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Emerging coal players in Asia-Pacific

While the coal scene in Asia is still dominated by government-owned companies and in Australia by the mining majors, a number of 'independent' coal players are emerging. How might the structure of corporate control in the Asia-Pacific coal sector evolve over the next decade and could any of the emerging independents (Banpu, Excel, Macarthur, Felix…) become leaders ?

INTRODUCTION

Coal is still the single most important fuel for the electricity sector worldwide, accounting for a steady 40% of the global fuel mix for power generation over the past three decades - and very likely to retain its lead for at least another decade or two.

Nowhere is the coal story more compelling than in Asia, where coal overtook oil as the leading power fuel in the 1970s and has not looked back. These days coal and lignite-fired power generation represents around half of all electricity supply in Asia, with the Asian giants, India and China relying on coal for approximately 70% and 75% respectively of their power generation requirements. If we add coal for steel consumption and other uses, the Asia-Pacific region now devours over two-and-a-half billion tonnes of coal every year.

ASIA-PACIFIC COAL PRODUCTION AND CONSUMPTION (2003)

Country		Coal production	Coal consumption	Surplus / *deficit*
	Million tonnes*	Mtoe*	Mtoe*	Mtoe*
China	1,667	843	807	36
Australia	347	189	50	139
India	367	172	185	*- 13*
Indonesia	115	71	19	52
Vietnam	19	11	**7	4
Thailand	19	5	10	*- 5*
New Zealand	5	3	2	1
South Korea	3	2	51	*- 49*
Pakistan	3	1	3	*- 2*
Japan	1	1	112	*- 111*
Taiwan	-	-	35	*-35*
Other	40	21	26	*- 5*
ASIA-PACIFIC	2,586	1,320	1,307	12
WORLD	5,119	2,519	2,578	

*Including lignite, coking coal and thermal coal **Estimate
Source: BP Statistical Review of World Energy, 2004; AWR Lloyd

Given the fundamental growth path that Asia is on, the region is likely to be consuming an additional billion tonnes or perhaps two by 2020 (a CAGR of 2% gives 3.6 billion tonnes and 5% gives 5.7 billion tonnes of coal consumption in the region by 2020).

This article considers who currently controls coal supply in the region and provides some indications regarding how the structure of control might change over the next decade or so, including the possible emergence of new independent industry leaders.

OVERVIEW OF CURRENT COAL SUPPLY STRUCTURE IN THE REGION

Currently about half of all coal supply in Asia-Pacific is still ultimately controlled by governments: principally the Chinese government (through the likes of Shenhua, Datong, Yanzhou…), but also the governments of India (Coal India, NLC…), Vietnam (Vinacoal), Indonesia (PTBA), Thailand (EGAT), New Zealand (Solid Energy) and others.

The next most important 'category', accounting for a further third of all coal supply in Asia-Pacific, is the thousands of unpredictable and often undisciplined small mining enterprises (each producing less than 1Mt/y of coal production) in China, some privately-owned and some owned by local townships. This atomistic crowd controls over 800 Mt/y of coal production, or about half of China's total coal supply.

This leaves slightly less than 20% of supply, in tonnage terms, that comes from conventional private sector corporations (around 470 Mt in 2003). Within this group, the main sub-group (controlling about 220 Mt of production in 2003) is the international mining 'majors': BHP Billiton, Rio Tinto, Xstrata and Anglo American. The mining majors manage some of the largest and best coalmines in Australia and are predominantly geared towards export to the north Asian markets of Japan, South Korea and Taiwan. The remainder comes primarily from the independent and junior mining companies in Indonesia and Australia.

ANALYTICAL FRAMEWORK ?

The extent to which the Chinese, Indian and Vietnamese governments in Asia 'let go' of their shareholdings in their large domestic coal companies over the long term – and the way that this is done (stock market listings, strategic divestments, JVs…?) – is clearly one of the most important aspects of any analysis of potential structural change. And while some of those that are 'let go' may become new leading regional 'independents', others may become acquisition fodder for the majors or for some of the existing up-and-coming independents.

While trying to predict how the situation amongst the state-owned coal corporations will evolve is difficult, perhaps even tougher is trying to 'pick' the winners and future leaders amongst the existing spectrum of independent and junior coal players in the region.

AWR Lloyd is a specialist strategy and M&A advisory firm with an exclusive focus on the Asia-Pacific mining and energy sectors. They have worked with two of the region's emerging independent coal companies over the past few years: one in Asia (Banpu, a coal-to-power group with operations and projects in Thailand, Indonesia and China) and one in Australia (Felix Resources, currently finalizing a merger with another Australian coal junior, White Mining). AWR Lloyd Chairman, George Lloyd, says "Growth for the sake of growth, as in simply adding tonnage, is a dangerous game. If this is a company's sole focus it may implode over the longer term as shareholder value is destroyed and as it loses the confidence of investors. With our clients the focus is very much on profitable growth that builds value for the company's shareholders. The companies that think in value terms and which have the necessary management skills are the ones that are likely to be still around in ten years time or more".

AWR Lloyd suggests the following criteria for assessing the potential of emerging coal independents to become leaders over the longer term:

1. *Management skills*: Management teams that really understand value and value maximization, with skills in identifying and securing value-creating growth opportunities (e.g. high quality, low cost-quartile mines) through acquisitions, mergers and organic expansion will generally be those that become leaders over the long term.

2. *Understanding of Asian coal markets:* Having insight into the way in which the Asian coal markets are likely to evolve over the longer term, including the impact of environmental pressures and penalties, will give a company a strong advantage.

3. *Emphasis on good corporate governance and social responsibility:* Companies that give due attention to good corporate governance, employee motivation, stakeholder relations and socio-environmental issues, will generally be more successful at creating constructive and innovative corporate cultures while reducing the likelihood of stakeholder conflicts and liabilities over the long run.

4. *Access to financial markets:* Apart from existing financial resources and future resources generated from internal cash flow, the ability to access external funding on favorable terms, is also important. A stock market listing on an international mining-friendly exchange plus good investor relations skills may be the key for some independents to fund growth over the next ten years through equity placement and through paper M&A deals.

5. *Quality and extent of existing undeveloped coal resources:* Those independent companies that already have extensive undeveloped coal resources will often be in a better position to generate value-growth through organic development and expansion, than those that rely mainly on acquisition. This could be particularly relevant at the present time when greenfield and brownfield costs per tonne of coal produced are well below those that can be achieved in the M&A market.

6. *Intentions and strategy of core shareholders:* If core shareholders are not committed to a company over the long term, then by definition, the company is likely to be acquired or integrated in a merger, and so will not be around as a leader in ten or fifteen years time.

Keeping the above criteria in mind, we have taken a quick look at some of the independent candidates that could become future industry leaders, first in Indonesia and then in Australia. We then turn briefly to consider whether any of the state-owned companies in Asia could eventually 'cut the umbilical cord' and become fully independent regional players over the next ten to fifteen years.

THE INDONESIAN INDEPENDENTS

Units: Mt (equity basis)

Indonesian players	Total	Met coal	Thermal coal Domestic	Thermal coal Export	Main assets
Bumi Resources	35.2	-	1.1	34.1	Arutmin, KPC
Banpu	13.0	-	0.8	12.2	Indominco, Jorong, Kitadin
Dianlia	12.4	-	4.6	7.9	Adaro
New Hope	10.0	-	3.7	6.3	Adaro
PTBA	9.9	-	2.2	7.7	Tanjung Enim, Ombilin
Samchully	8.3	-	3.0	5.3	Kideco
PTAT	8.1	-	2.4	5.7	Berau
Indika	7.0	-	2.5	4.5	Kideco

Sources: company reports, AWR Lloyd

The largest of the emerging independents is Bumi Resources, and in most respects, Bumi is no longer *emerging*, it is already a 'leader'. A hotels and tourism company until the late 1990s, Bumi has come from nowhere to become one of the region's leading coal producers and exporters, very much in the same league as the mining majors in terms of size of production in the Asia-Pacific region. This has been achieved in two dramatic steps, the first in October 2001, with the acquisition of Arutmin from BHP Billiton, and the second in October 2003, with the acquisition of Kaltim Prima Coal ('KPC') from Rio Tinto and BP. Now in control of two of Asia's prize coal assets, Bumi achieved production of nearly 40 Mt in 2004 and has plans to increase to 70 Mt/y by 2007, mainly through expansion of KPC.

At an operational level, Bumi still benefits from the world-class training received by many of its managers and staff from BHP Billiton and Rio Tinto. Bumi's marketing is taken care of through arrangements with Mitsubishi, Glencore and BHP Billiton. And, of course, Bumi is currently churning out unprecedented cash flows (with some analysts forecasting EBITDA of US$600 million this year). The company has the financial muscle to pay down debt, cover expansion capital expenditure requirements – *and* take on further acquisitions. So what could go wrong ? Perhaps not much, and it is hard to dispute the idea that Bumi is likely to remain a leading regional coal player for many years to come.

But Bumi does face a few challanges. For example the foreign holding structure acquired by Bumi when it acquired KPC obliges it to sell down 51% or face a large capital gains tax bill (some analysts have indicated a worst-case scenario of US$426 million). The recent deal divesting an 18.6% stake to the local government of East Kutai is a first attempt at structuring its way out of the problem. Some analysts believe that failure to pay by the East Kutai government will lead to a penalty involving return of a 10.6% stake to Bumi. But even if this satisfies the regulatory authorities regarding the sale of 18.6%, that still leaves 32.4% to sort out. One option is just to keep renewing its offer for sale each year with no buyers likely to emerge. The downside here appears to be the obligation to keep paying 45% income tax on KPC profits (as per the original contract of work). An IPO for KPC is another option but would create a messy and inefficient structure from an investor and corporate perspective.

And what of Bumi's prospects in the longer run ? While Bumi clearly knows how to put a deal together in Indonesia, it remains to be seen whether the company has what it takes to acquire assets overseas (say in Australia or China). There may also be questions about whether Bumi's corporate governance standards are strong and clean enough to allow it to obtain the benefits of a successful international stock market listing. A listing on London or the ASX could help the company obtain 'fair value' for its share price over the longer term and could be useful for raising further capital for expansion, or to use its shares as acquisition currency in an M&A transaction.

While not quite as explosive as Bumi's rise, Banpu's growth in recent years has also been impressive. With its equity market capitalization on the Thai stock exchange languishing below US$100 million in 2000, the company had arrived at a strategic crossroads. Chanin Vongkusolkit, CEO of Banpu explains: "We were too diversified and complex for a small company and our investor communications needed improving. We decided to take a close look at what our core skills and competitive advantages might be and have since tried to develop a new more focused strategy around these principles". With its roots in coal-mining in Thailand, Banpu made a decision to focus its financial and management resources more intensively on coal and to expand overseas, particularly in Indonesia and China. "The acquisition of the Indocoal assets through a two-stage transaction in 2001 and 2002 was a milestone in Banpu's development" states Mr Chanin, "The equity tonnage produced by Indocoal in 2000 was less than 4 million tonnes, but we saw strong growth potential. Through rationalization and investment these assets will generate almost 13 million equity tonnes of coal for Banpu in 2005 and 15 million in 2006." The Indocoal assets, for which Banpu initially paid around US$52 million through a convertible loan structure, included three in Kalimantan, two in operation, Indominco and Kitadin, and one undeveloped, Trubaindo, plus one undeveloped resource in Sumatra, Barasentosa. Banpu paid another US$10 million in 2003 to take 100% control of Indominco. Last year Indominco and Kitadin contributed a combined gross profit margin of around US$130 million.

In addition to the Indocoal assets must be added Banpu's 3 Mt Jorong operation in South Kalimantan, which the company developed from scratch in the late 1990s, as well as Banpu's remaining coalmines in Thailand and some initial tonnage from the new Daning mine in China. The company expects to be producing a total of around 21 Mt/y coal by 2006, of which towards 90% will continue to be for the export market (mainly the north Asian thermal markets, but also Thailand, India and Italy).

BANPU COAL ASSETS

Asset	Ownership interest	Country	Mine type	Forecast 2005 sales 100% basis (Mt/y)	Sales at full capacity 100% basis (Mt/y)	Year of full production (calendar year)	Markets
Indominco	100%	Indonesia	Opencut	8.0	8.0	Current	Export
Kitadin	100%	Indonesia	Opencut	1.8	1.8	Current	Export
Jorong	95%	Indonesia	Opencut	3.0	3.0	Current	Export & Domestic
Trubaindo	90%	Indonesia	Opencut	3.0	5.0	2006	Export
Daning	11%	China	Longwall	-	4.0	2006	Domestic
LP - 2	100%	Thailand	Opencut	2.0	2.0	Current	Domestic
CMMC	100%	Thailand	Opencut	0.6	0.6	Current	Domestic
Total				18.4	24.4		

Banpu is also developing a complementary and synergistic strategy in coal-fired power, not only with the pioneering BLCP 1,400 megawatt coal-fired power plant in Thailand (due to come on-stream in 2007 at a cost of US$1.3 billion, 50% owned by Banpu) but also through new projects in other Asian countries. The Barasentosa coal resource in Sumatra, for example, acquired through the Indocoal deal, could be developed in conjunction with a mine-mouth power plant. Banpu is relatively unique in its ability to invest in vertically integrated coal/power projects and in the long term this could arguably give them an advantage in parts of Asia where lower grade coal resources and lignite favour mine-mouth power plants. A good example might be in India, where there are extensive low-grade coal and lignite resources and where foreign companies are currently only allowed to have majority control in ‘captive’ mines for power generation.

In line with its more focused corporate strategy, Banpu has also made moves to restructure and gradually divest non-core assets (including interests in a port, industrial minerals mines, a chemicals company and gas-fired power). Today Banpu can boast a market capitalization of US$ 1.1 billion, more than fifteen times what it was four years ago, and a basket of promising greenfield and business development opportunities in the pipeline.

Mr Chanin sees further organic growth potential from Banpu’s existing coal resources. SRK Consulting and two other technical consulting firms, have recently confirmed Banpu’s total equity coal resources at about 1,150 Mt including 225 Mt of Proved and Probable reserves. “We will also continue to look out for new acquisition opportunities in Indonesia and other countries in the Asia-Pacific region, but will be careful to avoid over-priced assets at this point in the cycle. We are mainly interested in assets where we can identify strong upside value potential that Banpu’s skills can unlock” says Mr Chanin; “We see China as an important source of business development opportunities for Banpu over the coming years and we took our first step by investing in AACI in 2003. These are still early days, but so far the projects are developing well and according to plan. If we take a long term view, then other countries of interest could include Vietnam, India and Australia”.

[BANPU PHOTOS: ONE OF CHANIN, ONE OF INDOMINCO]

With net debt to enterprise value (market capitalization plus net debt) running at only 12% and liquid investments in non-core listed companies worth around US$370 million, the company looks to have a large, albeit partially concealed war-chest, both for further organic growth and acquisitions. Banpu’s relationship with the capital markets appears to be good and its ability to secure large-scale project finance (e.g. BLCP) and low-priced corporate debt (87% fixed-rate) points to strong financial skills and the potential to raise further funding for growth over the long run. With its reputation for good corporate governance, it may also find a willing international investor audience if it were ever to list on an international stock exchange. Perhaps the main challenges for Banpu will be whether they can succeed in China (where other foreign investors have failed) and whether they have what it takes to replicate the success of the Indocoal acquisition with similar or larger-scale acquisitions in the future.

Amongst the main players in Indonesia, Bumi and Banpu stand out. Taking a look at some of the other players, for example Dianlia, Indika, PT Amardian Tritunggal, Samchully, and PT Bukit Asam, all have strong potential but none appear to have the strategic drive and substantive trackrecord that Bumi and Banpu have demonstrated.

Samchully, the Korean industrial group is struggling with the foreign ownership rules and has been forced to sell down to a 49% position in Kideco, the 17 Mt/y mine in East Kalimantan. PT Indika Inti Corpindo (backed by the Sudwikatmono group and power giant China Huadian Group) now owns 41% of Kideco but recently lost out in bid for a controlling position in Berau (9 Mt/y) to PT Amardian Tritunggal ('PTAT'). Whether PTAT, backed by PT Buma, (the main Berau contractor) and the Salim group will try to acquire more assets and whether it has staying power remains to be seen.

The Soeryadjaya/Dianlia group may also be one to watch. Hitherto mining contractors (like Indika and Buma/PTAT), the group acquired 51% of 24 Mt/y Adaro in 2002, one of Indonesia's other prize coal assets with its low-ash, low-sulphur 'Envirocoal' brand. The group now appears to have put together a consortium to take out New Hope's 41% position in Adaro. But will the group hang on to Adaro and develop the 600 Mt lower grade Wara resource, or flip Adaro at a profit to one of the bigger players, rumored to be negotiating in the wings ?

Finally on the Indonesian coal scene, there is 71% state-owned PT Bukit Asam ('PTBA'). PTBA was listed on the Jakarta stock market in 2002, and is sitting on billions of tonnes of low-grade coal resources plus around 350 Mt of coal reserves (the latter with an average quality of about 5,950 Kcal/g, much of it exportable). Due to reliance on the state-owned railways to the ports of Tarahan and Kertapati and the government's inertia in promoting new coal-fired power plant in Sumatra, PTBA has been stuck at production of around 10 Mt/y for many years. Between now and 2008, though, railway track improvements should enable an increase to 15 Mt/y. Perhaps more importantly, the development of new mine-mouth power plants in Sumatra over the longer term (perhaps even supplying electricity to Singapore and Malaysia), should unlock the full potential of the company. There are already several such projects, some involving equity participation from PTBA, in the pipeline. While the Indonesian government looks keen to hold on to majority control for the moment in PTBA, taking a ten or fifteen year view, it seems likely that the company and its assets could ultimately be acquired by one of the bigger players (Bumi, Banpu, BHP Billiton…?) or even by a major power generation group.

Looking to the future, another development in Indonesia that we can already anticipate is the 'return of the majors' and perhaps linked to this the evolution of Indonesia as a participant in the regional coking coal market. With the sale of KPC and Arutmin and the closure of Kendilo, it appeared as if the mining majors had been pushed out of Indonesia for good. But it now looks as though BHP Billiton, at least, will be back with a vengeance, not least with their planned 10 Mt/y hard coking coal mine at Maruwai in Central and East Kalimantan, scheduled for commissioning by 2010. An interesting side-story associated with this is the rumour that Steel Authority of India Ltd ('SAIL') is considering co-investing in Maruwai to help meet its desperate need for imported coking coal for planned steel production of 20 Mt by 2011-12.

THE MAJORS IN AUSTRALIA

Units: Mt (equity basis)

Majors and foreign owned	Total	Met coal	Thermal coal	
			Domestic	Export
BHP Billiton	62.7	50.1	5.0	7.6
Xstrata	40.2	12.2	4.0	24.0
Rio Tinto	38.9	9.1	-	29.8
Anglo American	26.2	9.1	9.1	8.0
Idemitsu	7.5	-	-	7.5
Peabody	7.1	5.5	-	1.6

Sources: company reports, AWR Lloyd

Moving down the map to Australia, the structure and nature of corporate control in the coal sector is quite different. The international mining majors have dominated the production of coal for many years and control much of the port capacity. Between them, and on a '100%' basis, the four majors, (BHP Billiton, Rio Tinto, Anglo American and Xstrata) have effective control over approximately 220 million tonnes of coal production in Australia, or around 60% of total coal supply in the country.

BHP Billiton stands out not only as the largest of the four in Australia (total 63 Mt equity basis in 2004) but also as the outright heavyweight champion in metallurgical coal, with over 50 Mt of equity tonnage in 2004 (or 76 Mt when the minorities owned by Mitsubishi and Mitsui are included). Xstrata comes in second at 40 Mt (equity basis) in 2004, including 12 Mt of metallurgical coal thanks mainly to the Queensland assets acquired through MIM. Rio Tinto is a close third with 39 Mt. Rio Tinto has been the leading thermal coal exporter from Australia, but strengthened its metallurgical position last year through the development of the Hail Creek mine. Anglo sells more domestic thermal coal than the other three, but is smaller in overall terms with Australian production total of around 26 Mt in 2004.

Looking forward, the majors are expected to defend their leading positions in the Australian coal industry, but each with a slightly different emphasis. BHP Billiton has clearly shown its intention to strengthen its grip on the metallurgical coal markets with a target of attaining 100 Mt/y managed production by 2010 mainly from Australia. The expanded production will come partly from greenfield and brownfield expansions within the Mitsubishi and Mitsui joint ventures and partly from directly-owned projects such as Dendrobium and Illawara.

Rio Tinto has also recently been expanding metallurgical coal production but thermal coal is likely to remain the focus with new projects such as the 10Mt/y Clermont mine succeeding Blair Athol on its depletion in 2010. Xstrata will also emphasize thermal with potential to add up to 10Mt/y of new capacity from the Rolleston project plus expansion of the Ulan longwall operation over the next five years. Anglo, meanwhile, in the nearer term at least, is likely to concentrate on new projects and 'add-on' assets that replace depleting assets.

Two companies on the Australian coal scene that don't fit either the 'majors' or the 'independents/juniors' categories are Peabody and Idemitsu. Having sold out its old Australian coal assets to Rio Tinto in January 2001, US coal giant Peabody returned only a year-and-a-half later with acquisitions in the metallurgical coal sector, and now controls over 7Mt/y of production. It is not clear yet whether this forms part of a renewed and longer term commitment to international expansion, or whether it represents shorter term opportunism to benefit from the cyclical rise in metallurgical coal prices.

Idemitsu, Japanese energy and petrochemicals group, also controls around 7Mt/y of production from the Apollo and Ensham mines. Idemitsu may be around for a while, but it seems like an unlikely candidate for any large-scale ambitions in coal.

AUSTRALIAN INDEPENDENTS & JUNIORS

Despite the imposing size of the international mining majors in the Australian coal industry, there is certainly enough coal in the ground to support a thriving and entrepreneurial tier of independent and junior coal companies as well. While short term port and infrastructure constraints may limit expansion potential amongst this group, longer term expect to see explosive growth from one or two of these players.

Units: Mt (equity basis)

The independent and juniors	Total	Met coal	Thermal coal	
			Domestic	Export
Wesfarmers	12.7	4.6	6.3	1.7
Centennial	11.1	0.4	8.2	2.4
Excel	4.9	1.3	-	3.5
Macarthur	3.8	2.8	-	1.0
Jellinbah	3.7	3.7	-	-
New Hope	3.4	-	1.4	2.0
Foxleigh	2.0	2.0	-	-
Felix	1.7	1.0	-	0.7
Gloucester	1.7	0.6	0.3	0.8
Austral	1.2	1.2	-	-

Sources: company reports, AWR Lloyd

The biggest independent player in terms of Australia-based coal production is Wesfarmers, with production in 2004 of nearly 13 million tonnes of both metallurgical coal (for the export market) and thermal coal (for domestic power producers and for export). Wesfarmers is diversified A$8 billion turnover Australian conglomerate with interests in hardware retailing, coal, gas, insurance, safety products, chemicals and fertilizers. Given their value focus, one might think that now could be a time for Wesfarmers to sell out of coal. Perhaps they'll wait until the next up-cycle, but one might guess that by 2020 they may have exited the coal scene.

A similar size, but a different animal, is Centennial with equity tonnage in 2004 of around 11 Mt, almost exclusively for the thermal market and predominantly under long-term contract with New South Wales power producers. Centennial's biggest growth spurt was the acquisition of Powercoal in July 2002, previously owned by the NSW government, adding around 9 Mt of capacity and the power contracts. Total attributable tonnage should rise to about 15 Mt this year, and two further greenfield and brownfield developments (Mandalong South and Anvil Hill) are likely to add up to a further 10 Mtpa over the next few years. Centennial has been accredited with a highly competent and entrepreneurial management, albeit with perhaps a tinge of conservatism. Further acquisitions seem possible, but given the company's wide-open free float on the ASX it may also end up being a target itself at some point.

Below Wesfarmers and Centennial, on the size scale, there is a vibrant group of around eight to ten junior coal players each with production in the range of around 2 to 5 Mt/y, and most of which seem oriented, at least in the short term, towards the metallurgical markets, including PCI coal.

The odd-man-out in this group is New Hope, with Australian production of just over 3 Mt of thermal coal in 2004 from three small open cut mines in Queensland (55% exported), but with an additional attributable 11 Mt from its 41% interest in the Adaro mine in Kalimantan, Indonesia. With the reported conditional sale of this stake, New Hope will be transformed to being a junior Australian coal play, but with a conspicuously large lump of cash on its balance sheet. Whether this gets paid out to shareholders or whether it is used for further acquisitions in Australia or overseas is not clear. But it seems possible that conglomerate Washington H Soul Pattinson, the 63% shareholder in New Hope, is looking to get out of coal at the peak of the cycle. If this is the case, the Queensland mines could also be up for sale.

Putting New Hope aside, the two leading juniors for the moment are Macarthur and Excel, both ASX-listed companies with dynamic and growth-oriented management teams. Excel, with production of about 5 Mt in 2004 has very extensive coal reserves (350 Mt) as well as over a billion tonnes of additional resources. With low net debt and a market capitalization equivalent to around US$650 million, the company should have sufficient latent financial strength to go a long way towards funding their organic growth potential, starting with the Wilpinjong, Moranbah and Wambo expansions projects.

Macarthur is the leading independent PCI coal producer with a market share of 36% of the total export PCI market. With current attributable production of 4Mt/y, Macarthur may not grow as quickly as the other players in the short term as many of its pipeline projects are still in an early stage of development and there are port capacity constraints that will need to be solved. Longer term, however, with a dynamic and growth-oriented management, expect bigger things from this company including its possible emergence as a player in the hard coking coal markets, given its recent discovery of hard coking coal deposits and investment in coking plant.

Austral and Gloucester are two ASX-listed coking coal players with production of around 2Mt/y each, although Gloucester's production is around half thermal. Both are widely-held in the stock market and could become targets either for other juniors or independents or potentially for Peabody or one of the Asian steel groups hungry for coking coal (e.g. SAIL, Tata Steel…?). Announcements from Austral and press coverage already indicate that potential acquirers are already moving in on this company, and it seems possible that Gloucester may also succumb at some point.

Last, but almost certainly not least, in the analysis of the Australian line up of independents, is Felix Resources. Watch out for this company, a recent product of a merger of the RMM-owned Yarrabee mine and listed AuIron Energy. Appearances can be deceptive with only 1.5 Mt of PCI and thermal production in 2004, Felix Resources now has plans afoot to increase its attributable production to almost 14 Mt by 2010 from existing resources and from resources acquired through the merger with unlisted White Mining (scheduled for imminent shareholder approval). The post-merger company will have a diversified range of coal products covering PCI, semi-soft coking and thermal coals.

Jon Parker, Managing Director of Felix Resources, describes the company and its strategy as follows: “Felix is a growth-orientated resources company with a primary focus on the profitable production of coal. Completion of the White transaction will position the merged entity as a significant Australian coal producer. It will lead to an immediate increase in Felix’s coal production and will also provide the company with a pipeline of near and medium-term development projects”.

[Photo ?]

CHINA AND INDIA

While Indonesia and Australia are the main playing fields for private sector companies at the moment, if we take a ten-to-fifteen year view, it is also worth considering what could happen in China and India.

Today, the top ten coal producers in China control less than 25% of national coal supply. To help prevent power shortages and with the objective of gaining better control over coal supply, at the National Coal Industry Reform and Development Conference in December 2003, the Chinese government announced a policy of promoting the formation of up to ten giant coal corporations. It is intended that after a phase of mergers, acquisitions, rationalization and closures (a phase which is already under way), the new giants will control around 60% of national production, each with output of at least 50 Mt/y and some with production of 100 Mt/y or more.

TEN LARGEST COAL PRODUCERS IN CHINA (2003 OUTPUT)

Company	Tonnes (million)	% China’s total
Shenhua Shenfu Dongsheng	73.8	4.6%
Datong Coal	50.1	3.1%
Yankuang (Yanzhou)	45.6	2.9%
Huainan Mining	28.3	1.8%
Xishan Coal & Electricity	28.1	1.8%
Pingdingshan Coal	26.7	1.7%
Pingshuo Coal	26.5	1.7%
Kailuan	25.5	1.6%
Yangquan Coal	22.7	1.4%
Huaibei Mining	20.2	1.3%
TOP TEN TOTAL	347.5	21.9%

Source: China Coal Information Institute

For the moment the only company to break away from the pack, albeit on a ‘leash’ (still 55% state-owned), is Yanzhou. Listed in an IPO on the Hong Kong stock market in 1998, with an ADR on New York, Yanzhou has peformed well and its management is generally considered better than the Chinese average. The company currently has a market capitalization of around US$4.3 billion and low financial gearing. From a base of five large underground mining operations in Shandong, producing about 43 Mt in 2003, and an associated 2 billion tonnes of reported reserves, Yanzhou has recently nearly doubled its coal resource base by acquiring two undeveloped resources, with reported reserves totaling 1.5 billion tonnes and planned production of around 12 Mt by 2010.

Yanzhou is one of the leading Chinese coal exporters with an estimated 26Mt of thermal and metallurgical coal exports in 2004, and the company will be keen to maintain access to premium customers in Japan and other north Asian countries over the long term. In addition, in 2004 Yanzhou made its first overseas coal-mining acquisition in Australia, with the purchase of the Southland Coal mine in Hunter Valley from Gympie Gold. Southland has reserves of 41 Mt and produces mainly hard and semi-soft coking coal. Yanzhou has expressed its intention to expand internationally and so Southland is likely to be just the first in a series of acquisitions over the next ten to fifteen years.

But with the vast and seemingly insatiable appetite for coal in the domestic Chinese market, Yanzhou's capital and attention may remain balanced towards servicing domestic requirements. Further large-scale acquisitions in China seem very likely over the longer term.

Shenhua is slated to be the next Chinese coal giant to be privatized and others will probably follow. Whether the government will ultimately allow companies like Yanzhou or Shenhua to pursue strategies independent from government shareholder control and interference is not clear, but taking a very long-term view, this would seem possible. For the foreseeable future though, the more interesting question from the point of view of 'emerging independents' is what opportunities China will bring for acquisition and organic growth for companies like Banpu and the acquisitive Australian juniors. So far the AACI joint venture including Banpu is the only example of foreign investment in the coal sector, but it appears to be progressing well, albeit slowly, and more examples of this nature will surely follow.

In India, while Tata Steel has some of its own captive coking coal mining, there is little evidence of any other significant private sector investment in the coal industry at present, let alone large-scale foreign investment. Current regulations only allow investment (if a foreign company is seeking majority equity control) in captive mines for power generation or steel making, and even here bureaucratic red tape and other hurdles make identifying and securing coal resources of an economic size and quality almost impossible in practice. Indications of imminent liberalization were reported for many years, but the current administration appears to have ruled this out. Coal India has embarked on a slow process of 'corporatization' since 1996 and has to generate its own funding for growth, but as yet this has led to few opportunities for co-operation with foreign companies or for foreign investment.

In the short term, the flow of coal-mining investment is likely to be from India to other countries, as steel companies like SAIL and Tata Steel, and power companies like Tata Power acquire mines abroad to sure-up long term import supplies for steel-making and power generation and to hedge against further increases in metallurgical and thermal coal prices. In the longer term, however, with coal demand for electricity consumption increasing at rates comparable to those in China, the pressures on Coal India to liberalize may become more intense. Ultimately, and looking out to 2010-2020, it seems reasonable to assume that these pressures may lead to some Coal India subsidiaries becoming independent and some significant foreign investment opportunities emerging.

CONCLUSION

In ten years time there is a high probability that Asian governments and the international mining majors will still be pulling most of the strings in the region's coal sector. But there is also a strong possibility that one or two independent coal companies will emerge as regional leaders. From the cursory review above, candidates could include Bumi, Banpu, Excel, Macarthur, Felix and perhaps Yanzhou, although some of the names may change (e.g. through mergers), and – of course – new entrants may appear (Ivanhoe in Mongolia comes to mind). The timing may then be ripe by 2015 or 2020 for those that are still around to take advantage of emerging investment opportunities in China, India and other parts of Asia (Vietnam, Mongolia, Siberia, Russian Far East, North Korea… ?).