From miner to major

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If you want to know when metals major Billiton might return to the project finance market, keep an eye on the Mozambican health workers spraying the bush against malarial mosquitos.

Billiton's 250,000 tpy Mozal aluminium smelter in Mozambique is nearing completion and will go into production in September. An $850 million second pot line to double output is already at pre-feasibility stage and the progress of the anti-mosquito war is among the factors that will determine whether it goes ahead.

Michael Campbell, manager of public affairs for Billiton South Africa, claims: ?Mozal is 95% complete. The first anodes have been produced and we will have first metal in September. The project expansion will depend on three things. Firstly, our people have to be satisfied as to the sustainability of aluminium ingot production from Mozal Phase One. Second, the harbour at Maputo, where we have a berth, needs to be upgraded both for the additional raw material imports and the export of finished goods: CFM has signed heads of agreement for the upgrade with the Mersey Docks & Harbour Company. Then, progress depends on the malaria spraying programme. Malaria is a more serious problem than we expected at first. Of course market conditions will also be a factor.?

To tackle the mosquito problem, Billiton has improved its on-site medical services, to ensure early detection and stabilisation of malaria cases, and to fly workers out to well-equipped hospitals if necessary. On top of its own spraying programme in the immediate vicinity of Mozal, the company participates in, and has committed $500,000 to, the Lebombo spraying project, an anti-malaria initiative supported by the Mozambique, Swaziland and South African governments and the World Health Organisation.

Another factor that will influence Billiton's decision about expansion at Mozal is the opportunity to take control of the Worsley bauxite and alumina complex in Australia. Billiton owns 30% of Worsley, and has pre-emptive rights to buy a controlling 56% stake that Reynolds Aluminium of the US is compelled to divest under anti-trust conditions attached to its merger last year with Alcoa. Campbell of Billiton said it would decide whether to exercise its right ?depending on how the sale is structured?.

Metals analyst Raj Kohli at Banque Paribas expects Billiton to go ahead with the purchase. ?This is a large-scale, low-cost investment, just right for Billiton,? he says. ?Worsley is one of the lowest-cost alumina producers in the world and would be a reliable supplier for possible future smelter expansions. If anything they will go long on alumina.?

The initial $1.3 billion Mozal project was Mozambique's largest ever investment, and the expansion, if it goes ahead, will certainly be the largest Billiton project medium-term.

Anything on that scale would be a candidate for project finance. Willi Murray, head of treasury at Billiton, says: ?If a project is of a size that warrants project finance, we will be likely to come into the market; projects costing $200 million or less are likely to be financed from our own resources. We take each project, look at the return and the risk parameters, and decide on the best methods to finance it.?

Analysts expect Mozal Phase Two to be 100% Billiton-owned ? whereas in the initial smelter project Billiton took a 47% equity stake alongside Mitsubishi (25%), the Industrial Development Corporation of South Africa (24%) and the Mozambique government (4%). Andrew Howard, metals analyst at Dresdner Kleinwort Benson, pointed out: ?If Phase Two goes ahead, Billiton's stake in the Mozal project overall could rise to 75%, and this in turn could lead to them restructuring debt.?

Prospects for new projects

Billiton is a South African company that has successfully turned itself into an international one, a transformation crowned by its listing on the London Stock Exchange in mid-1997. It has substantial positions in the markets for aluminium, coal, nickel, ferroalloys and industrial minerals.

The company weighs its project finance needs against its internally-generated revenues ? currently riding high on the back of strong metals prices ? and a credit facility estimated by analysts at about $1.9 billion. It has not securitised debt in the past and Murray says securitisation is ?simply a possibility? for the future.

Apart from the Mozal expansion, other Billiton projects that may require off-balance sheet financing in the short and medium term are:

? The addition of a stub line to raise output at the Hillside aluminium smelter in South Africa from 500,000 tpy to 650,000tpy, at an estimated cost of $450 million. Campbell of Billiton says: ?This is further behind than the Mozal expansion. It is subject to Environmental Impact Assessment (EIA) by the South African authorities, to determine impact on the local community and environment, which could take a further six months.?

? A joint venture by Samancor, the Billiton subsidiary, and Anglo-American, to build two furnaces and a pelletising facility at the Mooinooi ferro-chrome plant near Rustenburg, South Africa. This debottlenecking project is also in the EIA process, and is subject to board approvals and market conditions.

? The Ravensthorpe nickel project in Western Australia, in which QNI, a wholly-owned Billiton subsidiary, signed an agreement on 17 May to buy a 40% direct joint venture interest from Comet Resources. This involves building a mine, ore beneficiation facility, acid pressure leach and hydroxide precipitation plant, to feed QNI's 25,000tpy Yabulu refinery, which may be in line for an expansion up to 65,000tpy in 2002-03. The latter could require up to $700 million project finance.

? Development of Mount Arthur North, a coal field in New South Wales, Australia, owned by Billiton subsidiary Coal Operations Australia Ltd and adjacent to its Bayswater mine. Billiton expects to develop the field to produce up to 8 million tpy from 2003.

? Expansion of the Khutala coal operations and upgrading of the Richard's Bay coal terminal in South Africa.

? Further out, possible development of the Lanping zinc-lead ore district in the Yunan province of south-west China, where Billiton subsidiary Billiton China BV last year entered a preliminary cooperative agreement with the Yunan LanPing NonFerrous Metals Company with a view to a $500 million 200,000tpy zinc project.

Other possible expansions include the purchase of Shell's coal assets in Australia, for which Billiton is a bidder, and of Venezuelan aluminium assets that are to be privatised.

Current project loans

Billiton is a valued partner for both project financiers and multilaterals, as can be seen from the line-up of lenders on its two most recent deals, Mozal Phase One and the Cerro Matoso nickel project in Colombia.

The multilaterals led the way on Mozal Phase One, launched in October 1998. Equity of $520 million was marshalled alongside senior loans of $670 million and subordinated loans of $150 million. The senior debt was provided by IFC, supported by the Credit Guarantee Insurance Corporation of South Africa ($400 million), the Compagnie francaise d'Assurance pour le Commerce Exterieur (Coface), the Commonwealth Development Corporation (CDC), DEG of Germany, the Development Bank of South Africa and Proparco; the subordinated debt was from IFC, CDC, DEG, DEBSA and Proparco.

For the Cerro Matoso expansion, a $240 million senior debt facility, using offshore accounts and with full political risk assurance, was granted in December last year by a group of six lead arrangers ? Barclays, Citibank, Deutsche Bank, ABN Amro, Australia and New Zealand Banking Group and the Export Development Corporation. Another project ? the $600 million expansion of the Worsley alumina refinery from its present capacity of 1.88 million tonnes to 3.1 million tonnes, which began in late 1997 ? is near to completion.

Market sources claim future deals are being discussed with Billiton by the banks that participated in the Cerro Matoso loan, and Chase Manhattan, among others. A London project financier says: ?From Billiton's point of view, project finance can be useful for laying off some country risk. From the banks' point of view, it is a very large corporate that can command good pricing.?

Commodity risk and country risk

Billiton appears an even more attractive target when one looks at the bull markets in the metals commodities it trades. Analysts are unanimous that the mid-term fundamentals are robust, with healthy industrial production in Europe, the US, and Asia excluding Japan ? although that assumes that the US economy is heading for a soft landing rather than a bump or a crash.

Nickel, which is soaring above $10,000 per tonne, is expected to come down slightly but will not sink. James May of Metal Bulletin Research says: ?Further upside is possible short-term, because stocks are low and there are production difficulties, particularly associated with strikes in Canada. In the mid-term, new laterite production in Australia and the impact of high Russian exports may bring about a slight fall.?

The sharp increase in demand for stainless steel is as good for ferro-chrome as for nickel, he adds. ?Stainless steel production is expected to grow strongly for the rest of 2000. In the ferro-chrome market, the presence of unexploited production capacity, including Billiton's, limits the upside potential. Price strength is therefore dependent on producers' ability to restrict supply.?

May says aluminium prices failed to return to their January highs of around $1750 per tonne, despite strong demand and alumina tightness. ?While strong demand points to prices rising, we are cautious about this prospect because producers appear able to continue to meet demand from current capacity.?

Another issue for lenders to Billiton ? with Mozal Phase Two and Hillside figuring so prominently on the list of upcoming projects ? is country risk in southern Africa.

Steven Bailey-Smith, economist (southern Africa) at Dunn & Bradstreet, says that although Mozambique's country risk rating had been downgraded to DB5c as a result of the floods, the disaster would not fundamentally damage the economy in the mid or long term.

?Paradoxically, the floods will probably improve Mozambique's mid-term outlook,? he adds. ?A great deal of donor money is pledged and may provide foreign investment, following what has already been invested in the Mozal project.?

Bailey also describes as ?exaggerated? the claims that much-publicised political clashes in Zimbabwe will have a knock-on effect on South Africa, Mozambique and other countries.?In Zimbabwe itself the election is unlikely to result in any fundamental political realignment, mainly because of the presence of presidential appointees in parliament. There is the possibility of continuing stalemate, followed by intervention by the army. But the mechanisms for a knock-on effect are not there. Any political migration will always be vastly outweighed by economic migration from Zimbabwe and the other surrounding states to South Africa, which is a much more significant factor.?

Nigel Keyser, metals analyst at JP Morgan, is more cautious: ?There are some problems in South Africa which, despite the progress of reform, need to be taken into account in the long term. The first is the impact of Aids on the health of workforces. In many cases the rate of infection is 30-40%, and among miners it tends to be higher.

?The second is that black empowerment programmes put a question mark over the valuation of reserves ? in Billiton's case, those of manganese and chrome. Government policy is that communities should be able to exploit reserves in cases where they would otherwise be left undeveloped by companies.? Thus Samancor may have to dispose of reserves in such a way as market discipline would be affected.

These factors are challenges that Billiton will meet head on.