

UTAH MINING AUSTRALIA LIMITED

By R.D. Eabry

(This address was given by Mr. Eabry, a Director of both operating and listed companies, to a meeting of the Victorian Branch of the Society on 18 September 1972.)

This is the first occasion, since the listing of the shares of Utah Mining Australia Ltd. ("UMAL") somewhat over two years ago, that an opportunity has been taken to give a group of analysts a portrayal of Utah's role in Australia. I am delighted to be before you to give this account, concentrating, as it does, on the activities of Utah Development Company ("UDC") in which UMAL has a 10% equity interest. The 90% equity interest in UDC is held by Utah International Inc. ("UII") which is San Francisco-based.

Because this is the first appearance by Utah before a group such as yours, I shall, in the initial stages, take a little time to provide a backdrop to the operating scene in which UDC is actively engaged through mining, mine development and mineral exploration in Australia.

UDC, for its own account, operates entirely within Australia. Its Queensland coking coal interests comprise 100% ownership of the Blackwater mine, management and 85% ownership of the two producing mines at Goonyella and Peak Downs and in the Saraji mine, presently under development.

These three producing mines and the Saraji development all lie in the Bowen Basin in Central Queensland. Through its 85% interest in the Central Queensland Coal Associates Agreement with the State of Queensland, and in an Authority to Prospect in areas close to existing coking coal mining operations and developments, UDC has an interest in further coking coal deposits, the potential for economic development of which is being investigated.

At Blackwater, Utah is entitled to mine and export 100 million tons of coking coal, and from the Central Queensland area, the subject of the agreement between Utah and its co-venturer and the State of Queensland, the combined exports cannot exceed 300 million tons, the second 150 million tons of which may be mined and exported only if such tonnage represents not more than 30% of the recoverable reserves in the area covered by the existing Authority to Prospect. These limits may be exceeded only with the approval of the Governor in Council by published Order in Council.

In addition to its coking coal study programme in the Bowen Basin, UDC is itself engaged in exploration for coal and other non-ferrous minerals in other parts of mainland Australia, and also participates with other companies, through joint ventures, in studying and evaluating other areas with the object of locating commercially mineable ore, ferrous and non-ferrous.

Outside coking coal, and exploration, UDC holds a one-third interest in the iron ore producing mine at Mount Goldsworthy in Western Australia and in an additional iron ore mine nearby, which is under development for purposes of increasing output from the Goldsworthy area to 8 million tons of iron ore annually.

In this paper the emphasis will be directed to UDC's coking coal operations, mainly by reason of the relative significance of coking coal in the current and potential totality of operations of UDC in Australia.

With that background, I shall now concentrate on certain aspects of UDC's coking coal operations in Australia, with particular emphasis on marketing and sales, and on financing and accounting. Nevertheless, your attention will be invited to other aspects of UDC's coking coal operations including methods of

production, utilization of natural resources and costs of product transportation.

In reviewing the coking coal operations of UDC, I think I need pave the way by expanding on the previously given outline of existing operations and developments. References to tons in this paper are to long tons.

Firstly, there is the Blackwater mine, 100% owned, which commenced production of coking coal on its Special Coal Mining Leases by strip mining methods in the latter part of 1967, and made its first shipment in January, 1968. By the end of this year its annual production capability will be 4 million tons, available for shipment through the Port of Gladstone. Against this annual capacity, firm contracts, extending to December, 1977, are held for annual tonnages of 3.25 million tons with a further 300,000 tons annually under option. Contract backlog at July 31, 1972 including 1.5 million in optional tonnages, amounted to 19.4 million tons, the U.S. dollar proceeds of which, without taking account of future cost escalation adjustments, exceed \$U.S. 260 million.

Secondly, the Goonyella mine is now operating at its rated production capacity of 4 million tons of coking coal annually. UDC's 85% interest in the Goonyella annual production is 3.4 million tons. Under long term contracts concluding in 1984, UDC's commitment is for delivery of 42.925 million tons of coking coal to Japanese mills. Of this, 1.7 million tons of contract coal had been delivered by July 31, 1972, leaving the then UDC contract backlog at 41.2 million tons, with a value, before future escalation, of over \$U.S. 550 million.

Thirdly, the Peak Downs mine, export shipments from which commenced in July, is now being developed to a production capability of 5 million tons of coking coal annually, UDC's share of which is 4.25 million tons annually. The now planned capacity at Peak Downs represents an increase of 1.3 million tons per annum over the originally planned annual capacity of 3.7 million tons. The commitment to development of the Peak Downs mine was based on long term sales contracts, then and now held, covering the delivery of 34.5 million tons (UDC's share 29.325 million tons) between 1972 and 1984. As only 65,000 tons of Peak Downs coal had been shipped at July 31, 1972, the UDC Japanese contract backlog at that date for Peak Downs coal remained virtually the same as the original contracted quantity at a value, without future escalation, of over \$U.S. 390 million.

Since original commitment to the Peak Downs project, UDC has negotiated long-term sales contracts for delivery of coking coal to European buyers from both Peak Downs and from the new mine under development at Saraji. After introducing the Saraji mine, now in initial development to you, further reference will be made to these recent marketing developments and to tonnages and values of coking coal committed under European contracts and under contracts negotiated this year for future deliveries of Saraji coal to Japan.

The fourth mine will be Saraji, located south of Peak Downs but under the same lease area, the second of the four leases for which UDC and its 15% co-venturer have rights to apply under their agreement with the State of Queensland. The planned production from the Saraji mine is 4.5 million tons of coking coal annually with the first shipments scheduled for late in 1974.

Sales of Peak Downs and Saraji coking coal to Europe which were announced earlier this year are on a C. & F. basis and are firm for five years. Most of the European contracts extend for further periods averaging a second five year span, but are subject to the successful conclusion of price negotiations towards the end of the first five year period. All sales contracts with European

buyers concluded at this time are for the sole account of UDC and are on a C & F basis. Total tonnage of UDC coking coal committed for European delivery between 1973 and 1984 is slightly more than 30 million tons, the sale of a little more than half of which from 1979 onwards, is subject to price negotiations. Part of the coal bound for Europe will be mined at Peak Downs, and the remaining European requirements will be met from Saraji production. To July 31, 1972, deliveries to Europe totalled about 461,000 tons, and at that date the tonnage contract backlog was 30 million tons with realisations, on the estimated FOB equivalent to estimated C. & F. realisations (before escalation commencing July 1974 or any exchange rate variations which might occur after January, 1975) of over \$U.S. 550 million.

Because all of the European sales have been for the sole account of UDC the recently negotiated sales of Saraji coal to Japanese buyers will not, as between the Central Queensland Coal co-venturers, be in the proportions 85.15. In order to correct the imbalance between the co-venturers arising from the UDC European sales, UDC will be entitled to sell only 77.5% of the approximately 27 million tons of Saraji coking coal committed for sale to Japanese buyers between 1974 and 1984. UDC's share of the Saraji tonnage committed to Japan will accordingly be 20.9 million tons, which, at existing FOB contract rates, represent projected realizations to UDC for Saraji coal of the order of \$U.S. 370 million.

The European and the Japanese long-term sales contracts are expressed in U.S. dollars and all contain cost protection provisions subject to certain ceiling levels, and the recent contracts incorporate provisions to protect UDC as the seller, in the event of future exchange rate variations. To varying degrees, and consistent with similar provisions in the earlier contracts, plus and minus options are reflected in the contracts entered into this year for coking coal deliveries from Peak Downs and Saraji for both European and Japanese destinations.

South of Saraji, a new town, to be named Dysart, will be constructed and if, after further evaluation and studies, including marketing and financial investigations, a decision is taken to commit the Norwich Park deposit to production, the new town of Dysart will service both Saraji and Norwich Park.

To summarize, on the completion of presently committed coking coal projects, an investment of over \$A350 million will have been made, and capacities and tonnages committed for export will be as follows:

	<u>Million Tons</u>	
	<u>Annual capacity</u>	<u>Approximate annual output committed from 1977 subject to minus options</u>
Blackwater	4.0	3.5
Goonyella	4.0	4.0
Peak Downs/Saraji	9.5	8.5
	<u>17.5</u>	<u>16.0</u>

You will appreciate that there is a building up process in terms of production and delivery under contracts for future supply of coking coal. It is for this reason that I have selected 1977, which is the time when deliveries under contracts negotiated will

have built up to maximum annual levels.

UDC's share of annual production from the four mines will by 1977, exceed 14 million tons annually.

Measured reserves, in product tons, at the end of July 1972, and total coking coal tonnages committed under contract, subject to minus options and to coal subject to future price agreement, are now summarized:-

Million tons (rounded to nearer million)

	<u>Measured reserves</u> <u>July 31, 1972</u>	<u>Total coking coal</u> <u>tonnages committed</u>
Blackwater	46	19
Goonyella	64	41
Peak Downs/Saraji	120	80
	<u>230</u>	<u>140</u>

The foregoing figures are totals and before deducting the interest therein of UDC's co-venturer in Goonyella, Peak Downs and Saraji. Contract backlog at July 31, 1972 attributable to UDC, amounted to 140.9 million tons of a value of over \$U.S. 2,120 million.

If minus options are eliminated from contract backlog and if mutual agreement is not reached with European purchasers after the initial firm five year contract period, the contract backlog would reduce to about \$U.S. 1,900 million

UDC has adopted a long-term policy with respect to its presence in Australia. It has proceeded with financing and committing to the huge capital investment involved in its mining projects only after having the backing of long-term sales contracts with price escalation provisions. In this connection, UDC recognizes that:

- * Long-term contract prices, will in most circumstances, be below prices which might be obtained on spot sales or under short-term supply arrangements;
- * Prices negotiated are also influenced by aggregate levels of tonnages for which buyers are committed and the length of long-term contracts;
- * Long-term coal sales contracts negotiated by UDC, which contain cost escalation protections, (reflected in increased prices per ton) may have resulted in slightly lower base prices. The degree, if any by which there might be a lowering of base prices constitutes the cost of cost insurance or the future value to the producer of cost protection.

As a result of its long term pricing policy, UDC may not at all times have attracted prices under its large long-term contracts, equal to the realization levels of coking coal with similar characteristics sold on a spot or short-term basis. Clearly however, subject to and consistent with its policy, UDC has sought to maximize sales realizations. It is extremely difficult to compare the relative quality and characteristics of competitive coking coals, but UDC believes that, in the main, its prices at the time long term contracts were negotiated have been in line with and in some instances above, the prices of competitive coals of similar quality, negotiated by way of forward contract by competitive companies. It is acknowledged that special situations have developed in the market from time to time, as a result of which, there has been the appearance that

Utah's Australian coking coal may have been underpriced. In fact, the apparent pricing inconsistencies have, in nearly all cases, represented the acceptance by the market of excess prices, not necessarily over the long-term, because of certain differing special situations which have arisen in the period when UDC has been active in the international marketing of coking coal. Cost escalation protection clauses which are contained in all UDC's current coal contracts relate to defined costs, and account for approximately 70% of the costs involved in the production and land transportation of coking coal. As I stated earlier, in the recently negotiated contracts, provision is also made in respect of future exchange fluctuations.

Because production targets of the Japanese steel industry have been revised downwards and because of a significant fall in actual production below Japanese steel output predictions, the current and short-term future prospects of further increases in Australia iron ore or coking coal exports to Japan is not encouraging.

In iron ore, spot purchases have ceased, where annual option arrangements exist, minimum quantities are being taken out and, further, additional cut backs and deferred arrangements have been made with respect to iron ore deliveries.

The situation in Japan with coking coal, particularly in the case of UDC, partly because of its record for reliability, is not nearly as unfavourable as that applying to iron ore. Australian coking coals have penetrated the Japanese market to the extent that their share has risen despite a downward revision of Japanese coking coal requirements, and UDC is the largest Australian supplier.

Nevertheless, as I have said, the near-term outlook for further sales of Australian coking coal to Japan cannot be regarded as encouraging.

UDC, through UII's marketing division, has virtually pioneered the entry of Australian coking coals into the European market, and if all options are exercised by buyers under contracts entered into this year by UDC, deliveries of UDC coking coal to Europe will exceed 30 million tons between now and 1984.

Operating for UDC, UII is continuing to be active in its marketing effort in Europe and the prospects of sales to Europe of part of the presently uncommitted tonnages from the mines operated by UDC are by no means unfavourable.

Over the longer-term, one can be more bullish on prospects for additional sales of both iron ore and coking coal to Japanese consumers.

But because of the large quantities of coking coal already committed for delivery to Japan and Europe present priorities focus on the production front. Goonyella's first shipment was three months behind schedule - this delay being caused by adverse climatic conditions in terms of both weather and industrial relations mainly at the port. I am pleased to report that Goonyella is now producing at its rated capacity. Peak Downs commenced shipments on target and its development to the planned annual capacity of 5 million tons is proceeding to schedule. The Blackwater expansion to an annual production capability of 4 million tons is on schedule. The Saraji project is in its primary phase. Provided reasonable industrial relations prevail during the course of the planned Saraji development, the management of UDC believes that construction and development of the necessary facilities will be completed in time for Saraji exports to commence in late 1974.

You may be interested in my making some reference to the subject of utilization of resources.

Some criticisms have been levelled recently against strip mining operators for confining their initial mining operations to the open strip mining. I do not propose to embark upon a long argument on this subject, but I do however want to alert you to some of the factors relevant to this controversy. Firstly in terms of conservation of natural resources, strip mining has very significant advantages over mining by underground methods. For example, in relation to UDC's Queensland coal areas, approximately 90% of the coal in situ is recoverable by the application of strip mining methods whereas if those reserves constituted underground reserves, and were mined by underground methods, something between only 30% and 35% of the coal in place would be recoverable in the thick seam conditions prevalent in UDC's areas. Technology in methods of removing overburden has advanced to the point that it is now possible to expose coal seams to a depth of about 200 feet by the use of walking draglines with relatively large shovel capacity. It is not, in my view, beyond reasonable probability, that in the next ten to twelve years (the time span of UDC's existing contracts) technical advances will lead to a capability of mining to depths of say, 400 feet by strip mining. If this forecast becomes a reality, the utilization of the coking coal resources and conversely their conservation, will have improved greatly. Apart from the physical advantages of strip mining as regards economic utilization of resources, strip mining enjoys enormous advantages over underground mining in terms of the safety and health of the employees engaged in mining. The environment in which those employees work is infinitely better than the conditions to which underground miners are accustomed and exposure to adverse health and to accident (including fatal accidents and human disasters) are so much diminished where strip mining methods are employed.

In addition to those who condemn strip mining there has been some criticism of the cost advantages available to strip mining operators in Queensland, compared with the costs borne by underground producers in New South Wales. Clearly there is a cost advantage in strip mining over underground mining, but equally at least, there is the need to commit to very high levels of capital investment for a strip mine to be brought into production.

One of the largest cost disadvantages sustained by the New South Wales producers is the level of land transportation costs which they bear in transporting and delivering coking coal from their deposits to the respective ports of export. In this connection, the New South Wales Government Railway appears to have imposed heavy burdens on the New South Wales producers. UDC, as a Queensland producer, bears freight costs for carriage of its coking coal by the Queensland Government Railways at cost levels which are substantially lower than the N.S.W. equivalent costs. Despite this, the Queensland rail freights are known to be at levels which produce substantial freight profits to Queensland and both the Queensland Government and UDC recognize and acknowledge the contribution to State revenues in the form of freight profits, which ensue from coking coal operations in Queensland managed by UDC.

It is interesting to note that even though UDC enjoys lower rail freight rates than competitive producers in New South Wales, the Queensland rates borne by UDC, per ton mile, are, in the case of Blackwater coal, 3 times the ton mile costs which Goldsworthy Mining Ltd. incurs in carrying iron ore over its private line from Goldsworthy to Finucane Island, and the Goonyella and Peak Downs coking coal bears rail freight costs which are $3\frac{1}{2}$ times the comparable cost of transporting iron ore over the Goldsworthy/Finucane Island privately-operated line in Western Australia.

In comparing competitive exporters of coking coal, it is also to be recognised that rail and port capability and efficiency

in coal handling, and port capabilities at the ports of shipment and outturn, have a significant bearing on the efficient and economic production and distribution of coking coal to overseas destinations. In this connection, UDC enjoys some cost advantages, but has earned its part in deriving the benefits which flow in consequence, through the construction, at the cost of UDC and its co-venturer, of a major port at Hay Point capable of handling ships of up to 110,000 dead weight tons.

Of some significance also is the high labour cost element in costs of underground mining which, in the Australian scene, results in quite a degree of proneness to cost escalation. Japanese buyers of coking coal are aware of this, and view, with some caution, potential price rises likely to arise from the application of cost protection formulae in long-term contracts with underground producers.

UDC has developed an impressive growth record in Australia. This has arisen through its expertise in marketing, financing and production and the establishment of unequalled reliability for delivery on time, in accordance with contract requirements and specifications.

To finance the huge capital requirement in the mining projects in Australia which UDC now has in operation and in immediate prospect, UDC has raised substantial funds - in amounts far beyond those that UDC could arrange on its own credit - by committing the full faith and credit of UDC and guaranteeing, in effect, UDC's repayment obligations.

UMAL has not been asked to join in financing or otherwise participate in the financing of UDC projects. UMAL's issued capital has remained constant, since flotation, despite capital investment, expended or committed by UDC, of over \$A300 million since UMAL was formed in 1970. The injection of overseas funds by way of loan funds, into UDC has clearly constituted an advantage to UMAL shareholders whose present and potential earnings per share have not been and, on present policies of UDC, are unlikely to be diluted through calls for additional capital to finance its share of UDC's expansion.

Recognizing that proceeds from sales are received in United States dollars you may be interested to know that external borrowings of UDC made to partly finance mine development, which totalled the equivalent of \$A131 million at July 31, 1972, comprised loans repayable as to \$A31 million in Australian currency and as to \$U.S. 119 million in U.S. currency.

Turning to accounting, you, as analysts, have no doubt noted that UDC provides for current and deferred taxation. Accordingly, the provision for taxation charged against profits is equal to 47.5% of the accounting profits before taxation. Because of the opportunities available for accelerating the write off of mining costs for Australian taxation purposes, the cash flow from operations in the early years substantially exceeds the declared profits.

Under current accounting practice, all exploration costs are written off against profits. Depreciation and amortization of mine facilities and equipment is provided on a unit of production basis. Financing costs of identifiable new borrowings made to finance the development of committed projects, before their commencement of operation, are capitalized and amortized over the productive lives of the properties so financed.

It has not been my purpose to utilize time in dwelling on levels of profits experienced by UDC. These are reported quarterly on a comparative basis, together with comparative figures with respect to coking coal and iron ore shipments. Moreover, it is not the policy of UDC or of UMAL to make predictions as to future levels of profitability. But as you now know the level of profits

of UDC for the first three quarters, it would not be giving away too much if I were to say that it will be intriguing to see how the UDC profit for the complete current year compares with the consolidated profit of Utah International a mere five years ago.

Additional to the financial and other studies involved in a review of the prospects of any company under analysis is the need to appraise the expertise and consistent capability of the management which produces the results. In this connection, I, representing the 12,000 Australian stockholders owning 10% of UDC, have nothing but admiration for the outstanding management ability available in UDC. Moreover, I am greatly impressed by the integrity shown by the management of UII and UDC in the direction and control of their Australian operations, their recognition of the responsibilities in carrying on business outside the United States, their conscious efforts to ensure that the Australian minority is fairly treated, and their open door approach to my representation of the Australian ownership in UDC.

Finally, I would like to conclude by quoting the closing remarks made by E.W. Littlefield, Chairman of UII, who is also Chairman of UDC, in an address given to the non-ferrous metals analysts in New York City in March. These remarks are equally applicable to UDC today. Mr. Littlefield said:-

"We are not without our problems in Utah International but we are not about to trade either our problems or our prospects for those of others we see around us."

Thank you.

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