FINANCIAL REVIEW

SE Companies and Markets

HD **Yancoal reboot unacceptable**

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WC 1,175 words

PD 16 December 2014

SN The Australian Financial Review

SC AFNR

ED First

PG 28

LA English

LP

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Yanzhou's arch little plan to re-capitalise its financially stressed Australian coal outpost, Yancoal, while stripping the rights of minorities en passant has thankfully been deemed unacceptable by the takeovers regulator.

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Reduced to its basics, the Yanzhou plan was to raise $US2.3 billion ($2.8 billion) through an expensive note issue that offered the owners of 22 per cent little incentive to support beyond risking a dilution of heroic proportions.

Yanzhou owns 78 per cent of Yancoal and the most likely result of the now partially scuttled subordinated capital note issue was that the Chinese coal company would have been given a call to move to 98.8 per cent of the business.

The Takeovers Panel has slapped an unacceptable circumstances ruling on proposal and ordered that Yanzhou can continue only if the notes are not convertible into Yancoal shares. The ruling obviously sets out to test fully the motivation of the issue.

On the one hand, if conversion proves critical to Yanzhou and it pursues other less sustaining options, then critics will be furnished with proof of their view that something sinister was afoot here.

But if, as Yanzhou and Yancoal claimed, this was all about taking the most sensible pathway to re-capitalisation, debt reduction and fulfilment of Foreign Investment Review Board obligations to sustain a solvent Yancoal, then the capital notes issue can still happen.

All Yancoal and Yanzhou need to do is either accept that the notes cannot convert or seek approval for any conversion of the notes at a shareholder meeting that offers 50 per cent vote of support. Of course, given Yanzhou would not be able to vote at that meeting, then routinely winning a mandate seems unlikely.No guarantees against dilution

We can say that with some certainly only because Noble Group owns 13.4 per cent of Yancoal and it is not a fan of an idea that would see it needing to throw $308 million into the company with absolutely no guarantee that it would not endure crippling dilution anyway.

The way the original plan worked, there was every chance that, on full conversion, Noble would have been diluted to less than 10 per cent. And at that point compulsory acquisition would have been both possible and likely.

For whatever reason, the panel was called to decide on this one not by Noble, but by another rather smaller Hong Kong-based owner in the form of Senrigan Capital and its very angry founder Nick Taylor. Taylor asked for either the note issue to be subject to a vote or that the scheme be withdrawn. Technically, he didn't quite get there, but effectively he did enough to achieve his ambitions. Which all leaves the pressure right back on the independent directors at Yancoal who decided that an idea baked by Goldman Sachs, but ultimately delivered by Deutsche Bank was the most appropriate way to go here.

As we have previously noted, for reasons that remain its own, Goldman's worked on this one until only weeks before Yancoal went to market. When it walked, DB picked up the mandate.

Before heading to the panel, Taylor of Senrigan made it known to the Yancoal independents that he believed they had failed in their obligations to act in the interests of all shareholders.

That position would seem to have been endorsed by the panel, which observed that the notes were "a complex security, which require a significant capital contribution and are unattractive to Yancoal shareholders other than Yanzhou".

In the end, the panel accepted the argument that the net effect of this arrangement could be that compulsory **acquisition** may occur at a cheaper price than would be the case through ordinary acquisitions of shares. Which all leaves Yancoal and Yanzhou pondering where they go next. Those options stretch from formal contest on the panel ruling to renewed reconsideration of the other five recapitalisation plans originally considered by the independent directors. They also include the potential for some pretty hard decisions on the active shape of a **mining** business patently left under critical pressure by the fact that it is a collection of tier two **coal** mines in a tier one **coal mining** world.

The really odd thing about the way our **iron ore** and **coal** pricing shock has so befuddled Treasury is that these deficit exploding events were so actively anticipated by the miners themselves.

A rapid reversal in bulk commodities prices sits a root cause of a $7 **billion** shortfall in Commonwealth revenues.

The result is a budget in even bigger revenue crisis than imagined as recently as May and a government now prudently, if belatedly, banking on worst case pricing outcomes rather than hoping for the best. The May numbers were built, for example, on **iron ore** pricing that would fall from over $120 a tonne to range around the $90 mark by May next year. Plainly the price has surprised on the downside, which is what commodities prices tend to do. So, arguably rather too late, Treasury is running a quite reasonable worst case flatline estimate of $US60 a tonne on its estimates through to June 2016. If anything, this number is sensibly over-cautious.

As we keep identifying, **iron ore**'s majors believe that the price will be set by the highest cost major seaborne trader and that is Brazil's Vale. It is still the world's biggest single producer and its average costs range around $US65 a tonne.

It might not surprise then that $US65 was the base case when BHP Billiton began preparing for old pricing decks to be new again.

Let's be very clear here.

BHP called the end of the boom in October 2012 when then chief executive Marius Kloppers delivered the concept of "mean reversion" to the modern business lexicon. Ahead of that BHP has canned two long-mooted mega-projects, Port Hedland's Outer Harbour and South Australia's Olympic Dam expansion. By then the **company** was also well into a re-basing [of] the cost of contracted goods and services through Project Reset.

Now, given the nature of big business, what we see is always months in the making. So the likelihood is that BHP was began re-cutting its fiscal cloth from, maybe, the first quarter of 2012. The Rudd-Gillard government's disastrous attempts to earn a fairer share of the resources boom through two vastly different **mining** taxes accurately reflected the dismal state of dialogue between the Commonwealth and its **mining** industry. With the RSPT, the Rudd administration thoroughly misunderstood the danger its was inviting by initiating such a fundamental shift in investment settings and legacy ownership.

With the MRRT, the Gillard administration thoroughly misunderstood how the changed design offered by the miners would effectively neuter the potential windfall.

So, instead of anticipating this most profound and worrying erosion in terms of trade and the even more worrying growth in our fiscal deficit, the government is left chasing the tide.

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

IN i112 : Coal Mining Support Activities | ibasicm : Basic Materials/Resources | imet : Mining/Quarrying

NS ccat : Corporate/Industrial News

RE austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania

PUB Fairfax Media Management Pty Limited

AN Document AFNR000020141215eacg0001o

