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HD **Arrium faced a $754m question**

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The $754 million equity raising by iron ore and steel group Arrium is being hailed by some as prudent and by others as desperate. The truth lies somewhere in between. The reality is the company that has been carrying too much debt on its balance sheet really did not have a choice.

One need look no further than the price of the new stock being issued - a 40 per cent discount to the company's value-weighted average price over the past three months - to understand that it could not chance failure. It needs the money to fortify the company in the face of a steeply falling iron ore price.

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Investors will be able to pick up these new shares at 48¢. In March, Arrium shares were trading at more than $1.50.

Arrium cannot afford to ride out the weakness in the iron ore price. While its cash costs of producing iron ore sit around $73, the total cost, including servicing debt, is thought to be greater than the current iron ore price of about $US82 ($91).

It noted on Monday that if current conditions continue, its net debt will blow out by between $100 million and $300 million by December this year - in the absence of a capital raising. And this is despite a cost-cutting initiative that should bear fruit in the current financial year.

And Arrium is not at the top end of costs relative to other smaller iron ore producers. Many others are already bleeding red ink. Only a few, including large players Rio Tinto, BHP Billiton and Fortescue, are making any money out of iron ore at these prices.

Arrium (formerly known as OneSteel) at least has the capacity to raise money. Most of the smaller producers are completely at the mercy of the iron ore price.

And while there is a school of thought that says the major producers are happy to see the iron ore price fall in order that smaller producers (and high-cost Chinese mines) are pushed out of the market, such an outcome makes little sense for BHP and Rio shareholders as these companies will produce less profit as the commodity price falls.

Only months ago, Arrium and other producers were forecasting a recovery in prices to more than $US100. Arrium even paid a dividend - a move that with the value of hindsight looks profligate.

But few in the field are willing to make these kinds of predictions at the moment - and none would bet the house on it.

If Arrium is looking for something to blame, it might first stay close to home. The company's debt levels are high because (like plenty of other corporates) it acquired an expensive business almost minutes before the onset of the global financial crisis.

While the business itself, Moly-Cop (which operates in grinding media) is a sound one with reasonable growth prospects, Arrium paid too much for it and in doing so ratcheted up its gearing.

It is now having to raise expensive **equity** to pay off that debt.

But if it wants to find some additional culprits, it need look no further than the large local producers, BHP Rio and FMG - that have been adding supply at unprecedented rates and in doing so adding to the downwards pressure on the **iron ore** price.

The final piece in the **iron ore** price equation is **China**. Months of economic data - the most recent of which emerged over the weekend - shows that the rate of growth is slowing ahead of that which its government had forecast.

Over the past couple of days, reports on **Chinese** factory production, retail sales and asset investment all came in weaker than expected.

There is now an increased expectation that the government will need to introduce a new stimulus package to kick-start growth sufficiently to reach the promised levels of economic growth of 7.5 per cent.

Meanwhile, Arrium cannot give any real earnings guidance to the potential and existing investors due to all the unknowns, including the **iron ore** price, the exchange rate and scrap metal prices. It will say only that 2015 profit is expected to be lower than 2014.

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