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CEO on Smelter DFS & Update

Open Briefing with CEO Peter Toth

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In this Open Briefing®, Peter discusses

- Sarawak Smelting Project DFS
- September quarterly production
- Company outlook

Open Briefing interview:

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OM Holdings Limited (ASX: OMH) on 8 November 2011 released a summary of the key financial highlights from its Definitive Feasibility Study (DFS) recently approved by its Board for its proposed 600,000 tonnes per annum (tpa) OM Sarawak Ferro Alloy Smelting Project in East Malaysia (Sarawak Project). What is the rationale behind OM Holdings building and operating this smelter?

CEO Peter Toth
There are two parts to the rationale behind this unique project. The first is the dynamic transformation occurring within the ferro alloy industry which is very heavily dominated by China – about 50% of the world's manganese alloys and about 70% of the world's ferro silicon alloys are currently produced in China. This of course reflects the significant production and consumption of steel occurring in China today. However, China, which was once a major exporter of manganese ferro alloys and today still is a major exporter of ferro silicon alloys, is increasingly facing power availability and cost issues on top of a government imposed 20 to 25% export duty in effect 'discouraging' the export of these energy intensive products. This is making Chinese ferro alloy exports both increasingly expensive and strategically unreliable in the long term.

The second part of the rationale lies in the unique characteristics of the Sarawak Project itself – the benefits of its location, including access to competitively priced long term reliable hydro energy, its proximity to raw materials and to major markets and customers in Asia, existing and newly built infrastructure and the lack of import and/or export duties, and a five-year tax holiday, amongst others. The Sarawak Project will have access to 500 MW of competitively priced electricity under a 20-year contract, which will mean it will be one of the largest and lowest cost alloy smelters in the region and in the world. Ferro alloy production requires very high energy consumption – about 4,500KWh/t for silico manganese, approximately 25% of its total direct production cost, and around 9,100KWh/t for ferro silicon, close to 48% of its total direct production cost. It is not often that you can generate an opportunity with all these competitive advantages in one project, with long term certainty around competitive energy pricing being critical.

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What are the key risks to the capex budget for the Sarawak Project and what will your local partner bring to the development and ongoing operation of the project?

CEO Peter Toth
As it currently stands, the Sarawak Project's key risks are execution related. We've begun the Detailed Environmental Impact Assessment (DEIA) process and we're managing this actively in order to complete it by the deadline of Q2 2012. The project also relies on the planned completion of the Samalaju Port, a dedicated port facility built to service the Samalaju Industrial Zone. Timely completion of the port (particularly the interim phase comprising the barging berth and a 7.0 m deep channel) will ensure that the project can import the raw materials necessary for the testing, ramp-up and full capacity commissioning of the project.

A Power Purchase Agreement (PPA) between OM Sarawak and Syarikat Sesco Berhad (SESCO), the Sarawak power company, is expected to be completed by the end of Q4 2011. Construction is scheduled to start once financial close for the project has been achieved and all regulatory approvals are met, expected to be no later than Q3 2012.

The smelting technology to be used is established, tried-and-tested technology used in most smelters around the world, so there is no technology risk associated with this project. Our preferred engineering, procurement and construction (ECP) contractor, Sinosteel Jilin Electro-Mechanical Equipment Co., Ltd, is a well established and experienced designer, manufacturer and installer of this smelting technology and equipment.

Our strategic partner, Samalaju Industries Sdn Bhd (SISB) is a subsidiary of Malaysian Stock Exchange listed Cahya Mata Sarawak Berhad (CMSB). It has interests in construction and building materials, road maintenance and pipe manufacturing and is also involved in various aspects of the developments of the Samalaju Industrial Zone. SISB's local knowledge, specific expertise and involvement in various aspects of the project will be invaluable.

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How dependent is the feasibility modelling and forecast 30% project internal rate of return (IRR) on your ability to conclude the PPA with SESCO within the terms assumed in the DFS?

CEO Peter Toth
Energy is one of the most significant cost elements in the financial modeling and the actual operations of this project. The power cost assumptions in the project's financial model mirror the terms of the nearly completed PPA. We expect to conclude the PPA by the end of the year and once that agreement has been signed we will have contractually locked in the smelter's power costs for the next 20 years.

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The DFS modelling for the Sarawak Project indicates expected gross margins of 27% on 310,000 tonnes of production of ferro silicon and 15% on 290,000 tonnes of production of manganese alloys. How do these compare with margins at existing production facilities in the Asia Pacific region?

CEO Peter Toth

These attractive gross margins for the smelter indicate its favorable cost structure on conservative alloy sale price assumptions. The key competitive advantage of this smelter comes from its highly competitive power costs over its 20 year life. I have no doubt that the Sarawak smelter will be one of the lowest cost smelters in the Asia Pacific region, and also globally. Only by ensuring a long term sustainable position at the bottom of the alloy industry cost curve can the long term viability and success of any smelter, new or old, be achieved.

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What progress have you made in advancing the requisite government and environmental approvals for the project, and given other mineral processing plants in Malaysia have recently met with resistance from local communities, how are you seeking to deal with any community concerns?

CEO Peter Toth

Our advantage in this respect is that the smelter will be located in a purpose-built dedicated industrial estate. The project has been designed and will be built from the ground up to comply with all the required rules and regulations. We are being assisted by Malaysia's largest environmental consultancy firm, Chemsain Konsultant Sdn Bhd, to deliver the environmental impact assessment study by Q2 2012.

As one of a number of large scale industrial manufacturing operations being developed in the Samalaju Industrial Zone, we'll be providing significant opportunities for training, employment and economic development in the region and in the state.

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You've already entered into initial agreements with potential large off-take partners such as JFE Shoji of Japan (JFE). What level of commitment are you seeking in these agreements and is it your intention to seek off-take partner involvement in funding the project?

CEO Peter Toth

The Asian steel industry in general and large integrated Asian steel mills specifically are evaluating this smelting project favorably because it will assist them with their alloy sourcing diversification strategies and establish a large, low cost and reliable supplier of ferro alloys in the region. It is our intention to lock in long-term off-take agreements with major customers and distributors for approximately 60% to 70% of the smelter's production, which will significantly de-risk the project as well as assist with its financing and bankability process. We are confident of achieving this level of off-take commitment.

JFE has expressed an interest in equity participation in the project and we're in the process of discussing this further. We're also in discussions with other large Asian steel mills for off-take agreements, some of which may also potentially involve equity participation.

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How will the funding for the Sarawak Project be structured and what do you expect joint venture and off-take partners to contribute to the funding package?

CEO Peter Toth

We're planning for a funding structure that is sourced 70% by project financing and 30% by way of equity from the project's shareholders. The equity component will then be split 80% OMH and 20% SISB. So our share of the project's equity funding will be approximately US$120 million. We intend to fund this commitment via the application of surplus funds from a US$125 million five-year debt facility currently under negotiation and from funds raised by divesting certain non-core equity investments. We will also consider and evaluate the need for a focused share placement to strategic investors, who support the company's and the project's fundamentals, while seeking to ensure that dilution of existing shareholders is kept to a minimum.

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Construction has begun at the South African Tshipi mine (OMH 13% effective interest) with a ground breaking ceremony recently held, and first production is targeted for the second half of 2012. How important will Tshipi production be to the proposed Sarawak Project and are you confident of sufficient sustainable supply of raw materials to the smelter?

CEO Peter Toth

The smelter will predominantly rely on the company's 100% owned Bootu Creek mine for its high-grade siliceous manganese ore requirements, supplemented by high-grade ore from Tshipi. Of the 600,000 tonnes of planned production, approximately half will be ferro silicon and half will be manganese alloys. The smelter's product mix as well as sintering capacity will ensure that raw material consumption options are fully optimised, both technically and commercially.

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OM Holdings' manganese ore production for the September quarter was 231,166 tonnes, down 13% from the previous quarter's record production of 265,543 tonnes, and the cash cost per dmtu rose by 13% to A$4.27/dmtu. To what extent was this performance due to your trial processing of stockpiled lower grade ore? Was the trial successful and do you still anticipate meeting your target of annualised production of 1 million tonnes?

CEO Peter Toth

We're on track to achieve record annual production at Bootu Creek this year and continue to run as close to the 1 million tpa annualised capacity as possible. The cost performance of the mine is obviously linked to its production output. We made a decision to trial a lower grade ore source in September as part of our preparation for potential interruptions to mining activity during the coming wet season. While the lower grade feed had an impact on our total production tonnes and therefore cost performance during September, it was still within the normal parameters of the mine's operations and has helped us to confirm a viable production strategy alternative for the wet season.

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What is your view on the outlook for manganese prices given the recent flattening in Chinese stockpile volumes and in the face of current global economic uncertainty?

CEO Peter Toth

We believe that continued strong demand for manganese units from the Chinese and global steel industry will persist. While short term supply side considerations continue to drive current ore and alloy prices, we continue to believe that the manganese industry fundamentals are solid and the medium to long term outlook for manganese market is positive.

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Thank you, Peter.

For more information on OM Holdings, visit www.omholdingsltd.com or call Peter Toth on +65 6346 5515

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