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AUTHOR: Tansy Harcourt SECTION: BUSINESS NEWS ARTICLE TYPE: NEWS ITEM AUDIENCE : 219,242
PAGE: 23 PRINTED SIZE: 1258.00cm² REGION: National MARKET: Australia ASR: AUD 67,032
WORDS: 1875 ITEM ID: 1747423715

03 DEC, 2022

The investors cashing in on a love of coal

Weekend Australian, Australia

The investors cashing in on a love of coal

It emits greenhouse gases but offers impressive returns

TANSY HARCOURT

Finding someone willing to stand up and say they love investing in coal is about as hard as most people would think.

But they're out there making a dump truck of money – 20 per cent-plus returns compared with 5 per cent for the ASX 200.

Those who will talk say that to ignore coal when there are currently no viable alternatives to use for bulk steel and energy production is about as silly as cutting off your nose to spite your face.

"It's an opportunity to pick up assets when the market is down," says Nick Jorss, chairman of Bowen Coking Coal and founder of Stanmore Coal, which purchased the Isaac Plains coal mine – now a $2.7bn company – for $1.

"I guess I've carved a niche out of buying unloved assets."

Coal mines are out of favour because both thermal coal – used to generate electricity – and metallurgical coal – used for steel production – are major contributors to carbon emissions.

And this has led many fund managers and banks to ban investment or lending to the sector due to environmental, social and governance concerns.

"My experience is that when prices are down then everyone runs around saying 'coal is dead' and sells out, but when prices run they don't like to miss out on the investment return and have to buy back in," Jorss adds. While it is good to think about the environment, he says, Australia – like many other countries – does not have enough of any other form of baseload power and there are no viable alternatives to making commercial quantities of steel.

A more high-profile character who has won, lost and is trying to regain a fortune buying out-of-favour mines is Nathan Tinkler, who has bought a stake in Jameson Resources, a coking coal explorer in Canada, having been outbid on Australian Pacific Coal.

"The fundamentals of what people want to believe and reality – well that gap is just getting bigger," says Tinkler. "Demand for thermal and met coal will just increase. We need thermal coal. It's fundamental to our existence."

While the former coal baron's name is mired in controversy, many perceived blue-chip names are also seeing a massive arbitrage between virtuous corporate behaviour and the need for the black stuff that comes out of the ground to make the lights switch

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'It's making money': The investors cashing in on their love of shunned coal

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on and build our cities. Wealthy businessmen including former advertising executive John Singleton, pearling dynasty scion Nick Paspaley and property and resources investor Brian Flannery are among those who have added to their fortunes by buying into coal.

APC's biggest creditor, Trepang Services, is part-owned by the Paspaley family and the company had previously agreed to sell its coal assets to Paspaley Group in return for the extinguishment of $30m of debt.

Angus Aitken, a broker at Aitken Mount Capital Partners, says the attraction of high-quality coal equities is simple – there is no supply coming on, with financing and permitting virtually impossible. "The fact many institutional investors cannot own coal stocks is why all the money will be made by high-net-worth investors who focus on cash flows and buying things cheaply," says Aitken.

"We think coal prices are just going to remain higher for many, many years to come. No sector will generate more free cash flow than coal."

Coal prices hit record highs last year, even as more governments worked to build renewables in their energy mix.

Since then prices climbed higher, to a new record of $US450 per tonne in September, as Russia's invasion of Ukraine increased fears of shortages of natural gas for power generation, compounding the already existing undersupply in global markets. The price is currently about $US320.

In Germany, a country that has set itself a goal of cutting 95 per cent of greenhouse gas emissions by 2050, five power plants that burn low-rank coal lignite – the highest carbon dioxide emitter – will be reopened to cope with the feared power shortage as winter looms.

The fact is that governments will do whatever needs to be done to make sure people have power, according to Flannery.

Flannery purchased the Vales Point coal-fired power station for $1m from the NSW government alongside Trevor St Baker.

Two years later, it was revalued at $722m.

While also having invested in solar, Flannery remains a passionate backer of coal.

"It's making money and I'm interested in making money," Flannery says. "It's making money because people want to buy it. Just look at what's happening in Germany. It's a simple supply/demand issue."

Flannery, a mining billionaire and property investor (he owns a sizeable holding in Byron Bay), is sceptical that enough renewable energy will be online to meet the Albanese government's target of a 43 per cent cut in emissions by 2030.

"Investors are starting to look at things differently," Flannery says. "Renewables will also be a big industry but we can't afford to shut coal down until we have a backup plan. We just don't want to shoot ourselves here."

He says Whitehaven Coal is "making lots of money", with shares rising more than 250 per cent this year after posting a record $1.95bn profit on the back of high coal prices.

Flannery sees short-termism across the board, from governments that haven't put in enough work on renewable energy, a lack of progress on finding a better way to make steel than using coal, and ESG policies of some fund managers and particularly by banks and insurance companies that pretend coal is not a necessity.

"Our big four banks won't lend any more. It's only for long-term customers and even then when that rolls off they won't re-lend," Flannery says.

All the while demand continues to increase on the back of a rising population needing more power and steel for construction. As it stands, about 70 per cent of the world's steel is made from coal and iron ore in roughly a two-to-one ratio mix. The product remains the most important construction material and is used in everything from buildings to cars and turbines.

Australia is the biggest exporter of iron ore in the world and the industry has created some of the country's richest people – Hancock Prospecting's Gina Rinehart and Fortescue Metals' Andrew Forrest.

"There are certain needs you just can't avoid," Flannery says. "Green steel using hydrogen is just not economical right now. It's all reliant on government subsidies and some of the technology is still 20 years away."

This magnetic repulsion between banks and investors trying to reduce their exposures to carbon emitters and the growing demand for coal has turned many of these companies into virtual cash machines.

As a result, those who are able to get comfortable with the ethics of coal are demanding and enjoying massive risk returns of more than 20 per cent based on spot prices, with New Hope, Whitehaven, Yancoal and TerraCom among those smashing profit records in August and delivering huge returns.

It's a stark contrast to the 5 per cent returns of the ASX 200 and heavy littering of cautious – if any – forward-looking profit statements of the broader stockmarket.

Coal companies are reliant on shareholders because they generally can't raise bank debt to fund expansion and their shareholder pool is limited because professional investors and industry superannuation funds usually cannot buy in because of ESG mandates.

The ASX-listed investment group Washington H. Soul Pattinson has always "felt good" about its investment in New Hope, says managing director Todd Barlow – although the company has reduced its shareholding from 60 per cent to about 40 per cent as part of a portfolio rebalance.

Barlow, who sits on the board of New Hope as the coal company's largest investor, says his firm takes the view that it's better to take an active role in ensuring coal is mined with a strong ESG focus, including land rehabilitation. "We've never taken the approach that if we sell down New Hope that somehow the world is going to be a better place," Barlow says.

It's a view shared by Tanarra Capital's John Wylie. "Forcing disinvestment just changes the ownership and sometimes you end up with less transparency, which can worsen the situation," the veteran investment banker says. "Coal ownership needs a nuanced approach."

What isn't nuanced is the risk that comes with coal investing. Apart from the volatility that comes with anything dependent on global spot prices, there are persistent calls for a hard shutdown of coal mines because of their contribution to greenhouse gases. Data released last year, for instance, showed Australia had the highest level of emissions from coal per capita, significantly above second-placed South Korea and others including China and the US.

But even Bain & Co's Australian head of sustainability and responsibility practice, Agathe Gross – who is calling for a greater emissions reduction target of 50 per cent instead of 43 per cent – believes it is just not realistic to shut these mines down in the short term. "Can you afford to keep the lights on if you shut them down tomorrow? Probably not, so it needs a more measured approach," Gross says.

The inevitability of coal mine closures means that for companies investing in new mines or greenfield projects the numbers need to stack up quickly.

Barlow says New Hope's biggest recent investment in coal was the $860m purchase of a 40 per cent stake in Bengalla Mining from Wesfarmers in 2018. It took four years to recoup its money the first time – when coal prices fell below $50 – then 18 months to earn the same amount from the investment again. Barlow says it will take less than a year to earn the amount a third time.

"It's a function of buying well and the coal price now being really high," Barlow says. "If you're getting paid back in four years, that's a 25 per cent return per annum. But then with the coal price now going much higher, it's paying us back one time to capital every year. So that's a very attractive return on investment."

Mining is a cyclical industry with high regulatory risk. But as retirees, or those soon to be, look at their ever shrinking share portfolio and diminished dividend returns, there is an obvious question to be asked: is there still ethical money to be made investing in coal?

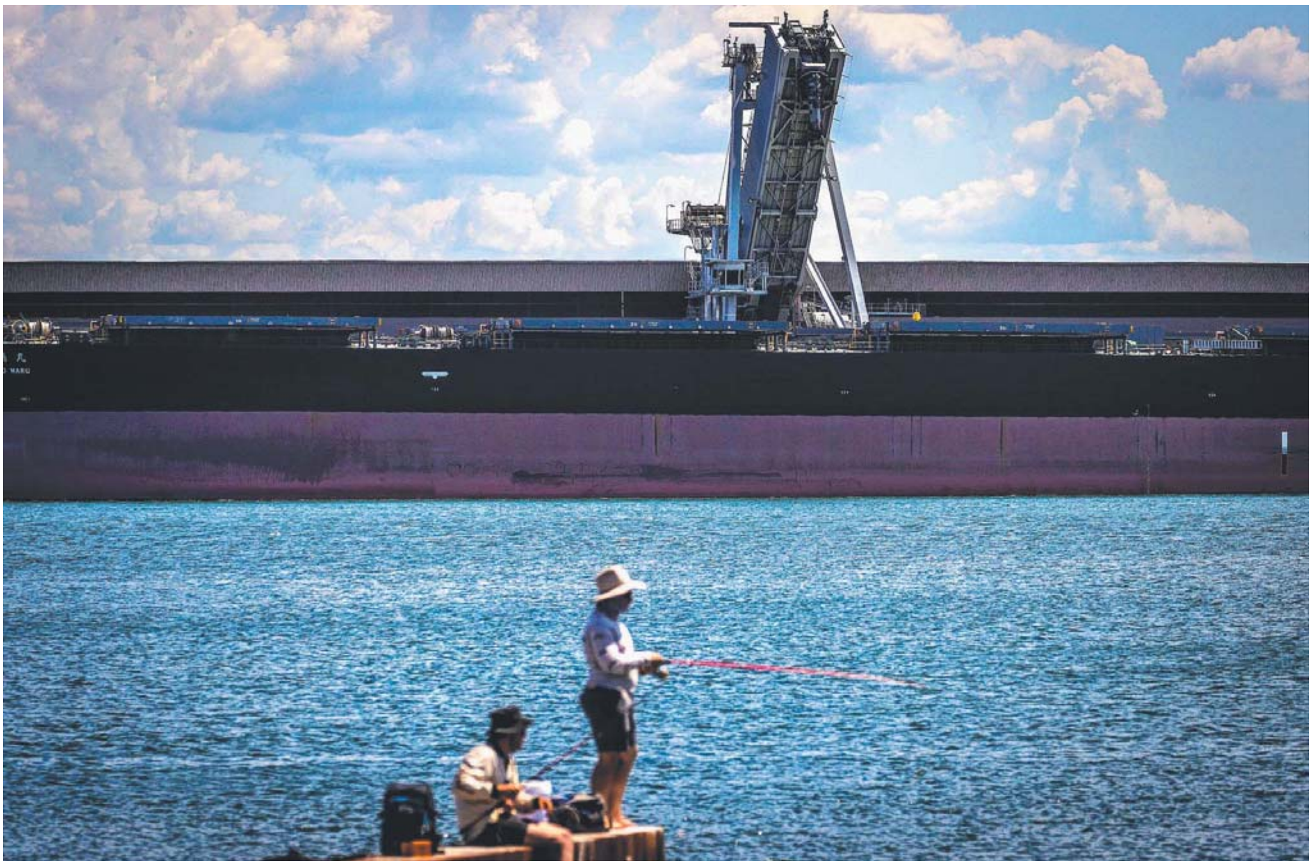
Jorss is one who thinks there is still plenty left in the tank.

"You need steel to industrialise and to decarbonise," he says.

"Most sensible investors understand this is not going to be a rapid transition. Not with met coal. I think prices will stay generally higher for a long period of time."

‘We think coal prices are going to remain higher for many, many years to come’

ANGUS AITKEN
AITKEN MOUNT CAPITAL PARTNERS BROKER



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A bulk carrier is loaded with coal at the Port of Newcastle. Coal prices hit record highs last year

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Souls Patts managing director Todd Barlow, and a protester dressed as then-prime minister Scott Morrison in 2019