Nice Resources (Hong Kong), an affiliate of the General Nice Group that is said to control one-tenth of China's exports of coke. With its new parent, Abterra has broadened the scope of its business significantly to become a supply-chain manager of iron ore, coal and coke — all raw materials used to produce steel. However, instead of being able to talk up its bright prospects as China continues industrialising, Abterra's CEO Jaffe Lau has had to constantly explain unusual transactions and agreements by his company to investors and market regulators.

Just two weeks ago, Lau was busy providing the Singapore Exchange with information on a curious deal between one of its major customers and a vendor of a coal mine and two iron-ore mines that Abterra is in the process of acquiring. According to filings by the company, a major customer that it refuses to name has been slow in meeting its payment obligations. As a result, the company made an allowance for doubtful debts of \$10.2 million during the six months to December. For the six-month period, the company fell into losses of \$15.6 million. This was despite revenue falling just 1% to \$215.3 million, as a decline in trading activities and prices of iron ore was partially offset by the coking-coal segment.

CEO Lau insists that the customer will pay up, even though it is suffering as a result of the economic downturn. "We understand the difficulty of the major customer because of a halt in [steel producing] activities during the Olympic games last year and the

economic slowdown," he said at a media briefing after the company's AGM two weeks ago. However, noting that the "ultimate owner of the major customer is a well-regarded company in the minerals industry in China", Lau says it is unlikely that the debts won't eventually be paid.

All in, the unnamed customer owes Abterra some \$125.4 million. Under a repayment plan, the company now expects to receive this amount over a period of 36 months. However, at Abterra's request, a portion of the debt will be paid to a third party from whom the company is acquiring some assets. Abterra is buying a 49% stake in Shanxi Taixing Jiaozhong Coal Industry (Jiaozhong) and a 22.8% stake in Zuoquan Xinrui Metallurgy Mine (Xinrui). It expects to complete the acquisitions by this year but it doesn't have enough RMB currency reserves to pay the vendor, Shenzhen Manfu Industrial. So, Abterra has arranged for the major customer and that customer's ultimate owner to make good an outstanding \$68.5 million that it owes Shenzhen Manfu Industrial. As at Dec 31, Abterra had a cash balance of \$46.8 million in Singapore and US dollars.

"No known relationship between the vendor and the major customer has been declared to the company," Abterra said, in reply to an SGX query about the arrangement. Nevertheless, these unusual arrangements and transactions have made investors wary of investing in shares of Abterra. While it might have a bright future, riding on China's voracious de-



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mand for steel, it seems clear that its fortunes are closely tied to a web of relationships over which there is little transparency.

Indeed, the ultimate owner of the major customer has assumed responsibility for the outstanding sum in the event of a default. And, to enhance investor confidence, Lau and Abterra's chairman Cai Sui Xin have undertaken to provide an additional layer of guarantee of up to a maximum of \$47.6 million if the ultimate owner also defaults. "We have faith in the customer as it is a long-time customer of Abterra's parent GN," says Lau, who is himself a shareholder of GN. "Next year, [we] won't have this problem," says general manager John Baey. Abterra has stopped extending credit to the customer.

Can investors put their trust in



Abterra, which clearly doesn't operate independently? Is poor transparency par-for-the-course when investing in fast-growing but immature markets like China? Is it just a matter of time before Abterra delivers a nasty surprise to investors?

Acknowledging that Abterra is a public-listed corporate appendage of its parent, Lau says GN has a lot of experience in the coal and iron-ore industries — about 17 years' worth, in fact. And, so far, Abterra has clearly benefited from its association with GN. In 2006, GN acquired a 65% stake in Abterra from Hong Kong's Prosperity Steel. Abterra has since shown a marked improvement in its results, managing a turnaround in FY2007. For the financial year ended June 30, 2008, it posted a 14-fold jump in earnings to \$13.8 million, while revenue surged 235% to \$392.3 million (Abterra has since changed its year-end to December).

The big question is whether leaning on GN's relationships will continue to be a boon rather than a bane now that the world is in recession and commodity prices have dropped sharply. Abterra reported a loss for the six months ended December 2008.

Apart from the allowance for doubtful debt, the company was hit by a \$10.1 million impairment loss on its investment in Tianjin Lant Development due to adjustments in valuation assumptions as economic conditions have changed dramatically since it acquired a 45% stake in the associated company last February. Still, Tianjin Lant, which provides iron

ore, coke and coking-coal bulk handling services in Xingang Port in Tianjin, China, remains a strategic asset to the company, says Lau.

Lau admits that the economic conditions are challenging as the company's business is volume-driven. Faced with an oversupply of steel, China, the world's largest steel-making country, is said to be targeting to eliminate 72 million tonnes of inefficient iron-making capacity and 25 million tonnes of steel-making capacity by 2011, according to the National Development & Reform Commission. Meanwhile, the World Steel Association expects China's steel demand to dip 5% this year versus a 15% fall globally.

However, Lau remains optimistic of the company's long-term prospects. "The worst is probably over," he says. "We expect China to recover sometime next year." And, to position Abterra to ride the demand for steel in the long term, the company is looking to secure its supply of coal and iron ore through the acquisition of Jiaozhong and Xinrui this year. "It's not easy to acquire coking-coal mines any more," says Lau. "You need to pay a high price." But, with a little help from its parent and its business partners, he is hoping that Abterra will make it. ■