

EUREKA *report*



A step ahead of the coal trains

By Gavin Madson
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PORTFOLIO POINT: There's no need to wait for QR National bonds to tap Australia's strong coal export trade.

QR National's 11% gain since listing on the equity market caught many by surprise. Although it is still early days, the support reflects growing confidence in the factors that underpin the QR National growth story.

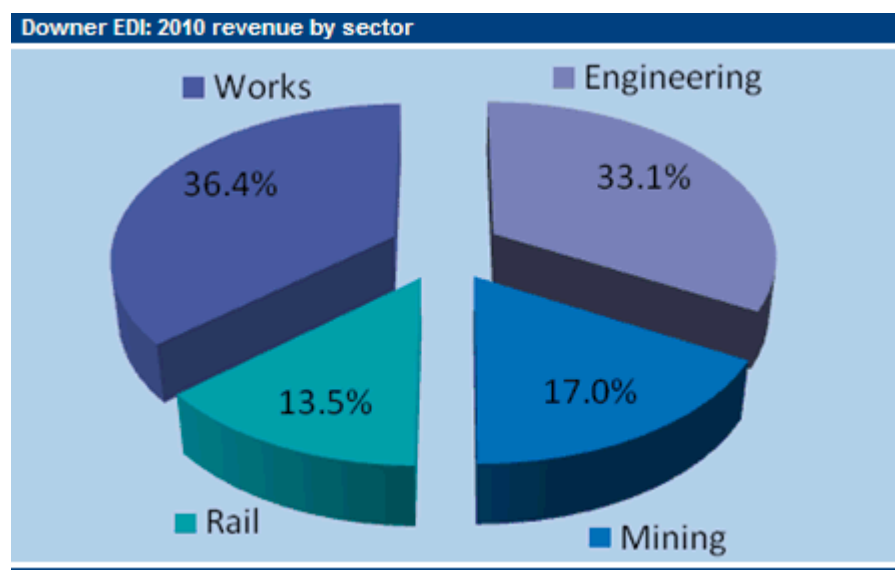
While there are currently no opportunities for investors looking to buy QR National debt, you will be pleased to know that if you are a believer in the long-term Australian commodity export story (for more, click [here](#)) there are other ways in which investors can gain exposure to fixed income investments with the same growth drivers and the benefits these offer.

Wholesale and retail bond investors would do well to pay particular attention to the fortunes of both Downer EDI and the Dalrymple Bay Coal Terminal.

Both companies are inextricably linked to the growth in demand for Australian commodities (particularly Queensland's coal reserves), the same demand growth that will underpin QRN's future and its current share performance.

Downer EDI (DOW)

The Downer EDI Group is one of Australia's largest engineering services firms with revenues of more than \$6 billion and market capitalisation of almost \$1.6 billion. Almost one third of these revenues are drawn directly from the sectors driving QR National – rail and mining – with both sectors highlighted as the driver of Downer's growth in the coming year.



Source: FIIG Securities, Downer EDI annual report

Queensland Rail represented almost one quarter of Downer's rail divisions' revenue in 2010 and the continued growth in coal export volumes in coming years will underpin the growth in Downers' rail freight build and rail freight

maintenance contracts. The maintenance contracts in particular add some consistency to the company's revenue streams as contracts are often for five or more years.

Consistent with other major privatisations, it can be expected that in the medium term QR National will seek to outsource more of its engineering operational costs providing further opportunities for Downer.

The other division driving Downer's growth is its mining engineering services division, which provides contract mining to clients, from whole-of-mine contracts to undertaking specific mining tasks. The QR National story is dependent on the continued growth in mining in Australia and Downer is well positioned to take advantage of this growth as one of the largest providers of contract mining services in the country.

Dalrymple Bay Coal Terminal

The logical progression of increased mine freight volume is increased demand for export facilities. Dalrymple Bay Coal Terminal, south of Mackay, is the largest coal export terminal in the world, with a capacity of 85 million tonnes a year.

It is essential infrastructure in the delivery of Queensland's Bowen Basin coal reserves to the export market. In recent years the coal export market has boomed, largely on the back of economic expansion in emerging markets, particularly China and India. Queensland's coal mines are geographically well positioned to continue to benefit from ongoing demand in Asia with Dalrymple Bay Coal Terminal playing a key role in delivering this coal to market. ABARE forecasts Australian coal exports to grow at a compound annual growth rate of over 11% from 2010 to 2015.



The strength of Dalrymple Bay Coal Terminal's business is underpinned by the regulated nature of returns, the lack of operating risk and the strength of its key contracts. DBCT bears no volume risk as capacity is guaranteed through take-or-pay contracts with customers.

The counter-party risk on these contracts is relatively low given the key customers (mine owners), which utilize the terminal include Rio Tinto Coal, BHP Mitsui Coal, Anglo Coal, Xstrata, Peabody and Macarthur Coal.

The take-or-pay contracts are based on the nameplate capacity of the terminal, as such, where volumes fail to meet nameplate capacity, the charge per tonne to the customer is increased resulting in no negative financial effect to DBCT.

The responsibility for operations and maintenance of the terminal lies with an operating company under a five year agreement (to 2014) with the owners of the operating company also the key terminal customers, thus aligning their interests in the operation of an efficient terminal. All operating costs are recovered via a direct pass-through to the

users.

With recent expansions (and continued further planned expansions) to coal export facilities in Queensland supporting QR National's growth story, Dalrymple Bay Coal Terminal represents the most closely aligned fixed income investment to QR National and at current prices is likely to offer better returns than any future bond offer coming from QR National itself.

DBCT represents a high-yielding infrastructure asset, which continues to be an essential part of the commodity delivery chain in Australia.



Both the Dalrymple Bay Coal Terminal and Downer EDI bonds provide fixed income investors the opportunity to ride the same commodity wave that QR National investors are backing – while offering far superior yields to what we expect when QR National taps the bond market.

Bonds in both companies are widely available at wholesale rates or at specialist broking houses in minimum amounts of \$50,000.

Dalrymple Bay Coal Terminal offers both fixed and floating bonds with 2016 maturities, while Downer has a fixed bond available maturing in 2013. Both companies are offering yields in the mid 9% range. Based on other recent fixed interest bond raisings in the infrastructure sector, we would expect QR National bonds, when they come to market, to offer a yield of 8–8.5% based on current market conditions. Both Downer and Dalrymple Bay Coal Terminal would offer higher yields for bond holders while being subject to the same key business drivers as those securing QR National's future.



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