FINANCIAL REVIEW

HD	**BHP, Rio chiefs' first-year report cards in**
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The vibe at BHP Billiton's Melbourne head office has changed dramatically in the past year. The hot soup which was famously banned from employees' desks under former boss Marius Kloppers is now sold in the staff cafeteria and apparently can be consumed anywhere in the company's new Collins Street digs.

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Fancy espresso machines and in-house barristas have replaced the satchels of tea bags and instant coffee, while everyone from the chief executive down works in open-plan offices. Staff describe the switch to a more open and inclusive culture under Andrew Mackenzie, who started in the job last February, as a breath of fresh air.

But a lot more has changed at BHP under Scottish-born Mackenzie's watch besides the culture. Like Rio Tinto and other global miners, the new generation of management that has been installed in many of the industry's biggest players are focused on productivity and costs rather than expansion.

Mackenzie was in a similar situation to Sam Walsh at Rio when the miner released its December-quarter production numbers on Wednesday.

Both chief executives have been in the job for about a year and the latest data is being scrutinised closely as the market assesses their performance 12 months in.

Both are getting solid report cards so far, although there is intense pressure to under-promise and over-deliver.

BHP's December-quarter numbers under-delivered in some areas – but only slightly. The miner is likely to exceed guidance for its key iron ore division for the full year.

What differentiates BHP from Rio is its petroleum division, which some analysts see as a good hedge against any downturn in demand for iron ore.

BHP's first-half petroleum production fell 4 per cent in the December quarter, although guidance for output to hit 250 million barrels of oil equivalent remains locked in. The problem for BHP is it will take time to build the petroleum base to get the cash flow, and investors who have watched the company pour billions of dollars into US shale gas are getting impatient.

BHP spent $US2.4 billion ($2.7 billion) on drilling and development in its US shale business in the half, with spending tracking well above its budget of almost $US4 billion for the full year. But that will slow.

Capex is a dirty word in the mining industry at the moment, after decades of over-enthusiastic spending. But mining bosses like Mackenzie walk a fine line juggling the pressure from investors not to spend a cent, with the need to run a mining company properly and invest for the future.

UBS analyst Glyn Lawcock said BHP's metallurgical coal numbers for the quarter hit it out of the park, while copper production was also ahead of forecasts.

BHP maintained its highest margin business, iron ore, for the year at 212 million tonnes. Based on the numbers so far, it looks like it could exceed that target.

Iron ore production rose 16 per cent in the December quarter to 48.9 million tonnes. This was slightly below the 49.3 million-tonne consensus, according to Bloomberg.

Lawcock says one problem is that investors have become so used to seeing big jumps in production numbers quarter on quarter, they are disappointed when there is inevitably a flat result. BHP shares fell 0.8 per cent on Wednesday – but so did Rio Tinto's.

The big challenge at the moment is coming from expectations around iron ore prices, which are trading well above where analysts think they are heading.

The mood in China at the moment is the same as Australia a week before Christmas. Everyone is preparing to go on holidays and Chinese steel producers are running down their stocks.

Iron ore is now expected to fall to $US100 a tonne this year, with further declines in 2015.

As housing markets heat up, so too does the temptation for mortgage brokers to fiddle the numbers to land a big home loan commission. Mortgage brokers have gone through some lean years since the global financial crisis as turnover collapsed and prices fell. Competition in the broking space is intense.

New responsible lending laws mean brokers as well as the lenders are legally obligated to ensure their clients can afford the loan. What usually happens is brokers push the client into chasing the dream home they cannot afford, falsify information to ensure they get the loan or commit outright fraud, where they seek the entire loan themselves.

The corporate regulator hopes to send a warning shot across the bow of the industry with the latest actions it has taken against two former mortgage brokers. They will be announced on Thursday.

They take the total number of banning or convictions up to 8 since November. There are 23 investigations under way. It does not sounds like a lot, but ASIC has only had the power to crack down on dodgy brokers since 2010, so the momentum is now building. It is a sector of the market which has not had enough scrutiny until recently, particularly when compared with financial planning.

ASIC also wants to head off criticism it has overlooked the mortgage broking industry.

This campaign is not about the lenders, including the big four banks, which are usually unaware they are being fed misleading or false information.

But they should not be exempt from ASIC's scrutiny, and the regulator wants to send the message that they must also clean up their act when it comes to home lending standards.

Reassuringly, some lenders and other industry participants are reporting incidents to ASIC themselves.

ASIC's enforcement actions in the last three months include two criminal convictions, three permanent bannings and three temporary bannings.The lack of criminal convictions is still a frustration for regulators though, and a clampdown by the courts on dodgy mortgage broking practices would help send out the right signal to the industry.

The sale of a stake in Jetstar may sound like a radical move but it is not beyond the realms of possibility as Qantas weighs up almost every option to cut costs and shore up the balance sheet.

As reported in this week's The Australian Financial Review , the partial sale of Jetstar is more likely than a stockmarket float of the low-cost carrier. It would make more sense, though, to look at the partial sale or float of the profitable Frequent Flyer business. There is a danger for Qantas going down this path, as it is effectively whittling away at one of its most valuable businesses.

Still, it would be a way to unlock the value of the loyalty programme, which has about 10 million members and is estimated to be worth $3 billion. This is not reflected in the current Qantas share price. The worst case would be that Qantas's financial situation deteriorates and it gradually sells off all its profitable businesses in coming years, leaving a loss-making airline which eventually collapses in the same way Pan American Airlines did in 1991. Let's be clear. This is not about to happen in Qantas's case.

The arrival of a third-party investor would inject much-needed cash into Qantas's coffers. Separating Jetstar from the mainline airline would also circumvent foreign ownership restrictions, which do not apply to the domestic business and allow a foreign airline or another party to take a **stake**. This is what Virgin Australia has already done.

There are endless scenarios. Qantas could sell a **stake** in the whole Jetstar group or just geographical divisions. It would do well to give up its minority stakes in Asia altogether, which are increasingly becoming a financial burden on the airline, although it would be hard to fetch a good price.

The only thing that is not on the table in the review is Qantas's 65 per cent market share, which it wants to protect at all costs. This rules out the **sale** of a majority **stake** in Jetstar, which would just open up the market to another competitor. But it does not mean a third party could take a minority **stake** on the understanding the domestic market share would not be whittled down.

In the debate about Qantas's future it has almost been forgotten that the airline looked seriously at a merger deal with British Airways in 2008. That idea, brokered by former chief Geoff Dixon, looked like it might become reality for awhile but eventually became unstuck by differences over the merger ratio and who would get the top board and management jobs.

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Tony Boyd is on leave

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