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Coal market won't deter Cuesta

Richard Roberts, 20 November 2013


Drilling at Moorlands in central Queensland.

UNFASHIONABLE it may be, but thermal coal has been the focus of some heavy deal-making in the Clermont area in central Queensland in recent times and that's undoubtedly fanned support for minnow Cuesta Coal and its emerging Moorlands project.

Not in the same league as Clermont, 50.1% of which has been sold by Rio Tinto to Glencore-Xstrata and Sumitomo for a whopping $US1 billion, but certainly now comparable to what's left of nearest neighbour Blair Athol, Moorlands is going to come under some serious scrutiny over the next 12 months or so as Cuesta (ASX: CQC) moves from scoping study phase through a definitive feasibility study in a bid to get a mine up and running in 2016.

Can it shape up alongside Clermont and the once mighty Blair Athol, valued by new owner Linc Energy at about A$180 million (with a JORC resource of 46 million tonnes) after Rio Tinto walked away from the 28-year-old mine at the end of 2012? Cuesta managing director Matt Crawford obviously thinks it can.

"I think there are a lot of [coal] projects that are going to be put on hold and only a few will get away, and they'll need bloody good economics to get away," Crawford said in reference to the current environment of low thermal coal prices and still-high development and operating costs.

"And we wouldn't be spending money on Moorlands if we didn't think that was [its economics were sound].

"I'll be honest with you, if you've got a project with a 3.2:1 strip ratio for 30 years and you can't get that away I don't think there's going to be too many that do get away."

Cuesta has raised about A$20 million of equity funding this year via major shareholder, China's Beijing Guoli, and more recently Hong Kong investment firm Hanford Holdings, to complete the purchase deal that saw it combine its Moorland thermal coal deposit with neighbouring Orion to form the current Moorlands project.

About 30km west of Clermont and 10km from Blair Athol in the Moorlands Basin, or Western Bowen Basin, Moorlands has a current JORC resource of 146 million tonnes. Cuesta has just completed drilling aimed at increasing confidence in the resource, particularly in the proposed start-up South pit (soon to be measured and indicated rather than inferred/indicated) and has the cash in the bank to move to definitive feasibility study work in the first quarter of 2014. At its projected burn rate, the cash will probably take the company through to the middle of the year.

Crawford, who has worked in the Australian coal industry, mainly as a consulting engineer, for more than 10 years, was joined on the Cuesta board earlier this year by non-executive chairman Brian Johnson, an industry veteran involved in establishing ASX-listed public companies such as Austral Coal, Portman Mining and Mount Gibson Iron. He was also previously chairman of South Blackwater Coal and Linc Energy.

"He's a bloke who's been there and done it in this space and we needed someone to guide the ship and he fit the bill perfectly," Crawford said.

Blair Richardson, ex New Hope Coal and Rio Tinto, also joined Cuesta in the past 12 months as general manager of exploration and development.

While the manner in which it has rebuilt its cash reserves, following a 2012 IPO, has raised some eyebrows – Cuesta followed a July 2013 placement at A18c/share to Beijing Guoli to raise A$12 million with an unheralded issue of new equity to Hanford at a nominal 11c/share to raise a further $8.4 million – Crawford said it was important to build the shareholder base ahead of a project development phase and he indicated Beijing Guoli accepted current capital markets made it difficult to attract support at preferred pricing levels.

He maintains Beijing Guoli looms as a potential future offtake party for Moorlands coal.

"Moorlands has similar coal to Blair Athol and Clermont," Crawford said. "Our main seam is 10-12m thick and we've got some other 5-6m thick coal seams. Clermont and Blair Athol had 30m-plus coal seams … we don't have those but we have got a pretty good deposit.

"The seams are the same age, in the same formation, so very similar coal quality and our seam's all opencut.

"The key advantages of this project are it's located close to infrastructure. It's only 14km away from the existing railway line at Blair Athol; we've got a shallow depth to first coal – in the South pit that's only about 40m, so fairly shallow; and we've got thick coal seams, so fairly easy to mine. There are very few deposits now with those sorts of attributes in Queensland. Our focus is to keep our capital costs down by going with a simple [contractor run] truck and shovel operation."

The development and operating cost scenarios for Moorlands will play out over time, along with the value investors ascribe to the enterprise (Cuesta's market capitalisation this week was A$27 million), but the recent Clermont and Blair Athol deals are instructive on several fronts.

Linc thinks it's got at least 10 years of production left at Blair Athol and that a 3Mtpa operation is attractive at current thermal coal prices and in the present cost environment.

UBS believes Glencore-Xstrata and Sumitomo picked up "marketable reserves" at Clermont for about US$13.50 a tonne. Another bank, Macquarie, said at 12Mtpa Australia's third largest thermal coal mine was in a first quartile margin position.

"The mine has a low strip ratio of 3.2:1 and 90% of washing can be by-passed for 90% of the coal," Macquarie said. "We believe that Clermont's FOB cost is approximately A$65/t, implying an EBITDA margin per tonne of approximately A$15/t at current spot prices."

That obviously doesn't leave a lot of margin for others if $65/t is the benchmark FOB cost level.

Crawford sees a 2Mtpa operation at Moorlands as a "decent size [to] get positive cash flow into the company as soon as we can".

"Definitely the margins on mining contractor operations have improved, no question about that, and the cost of doing business overall in Queensland, including exploration, has got better," he said.

"I think the industry is still going through cost saving measures at the moment and I think we'll continue to see costs come down, for mining rates, etc, over the next 6-12 months.

"We certainly need to get more competitive again on the global scale. It did get out of hand a bit in terms of the industry ramping up production when thermal coal prices were very good in 2010."

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