WICET

Wiggins Island Coal Export Terminal Pty Limited

Submission to the Productivity Commission
on its Draft Report titled

"Australia's Export Credit Arrangements"

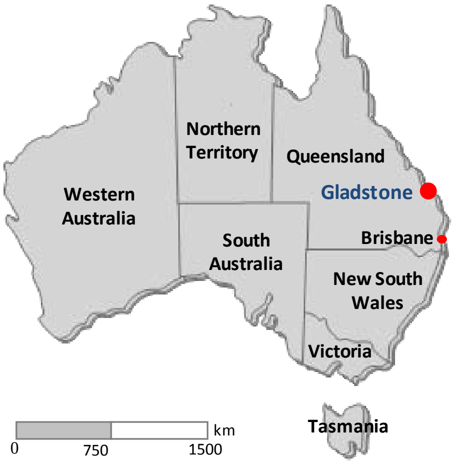
19 March 2012

Contents

1 Background

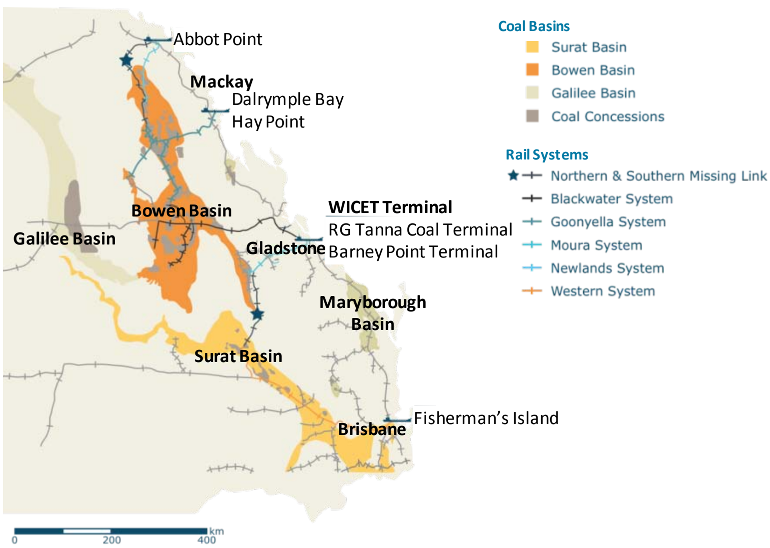
Wiggins Island Coal Export Terminal (**Terminal**) is being developed in the Port of Gladstone, ~525 kilometres north of Brisbane, Queensland (Figure 1), by the WICET Group. WICET Holdings Pty Ltd (**Holdings**) is owned by a consortium of coal producers and controlled by the users of the Terminal. Holdings' wholly owned subsidiary, Wiggins Island Coal Export Terminal Pty Ltd (**WICET**) owns the Terminal assets, has entered into various tenure arrangements for the Terminal land, a Terminal Operating Agreement (**TOA**) with Gladstone Ports Corporation (**GPC**), and Take or Pay Agreements (**ToP Agreements**) with eight coal producers that will use Stage 1 of the Terminal. WICET has also entered into various construction and procurement contracts for the Terminal.

Figure 1 – Location of Gladstone



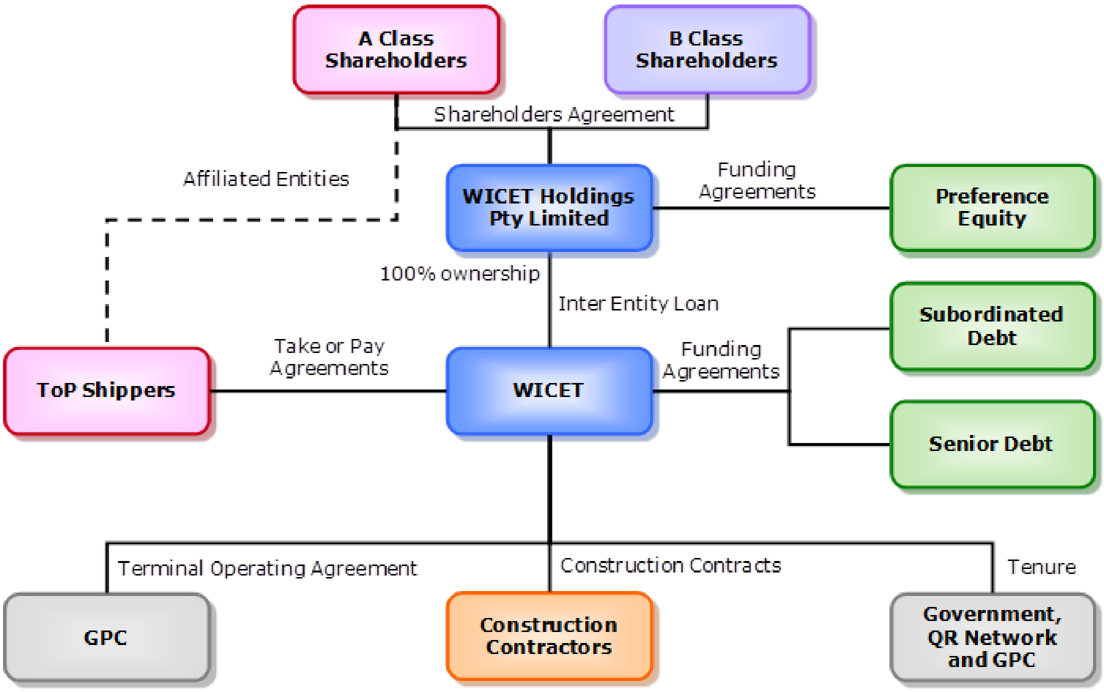
The Terminal, once fully developed, will service coal mines in the Bowen, Surat and Maryborough coal basins in Queensland (Figure 2) that currently or are planned to have rail transport connections to Gladstone. Access for future capacity at the Terminal is governed by the Wiggins Island Terminal Access Policy (**WITAP**) which is designed to ensure equitable and transparent allocations of capacity to the industry.

Figure 2 – Coal Basins and Infrastructure



Stage 1 of the Terminal is contracted for 27 million tonnes per annum (Mtpa) of capacity, has an estimated capital cost of $2,446 million, and is scheduled for completion in mid 2014. The financial structure of the WICET Group is illustrated in Figure 3 below:

Figure 3 – WICET Group Financial Structure



Financing of Stage 1 was completed in September 2011, as outlined in Table 1 below:

Table 1 – WICET Stage 1 Finance Facilities

	US$ Facilities	A$ Facilities
Senior Debt		
Construction Facility	$2,400m	
Cost Overrun Facility	$350m	
Liquidity Facility	$100m	
Working Capital Facility		$50m
Letter of Credit Facility		$100m
Subordinated Debt		
Gladstone Long Term Securities (GiLTS)	$50m	$450m
Preference Equity		
Wiggins Island Preference Securities (WIPS)		$550m
Total Facilities	US$2,900m	A$1,150m

The Senior Debt facilities have been provided by 19 domestic and international banks, whilst the GiLTS (subordinated debt) have been provided by 13 investors, comprising Australian funds managers and associates of some Stage 1 Shippers (coal producers exporting through the Terminal).

The WIPS (preference equity) has been entirely financed by Stage 1 Shippers/Shareholders as no offers of finance considered acceptable to the Shareholders were received from external financiers.

WICET estimates that Stage 1 of the Terminal, when fully operational, will enable increased export revenue in excess of $3,000 million per annum, providing significant growth in the Queensland coal sector with additional employment in the mining and services industries. Final capacity of the Terminal, once fully developed, is expected to exceed 80 Mtpa.

Construction of the Terminal is also benefiting local industry, with a number of smaller local companies contracted to construct or supply services to WICET, including BMD Constructions Pty Ltd, Civil Mining and Construction Pty Ltd and the Maroon Group, in addition to larger contracts to John Holland Group, Worley Parsons and Abigroup (Lend Lease).

2 EFIC Participation in WICET

Export Finance & Insurance Corporation (**EFIC**) participated in the Stage 1 financing by providing a US$100 million guarantee to support funding by Sumitomo Mitsui Banking Corporation of Japan, enabling that financial institution to significantly increase its participation in the Senior Debt facilities. EFIC's participation was noted in a published Case Study.

3 Productivity Commission Draft Report

WICET is noted in Section 6.2 of the Productivity Commission (**Commission**) Draft Report as an example of EFIC's support of large corporate clients with domestic resource projects. The Commission found "*no convincing evidence to indicate there are failures in financial markets that impede access to finance for large firms, or for domestic resource projects*" (page 99). In addition, and in relation to WICET specifically, the Report states "*It is not apparent what impediment to access to private finance or shareholder equity, caused by failures in financial markets, would have stopped the project proceeding*" (page 102).

WICET would like to comment on these statements and various consequential conclusions drawn by the Commission in the Report.

3.1 EFIC Support for Domestic Resource Projects

Resource projects generate 72%[1] of Australia's merchandise export revenue. Many new resource projects require significant off-site infrastructure developments, the cost of which can actually exceed the individual mine development costs.

For smaller resource companies, the need to raise additional finance for off-site infrastructure may not be possible on their own balance sheet or through project finance, and their shareholders would not be investing in those mining companies for a return commensurate with an infrastructure asset.

Support from EFIC in these circumstances can be vital to the successful financing of new projects.

3.2 EFIC Contribution to WICET Financing

3.2.1 Support from Export Credit Agencies or Government Supported Financiers

In WICET's case, the capital cost of Stage 1 is estimated to be A$2.4 billion, which required total funding facilities of the order of A$4 billion including interest during construction, overrun facilities, working capital

[1] In 2010/11 from Table 3 of the "Resources and Energy Statistics" publication of the Bureau of Resources and Energy Economics for the December 2011 Quarter

and guarantee facilities. In the financing, US$780 million (26% of total senior debt) and US$50 million (10% of the subordinated debt) was provided by (or in EFIC's case supported by) sovereign export credit agencies or government supported financiers from Korea, Germany, China, Canada and Australia. The Project would not have proceeded at that time without the support of these entities, and WICET was under significant pressure to complete the financing within the parameters of its agreement with the State of Queensland.

3.2.2 Market Gap

The Commission has made several statements in respect of market gap and the WICET financing. WICET addresses each of these in turn.

"*The market gap mandate is meant to constrain EFIC's activities to parts of the market that are not served by the private sector, thereby seeking to ensure that it complements, rather than competes with, private sector providers*" (page xxviii).

- EFIC's participation in the WICET financing did not crowd out or compete with private sector providers. Not a single potential financier or investor was excluded from the financing because of EFIC's involvement. EFIC plays an essential role in financings which are also supported by private sector providers, providing a signal to other financiers that the project is considered of importance to Australia. Indeed, EFIC's participation in the financing could not be confirmed until a market gap was demonstrated.

"*In the Commission's view, it is likely that projects EFIC has supported, such as the Wiggins Island coal export terminal … may have proceeded without EFIC's involvement. … There are 19 financial institutions providing finance to the project, and EFIC is providing only a small proportion. It is not apparent what impediment to access to private finance or shareholder equity, caused by failures in financial markets would have stopped the project proceeding*" (page xxviii).

- The WICET financing requirement of approximately A$4 billion was a large funding requirement in any market, and is particularly large in the uncertain market conditions (impacted by the European sovereign debt crisis) that prevailed at the time financing was sought for the Project. The fact that 19 financial institutions supported the senior debt financing and 13 investors provided the subordinated debt financing indicates the breadth of the global market that was tapped in order to source the total funding requirement. Global capital availability is not unlimited for a single project as the Commission has also noted in its report.

- Capital availability is also limited by the nature of the risks. For large construction stage projects, capital is available only from discrete subsets of the global capital markets. Sovereign agencies play a key role in funding construction stage projects.

- The fact that EFIC only supported a small proportion of the financing does not provide any indication that its support was not a valuable and necessary contribution to the funding of this project. Without EFIC's participation and expression of support for the Project, WICET would not have been able to source the required level of funds from the market, and WICET was, at that time, under significant pressure to complete the financing within the parameters of its agreement with the State of Queensland.

"...*EFIC's support for a transaction leads to a misallocation of resources in the economy. If EFIC's price does not reflect the full economic cost of provision, including the opportunity cost of capital (that is, EFIC is subsidising that transaction), then EFIC may crowd out private sector finance (or shareholder equity)*" (page xxix).

- The price at which the EFIC guaranteed portion of senior debt is provided to WICET is on exactly the same terms and conditions as all other senior debt lenders. This was determined as part of the extensive capital raising process for the transaction. As EFIC is providing a guarantee of a portion of senior debt, rather than directly lending, EFIC only retains a portion of that return and Sumitomo Mitsui Banking Corporation, the lender of record, earns a margin within that return.

- The other export credit agencies or government supported financiers earn the full market return being paid by WICET as they are providing direct funding and not guarantees to other financiers.

"*The 'market gap' mandate may encourage EFIC to take on some transactions that are riskier than private sector providers are usually willing to accept given the expected returns from the transaction*" (page 97).

- As noted previously, the WICET transaction achieved the support of a broad range of financiers and investors and EFIC participated in the transaction on the same risk profile that private sector providers accepted.

3.2.3 Timing and Government Requirements

EFIC's involvement from April 2011 and final commitment in September 2011 was a critical component for WICET being able to complete the financing. WICET's mandate could have been withdrawn by the Queensland Government had Financial Close not been achieved within the State's timeframe.

3.3 WICET Shareholders

WICET's A Class Shareholders and Stage 1 Shippers are a diverse group of companies with varying financial strengths:

Corporate Group	Tonnage
Aquila Resources Limited	1.6
Bandanna Energy Limited	4.0
Caledon Coal Pty Limited	4.0
Cockatoo Coal Limited	3.0
Yancoal Australia Limited	1.5
Northern Energy Corporation Limited	0.5
Wesfarmers Curragh Pty Limited	1.5
Xstrata Coal Queensland Pty Limited as manager of the Rolleston Joint Venture	10.9
Total	27.0

A number of these companies are establishing new or substantially expanded mining operations at considerable cost, and with limited sources of finance available to them.

The Shareholders or associates thereof contributed all of the preference equity requirements (A$275 million) and a substantial portion (A$264 million) of the total $500 million of subordinated debt, as insufficient acceptable external funding offers were received for those funds, and the Project would not have proceeded without Financial Close occurring. The returns on the preference equity could exceed the average cost of funds of the Shareholders, but it is unlikely that the return on the subordinated debt would be sufficient for the mining company Shareholders to service their external funding and provide an adequate return to their own shareholders.

Off-site infrastructure, especially when shared with other users, is not as risky an investment as a mining operation, and accordingly, the cost of funds for those assets should be less than the users' cost of funds. Indeed, in a similar precedent, a new coal export terminal (Newcastle Coal Infrastructure Group) was initially financed entirely from external financiers. The WICET financing had a similar objective.

However, as noted above, there were insufficient offers of finance received for those tranches of the finance on terms acceptable to the Shareholders, which was partly due to the inability of Australian investment and superannuation fund managers to evaluate construction risk, or, due to constraints in their mandates from investors, to invest in products that do not have adequate (usually investment grade) credit ratings. Financiers such as EFIC, with the ability to evaluate and price construction risk, were therefore critical to the successful financing of the WICET Project.

The nature of the subordinated debt and preference shares will enable them to be on-sold by the Shareholders at some stage in the future to free up resources for ongoing mine development. WICET envisages this will occur after completion of Stage 1 when the Project has demonstrated steady performance and the instruments can be appropriately rated to appeal to the capital markets.

3.4 Conclusion – EFIC's Leadership Role

The Commission has indicated that it *"does not consider that the market gap concept is helpful in establishing whether government intervention may be warranted because the export finance and insurance market is not working efficiently"* (page 98).

However, the role that EFIC plays is much more important than plugging a market gap. EFIC provides a vital leadership role to the transactions it participates in. Each financier or investor that also participates in a particular transaction undertakes its own credit and investment analysis and due diligence in assessing their participation. EFIC's involvement, however, indicates to those participants that a particular project is of sufficient national or strategic importance, providing crucial support to the project and its financing. EFIC is clearly able to participate on the same terms as other financiers, without either subsidising them or crowding them out.

In fact, compared to the export credit agencies of other nations, EFIC is only able to participate in relatively small volumes in any given transaction on the basis of a comparatively limited mandate and, in WICET's case, as a guarantor rather than a direct lender. This still required the financial market to supply the actual funding for EFIC's share of the Project's finance requirements. Other export credit agencies are able to support their national interests where, for example, a project is broadly tied to the procurement of goods or alternatively where it aligns with the export credit agency's country's national or economic objectives.