Rob Yeates and Associates Pty Ltd
Level 4 15-17 Young Street
Sydney NSW 2000

6 May 2015

National Competition Council
GPO Box 250
Melbourne Vic 3001

Subject : **Supporting Document for Application for a declaration recommendation in relation to the Port of Newcastle by Glencore Coal Pty Ltd**

Dear Sir,

Background

Rob Yeates ("The Author") of Rob Yeates and Associates Pty Ltd was requested by Glencore Coal Pty Ltd ("Glencore") to provide supporting information for their Application to the National Competition Council ("Application") for a declaration recommendation in relation to the Port of Newcastle.

The Glencore Application arises in the context of the New South Wales Government's recent[1] privatisation of the Port of Newcastle. The particular service relates to the use of the shipping channels at the Port of Newcastle by vessels calling at the coal export terminals located within the Port precinct. The new operator of the Port, Port of Newcastle Operations Pty Ltd[i2] ("Port of Newcastle Ops") has a long term lease arrangement with the NSW government.

[1] May 2014

[2] Port of Newcastle Operations Pty Ltd is trustee for the Port of Newcastle Unit Trust ("Port of Newcastle Ops") through a long term lease arrangement. Port of Newcastle Ops is jointly owned by investors Hastings Funds Management and China Merchants Group. Hastings, a global fund manager, specialises in infrastructure equity and debt. China Merchants is headquartered in Hong Kong with business sectors which include infrastructure, property development and financial investment.

The catalyst for the Glencore application is the Port of Newcastle Ops[3] having recently[4] increased prices for coal ships using the shipping channels to enter the Port. Glencore's concern is that this provides no certainty in relation to the scale or nature of future cost increases and therefore creates commercial risks for current and future coal mines and projects in the Hunter Valley.

In particular, the Glencore request was to provide perspective on the perceived risks associated with uncontrolled price setting of access charges for use of shipping channels at the Port of Newcastle.

<u>The Author's Relevant Experience</u>

The Author has worked in or been associated with the Australian coal industry for over 40 years. Experience particularly relevant to the subject of this letter is :

- Initially as GM Marketing, then GM Development and then Managing Director of Oakbridge Pty Ltd, a major NSW coal producer and exporter (1989-1997). During this time Oakbridge developed a major new underground coal mine and materially expanded a major open cut mine, both in the Hunter Valley.
- As a Director of both Port Waratah Coal Services ("PWCS") and Port Kembla Coal Terminal ("PKCT") (1991-1997)
- As a mining industry consultant (1998-2015), doing due diligence work for banks and investors on various coal mines and projects, including many which either did or planned to export through Newcastle. This has included coal mine developments and expansions which have been funded by non-recourse loans.
- Consecutively as Adviser, Project Director and CEO for Newcastle Coal Infrastructure Group (”NCIG") (2004-2014). NCIG was funded in large part by non-recourse bank loans. As part of this funding, extensive funding suitability reviews and due diligence studies were carried out on the NCIG construction project and also on the costs, risks and future of the Newcastle coal export industry and mines.
- As Director (non-executive) of Cockatoo Coal Ltd (2005-2015). Cockatoo Coal is a small[5] coal company exploring, operating and developing coal mines, and has had dealings with ports in NSW and Queensland.

[3] Details in Glencore application

[4] Effective January 2015

[5] Market capitalization of $100M -$200M

Port of Newcastle Based Coal Export Industry

Glencore has described the existing Hunter Valley export coal industry in their Application.

Further to this, forecasts are that coal exports through Newcastle will continue to grow[6] [7]. These growth forecasts are based on forecast world demand growth, and importantly that Newcastle coal exports are competitive in cost and price in the global market.

In 2014, coal exports through Newcastle totalled 160Mt. Growth since 2009 has been an increase of 70Mt or 80% over 5 years. Current coal export terminal capacity in Newcastle is 211Mtpa. PWCS is seeking development consent for further capacity to take total port coal export capacity to 281Mtpa to be able to meet forecast future coal export demand. The expected cost of this terminal expansion work is in excess of $5 billion.

This will require future expansions and mine developments of 120Mtpa, which will cost of the order of $10 billion to $15 billion. These expansions and developments will only occur if the planned production is cost competitive.

While the coal industry is currently subdued and prices are depressed, work is proceeding in preparation for development of new mines which plan to export through the Port of Newcastle, including :

- Shenhua’s Waternmark coal mine,
- Kepco’s Bylong coal mine,
- Malabar Coal’s Spur Hill coal mine
- Yancoal’s Moolarben underground coal mine
- Whitehaven’s Vickery mine
- Cobbora mine

Funding for Coal Expansion and Development Projects

Future funding requirements for coal mine expansions and developments, and for related infrastructure developments are expected to be in the range $15B to $20B. As has been the practice in the past, a large portion of this funding will be by way of bank borrowings and from investors such as superannuation funds, investment funds, private equity sources and joint venture participants.

[6] See PWCS Environment Assessment.
http://majorprojects.planning.nsw.gov.au/index.pl?action=view_job&job_id=4399

[7] ARTC 2014-2023 Hunter Valley Corridor Capacity Strategy
http://www.artc.com.au/library/2014%20HV%20Strategy%20-%20Final.pdf

The banks and investors will carry out due diligence on the mine projects to assess, inter alia, the project risks.

For coal mines and projects exporting through Newcastle, this due diligence has normally in the past consisted of reviews of :

- Coal title, tenure and approvals
- Environmental considerations and constraints
- Coal resources and reserves
- Mine plan and schedule
- Coal processing and coal quality
- Access to rail and port
- Capital and operating costs
- Coal markets and revenue

The recent privatisation of the Port of Newcastle, coupled with the subsequent 40% increase in harbour dues[8] will almost inevitably result in the commercial arrangements for port access being on bank and investor due diligence review lists. Traditionally for Newcastle shipping access, arrangements have not been regarded as high risk, as it was NSW government controlled, and generally considered that the government was supportive of coal exports and export growth in principle, and was also a recipient of per tonne coal royalty payments. The overall port shipping capacity of the Port of Newcastle has been subject to assessment by the previous Newcastle Port Corporation, and found to have sufficient capacity for the level of coal exports currently being planned. Various other aspects of shipping access have in the past been assessed by funders and considered low risk[9].

Due diligence on the shipping access arrangements can be expected to include :

- Shipping access security of tenure
- Shipping access pricing

(a) Shipping access security of tenure

The assessment of shipping access risk can be expected to be elevated above its direct cost ramifications, due to the monopoly position of the shipping channel provider. In short : no shipping access means no shipping. For a Newcastle coal exporter this would effectively shut that producer out

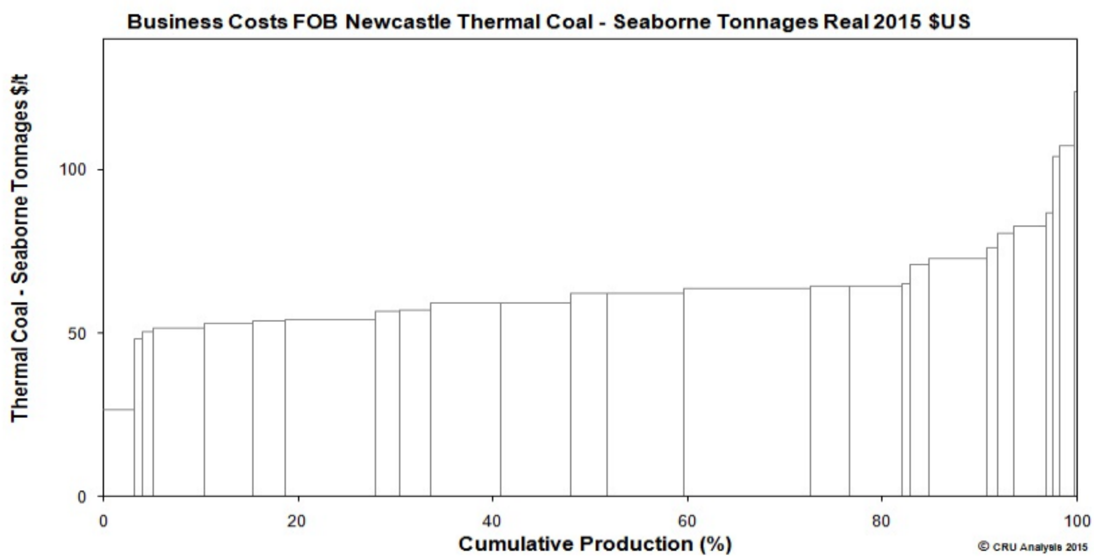
[8] Glencore estimates in Application.

[9] These include maintenance of channel depths and obstructions or shipping accidents in the main channels.

of the export market[10]. Newcastle Port, under government control, has traditionally made available access to all shipping, subject only to adequate safety and maintenance standards, and capacity (both the capacity of ship to be loaded (its load rate), and the overall capacity of the port). The replacement of government control with a commercially driven port operator can be expected to lead to heightened awareness by funders and investors of shipping access arrangements and constraints.

(a) Shipping access pricing

The shipping access charge is currently just less than 1% of the FOB cost of export coal. In the current market, where many producers are operating at a loss, any increase in the access charge either adds to losses or represents a material portion of the producers' margin. The 2015 Newcastle export thermal coal cost curve[11] is shown below. Current spot thermal coal prices are US$60 and contract prices US$70 per tonne. From the thermal coal cost only the least cost 85% of production is making a positive margin on sales, and for these mines the average margin is <US$10 per tonne. For the 2nd and 3rd cost quartiles[12] the average shipping access charge is between 10% and 100% of the margin. For mines in the 4th quartile of the cost curve there is no positive sales margin, so the shipping access charge simply adds to the loss.



Bank funding will continue to be sought by coal producers for mine expansions and new mine projects. Important in this, especially for smaller producers, is project finance funding, where the bank's security is limited to the project. Bank due diligence on project finance funding can be

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[10] Minor tonnages have in the past been shipped via Port Kembla, but these are at a high transport cost, and subject to Port Kembla having adequate capacity, which has not always been the case.

[11] Source CRU through Glencore

[12] Represent 50% of production from 25% to 75% positions on cost curve.

expected to be more extensive due to the lesser security being taken by the lender. Coal industry examples[13] of project finance funding in the last 18 months include :

- Glencore's acquisition of a share of the Clermont coal mine in Queensland
- Cockatoo Coal bank facility to fund the Baralaba coal mine expansion in Queensland[14]
- NCIG funding of all stages of coal terminal construction[15]

Should potential financiers not be able to assess the risks of shipping access security of tenure and pricing as low, then the potential financier may :

- Elect not to provide funding, or
- Increase the funding costs to cover the perceived risk

If pricing of shipping access was regulated, this could be expected to be perceived as a reduced level of risk to the exporter.

Summary and Conclusion

Coal mines and related infrastructure developments for coal exports through Newcastle into the future can be expected to require billions of dollars of additional funding. The recent privatisation of the Port of Newcastle, coupled with the subsequent significant increase in harbour dues will almost inevitably result in the commercial arrangements for port access being on bank and investor due diligence risk review lists. Regulating this monopoly service should alleviate this risk.

Should you wish to discuss this further, my contact numbers and email address are given below.

Yours faithfully

R.A. Yeates
Consultant
Phone : 02-92417277 E-mail : ryeates@bigpond.net.au

[13] Note that the recent Whitehaven Coal refinancing is a corporate facility, not a project financing.
[14] This facility was eventually not used.
[15] $2.6B over period 2008 to 2014