



FROM TRADER TO MINE OPERATOR

Coal and iron-ore player Abterra expands upstream, riding the uptrend in China's steel sector

TEXT & PHOTO _ ANDREW VAN BUREN

OUR RIDE FROM the 3.5 million-strong city of Taiyuan in northern China's Shanxi province – the country's biggest coal-mining region – to Abterra's newly-acquired coking coal mine some two hours away was a picturesque odyssey.

We rode on smooth byways past cornfields and stone-homed villages, up serpentine routes which were not even in existence a few short years ago. They were made possible by the massive wealth and employment opportunities that chased the recent commodities boom in China,

backed in large part by the country's rise to No 1 global steel producer status.

This writer savoured the opportunity provided by Abterra, one of only a handful of mining companies listed on the Singapore bourse, to visit its coking coal mines. It was my first visit to such a place – the very heart of the commodities boom which, if you believe the predictions of commodities guru Jim Rogers, will be around for a long time.

What are Singapore-listed Abterra's prospects now that it has ventured into owning stakes in coking coal mines? And

how much will it reap from China's aggressive infrastructure expansion? Until recently, Abterra was a trader of commodities: it imported iron ore into China from Australia, India and Indonesia and sold it to steel mills. It also imported coking coal and exported metallurgical coke.

In a major move to transform itself, Abterra recently signalled its ambition to expand upstream and become a mine owner and operator.

In May, it paid 188 million yuan (\$\$39.5 million) for a 49 per cent stake in Shanxi Taixing Jiao Zhong Coal Indus-



A coking coal mine
in Shanxi province

try Co, which delivers coking coal for the production of steel. This writer visited this mine as well as Zuoquan Yongxing Coal Company (also in Shanxi), in which Abterra acquired a 15 per cent stake for 45.75 million yuan in 2007.

As the Jiao Zhong mine will be accounted for as a subsidiary, the Abterra management is excited about its impending boost to group revenues, especially when approval is obtained to raise annual production capacity six-fold to 900,000 tonnes.

The surge in production will enable

Abterra, which recently sported a market capitalisation of around S\$330 million based on its stock price of 6.5 cents, to ride the long-term uptrend of China's steel-making sector. More immediately, the country's massive 4.5 trillion yuan economic stimulus package, part of which will fund the steel-hungry infrastructure and industrial mega-projects, is a boon.

As a coking coal-miner, coke processor and iron ore firm with mining and logistical operations in China, Abterra has its fortunes tied to the performance of China's steel industry, as coking coal and iron ore are the chief raw material inputs used in making steel.

All S\$65.8 million of its revenue in the first quarter of this year came from trading commodities. But its revenue composition will look very different when its new coking coal and iron ore mines start to make contributions.

Abterra stands to benefit from its links with its parent company, General Nice Group, which now owns 40 per cent of Abterra after a buyout in October 2006.

Some background on the General Nice Group: It is one of China's largest producers of metallurgical coke, a product processed from coking coal and used in the production of steel. In 2008, the total assets of General Nice Group reached HK\$7 billion (S\$1.3 billion) and revenue stood at more than HK\$8.8 billion. Aside from Abterra, General Nice Group has another subsidiary – Loudong General Nice Resources (China) Holdings – which is listed in Hong Kong.

Explaining the significance of Abterra's Jiao Zhong stake, Jaffe Lau, CEO of both Abterra and General Nice, said: "Jiao Zhong complements our trading business very well. We are not only able to secure a steady supply of high-quality semi-hard coking coal which sells at a premium compared to thermal coal, this acquisition has also provided us with a platform to participate in the booming PRC resources industry."

Jiao Zhong will begin making contributions to Abterra later this year but Abterra will reap the full benefits in 2011 after it finishes upgrading the facilities, added Mr Lau. That Abterra was able to purchase the Jiao Zhong stake was unusual as Chinese coal mines are tightly governed as national assets. Adding sizzle to its coup, Abterra, whose stock sometimes is traded heavily on the Singapore Exchange, clinched a whopper of a bargain.

Just consider that at the time the Abter-

ra-Jiao Zhong deal was closed, Singapore-listed Noble Group was offering A\$447.7 million (2.498 billion yuan or S\$538.3 million) for a 78.3 per cent stake in Gloucester Coal, which has 38 million tonnes of coal reserves. Abterra, in comparison, paid 188 million yuan for a 49 per cent stake in a company with access to 50.3 million tonnes of coal.

The latter reserves were confirmed only recently – and certainly they are a sharp increase from the 10 million tonnes that were documented when the deal was inked two years ago.

Yang Guangling, general manager of the Taixing Jiao Zhong mine, said he was upbeat on the sector, and on the sustainability of selling prices going forward.

"In 2007, when we announced plans to buy this mine, not including tax, selling prices for raw coking coal were 270 yuan a tonne. Now it's 800. I don't think it will return to 2007 levels again anytime soon. And as further proof of strong demand, remember that nation-wide, coking coal capacity is at an average utilisation rate of 80 per cent."

Abterra plans to continue making strategic acquisitions of coking coal mines to grow its production capacity to five million tonnes per year over the next two to three years, from the current 1.05 million tonne capacity of its two mines.

In Shanxi province, where General Nice has business connections since 1992 and is its first foreign investor, Abterra is authorised to operate the mine and will have a larger piece of the action following mass closures of non-compliant mines.

As part of a stepped-up effort to streamline and strengthen the industry in the run-up to China's 60th anniversary on Oct 1, the Shanxi government will tighten its clampdown on small coal mines to restrain supply and, more importantly, to avoid mine accidents ahead of the all-important National Day.

Partly due to the forced coal-mine closures – a campaign that has seen 2,690 operators in the province shrink to just 1,000 – coking coal prices have rebounded some 33 per cent from recent lows, versus a 10 per cent recovery in thermal coal prices.

Abterra's coal operations are in coking coal, primarily destined for domestic steel mills, and it does not engage in thermal coal mining, used mainly in power plants.

This is just fine with Abterra, as domestic coking coal shortages – chased by steel consumption growth – have meant that

China has been a net coking coal importer since 2004, but it is still a net thermal coal exporter.

“Shanxi is very strict. If the government catches you mining here without a licence, your power is summarily cut. The provincial government is also cracking down on illegal iron ore mines,” said Mr Yang.

He said government regulators even use helicopters to ensure compliance in some of the rugged terrain here.

“As the industry consolidates, it will become more profitable, efficient and safer. We will boost capacity to 900,000 tonnes per annum (tpa) from around 150,000 now at our Jiao Zhong mine. To do this, we will need around 300 million yuan investment,” he said, adding that the capacity uptick will take around one-and-a-half years to accomplish.

Mr Yang said his company benefits from a healthy relationship with the provincial government. “The government only wants licensed mines to operate as they are safer and contribute to fiscal revenue in the region. Also, we have had a stellar safety record since we bought the stake in Jiao Zhong in May,” he said.

He added that Abterra was “highly automated”, which meant fewer miners underground at any one time and less margin for human error. “We are mechanising, so short-term costs will increase with equipment purchases and power usage.”

And although the mine was currently below the stated minimum 300,000 tpa capacity, Abterra’s aggressive plan to boost capacity to around 900,000 tonnes in 18 months was allowing its operations there to proceed unhindered by bureaucrats.

Mr Yang added: “After

2006, the province received more power to crack down on illegal mines, and the authorities put a lot of effort into the campaign. Therefore, most mines in Shanxi are now in compliance with regulations and are more law-abiding. So now the government is targeting those that failed to get official licences or approval as many illegal mines nowadays don’t have safety equipment, and don’t pay required government taxes.”

Abterra was also keeping its eye on coking coal margins and selling prices, both of which have been rebounding of late – backed in large part by the more upbeat outlook on China’s steel sector.

“Our production costs including tax here are 200-300 yuan per tonne, with selling prices ranging over the past year from 700 to 1,500 yuan per tonne. Production costs will remain rather constant, and include electricity, raw materials, and labour costs. Wages are the most stable and won’t shift noticeably this year.”

He said that Abterra’s biggest buyer of coking coal – raw and washed – was nearby Shanxi Antai Group Holding Co. “One tonne of raw coking coal can become 0.55-0.6 tonne of refined/washed coal, which currently sells for around 1,300 yuan per tonne.”

The second day was highlighted by a visit to a mine producing another important commodity for China – iron ore. Another long and winding trip up switchback roads culminated in a stop at Abterra’s 22.8 per cent-held Zuoquan Xinrui Iron Ore Mine (to be acquired by year-end).

This acquisition is another example of Abterra’s move into more commodities as well as shifting up the supply chain to raw mining operations, in addition to its

ABTERRA FINANCIAL SNAPSHOT

	Q1 2009 S\$m	Q1 2008 S\$m	Change %
Revenue	65.8	44.3	49
Net profit	1.67	1.97	-16
Earnings per share (cents)	0.03	0.05	-40
Net asset value per share (cents)	4.01	3.97	4

Abterra said it still has a remaining payment of 160 million yuan plus options remaining to finalise the Xinrui acquisition.

Combined with the ongoing massive economic stimulus which is boosting activity in steel-hungry infrastructure projects across China, iron ore – even relatively low-iron-content domestic ore – will continue to command high prices from domestic steel mills.

With strong demand for steel, Abterra’s prospects look optimistic, which may be why Hong Kong-listed LeRoi Holdings recently entered into an agreement to accept shares of Abterra at a far higher valuation (255 million shares at 12.3 cents apiece, or twice the market price), in a swap that saw Abterra receive 385 million shares of LeRoi Holdings at 43.5 Hong Kong cents apiece, the market price.

Now with a 5 per cent stake in each other, the two companies will explore investment opportunities together in the coking coal, coke and iron-ore mining industry. LeRoi has identified resource projects in the region, which Abterra is keen to participate in.

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– Abterra’s Mr Lau

traditional focus on the supply and trading of various commodities.

The Xinrui mine, ranked No 3 in Shanxi province by size, has an annual production capacity of between 400,000 and 1.5 million tpa with total estimated reserves of some 37.9 million tonnes. Assuming steady output, this means Abterra will be busy supplying Xinrui iron ore to steel mills for nearly three decades!

UBS Investment Research recently raised its forecast for China’s crude steel output by 17 per cent to 530 million tonnes this year.

This flurry of activity at Chinese mills is hardly the behaviour of an economy practising austerity, or one lacking the confidence to seek aggressive growth and expansion – all qualities that Abterra is counting on to ensure good results going forward. **P**

