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Miners' Iron-Ore Pain Has Aussie Twist

More than usual, iron-ore miners are in a hole. And the Australian dollar hasn't thrown down a rope.

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Benchmark iron-ore prices are now $70 a metric ton, down nearly 50% this year. The largest miners of the steelmaking commodity, with the lowest costs, have ramped up supply even as demand from China has waned. Iron ore accounted for about 40% of earnings before interest, taxes, depreciation and amortization at Anglo-Australian miner BHP Billiton in the first six months of the year; at peer Rio Tinto, that figure was nearly 80%.

Usually, lower prices for Australia's key commodities would go hand in hand with a weaker currency, easing the pain for producers there. The biggest miners price their output and report earnings in U.S. dollars, but their costs for labor, transport and services are denominated in local currency. So a weaker Aussie dollar can effectively reduce costs in U.S.-dollar terms at mines there.

That hasn't happened this time. The average price of iron ore in the first half of this year was about $110, according to the Steel Index. So far in the second half, it is $86, down about 23%. And while Australia's currency has fallen since early September, on average it has barely budged: Just like in the first half of 2014, one Australian dollar has been worth, on average, US$0.91.

That makes iron ore's tumble all the tougher. Take Rio Tinto: The miner said in August that a 10% decline in the average iron-ore price would knock about US$1.2 billion off 2014's underlying earnings. But a 10% drop in the Australian dollar would add back about $500 million, mitigating the impact.

To some extent, the miners are at the mercy of global forces. Compared with ultralow interest rates around the world, Australia's benchmark interest rate at 2.5% looks attractive, as does the country's rare triple-A credit rating. The Reserve Bank of Australia has expressed unease about the currency's strength. But with inflation on target, it has stopped short of suggesting it will act.

There may be another factor at work. Even as the prices of Australia's key exports have fallen, the volume of exports has continued to rise, supporting the currency, argue analysts at Barclays. Rio and BHP have raised production, shipping extra tonnage at lower prices which means higher spending at their mines in the country. Australian miners such as Fortescue Metals have also boosted production.

Based on Rio's guidance, the miner could produce 12% more in the second half of this year than the first. But if average prices stay at current levels, that won't be enough to offset the hit to revenues, while the Australian dollar won't provide a cushion to earnings.

As the U.S. economy strengthens and the Federal Reserve moves toward raising rates, the Australian currency could weaken further. But that is both uncertain and unlikely to come soon enough to help winch the miners from a second-half slump.

-- Helen Thomas

France's Technip Explores

New Terrain With CGG Bid

When the going gets tough, the tough get merging. Or so oil-field services companies hope.

After Halliburton agreed to buy Baker Hughes for $35 billion, consolidation in Europe has started on a smaller scale. But French engineering and construction company

Technip's 1.46 billion euros ($1.83 billion) approach to seismic specialist CGG, which has been rejected, also doesn't have the same defensive appeal.

Technip is branching out when the seismic sector is under severe pressure. Budgets for building the big, complex projects in which Technip specializes are being squeezed as oil majors rein in spending.

But the market for seismic imaging is faring worse. Given oil's swift descent to under $80 a barrel, investment is set to be trimmed again and exploration budgets are among the easiest to cut.

Diversification can, as in the Halliburton-Baker Hughes tie-up, have merit. It enables companies to offer broader packages of equipment and services to the big beasts of the oil industry. But CGG's seismic imaging and exploration services are largely separate from the actual construction of projects.

Technip seems to be making a long-dated bet on a recovery in activity, argues Sanford C. Bernstein. Bringing in subsurface expertise may help advise clients on how best to exploit resources. Technip aims to separate CGG's asset-heavy, money-losing imaging business, keeping only its advice and equipment arms. That sounds easier said than done. And with seismic set to get worse before it gets better, the deal could put pressure on earnings as fleets lie idle. That the French government has a stake in both companies raises worries about potential state meddling to protect CGG.

One comfort is that Technip's 8.30 euros-a-share offer, at a 27% premium to where CGG's shares closed Wednesday, looks reasonable. Even without much overlap, if its pursuit is successful, Technip should be able to find savings, and cutting less than 2% of CGG's operating costs last year would justify the current premium on offer.

And even after jumping Thursday, CGG's shares are down 50% over the past year, trading at about 0.8 times last year's book value, according to FactSet.

But CGG's abrupt rejection also makes some sense. Many a company would be loath to sell for cash as the volatile seismic cycle approaches another trough.

That could further rattle investors should Technip pursue a deal that is more expansionist than defensive. All consolidation isn't created equal.

-- Helen Thomas

Overheard

Morgan Stanley analyst Adam Jonas can be gratified to know one thing: His reports get read by companies -- and fast.

Tesla Motors chief Elon Musk tweeted on Wednesday to dismiss rumors that the forthcoming Model X car won't have folding "falcon" doors.

That same morning, Mr. Jonas issued a report with a "clarification" of one two days before speculating the delayed launch of the Model X might be due to technical challenges with the doors. He said Tesla had set him straight. Still, he also on Wednesday slashed his earnings forecast for 2015 on lower anticipated Model X deliveries, but not his price target.

This tussle with Tesla echoes an incident in October. Back then, Mr. Jonas raised concerns about Ford Motor's launch of its new aluminum-body F-150 pickup. Later the same day, he issued a report offering "clarity" on this view. This one didn't refer directly to Ford refuting his concerns, but Mr. Jonas's note essentially laid out the car maker's side of things.

Analysts really can move markets -- and investor-relations departments.

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