Debt Loads Grow for Australian Miners

Falling Aussie drives up cost of repaying U.S. creditors

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SYDNEY—Faced with a weakening gold price at the end of last year, Australia's Newcrest Mining Ltd. decided to spend US$220 million on repaying some of its loans. Weeks later, its management had a surprise message for investors: Debt had gone up, not down.

It's just one example of the uphill struggle miners in countries such as Australia and Canada are facing due to shifting currency markets, which are driving up the cost of repayments particularly to U.S. creditors. The timing couldn't be worse—just as a downturn in world commodity markets is throwing their balance sheets out of kilter.

While commodity prices ran hot in recent years, many Australian mining companies reached out to lenders in the U.S., where they were able to get fresh capital at highly attractive rates. Now, with the Australian dollar down sharply against the U.S. currency, the cheaper loans they accessed have gotten considerably more expensive.

The Australian dollar has shed more than a fifth of its value in the past year, pushing well away from what had been parity with the greenback as recently as 2013. It's now trading at a six-year low, underpinned by a strengthening U.S. economy and tumbling prices for the commodities that resource-rich Australia's economy relies on heavily. On Friday in Sydney the currency bought US$0.7349, down from a recent peak of US$0.9506 in July 2014.

Not all Australian resources companies that tapped U.S. debt markets in a big way have been hurt by the Australian dollar's slump. The two biggest miners, BHP Billiton Ltd. and Rio Tinto Ltd., remain insulated because they report in U.S. dollars. But for those that hold U.S.-dollar- or euro-denominated debt while reporting in Australian dollars, including Newcrest and iron-ore company Atlas Iron Ltd., a tumbling local currency equals an expanding debt pile.

Newcrest, one of the world's biggest gold producers, saw net debt jump by 9% in Australian-dollar terms over the second half of last year to 4.29 billion Australian dollars (US$3.18 billion)—despite Chairman Peter Hay telling investors in October that his immediate priority was to reduce Newcrest's indebtedness. RBC Capital Markets says the recent Australian dollar falls likely swelled the company's net debt to A$4.54 billion at the end of June.

Meanwhile, the net debt of Atlas Iron, which temporarily shut down all its mines earlier this year as it grappled with the sharp iron-ore-price downturn, widened to A$169 million at the end of December, from roughly A$37 million six months earlier, partly also because of the weakening Australian-dollar exchange rate.

A rise in U.S. interest rates, near zero for more than six years now, would likely add to the difficulties for miners with U.S.-denominated debt and Australian-dollar balance sheets. “If they lift off in September, that could cause a world of pain for a company like Atlas Iron,” said Evan Lucas, Melbourne-based strategist for broker IG.

To be sure, there are a raft of benefits, too, from a weakening currency. As the Australian dollar depreciates, miners are able to get more money for their raw materials, which are typically sold in U.S. dollars. That benefit can be eroded, however, if commodity prices fall faster than the local currencies of the miners digging them up—which is exactly what’s been happening with commodities such as iron ore in recent months.

“Many companies opt to have their debt in U.S. dollars because they get paid in U.S. dollars, so it is a natural offset,” said Saranga Ranasinghe, an analyst for ratings firm Moody’s Investors Service. “[But] with the drop in all commodities prices, the benefit they would get from a lower Australian dollar on costs and prices may not be enough to offset the increase in their debt.” The full impact of the tumbling Australian dollar will become clearer when most of Australia’s miners report earnings this month.

The global mining sector loaded up on debt over many years as companies borrowed to build vast networks of pits, railway lines and port terminals to feed rising demand for commodities, especially from China. The 40 or so biggest miners together have racked up debts worth close to US$200 billion, according to consultancy EY, roughly six times higher than the figure a decade ago.

Australia is one of the world’s biggest suppliers of iron ore, coal and gold, which are shipped mainly to buyers in Asia. Some producers in Canada, another major resource exporter where miners borrow in U.S. dollars and whose currency too has fallen, are grappling with rising debt piles as well. Teck Resources Ltd. last month said net debt in local-currency terms rose to roughly 7.75 billion Canadian dollars (US$5.9 billion) at the end of June, from C$6.41 billion six months earlier.

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