

## Raspadskaya site visit findings



### Raspadskaya

Ticker (Bloomberg)

RASP RU

Price (as at 2010/03/03)

\$5,75

### Raspadskaya vs. RTS, 6M performance



Source: Bloomberg

Following our site visit to Raspadskaya on March 1, we retain our positive view on the stock.

We would summarize our findings as follows:

- ▶ Raspadskaya 2010's output might exceed 13 mt;
- ▶ No risk of underinvestment;
- ▶ Koksovaya mine story – very good but there are some temporary uncertainties;
- ▶ Contract policy – the quarterly basis now;
- ▶ Export markets – lots of pros, no contras;
- ▶ China coal business – a grey area;
- ▶ Logistics in Russia – play politics;
- ▶ Enrichment facilities – more than enough for now;
- ▶ The SPO – likely but not within the next 2 years.

Now in details:

### 2010 production plans

We think that Raspadskaya may increase production by more than 10–15%, as was announced in mid-2010. As a result, the total volume might grow closer to 13 mt).

Rationale: Growing demand for coking coal and the company's ability to easily increase production volume to above 13 mt. Moreover, coal enrichment facilities are enough to process these volumes of raw coal.

### No risk of underinvestment

There are no risks of underinvestment in shaft-sinking and tunneling works to prepare new longwalls. Raspadskaya didn't stop these works in 2009 and, which is more important, keeps up the certain volume of new longwalls as reserves so that the company could work nonstop.

### Koksovaya mine story

At the moment we would avoid making forecasts regarding production volumes at Koksovaya mine for a 2 years' period following its commissioning expected in 2011. "Commercial" launch of Raspsdskaya Koksovaya is scheduled for 2011, though the company is now carrying out some shaft-sinking and tunneling works and mines insignificant volumes there. The volumes of raw coal mined here depend on certain things: longwalls from which the company is going to start its industrial production have uneven coal layers, varying from 1.5 m to 3.0 m in height. It will surely impede smoother mining there. As a result, we'll see unequal production volumes and ups and downs in cash costs. This will last for a couple of years and then the situation will improve dramatically because of much better geological features of the next layer (e. g. it is more even with the thickness of about 7 m, necessitating fewer readjustments compared to the original layer).

### Contract policy

Now the company signs quarterly contracts with all Russian consumers. This system suits all at the moment. At the same time, Raspadskaya now feels more comfortable because of aggressively entering international markets, particularly the Asian ones (see further details below).

## Export markets: why international players want to buy Raspadskaya's coal and why it's good for the miner

*Firstly*, international markets, especially the Asian ones, will easily gulp down concentrate from Raspadskaya because of their desire to diversify risks of being tapped from few sources (mostly Australia).

*Secondly*, Raspadskaya's tiny export volumes (up to 3,5 mt in 2010) compared with those from Australia and other countries. Even though Raspadskaya will gradually step up its international presence further (first of all, in Asia) and increase volumes (up to 17 mt in a few years' time), it will undoubtedly still be able to find customers for its concentrate products on the international markets.

*Why?* Now Raspadskaya works with Japan JEF, Korean Posco and Asian subs of Thyssen Krupp. At least one of these companies, Posco, is going to aggressively enhance its market share on the regional market through either acquisitions or green/brown fields so that it will be able to produce up to 60 mt of steel pa. Having good business relationships with Posco and adhering to its policy of diversifying risks of "one-source", Raspadskaya might boost consumption of coal from this side. In addition, Raspadskaya's management is optimistic about the Indian market where steel makers face the same risks.

*Thirdly*, according to our talks with Raspadskaya's management, Asian steelmakers are going to use Russian coking coal concentrate factor as leverage with Australian, Canadian and Indonesian miners to get more favorable terms through inventories made from Russian coal, enabling them to get more leeway in negotiation process.

*Finally*, the announced changes to the overseas expansion strategy will definitely improve Raspadskaya's bargaining power domestically. Now Russian steel makers cannot dictate coal prices to Raspadskaya – there are always alternate supply chains, namely – the export markets.

### China – a grey area

Chinese coal business is supposed to present lots of hidden risks because the information coming from there, according to Raspadskaya management, remains controversial. We tried to figure out Raspadskaya's view on the Chinese coking coal business prospects, cash-costs and whether the coking coal import growth is sustainable. However, we got literally nothing from Raspadskaya because, as they said, the coal business remains opaque. From our point of view, this might be the reason why Raspadskaya tries to diversify its export delivery focusing not only on China but also on other countries in the region (Japan, Korea and in the future – India),

### Logistics in Russia

Raspadskaya's management said that this is rather a question of negotiation and political maneuvering between Raspadskaya and RZhD. The miner expects further hikes in railroad tariffs, but it didn't answer to which extent. As to tight capacities of Asian seaports, Raspadskaya is sure it will be able to ship the whole volume to the Asian markets because of relatively small volumes. However, no further comments followed.

### Enrichment facilities

Raspadskaya can easily increase capacities of its enrichment plant from current 15 mt pa to 17 mt pa to fully cover growing production of raw coal. Though no precise Capex figures were announced, we don't think they will be considerable.

### The SPO – no plans for now

The main reason – no investment story to offer to investors except for further production growth (which is trite) and higher prices. I don't rule out that Raspadskaya might acquire some interesting assets, but not at the moment. This might justify the SPO.

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