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HD **FIRB Yanzhou concession comes as a blow to Yancoal**

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The Treasurer is confident the miner will be kept afloat

WHAT is the value of a Foreign Investment Review Board condition?

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In the case of Yancoal Australia, it's tempting to say the answer is nearly half the share price.

Since Yancoal Australia's 78 per cent shareholder Yanzhou **Coal Mining Company** was relieved on December 11 of FIRB undertakings to dispose of part of its shareholding in Yancoal, the price has drifted steadily lower. And since Yanzhou this week abandoned plans that had been around since June to take out minorities in the Hunter Valley, NSW coalminer, things decidedly have taken a turn for the worse.

Yancoal shares ended the week at 42c, down from 58c on Tuesday before the bid was abandoned and from 72c before the FIRB conditions were removed.

Of course, the prolonged slump in **coal** prices hasn't helped. Other listed pure-play **coal** producers Whitehaven and New Hope are down about 13 per cent over the same period.

But the removal of FIRB conditions that would have forced Yanzhou to deal with Yancoal minorities appears to have been a costly exercise for shareholders, not least Yanzhou.

Yanzhou has effectively spent more than $5.5 **billion** buying Felix Resources and Gloucester Resources to form Yancoal -- one of the biggest publicly listed pure-play **coal** producers in the country. It has also extended around $2bn in outstanding loans to the group. Yet the current market capitalisation of Yancoal, which posted a $1.1bn pre-tax loss for the year to the end of December, is just $377.8 **million**. That puts it in the same league as other underperforming **Chinese** investments in Australia, such as Citic Pacific's grossly over-budget and behind-schedule Sino **Iron** project in Western Australia and Sinosteel's $1.2bn **acquisition** of Midwest, with its modest **iron ore** assets now shuttered.

The decision has left one of the longest running foreign investment sagas unresolved at a time when the government hopes to strike a free trade agreement with a **Chinese** government that is pressing for greater investment freedoms in Australia.

There are also expectations that Yanzhou will have to find a way of dealing with the Yancoal minorities and its mounting debt pile. Among the possibilities are a rights issue that would test the resolve of already battered minority shareholders to hang in there, a preference share issue or some sort of asset **sale** or debt-for-**equity** with Yanzhou.

Complicating the picture is the presence of commodities trader Noble Group, which owns a 13 per cent **stake** and has a director on the board in William Randall. Noble earns a 2 per cent commission on **coal** sales from Yancoal under an international marketing agreement inherited with the Gloucester **coal** deal that runs to 2040. It also bought $390m worth of **coal** from the **company** last year and received various fees.

It's the equity, however, that makes it the kingmaker in any move by Yanzhou to take full control of Yancoal. At 13 per cent it can stop Yanzhou moving to compulsory acquisition and can also decide a shareholder vote on a scheme of arrangement bid in which Yanzhou would not be able to vote.

Perhaps paradoxically, a selldown of the 8 per cent required under the original FIRB conditions would have strengthened Yanzhou's hand by creating a bigger counter to Noble's stake.

The removal of the FIRB conditions has not, however, stopped Yanzhou pumping money into the company to keep its investment afloat.

Just two days after abandoning the bid, Yanzhou agreed to lend another $US300m to Yancoal -- the first $US100m unsecured and covenant free -- to fund operating and capital expenditure.

Yanzhou is making good on its more recent undertakings to Joe Hockey to, in the Treasurer's words, ``continue to support Yancoal's ongoing operations in Australia, thereby maintaining its position as a major regional employer''.

``So long as Yanzhou continues to own at least 51 per cent of the shares of Yancoal, Yanzhou will ensure Yancoal continues to operate so that it remains solvent. In addition, Yanzhou will extend its existing loans to Yancoal if required, and will support Yancoal's plans to expand the Moolarben open cut mine.''

The Treasurer also said he was open to any proposals from Yanzhou to take 100 per cent ownership of Yancoal.

Mr Hockey's decision came in the wake of his controversial decision to block Archer Daniels Midland's $3.2bn bid for GrainCorp. Observers noted at the time that with the government keen to get back on message with its ``open for business'' mantra, it was an opportune environment to push for the approval of sensitive issues.

Mr Hockey's office declined to comment on Yanzhou's decision to walk away from the Yancoal proposal. But it's clear from his statement that jobs and solvency were two of the big selling points for Yanzhou's pitch.

Sources said behind the scenes lobbying went so far as to suggest that Yanzhou might not be able to support the company and may have to shut mines or suspend developments unless allowed to take full ownership.

That's a realistic threat at a time when other companies have been scaling back or shutting coalmines, as mining giant GlencoreXstrata announced this week with the closure of its Ravensworth mine.

Much has been made of the comparatively cheap credit available in China to state-owned companies, and it appears that has helped drive Yanzhou's expansion plans. But in Hong Kong, where Yanzhou is listed, there are emerging concerns that the group's balance sheet is stretching uncomfortably.

Yanzhou's gross debt to equity now sits at 138 per cent, and UOB Kay Hian analyst Helen Lau expects this to continue to grow, given its capex commitments.

Ms Lau noted that the Ashton mine expansion being funded by Yanzhou would only break-even at current prices.

``Yanzhou will need to continue to finance its domestic and overseas mine commissions and production ramp-up via borrowings,'' Ms Lau said, noting that the group's current debt had an average loan rate of 4 per cent.

``Yanzhou has the option and flexibility to structure its loans; hence we assume it can keep its average loan rate flat going forward. That said, its loans will continue to rise due mainly to rising capex and weak operating cash flow. Rising finance cost will remain a drag on its earnings.''

While the Yancoal investment has been a drain, it has brought some returns to Yanzhou.

According to Yancoal's most recent annual accounts, about $40m was paid or accrued by Yancoal to Yanzhou in relation to loans, bank guarantee fees and arrangement fees. With Yanzhou's loans to Yancoal having ballooned since then, that figure will likely be higher this year. But a worthwhile return from the assets remains a longer-term project.

CO yaptyl : Yancoal Australia Limited | ynzmn : Yanzhou Coal Mining Co Ltd | yankua : Yankuang (Group) Corp

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