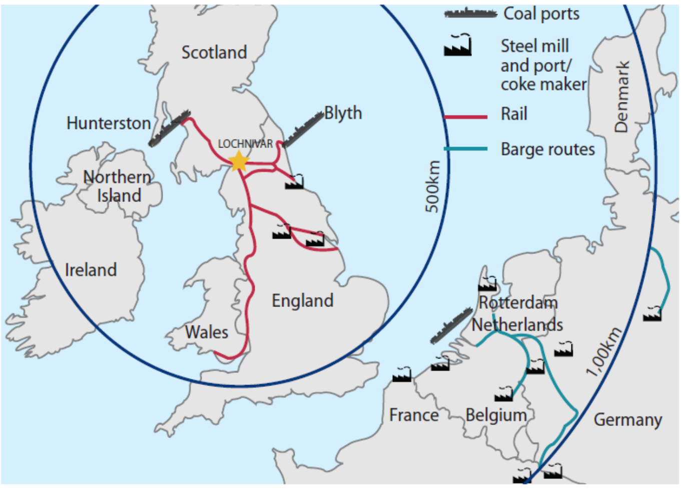
World news

SCOTLAND

Lochinvar measures up on paper

Richard Roberts



The investors who see coking-coal prices averaging US$160/t or more over the longer term and are taking a close look at the market-challenged Lochinvar project in southwest Scotland probably hold the key to future longwall mining in the UK.

A once prominent part of the UK's once conspicuous coal sector, longwalls are going the way of cheap power in the country (away).

Australia-based New Age Exploration, headed by former BHP Billiton executive Gary Fietz, has produced a robust scoping study on Lochinvar, indicating excellent returns if coking-coal prices are 30-40% higher than they are presently.

Without these prices, Lochinvar and most other new coking-coal projects of scale not in the hands of majors cannot be funded.

New Age has two 'cornerstone' investors – Resource Capital Funds and Singapore-based Chee Siew Yaw, which together own about 44% of the company equity – and will need others to enable up to US$25 million of exploration and further studies to be completed on Lochinvar in the next two years.

It is understood there is support in Australia and the UK for the project, but New Age is down to its last A$1 million or so.

Its diminutive market cap, about A$3.5 million, is dwarfed by the estimated US$284 million capital cost of the proposed Lochinvar project. While likely to retain the support of its two main shareholders, according to Fietz, New Age is basically already in capital restructuring mode at a time when debate about the merits of private-versus-public-vehicle funding of early stage exploration and development of projects like Lochinvar continues.

"At end of the day, the structure of the [*new*] investment will be determined by major investors," Fietz said in London.

"I am fairly confident we'll be able to attract the sort of long-term, sticky cornerstone investor we need because it's a great project.

"But it is challenging in this environment, when the share price is where it is. It is challenging to make it work [*for new and existing shareholders*] if we're going to raise a significant amount of money at anything like the current share price.

"An investor has to be confident coking-coal prices will recover, because if they don't then it's not going to be an attractive investment.

"We've been guided by the larger investment banks and analysts for the commodity [*with*] external forecasts that range from US$140/t-US$150/t, to US$180 or even US$200/t, in real dollars. We've used US$143/t.

"If you believe that [*forecast price range*] then the economics of the project are attractive – getting 20% IRR [*internal rate of return*] and US$260 million NPV. But that [*average realised price*] has to happen for that to be the case. And that's why you have to find investors who have a strong view on the coal price."

If it is developed, Lochinvar could become the first significant new underground coking-coal project in the UK for more than 30 years.

Likely low transport infrastructure costs associated with a short siding to an existing rail-line to British steel-makers is balanced by a need to develop a US$50 million decline to access coal at 220m depth.

New Age still needs to do a lot of drilling and some seismic testing to increase confidence in the longwall panels mapped out in its scoping study. Highly experienced coal (and longwall mining) engineers from consulting firm Palaris, and former UK Coal operations chief, now principal consultant at Australia-based Xstract Mining Consultants, Kevin Irving, have helped shape the current plan for up to 30 longwall panels aon average of 2km long, 200m wide and with a cutting height of about 2m, under 200-1,000m of cover.

Only four to five of the initial panels are constrained by 'structure' at this stage, reducing panel width to 140m. Data from recent drilling and some earlier drill-holes has been supplemented with information from more than 100km of historic seismic lines, but longwall-mine panels and their potential surface subsidence footprint must be plotted precisely.

Generally, poor ground conditions in the UK inhibit continuous-miner productivity levels, making earlier consideration of options to avoid the capital cost associated with a longwall at Lochinvar shortlived.

Nevertheless, three CM units would provide more than enough capacity to maintain roadway development in line with the needs of the Lochinvar longwall, while contributing 300,000t of the projected annual 1.9Mt run-of-mine coal output.

New Age has adopted conservative longwall and CM productivity benchmarks at this stage, which could mean production, and revenue upside, at the fixed cost base, depending on the conditions underground and of course coal prices.

With the current resource, projected yields from conventional processing, and assessed coal quality, the project could supply 1.4Mt of saleable product for local steel mills for more than 25 years.

All at a current cost of nearly US$300 million.

"The capex is not being raised as particular concern by anyone," Fietz told *Mining Journal*.

"It's about average for a mine of this size and plots on [*a comparative sector*] capital intensity line pretty well.

"The biggest challenge we face in this market is pricing, because at current commodity pricing we're not economic. I haven't seen an example of an undeveloped coking-coal project that's economic on today's US$110/t spot price or US$119/t quarterly price. At those prices you can't justify the capital to develop a project.

"Our breakeven benchmark price is $123/t, so we're close to being breakeven on current prices.

"If we were in production now we'd be fine because we have a good operating margin. At US$70/t FOB we're at the very bottom end of global seaborne coal cost curve, so our projected margins are better than most people at low coal prices.

"But if you've got to justify $284 million of capital to build the project then you need a better price."