AJBCC/ JABCC Joint Business Conference
Tokyo

October 2001

STEEL MAKING RAW MATERIALS

Opportunities and Challenges

Mr R W Kirkby
President Carbon Steel Materials
BHP Billiton

Australia – Japan Steel Making Raw Materials
Opportunities and Challenges

R W Kirkby
President Carbon Steel Materials
BHP Billiton

The final 30 years of the 20th century saw remarkable growth and development in the relationship between steel makers in Japan and the suppliers of raw materials in Australia.

Now, in the early part of the new century, it is appropriate to review how best to sustain the relationship for the next 30 years; and beyond.

Our rapidly changing world at the start of the 21st century offers great opportunities for resource-based industries - and it also presents a great many challenges.

Towards Globalisation

One very important trend is the growing focus on globalisation, which is having an enormous impact on how we conduct business.

As advances in technology and information exchange make the world a smaller place we can see opportunities for greater and freer international trade and the development of new markets. The change can be rapid and China provides a good example with its recent transformation into the world's second largest exporter of thermal coal and its potential to substantially grow coking coal exports while, at the same time, rapidly increasing its iron ore imports.

Freer trade and more markets will mean greater competition and a demand for lower prices. Our capacity to deliver these will depend on our ability to drive down costs. Capital and cost efficiency will continue to be keys to the future success of our industry.

We also face some broader challenges. The world economic slow down, in evidence before the horrific events in New York and Washington DC on September 11th, will have a significant impact for the short term.

And of even greater consequence to us are the particular economic pressures on regional growth in parts of Asia and Japan and this means we need to be prepared to look at different ways to structure our businesses in future.

Even so, it is worth noting the predictions of long term malaise following the Asian crisis in the late nineties did not materialise and recovery was quicker than expected.

Industry consolidation, which is already happening in some areas, is a path to improved returns for both raw materials producers and steel makers. This can be achieved in a competitive environment which provides security of supply.

The historical relationship in resource trading between Japan and Australia provides a solid foundation for further rationalisation, both on the raw materials supply side and for steel makers. The global issues we face may make it a necessity.

Our Historical Relationship

Historically our relationships go back to the 1960s when the growth of the Japanese Steel Industry lead to the development of large-scale iron ore, coal and manganese mines in Australia.

The decisions taken then were not without risk for those companies that sank large amounts of capital into developing iron ore and coal deposits which existed in Australia without exploitation to that time. But the results have been spectacular.

The figures are well known to us. In 2000FY Australia exported about 71 million tonnes of iron ore and 40 million tonnes of metallurgical coal to Japan, as well as significant tonnages of manganese ore, ferro alloys, nickel and tin used in the steel making process.

Australia's contribution to the Japanese industry is significant. The JSM sources about 54% of its iron ore and 63% of its coking coal requirements from Australia.

But the issue is how to meet the challenges of the future. How will the phenomenon of the emerging debate on globalisation change the way we do business?

Issues Facing The Mining Industry

Let me outline some of the key issues facing raw materials suppliers and steel makers.

Looking ahead for the next couple of decades I foresee many forces affecting demand, supply and our markets.

Changes in demand may be affected by:

- Growing population and economic growth – in China and India particularly
- Potential substitution of minerals by other materials – eg plastics for steel
- Recycling policies
- Concern about climate change and the environment generally

- Low returns in the steel industry

Issues affecting supply include:

- Pressures to limit access to land for exploration
- Demands to internalise a growing range of identified social and environmental costs
- Community acceptance of mining and minerals processing
- Access to capital and foreign investment policies

Changes in markets will be accelerated by:

- Increasing globalisation of markets
- More use of electronic commerce
- Trade liberalisation

Underpinning this is a long-term trend of reducing prices. Real prices for the resources industry on the whole have been reducing at about 2% per year

Long Term Resource Availability

Another issue is long-term resource availability, looking 50 years out. The consensus view amongst experts is that there will be no physical scarcity, but whether or not we experience economic scarcity - due to external costs being internalised by producers - is not so clear-cut.

Nevertheless we should not underestimate the impact that continuing managerial and technological innovation will have on supply. If the minerals industry cannot supply materials inputs at competitive prices, then alternatives will emerge in the medium term. Again, an example might be plastics to replace steel.

Industry Consolidation

Against that background we can expect further consolidation in both the steel and steel raw materials industries.

The process is already underway and significant mergers or alliances between steelmakers have been announced recently in Europe, USA and Japan.

In Europe 14 major steel companies were identified in 1995. Today these have reduced through business transactions and alliances to 8 companies or groupings.

There are changes afoot also in Japan, perhaps most notably the alliance slated for NKK and Kawasaki Steel which will move forward during the next year or so. These types of consolidations should result in improved competitiveness.

The synergies of these realignments, many of which cross international borders, provide real opportunity to improve productively and increase returns.

Effective acquisitions, mergers and joint ventures will improve margins and profitability and we have seen evidence of this on the supplier side.

Six years ago there were 14 major suppliers of iron ore around the world. Today, as a result of acquisitions and mergers there are essentially seven, with CVRD, RioTinto and BHP Billiton the major producers.

Consolidation to the same extent has not occurred in the coal industry, although the top five suppliers account for 55% of the seaborne trade in met coal – BHP Billiton Mitsubishi Alliance, Fording, Rio Tinto, Anglo American and MIM.

It is interesting to note that in recent years some of the main players in the Bowen Basin in Queensland have changed. For example Rio Tinto, Anglo American and Westfarmers basically have replaced Shell, Arco and Peabody. BHP Billiton has remained a constant.

In the Hunter Valley about three quarters of the semi soft coal production is largely in the hands of two companies – Rio Tinto and Glencore with the remaining 25% attributable to BHP Billiton and Anglo American.

Long term security of supply for the realigned companies in the steel industry will depend on the financial and technical strength resulting from the rationalisation among those companies which provide the principle raw materials, that is coking coal and iron ore.

Going forward security of supply at sustainable competitive prices will not be achieved with multiple smaller companies duplicating support resources and infrastructure to get their product to the markets.

Our collective purpose as suppliers of raw materials and makers of steel is to optimise returns and this can be achieved through sensible and appropriate industry consolidation contributing to our mutual benefit.

The Global Mining Initiative

An issue emerging from the focus on globalisation is sustainability and we are addressing this both within our own companies and at the international minerals industry level through the Global Mining Initiative (GMI). The GMI is a significant industry response to the debate about sustainable development.

The GMI is about the mining industry's contribution in the transition to sustainable development. It has been described as a change agent.

It was started by ten of the world's largest mining, minerals and metals companies, BHP and Billiton among them, with the purpose of developing a sustainable development model to provide global leadership for the mining and metals industry.

Through the GMI, and an associated track of work known as Mining Metals and Sustainable Development (MMSD) the industry expects to play a significant role at the World Summit on Sustainable Development, scheduled for Johannesburg in September next year to mark the 10th anniversary of the Rio Earth Summit (1992).

The Global Mining Initiative is an important leadership exercise, and most of the major mining companies of the world, including BHP Billiton, have signed up.

The manner in which the major companies, who usually compete vigorously with each other in the market, are co-operating in this exercise shows how seriously they view the sustainable development challenge.

This is not only about our balance sheets; it is about being socially responsible towards our employees and the communities where we operate and about responsible management of the environment. In this we have a collective accountability.

We must ensure that any trade-offs in the process result in balanced and sustainable outcomes. Society demands nothing less.

The Customer Relationship

A more specific issues for our mutual beneficial interest is customer focus and the need to ensure that we in Australia are supplying steel making raw material products to meet specific requirements in Japan as patterns of consumption develop and change to meet contemporary market needs.

Australian companies over the years have listened to their customers concerns and taken action to address these and to dramatically improve their reliability.

Australia has lead the development in new products, for example, of low vol low ash PCI coals and in recent years we've developed markets for new types of iron ore in cooperation with our Japanese customers.

Australia has also increased iron ore and met coal production in recent years to meet world demand at competitive costs. A number of major new raw material developments are in train or under evaluation, with the support of Japanese companies.

Never has the focus on customers been so great and in my own company this is reflected in our organisational structure. Each of the various businesses that together make-up BHP Billiton are now called Customer Sector Groups (CSG). It's a sign of the times.

But all Australian suppliers to the Japanese Steelmaking Industry acknowledge that a key element in the success of their commercial activity is the capacity to service customers and this goes to the heart of our need to be partners in business.

Summary

The operating environment in which we find ourselves is challenging. And it will continue this way for the foreseeable future.

We need to be responsible in our approach to managing this; after all we are seeking "win-win" outcomes.

We have a sustainable relationship in place and we need to maintain and enhance this.

The fact is the industry does face significant different challenges going forward than it did in the past. But there are opportunities about which we can be optimistic, including the positive results of globalisation – new and improved technology, an improved trading network and information exchange.

The future for suppliers of steel making raw materials in Australia and steel producers in Japan depends not only on our technical capabilities, but equally on sustainable performance and our capacity to satisfy a diverse group of constituents, including our shareholders (owners), our customers, the communities where we operate and our employees.

That is our challenge for the 21st century.