

Why Iluka hates the tax

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MINERAL sands group Iluka expects only a minor earnings hit from the resource super-profits tax. So why is its CEO David Robb so scathing about the new impost? *The Metal Detective* by Stephen Bell



In relative terms, Iluka looks like a rare “winner” from Kevin Rudd’s tax, in that it won’t suffer an earnings crunch in coming years.

The company’s valuable Mining Area C iron ore royalties are unlikely to be affected, while Iluka also believes that its ilmenite upgrading activities will be exempt.

And having spent large chunks of capital on its new Jacinth-Ambrosia and Murray Basin Stage 2 projects, Iluka “should be sheltered for some time” from the tax, Robb said at the company’s annual general meeting.

“The medium-term impact of this proposed tax on the overall value of Iluka as a business is likely to be small,” he said.

Broker research typically shows the earnings hit will be less than 5%. Compare that with the heavy whack taken by iron ore.

Entrust Private Wealth Management says the valuation of iron ore assets will decline the most under the RSPT, reflecting both the low-capital cost base of existing operations and the expected high profits of the industry.

Fortescue Metals will lose most value (–30%), but the net present value of Rio Tinto (–16%) and BHP (–10%) will also fall significantly, Entrust said in its latest newsletter.

In that light, it is no surprise the three iron ore giants have been the loudest tax critics.

Yet, despite getting off lightly, Robb is not about to break ranks and welcome the tax man with open arms.

Last week he lambasted the tax as an “ill-conceived, ill-considered and inappropriate” levy that is slashing investor confidence in the sector.

Robb is worried about the tax’s potential to cramp expansion plans in Western Australia – Iluka’s bruised heartland.

The company has already closed mines and idled two synthetic rutile kilns in WA, while a third (at Geraldton) is due to be put in mothballs later this year.

That would leave only one kiln, at Capel, still running.

But the prospect of tightening supplies, and higher prices, in the year ahead had Robb pondering a WA revamp.

The tax has thrown some of those plans into confusion.

For instance, Iluka's Tutunup South ilmenite project in WA's South West (deferred a year ago as a result of the GFC) was due to be revisited "in the next few months".

"It is a very important decision in the context of feedstock supply for our synthetic rutile business," Robb said.

"It's a very simple example of a project that we now have to make a decision about with absolutely no clarity on how this tax is supposed to work. So if the returns are not resilient to that uncertainty, you can't go ahead."

But he remains "hopeful" that the \$40 million mine will be approved.

Iluka's Cataby ilmenite project in the Mid West is another project mired in uncertainty.

"We have some time up our sleeve [on Cataby]," Robb said.

"But it is a bigger project with more capital. And it is a longer life project, therefore you are more exposed to future changes of the types we have just seen [in the RSPT]."

He believes there are some aspects of the tax that the boffins in Treasury "just haven't thought about".

One is the question of how companies deal with the value of land.

"For Iluka, developing a mining project often involves extensive investment in land," Robb said.

"And that hasn't been thought about as to how it will be treated by the RSPT. Is that an expense associated with the project or not?"

Iluka executives travelled to Canberra last week to point out some of the grey areas to Treasury officials.

"I think what you have is a clash between Canberra academic theory, and business and global investment reality," Robb said.

He proposed a hypothetical: imagine a company invests in a large project, which subsequently goes bad due to circumstances beyond its control.

With the benefit of hindsight, the original decision is criticised, and there is a media hue and cry about the project's demise.

"Do people really believe, in that circumstance, the government in the face of that outcry is going to write out a cheque for 40 per cent of the project?"

"The risk, as the investor sees it, is you may never get that 40 per cent if it all goes belly-up.

"The other practical issue is, if a company goes belly-up, it is in the hands of the receivers.

The cheque goes to the receiver. And, typically, the priority [creditor] would be the banks.”

Robb asked if people really believed the government was going to write out a large cheque, on behalf of Australian tax payers, to cover losses by banks that had invested in failed projects.

The industry’s criticism of this quasi-nationalisation of mining finally seems to have taken root in Canberra.

According to the *Australian* newspaper, the promised 40% tax refundability for failed projects is one aspect now up for “consultation”.

For Robb, and other investors in new mines, clearing up some of the absurdities of the tax can’t come soon enough.