Special Report: Wiggins Island Coal Export Terminal

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First operations imminent

Wiggins Island Coal Export Terminal (WICET) is expecting to commence operations in November 2014, adding a further 27Mtpa to Australia's coal export capacity. There has been speculation that WICET will face financial distress and risks being stranded, given delays faced by a number of its Shippers in bringing their mining projects into production. We believe WICET's security structure, capacity-based take-or-pay regime, and ability to 'socialise' its ongoing costs will protect the project.

Project nearing completion

In April, WICET reported that it was over 80% complete and was targeting first coal shiploading in November 2014. From this point, terminal capacity is expected to be ramped-up over the subsequent 12 months or so. We understand the project may be around 6% over budget (not unexpected given the 7 month schedule slippage) but still within the limits of its funding facilities. This first stage of WICET will add 27Mtpa of export capacity to total eastern Australia capacity that has already expanded by 162Mtpa over the last 5 years.

Completion tests

The two key tests that WICET will undergo as it is brought into operation are Mechanical Completion and Project Completion. Mechanical Completion (WICET's first loading of a shipment of coal) triggers the start of take-or-pay payments being made by the Shippers to WICET. Project Completion (WICET operating at 90% of capacity for 30 days within a 90 day period) will result in the conversion of all construction debt to a term loan. Concerns that the Project Completion test will not be met are uninformed. WICET can run this test by sourcing coal from a number of different avenues, not just its Shippers.

Key focus is capacity not throughput

Undoubtedly, actual throughput in the early years of operation will be well below nominal capacity, given the difficulties faced by a number of WICET's Shippers in bringing their projects into production. Reports of WICET potentially facing financial distress and asset stranding have focused on this low throughput being the key cause for concern. However, WICET is structured such that capacity and not throughput is what really matters from WICET's perspective. WICET's Shippers are required to pay for their contracted capacity irrespective of how much they use.

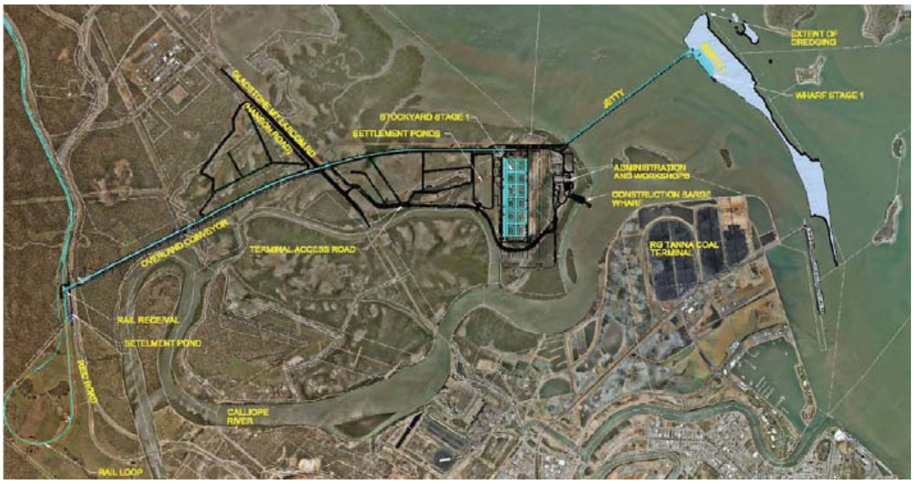
Mitigants to protect against defaulting Shippers

If any of WICET's Shippers are incapable of paying their take-or-pay obligations, then WICET has a regime which includes offering that contracted capacity to others and servicing operating costs and debt with take-or-pay bank guarantees (already provided by all Shippers and available to meet cost overruns) and termination payments. The ultimate protection (should all else fail) looks to be the ability to 'socialise' the terminal's ongoing financing and operating cost across the contracted capacity of non-defaulting Shippers via an increase in the terminal handling charge.

Overview

Wiggins Island Coal Export Terminal (WICET) is a coal export terminal being constructed at the Port of Gladstone, with a first stage capacity of 27Mtpa and a master plan for total capacity to 114Mtpa. The project sits to the west of the existing RG Tanna and Barney Point coal terminals at the port. WICET will include a rail receival facility, an overland conveyor, a stockyard, a jetty conveyor, and a single ship berth. Queensland Government-owned Gladstone Ports Corporation is leasing the land to WICET and will be the operator of the terminal on behalf of WICET.

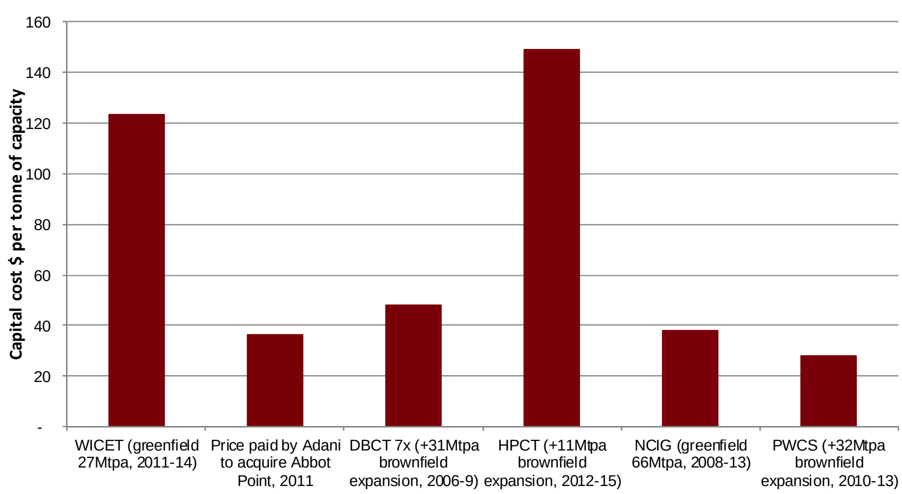
Figure 1: WICET project elements



SOURCES: WICET

Financial close on the funding for construction of WICET was achieved in September 2011 and construction commenced in December 2011. WICET's capital cost per tonne of new capacity is substantially higher than most other new capacity brought on-line over the last five years (we suspect this unit cost will reduce as staged expansions occur over time). WICET believes this is due to the location (ie. marine area) and design (eg. length of conveyor and jetty) of the terminal, with the construction market boom in Gladstone a secondary influence.

Figure 2: Estimated capital cost per incremental tonne of capacity



Note: WICET estimate includes all funded costs including debt service. It is difficult to ascertain whether cost information sourced on comparable projects is on the same basis.

SOURCES: Morgans, DBCT, BHPB, NCIG, PWCS

The funding for construction of the first stage of WICET was underwritten by long-term take-or-pay contracts with a group of coal companies. The terminal is entirely owned by these 'Shippers' in proportion to their contracted capacity.

Figure 3: Contracted capacity of WICET Shippers/Shareholders

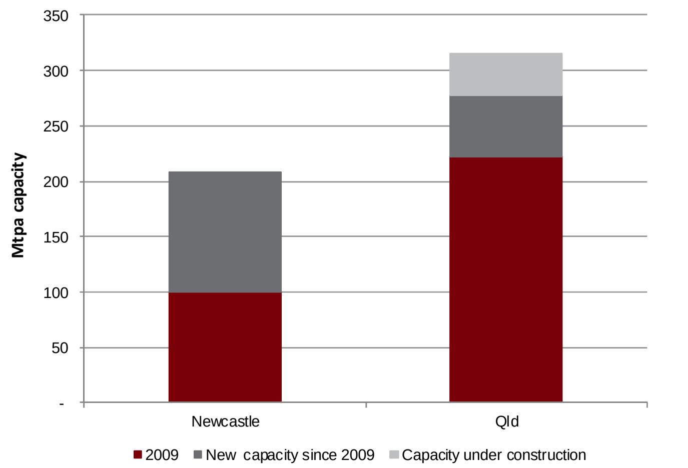
Source Mines	Mt	Corporate Group	Comments
Rolleston	10.9	Rolleston JV (75% Glencore Xstrata)	Glencore Xstrata rated BBB by S&P. Progressing 8Mtpa expansion of Rolleston.
Springsure Creek, Arcturus	4.0	Bandanna Energy	Facing difficulties bringing project into production.
Cook, Minyango	4.0	Caledon Coal	Acquired by Chinese-owned GRAM in 2011. Limited visibility re: source mine.
North Baralaba, Wonbindi	3.0	Cockatoo Coal	3Mtpa Baralaba Expansion targeting full production mid-late 2016.
Washpool, Eagle Downs	1.6	Aquila Resources	Eagle Downs added as WICET source mine - target first production 1H2017.
Yarrabee	1.5	Yancoal (100% Yanzhou)	Yarabee currently producing in excess of contracted capacity.
Curragh	1.5	Wesfarmers Curragh	Wesfarmers rated A- by S&P. Transfer of capacity from Barney Point to WICET.
Colton	0.5	New Hope Coal	Northern Energy acquired by New Hope Coal in 2011.
Total	**27.0**		

SOURCES: Morgans, company reports

The last in the current wave of export capacity additions

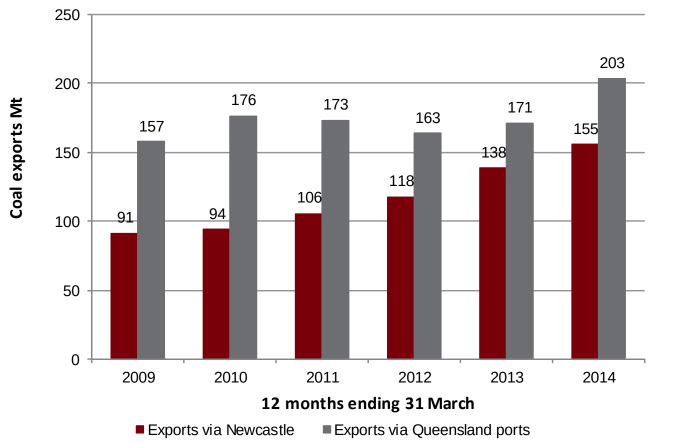
Completion of WICET (and the 11Mtpa expansion of Hay Point Coal Terminal due 2015) will complete the most recent surge in coal export capacity in eastern Australia. Over the last five years, 53Mtpa of coal port capacity has been brought on-line in Queensland and 109Mtpa in Newcastle. Between 2008 and 2013, coal export volumes across the two regions expanded by about 94Mt. Over the 12 months to March 2014, we estimate utilisation of coal export capacity averaged about 78% in Queensland and about 83% in Newcastle.

Figure 4: Additions to coal export terminal capacity



SOURCES: CIMB, COMPANY REPORTS

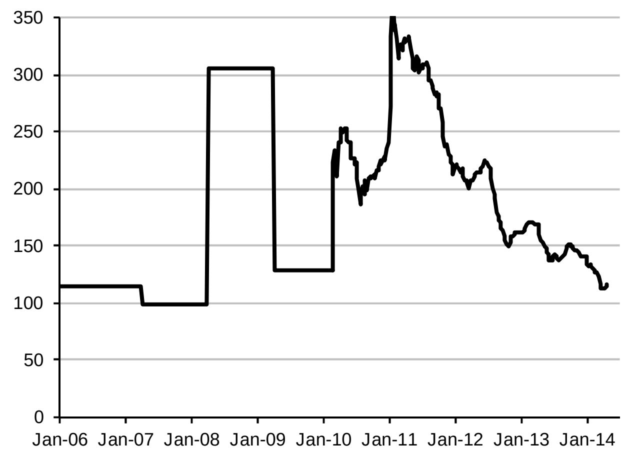
Figure 5: Coal export volume via coal export terminals in Queensland and Newcastle



SOURCES: NORTH QLD BULK PORTS, GLADSTONE PORTS CORPORATION, PORT OF BRISBANE, HVCCC

The current environment has made it difficult for a number of WICET's Shippers to progress new mine developments. The slump in coal export prices, the high A$, high cost structures, and delays in project timings have had a negative impact on expected returns and therefore access to project funding.

Figure 6: QLD Hard coking coal pricing (US$ Benchmark/ Index)



SOURCES: IHS, Morgans

Figure 7: NSW Export thermal coal pricing (US$ NEWC Index)

SOURCES: IHS, Morgans

The following is the latest status as we are aware of it for source mine of each of WICET's Shippers:

Figure 8: Updated progress of source mine capacity

Source Mines	Mt	Comments
Rolleston	10.9	Approvals secured and expanding toward 14Mtpa (from 8Mtpa). WICET allocation assumes expansion to 19Mt however this appears to be on hold. GLEN has reportedly been unsuccessful in on-selling ~5Mtpa of surplus WICET allocation.
Springsure Creek	4.0	EIS granted 2013; Grant of ML anticipated mid 2014 however +A$750m in project financing is yet to be arranged vs BND's market cap of ~A$50m and~ A$100m in cash. Vulnerable to potential delays.
Cook, Minyango	4.0	Introducing a longwall into Cook to lift output to 3.5Mtpa. Progress unclear, as is the development status of the Minyango longwall project, the original WICET source mine. Funding looks OK but Cook production has proven difficult over +30 years.
Baralaba North	3.0	Construction to 1Mtpa is underway, ML to 3.5Mtpa is anticipated 1Q 2015 but the balance of COK's project funding is required (~A$80m).
Eagle Downs	1.6	Construction underway toward longwall production from 1H 2017. AQA needs to secure a further +A$300m (via JV and or debt) to fulfil its current equity funding share.
Yarrabee	1.5	Appears well funded by the parent to ramp-up production however specific progress is unclear
Curragh	1.5	Ready to transfer existing production / port allocation over from Barney Point upon WICET ramp-up.
Colton	0.5	Slow progress toward grant of ML and Environmental authorities but no concrete plans for development.

SOURCES: Morgans, Publicly available company reports

WICET construction funding

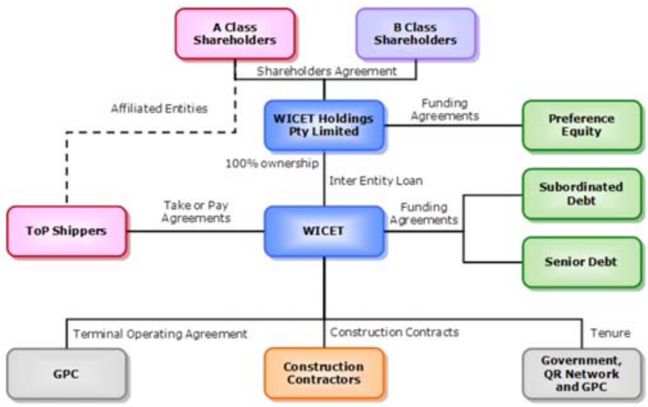
WICET's construction funding is provided by a mix of senior debt, subordinated debt, and preferred equity.

The senior debt was provided by 19 banks, including the four major Australian banks, partially supported by sovereign export credit agencies or government-supported financiers. The senior debt has a term of seven years. WICET says its bankers are generally comfortable with WICET being on-time with the current schedule and budget. It is not aware of any debt changing hands, albeit it doesn't have full clarity on this.

The subordinated debt was provided by a mix of WICET's Shippers and institutional investors.

The preference equity was entirely financed by WICET's Shippers. Some of this has since been on sold to external investors.

Figure 9: Project structure



SOURCE: WICET

Figure 10: Funding facilities

	US$ Facilities	A$ Facilities
Senior debt facilities:		
Construction	2,400	
Cost overrun	350	
Liquidity	100	
Working capital		50
Letter of credit		100
Subordinated Debt:		
Gladstone Long Term Securities (GiLTS)	50	450
Preference Equity:		
Wiggins Island Preference Securities (WIPS)		550
Total Facilities	**US$2,900m**	**A$1,150m**

SOURCES: WICET

Project timing

Mechanical Completion

In April 2014, WICET reported that construction was more than 80% complete and that first shiploading is targeted for November 2014, ahead of the 50% probability target of March 2015 (relevant for contingency planning). The original target was mid-2014, but delays were caused by a combination of construction market conditions, timing of various approvals, and project-related matters.

First shiploading is a key test for Mechanical Completion, as it proves that WICET is capable of transferring coal from its rail receival facility onto a ship. Mechanical Completion triggers the start of take-or-pay payments by the Shippers to WICET (see below).

We understand that the gantry stacker will be the most challenging element of the mechanical completion process, given it is quite unique. WICET says it is the first one of its type built in Australia, with only one other known example.

Capacity ramp-up

Once Mechanical Completion occurs, the ramp-up of WICET capacity to the nameplate 27Mtpa begins. At present, WICET expects this ramp-up to take between 6 to 12 months, with the profile to be ultimately determined by the terminal operator. Aurizon Network aims to have commissioned all of its Wiggins Island Rail Project track infrastructure by December 2015 to align with this profile.

Take-or-pay payments by the Shippers to WICET ramp-up in line with terminal capacity not throughput. During the ramp-up phase, a debt facility is available to provide liquidity to WICET to meet costs not covered by take-or-pay revenue.

Project Completion

Project Completion is an important milestone for WICET, as at this point the construction finance and related conditions are replaced by a term facility, which is serviced entirely by WICET's own cashflow. It is also the point at which take-or-pay payments are based on the actual costs of WICET, and the supporting letters of credit or bank guarantees are no longer required to support construction cost overruns.

There are various tests for Project Completion but the main one requires WICET to sustain 30 days continuous inloading and 30 days continuous outloading within a 90 day period at 90% of nominal capacity (27Mtpa). On our estimates, this may see WICET processing about 2Mt of coal within the 90 day period.

There has been speculation that WICET may not be able to run its Project Completion test, given the progress of certain WICET Shippers in bringing their projects into production. However, we understand that completion of the test doesn't require coal to be sourced from all of WICET's Shippers based on their contracted capacity. For instance, it can sourced from substitute Shippers, including potentially those currently shipping through other export facilities in Gladstone, or it can be provided by a subset of WICET's Shippers.

We understand that WICET is obliged to run the Project Completion test as soon as practicable. It is in the interest of WICET's Shippers for the test to be passed by the sunset date (late 2016), as they will be subject to a mandatory debt repayment if WICET defaults on the test.

Take-or-pay obligations

Under the Wiggins Island Terminal Access Policy (WITAP), Shippers contract for rights to capacity in the terminal subject to rolling 10 year take-or-pay agreements. The take-or-pay agreements specify the methodology for determining the Terminal Handling Charge (THC) that must be paid by a Shipper from Mechanical Completion, irrespective of whether a Shipper has utilised the capacity or not.

The THC is set on a cost-recovery basis. It is structured to recover forecast operating, maintenance, and debt and equity service costs, as well as tax charges and other costs. Excess revenue from the previous year is deducted from this amount. This amount is then converted into a unit charge by dividing by total contracted capacity (not actual throughput).

Disclosure by Bandanna Energy indicates that WICET's THC across all Shippers amounts to $351m per year, or $13 per tonne of contracted capacity (likely to be even higher initially on a per tonne of throughput basis). Based on industry sources, we understand this is between two to three times the charge for exporting coal through RG Tanna Coal Terminal in Gladstone. It also compares to $2.80 per tonne for Port Waratah Coal Services in Newcastle (down from $4.50 per tonne in Q12013) and $5.16 per tonne for the regulated Dalrymple Bay Coal Terminal (DBCT) in Queensland. The driver of WICET's high terminal charge is its high capital cost discussed earlier.

We expect that future refinancings of WICET's term debt may reduce debt service costs and therefore the THC for each Shipper. On the flipside, we note that the THC does not include an element for return of capital as per regulatory pricing models for DBCT and Aurizon's below rail network. We expect at some point this will kick in (debt will need to be amortised, equity redeemed), thereby increasing the THC.

Mitigating the impact of defaulting Shippers

It is possible that Shippers representing over 45% of WICET's contracted capacity may struggle to meet payment obligations during the initial years of WICET's operations given delays in bringing their projects into production. As such, there has been speculation that WICET is at risk of financial distress and asset stranding. We believe this is unlikely, given the project's security structure, the capacity-based take-or-pay obligations, and the 'socialisation' of costs among Shippers.

If a WICET Shipper is unable to utilise its contracted capacity it has the right to sub-lease (i.e. substitution) its capacity to others on a short-term basis. However, the Shipper would remain directly liable to WICET for the take-or-pay obligations, with the sub-leasing reducing the net amount the Shipper would need to fund from its own balance sheet.

If a Shipper defaults on a payment to WICET, WICET has the following steps available to it:

1. Call on the defaulting Shipper's bank guarantee. At financial close, all Shippers were required to provide their pro rata share of one year's worth of WICET's THC as security for WICET in the form of bank guarantees. WICET is obliged to use the bank guarantees to pay for debt service and operating costs during that time (the guarantees are also available to meet construction cost overruns until completion in the unlikely event that they cannot be funded by WICET's debt facilities);

2. WICET can offer the defaulting Shipper's capacity to a replacement shipper, if one can be found. Such a shipper would be required to take on the take-or-pay obligations of the defaulting Shipper. Also of note is that WICET's lending group has the right to reject the replacement shipper, so as to protect its credit position;

3. After 12 months of ongoing payment default and no replacement shipper being found the defaulting Shipper is required to make a termination payment. For each Shipper, the termination payment is approximately equal to its pro-rata share of WICET's financing and is covered by an unsecured guarantee from a parent entity (but not necessarily the ultimate parent). WICET is obliged to use the proceeds to pay down WICET's senior debt, thereby reducing debt service and the THC. We suspect that if a Shipper has got to this point of default then WICET will likely struggle to extract the termination payment from the Shipper.

4. An increase in the THC, as a result of 'socialisation' of WICET's ongoing costs (subject to a cap on finance costs) across non-defaulting Shippers.

Conclusion: WICET is expensive, but is ultimately protected by the balance sheets of its major Shippers

As an example of the above process, if a Shipper with 4Mtpa of contracted capacity defaults on its payment obligations, WICET may use that Shippers $52m bank guarantee (4/27ths of $351m) to paydown WICET's senior debt and thereby reduce finance costs for non-defaulting Shippers. However, ongoing costs would need to be met by the remaining non-defaulting Shippers, causing the THC to increase from $13 per tonne of contracted capacity to about $15 per tonne (27/23 x $13/t). This will make the unit cost of an already expensive port even greater for the remaining Shippers (and even more on a cost per tonne of throughput instead of per tonne of capacity basis given capacity utilisation is likely to be less than 100%).

Given the above security structure and socialisation of costs via the THC, we believe the likelihood of WICET facing financial distress is low. For lenders, the ultimate fall-back for the terminal is the balance sheets of WICET's higher credit quality Shippers, as they will ultimately be required to foot a higher THC for any Shipper unable to meet their take-or-pay obligations. However, we note that there may be commercial-in-confidence details contained in the take-or-pay and debt facility agreements that may result in a work-out situation in the event of severe terminal under-utilisation.

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