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HD **BHP cancels Downer contract**

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The immediate future of the biggest coalmine in BHP Billiton's Queensland fleet has been exposed as a matter of some debate with the global Australian's decision to cancel $360 million worth of contract digging by Downer EDI.

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The mining services contractor was supposed to spend the next two years removing overburden at the Goonyella Riverside mine, a task that now keeps 427 people busy.

BHP's coal boss, Dean Della Valle, said the decision to scrap the contract from September was part of a division-wide effort to "ensure every operation remains operating cash positive".

Della Vale would not be drawn on whether Goonyella was at, or near, a threshold that has been gloomily definitive for other operations in BHP's 50 per cent-owned BMA joint venture with Mitsubishi.

For maybe five years now, BHP's public financial line in the coal dust has been whether or not an operation is cash positive. In 2010 the company closed the Norwich Park and smaller Gregory mines because they has consistently failed that test of viability.

This story has been repeated right across the coal industry over the past two years. According to the Minerals Council, some 12,500 jobs have been crushed out of the Australian coal industry since 2012 by a concert of falling thermal and coking coal prices, our unyielding high US dollar exchange rate and our relentlessly high costs base.

In a speech recently, Della Vale illustrated the Australian industry's dilemma noting that "the world sets our prices and Australia sets out costs". "Using our systems, I can identify that it costs our business approximately 1.5 times more for a truck operator in the Bowen Basin compared to the same truck in New Mexico in the US. This highlights the productivity and cost challenge we have in Australia," Della Vale told a Brisbane audience in April.Goonyella expansion plans

Once upon a time – and I am talking here just four years ago – BMA had plans to expand the already substantial Goonyella operation from its current 16 million tonnes per annum nameplate to 24mtpa. The challenge is quite different now for a mine that's been on the watch list pretty much ever since BMA's coal's boom bubble officially burst with the final closing of the gates at Norwich Park, about 100 kilometres to the south of the Goonyella operation.

"Further measures to address wage and other costs are being undertaken at all mines in Queensland and NSW as we continue our detailed reviews of every aspect of our coal operations to ensure every operation remains operating cash positive," Della Vale said in a statement.

At Goonyella that means Downer EDI goes and the mine plan is revisited to trim the overburden removal requirement to a level that can be maintained by the internal mining crews. The net result of that is that, for an extended though not yet publicly defined period, Goonyella can sustain current production rates of about 16mtpa without its contractors and by throwing less capital at the task of overburden removal.

Just waiting for the dollar and the global market to save us is not a plan.

One of the paradoxes of the coal's current circumstance is that years of work on the export chains have started paying off. The best example of that is the Queensland rail network that supports BHP's Bowen Basin operations. It is in record smashing form. In 2009-10 the system hit a volume record by carrying 187mt to export producers. That threshold was passed on May 24 and the system is on track to carry easily better than 200mt this year.

The only problem is that a whole lot of that volume will be loss making because prices are so shallow and the exchange rate so punishing. As we've reported often enough, a good portion of those tonnes are being moved only because the freight companies have locked in take-or-pay deals that make it more expensive to stop moving coal than to stop digging it.Competitive framework recast

The prize in getting assets such as Goonyella right is something grander than merely sustaining the coal industry we have. As Della Vale's boss has made clear enough, often enough, BHP will not invest again in new met coal or thermal coal capacity until they generate prosperity through productivity enhancement.

Recasting the competitive framework of Australian coal from the mine face up the is the only way we can expect to secure our national share of the market growth ahead.

To assess the challenge ahead consider a graph on page 83 of World Energy Investment Outlook released earlier this month by the International Energy Agency. It presents the average total cost of greenfields thermal coal projects across coal basins in the US, South Africa, Colombia, China, Russia and Australia.

The best in class was the US Powder River Basin, where new mines are forecast to cost an average $US21 a tonne or so between now and 2024.

And the worst in class? You guessed it. Australia. The IEA estimates new capacity here will cost just shy of $80 a tonne through that period, which is a good 25 per cent more than just about anywhere else serious in mainstream coal right now.

The backdrop to our cost outlook is that the IEA insists demand for coal will continue to grow despite all the emission issues that some think cloud its future. It says thermal coal demand, for example, will grow at a compound annual growth rate of 2.4 per cent through to 2035.

In raw numbers that means demand will grow from today's 5.4 billion tonnes to 6.3 billion tonnes over the next 20 years. And a good deal of that increase could and should be sated by new Australian mines.

Baosteel's attempts to present itself as a suddenly uncertain suitor for Aquila appears to have been received with sensible contempt by mining services veteran Chris Ellison.

If everyone has this right, then Ellison's Mineral Resources has picked up better than 12 per cent of Aquila at a price nearly 15 per cent higher than the one pitched by Baosteel and its bidding partner Aurizon.

Now, Mineral Resources is a mining services business of some considerable renown and the owner of 5mtpa of Pilbara iron ore production. Like Aquila, Mineral Resources is a mirror of its founding management generally and Ellison most notably. So the big question here is just what Ellison is thinking about in paying a material premium to secure a stake that could become very strategic indeed if, as most expect, Aquila and its chairman Tony Poli decide to make a contest of the Baosteel-Aurizon approach.

As things stand, Poli and fellow Aquila founder Charles Bass speak for about 40 per cent of the company. Baosteel owns just shy of 20 per cent and its joint venture offer for control arrived conditional on 50.1 per cent acceptance. Which all means that, with the best will in the world from the rest of the Aquila register, the joint venture bid is going nowhere fast unless Ellison is open to a friendly discussion.

The potential that Ellison is open to the Baosteel option was the obvious first big worry for Team Tony when Wednesday morning's trading between M&G and Mineral Resources became apparent.

The attraction of some sort of deal with Baosteel is pretty obvious. Mineral Resources is a project builder of repute and Baosteel's success would seem to be the most likely short-term trigger for a final investment decision on the $6 **billion** project Poli has so long promoted.

Outside of the potential that Ellison's investment is supportive of Poli, the only other possibility here would seem to be that the bloke has eyes for Aquila himself. But this seems a least likely outcome.

It would require a bid pitched at something at least matching the $3.75 paid for the **M**&G **stake** and the only logical currency for that would seem to be Mineral Resources scrip. It would also require a contest with a potential future customer in the form of Baosteel and perhaps with a future project partner, Hans Mende's occasionally cantankerous AMCI.

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