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HD **Mining majors turn up the heat**

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Size matters in iron ore AS BHP, RIO slash costs

When you are a big player in a market under pressure it helps sometimes to sound a warning to would-be competitors by reminding them how good you are and, by implication, how tough it will be for higher-cost competitors.

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Rio Tinto did it last week by confirming it has permission to build a new Pilbara iron ore mine. BHP's Jimmy Wilson did it yesterday by telling the market he would increase capacity by 65 million tonnes and, in the process, cut costs by 25 per cent to below $US20 a tonne.

Right now BHP is producing iron ore at $US30 a tonne. Four years ago it was building capacity at $US150- $US200 a tonne.

Those metrics neatly show just what has happened to the mining services sector in recent months, because quite clearly BHP and Rio are not paying the big bucks to anyone any more, and that explains why that sector has been decimated. Wilson confided that 50 million tonnes of ore have left the market from high-cost Chinese producers so far this year and that would appear to be vindication of his strategy.

BHP and Rio want the high-cost producers out of the way, and while they can still dig up iron ore with internal rates of return of better than 35 per cent — even with the iron ore price at present levels — that tells you the big guys are going OK.

Obviously the bigger you are, the lower your costs. On simple economics, both BHP and Rio have their feet firmly on the accelerator, even if iron prices have fallen 22 per cent since May.

The implied threat to the little guys is: forget it — we are getting bigger and cheaper, and when the supply-demand equation evens out we have the game sewn up.

Wilson confided: "It's a tough old world out there and we have to do what we do for our own business." BHP has $US25 billion ($28.7bn) worth of equipment on the ground in the Pilbara to get iron ore from the mine on to ships.

Over at Atlas, capital expenditure last year was in excess of $370 million and right now its market value is closer to $325m.

The good news for BHP and Rio shareholders is that while in the short term Wilson sees a supply overhang, by 2025 he figures demand will be up 25 per cent to over 1 billion tonnes of steel a year.

The better news was that while China is adjusting, there is growth taking place all over Asia, and in short, BHP's Wilson is bullish and ready for battle.

Demand for iron ore would be growing at 2.5-3 per cent out to 2030, according to Wilson. He plans on leveraging his market power to lower production costs as fast as possible.

Everyone else is collateral damage on a grand scale.

The presentation was right on message for the new BHP with “simplicity” and “focus” key words used throughout the presentation.

Yet another review MINTER Ellison’s Charles Alexander notes the Harper review is just the latest of a long line of reports to have recommended the repeal of section 51(3) of the Competition and Consumer Act, which grants blanket exemptions to intellectual property rights.

Exemptions should still apply to cartel laws, but it’s a complex and important battle that is often overlooked in competition law.

Harper calls for more reviews, this time from the Productivity Commission, which no doubt pleased the PC’s Peter Harris because he asked for the review in his submission.

As Alexander notes, what is less clear is whether we need another major review of IP laws given the Australian Law Reform Commission has just completed a major treatise, which is yet to see the light of day in terms of government action.

Harris’s concerns are that in an age where the internet is meant to be driving disruptive technology through the economy, maybe the impact is being negated by being too protective of intellectual property.

Some worry, by way of example, that the US Free Trade Agreement locked Australia out of the game by extending copyright protection to US companies for 70 years — an increase of 20 years.

Trade Minister Andrew Robb is under pressure not to allow the same largesse as he negotiates the final stages of the Trans-Pacific Partnership Agreement.

Robb is hosting the 12 potential signatory countries at a meeting in Sydney at month’s end at which he will hope to get some agreements, in line with a deadline of early in the new year for the TPP to be signed.

While Robb chases his optimistic goal, the Harper Review puts a dampener on such agreements, arguing in the past Australia has been poorly served, at least when it comes to IP.

The concern is that in the rush to get farm and other deals through, not enough light is thrown on the impact of IP restrictions on Australia.

There is a fine balance between protecting the rights of creators and inventors and locking others out of the game so that innovation is halted.

Harper has agreed to tests to show whether IP rights come with public benefits. Minter’s Alexander welcomes the Harper focus but argues any further review should be well targeted to avoid overlap, and as the debate of section 51 (3) has shown, 5000 reports saying the same thing don’t amount to a hill of beans unless they are acted upon.

Ill-timed **equity** raising OVER the years dating back to the Colonial demutualisation in 1996, UBS has probably collected in excess of $250m in fees from companies run by Peter Smedley.

Some might say any loss the **firm** wears on the $754m Arrium **equity** raising will be small when you consider the revenue the **firm** has managed to collect over the years.

There was the demutualisation of Colonial, then a **sale** to CBA, then on to existing client Mayne Nickless where the good times continued to roll as UBS acted for Faulding when Mayne successfully bid for the **company**.

There were myriad capital raisings along the way and ultimately, in post-Smedley days, the Mayne break-up, on which UBS collected.

OneSteel has had its share of spoils, like the Smorgon Steel takeover. As noted last week, the real shame for Arrium shareholders is the value destruction in the timing of the **equity** raising, with outgoing chairman Smedley legendary for his dislike of debt.

The retail offer closes tomorrow and then any shortfall, which will be huge, goes for another bookbuild next Monday. Once that is wrapped up the banking losses will be known.

Given Arrium closed down 2.8 per cent at 34c a share against the underwritten price of 48c a share, just how much stock will be sold either via the retail entitlement issue or the bookbuild remains to be seen. Logic says it will be close to zero.

UBS was reportedly extraordinarily generous in the underwriting deals it was offering to fund managers to come to the party, so its $25m fee would have shrunk somewhat, and market estimates put the potential loss at $20m.Small in comparison to the full Smedley fee-paying history and even smaller compared to the damage done to existing shareholders at Arrium due to the ill-timed **equity**-raising.

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