FINANCIAL REVIEW

HD **Lynas back from the brink**

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As someone who has worked in the Coroner's Court in Sydney, Chanticleer is familiar with the smell of death.

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In fact, one day while covering an inquest into another gruesome murder on Sydney's mean streets, your correspondent was forced to evacuate the Coroner's Court building along with all the other staff, including the police prosecutor.

A failure in the air conditioning units at the court meant that fumes from down below, where post mortems were conducted, were seeping into the court room and making work untenable.

This slightly distasteful anecdote is a round about way of saying that until last week there was a distinct smell of death surrounding rare earths producer and supplier Lynas Corporation.

The **company** was due to repay $35 **million** of its $450 **million** in debt by the end of September. That was an impossibility which meant the **company** was on the edge of an abyss.

In a totally desperate move leading up to that debt repayment, Lynas employed Nomura's **Hong Kong** office to help find a solution to the debt problem.

The exact details of what Nomura came up with are known as the proposition was scrapped. But suffice to say the solution offered was not in the interests of Lynas's shareholders.

It would not be surprising if that desperation financing move by Lynas was similar to the outrageously expensive financing arrangement agreed early last month by US rare earths producer, Molycorp.

Molycorp did a deal with certain investment vehicles associated with Oaktree Capital. That **firm** is familiar to Australian investors because of its involvement in the rescue and relisting of Nine Entertainment Corp.

Oaktree comes from that group of hedge funds which specialise in the strategy called "loan to own". The companies who turn to Oaktree usually have to give up the family silver and a little more.

The word in the industry is that Molycorp is paying about 12.5 per cent interest on its new financing arrangements. Also, it has handed Oaktree warrants for shares equal to 10 per cent of the outstanding common stock at the close of the financing.

The Lynas flirtation with alternative funding arrangements was abandoned following the appointment of Amanda Lacaze as the new chief executive of the **company** four months ago.

She initially joined the board as a non-executive director. It was while sitting on the board that she was reminded of the perception gap that exists in Australia between what people think directors do and what actually happens.

Their power to influence the day to day running of a company is quite limited. Hard questions can be asked of management but the actual running of the company has to be left to the chief executive.

When Lacaze joined the board, Lynas was shrinking fast in terms of market capitalisation. It had become a serial offender in terms of its inability to deliver what it had promised.

While the company had built an $800 million rare earths processing plant in Malaysia on time and on budget it had not been able to make it work profitably.

Shareholders had reason to be disappointed that there was little to show for a total capital investment of $1.3 billion in Malaysia and at the company's mine at Mt Weld, north of Kalgoorlie in Western Australia.

The vision and entrepreneurial drive shown by the company's founder, Nick Curtis, was being overshadowed by operational failures.

Institutional investors had virtually abandoned the company's register. That left about 35,000 retail investors owning the company.

At one stage, Lynas was a top 100 company. Its market cap had soared during a bubble in rare earth prices.

But that bubble burst. Unfortunately, a big company mindset pervaded Lynas after the euphoria of a record high share price and the accolades from brokers and tip sheets.

It says a lot about the company's disconnection from reality that Lacaze was able to save $26 million in costs in her first three months in the job.

Operating costs were slashed by $16 million after the new CEO took the view that the company should only have offices either where it made things or where it sold things.

The office in Sydney, which cost about $25 million a year to run, was shut down.

Since taking over from former CEO, Eric Noyrez, in June, Lacaze has focused her attention on the rare earths plant in Malaysia. She has abandoned the volume throughput targets that guided the entire company's strategy. These targets ignored the importance to customers of the quality of product and the yield earned per tonne of ore processed.

This new approach should deliver profits but there will be short term pain because of restructuring charges. The switch to a new way of measuring the output from the plant in Malaysia is to be welcomed.

From July 1, Lynas now reports the number of tonnes of certified ore it has produced. That is ore that can be sold to customers.

Rare earth production is complex. The production is expressed in terms of the average price obtained but Lacaze will work on delivering more of the higher yielding product.

Broker Pattersons has underwritten the $83 million share issue announced last week. This successful completion of this issue in the next two weeks should be the turning point in the company's history.

It will bring in new institutional investors and provide an opportunity for investors to provide the capital to get the company through to profitability.

There are options attached to the shares being issued through the rights issue. That will open the way to raise another $66 million next year. Lacaze has shown in the past with her turnaround of telecommunications company, Commander, that she has what it takes to deliver operational improvements.

The difference this time is she has the capital to not only keep the company from death's door but deliver on the Curtis vision.

Australia's life insurance industry does not need to be reminded that it has got an image problem. Consumers are highly sceptical of the promises made by those selling life insurance policies.

That scepticism is warranted given that the person selling the product can walk away with a commission up to 1.25 times the first year's premium.

There is obviously an incentive in the system for life insurance sales people to churn customers out of one policy and into another. The system is skewed in favour of the intermediary who also collects a trail commission lasting for years after the **sale** is completed.

The industry structure is suited to high pressure sales. Policyholders are open to being churned because the premiums step up as the policy holder gets older.

Consumers, however, are smarter than they are given credit for. This is evident from the fact that the strongest growing segment in the individual life market is online sales of life policies.

That trend is likely to gather momentum following the release this week by the Australian Securities and Investments Commission of a report into the industry's unsavoury selling practices. The **company** under the most pressure is likely to be AMP which has the largest network of tied financial planners and is our second largest life insurer .

The 1990s were the golden age for life insurance salesmen. Many became very rich on the back of aggressive sales of capital guaranteed products.Unfortunately for AMP and NML, those capital guaranteed products came back to bite them when it was discovered there was a mismatch between assets and liabilities.

AMP has avoided the big switch to online sales of life policies because of the threat to tied network of financial advisers. The **company** has started a conversation with its advice network but i's in the early stages.

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