SE portfolio

HD **Ahead of the game**

BY Jeremy Chunn

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CEO Q&A

MORGAN BALL

TD

CEO BC Iron

Tenure

One year

One-year share price

18.8%

BC Iron chief Morgan Ball tells Jeremy Chunn how his company appears to have dodged the mining slowdown.

Much of the fortune of the nation's economy relies on the iron ore giants that operate in the Pilbara region of Western Australia, shipping low-cost raw material to the manufacturing hub of the globe, China.

But investing in these miners hasn't been a sure bet. Over the past year shares in BHP Billiton, Rio Tinto and Atlas Iron have lost value. And anyone hoping for generous dividends knows to avoid these companies altogether.

One company has outstripped the others by a very wide margin over the past five years: BC Iron's share price is up 970 per cent since 2009. Even better, it's paying a dividend around 9.4 per cent.

How do your operating costs compare with other miners in the Pilbara?

BHP and Rio are materially lower, which you'd understand given the size and quality of their asset and their infrastructure, Fortescue (FMG) used to be around the same range [as BC Iron] but they're below that now. From an operating perspective, you can throw a blanket over the rest of us: Mount Gibson, ourselves, Atlas, Moly Mines – we're all producing at the operating level about $45 to $50 a tonne. A key point for us is freight costs. Most contracts include the cost of freight, so because of our joint venture with Fortescue we're accessing "cape-size" vessels, compared with some other companies which are accessing slightly smaller vessels.

Howis the $A weakness playing out for you?

The Australian dollar is a commodity currency and you tend to see, as the commodity prices fall, the Aussie dollar falls. In the past two or three years that nexus has broken somewhat and we saw commodity prices fall and the currency stay very strong. What we've seen in the past six months is that alignment coming back into play. Although we've seen a drop in iron ore prices in the past few months, the Aussie drop more than compensates for that.

What's your outlook for the iron ore price?

We are comfortable in the short to medium term the price will stay in a band between $US110 and $US130 a tonne. It's a volatile commodity … but, in general, we think it will pull back to fall within that range for the next two to three years at least.

BC Iron has a sizeable offtake agreement with Henghou Industries.Tell us about that.

Henghou is a Chinese trader and they sell a lot of our ore to steel mills in China. They're a big advocate of BC Iron and lent the joint venture $50 million as a form of project finance. In return we gave them a guarantee offtake for 20 million tonnes … which finishes in 2018. We don't sell all of our product to Henghou.

Other than infrastructure access, how has your joint venture with FMG benefited BC Iron?

We sit on a joint-venture committee together and we are realising some cost synergies by accessing their buying power. We share a lot of operational expenses.

How many years are left in the Nullagine joint venture?

There are about six years of mining left, if you look at the reserve statement. We're in the market now talking about Project Inventory, which is assessment of lower grade iron ore and how we can beneficiate [refine] that up to a saleable product. We're hopeful there's a two-to-five-year mine life on the back of that.

Can you describe the cost benefits of the nearsurface mining operation?

It's an interesting one. The [machines] are like road profilers; we just churn along the top and there's quite good visual grade control, so we can get quite clever about what's DSO [direct shipping ore], what's low grade, what's mineralised waste, so there's less rehandling involved.

Certainly there are some environmental benefits; we're not blasting and spraying stuff everywhere.

Do the generous payout ratios at BC Iron indicate a lack of opportunities?

I would say no. We have a good little operation producing a really pleasing amount of free cash flow. We've always taken the view we won't necessarily warehouse funds for a rainy day. We would rather keep an appropriate amount of money in the bank to manage our business but return a larger amount to shareholders on the theory that, when the next capital opportunity does arise, shareholders will support us if we need to visit the market.

What is the outlook for dividends from BC Iron?

We believe we have an operation that can support a 30 per cent payout ratio no matter what the volatility of our environment has been.

What are your plans to pay off debt and how will it affect shareholders?

It's a balance. We're fortunate we have a good operation which produces pleasing free cash flow. It would be fair to say our dividend is slightly more measured because we're balancing it with paying off debt ahead of schedule. The reason for doing that is to keep the balance sheet nice and clean but it's been justified in the past six months because our debt is in US dollars. With a falling Aussie dollar, the fact we paid back more of that ahead of schedule was a positive for shareholders. The debt ratio will decrease.

What attracted you to the project in Brazil?

Other than the low-grade trial at Nullagine, growth for the company will need to come through some kind of transaction such as early stage exploration, farming into a project or an M&A transaction, if it makes sense for our shareholders. It's good to have some greenfields operations in the portfolio.

One of the attractions of the Cleveland alliance is we know a few of the guys, who are ex-FMG, and they have an established operation in Brazil and are used to dealing in that market. The fact it's a greenfield play means any money we're putting into Brazil we're putting into the ground rather than into a vendor's pocket. If a greenfield operation is successful, it's the best accretion for a shareholder.

Is the Brazil site close torail and a port?

Yes, that's why we chose it. There is rail being extended not far from where we're drilling, and there's a port planned. If we can find a decent iron ore deposit we'd have a better-than-even chance of getting it to market.

They're three or four years down the track, but we wouldn't expect to have an operation up any faster than that.

Could an investor looking at share price growth over the past five years ask: is this as good as it can get for BC Iron?

To that I would say, we'll continue to pay strong, robust dividends, and we will continue in just about any scenario we can imagine for the iron price and Aussie dollar to continue to produce very good cash flow. The past five-year share price performance isn't just about building the Nullagine project and bringing it to production: we did a $200 million deal 18 months ago which was a big contributor to that ongoing share price growth, so we've demonstrated we can do M&A transactions on accretive terms. We're continuing to look to do that, but shareholders can be comfortable we'll only do that on very disciplined metrics.

970%

The capital gain in BC Iron's share price for the five years to March 10.

75:25

The miner has the majority stake in a joint venture with Fortescue Metals Group at the Nullagine Iron Ore Project in the Pilbara region of Western Australia.

7.4%

Dividend payments as a percentage of the share price at March 10, including interim payment in March of 17¢ and final payment in September 2013 of 30¢.

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