

APRIL 2012
QUARTERLY COMMODITY INSIGHTS
BULLETIN



cutting through complexity

Q1 – 2012



Iron Ore

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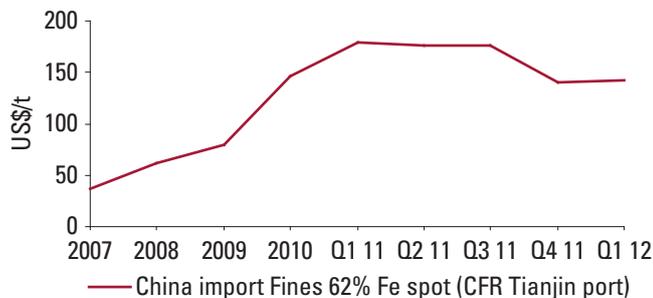
Commodity Lead – Iron Ore
KPMG In Australia

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Commodity outlook

Spot iron ore (62 percent Fe content) prices stabilized during the last three months at US\$130-135/t level, after witnessing a high of US\$193/t in mid February last year. The price fell down to US\$120/t level by October 2011 because of the destocking in China but made a slow recovery since. The last week of February saw a seven-day rally which took the price to US\$143/t on 1st March, 2012 and then again a strong rally helped it reach US\$148/t in the last week of March, 2012, attaining its five months high. This increase was due to strong Chinese steel production in the month of March and Chinese restocking ahead of the busy period of April and May.

Figure 1: Iron ore spot prices

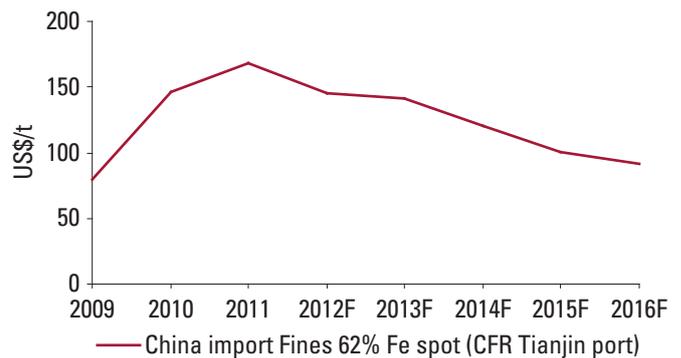


Source: IMF, UBS

As per UBS, average price for 2012 is expected to settle at US\$145/t, down 13 percent from 2011 average of US\$168/t due to weakening Euro zone and Chinese demand. In the medium term, the supply side is expected to see an increase in capacity as mine expansions and new projects commence production in next few years in Australia, Brazil and West Africa (Mauritania, Gabon, Cameroon and Guinea) outpacing the growth in demand. Accordingly the prices are expected to moderate in the coming years with a reduction of three percent in 2013 to reach US\$140/t and, in long term, to stabilize at ~US\$72/t.

But there is an upside risk to the price estimates due to project delays from environmental concerns, regulatory and infrastructure constraints and labor shortages in Brazil, West Africa and India.

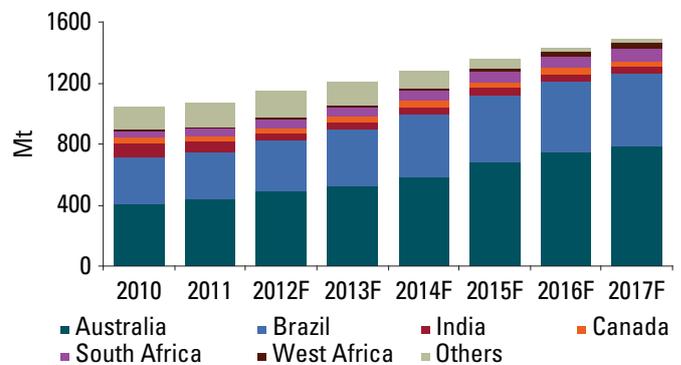
Figure 2: Iron ore price forecasts



Source: IMF, UBS, KPMG Analysis

Supply and demand

Figure 3: Global iron ore exports, 2010–17F



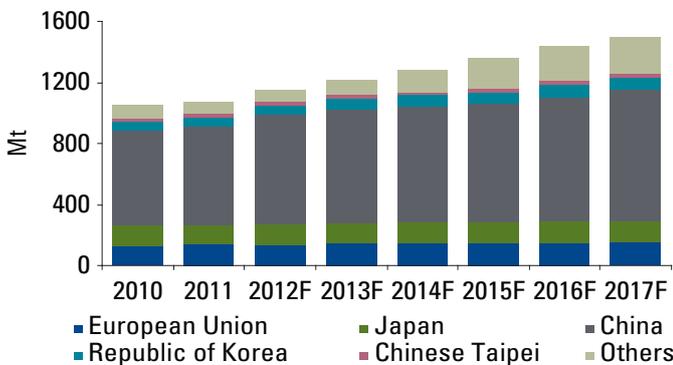
Source: BREE, UBS, KPMG analysis

- Australia is the leading exporter of iron ore in the world and its exports are expected to increase by 12 percent in 2012 to reach 493Mt due to increase in production from number of mines including that of Rio Tinto and BHP Billiton. The exports were up nine percent year-on-year basis in 2011. In the coming years, Australia is expected to account for the majority of the global growth in iron ore exports as growth plans, of especially BHP, Rio and Fortescue, are executed and additional production commences from their brownfield and greenfield projects. Therefore, BREE expects the exports to grow at an average annual rate of 10 percent to reach 779Mt by 2017.

- Brazil's exports are also expected to grow at a strong pace in the coming years. In 2012, the exports are expected to grow at six percent to reach 333Mt due to production expansion at south-eastern systems and at Carajas. The production is expected to ramp up further with a number of Vale's and ArcelorMittal's projects expected to commence their operations by 2017. Vale's Serra Sul project, alone, is expected to add 90Mt of annual capacity. A number of other projects are also lined up (for details refer to Table 3). Thus the exports are expected to increase in proportion to the increase in production. BREE expects the exports to increase at an average annual growth rate of eight percent to reach 489Mt by 2017.
- India, the number three exporter of iron ore in the world, has seen a decrease in its exports over the last two years. This is mainly because of clamp down on illegal mining, increased regulatory mandates and higher levy of duties and charges by the government. For instance, in mid-2010, Karnataka government announced a ban on production of iron ore to stop illegal mining. Similar restrictions were imposed in Orissa and Goa, as well. Further, the government has progressively increased the export tax to 30 percent of the iron ore value recently.

The exports are expected to fall down to 43Mt in 2012 and with expectations of Indian government encouraging conservation of raw material for domestic steel manufacturer, there can be further downside to the amount of exports.

Figure 4: Global iron ore imports, 2010-17F



Source: BREE, UBS, KPMG Analysis

As per a report by Bureau of Resources and Energy Economics, Australia (BREE), 2011 saw an increase in global trade market volume to 1,075Mt from 1,051Mt in 2010, mostly, due to the increase in imports from China (645Mt from 619Mt). In the short to medium term, the growth in

imports is expected to be driven by demand from China supported by demand from Republic of Korea.

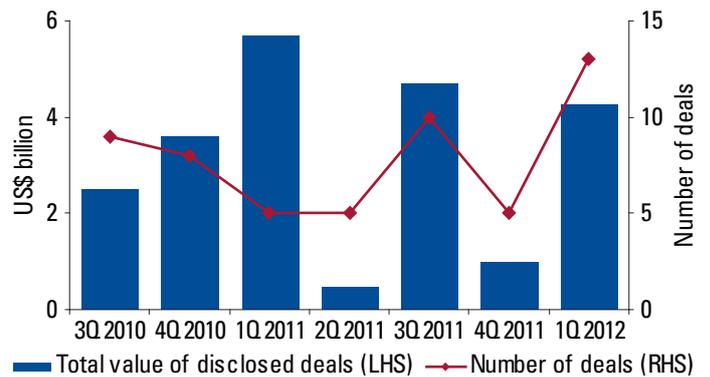
- China has been the world's largest importer of iron ore in the last few years and is expected to continue to lead in the coming years, as well. This is primarily due to rising demand of imported ores (which are of high quality compared with domestically-produced ores) by Chinese steel producers, along with demand from steel mills that are located in coastal regions with easy access to ports. Also efforts are being made to increase the average grade of steel produced which necessitates high grade iron ore, again providing support to high grade imported ores. Thus BREE expects China's imports to increase at an average annual growth rate of five percent to reach 854Mt by 2017. But still there is a downside risk due to the slowdown in Chinese economy.
- Imports by other major iron ore consumers such as the Republic of Korea, the EU and Japan are expected to continue to increase in line with modest growth in steel production – at an annual average rate of five per cent, two per cent and two per cent, respectively, over the period 2012-17.

Key developments

Ownership changes

In the first quarter of 2012, the total value of major deals announced in the iron ore industry was US\$4.26 billion, down 25 percent from US\$5.70 billion in the first quarter of 2011, as shown in Figure 5. Number of deals announced in the first quarter of 2012 increased to 13 as against five in the last quarter of 2011. Out of the 13 deals announced in the quarter, three have been successfully closed.

Figure 5: Value of major deals announced in iron ore industry



Source: Merger Market, KPMG Analysis

Table 1: Top Iron ore deals announced in Q1 2012

Date announced	Target	Target nation	Acquirer	Acquirer nation	Status	Value of transaction (US\$ million)	Stake (%)
30-Mar-12	The Roy Hill Project	Australia	Marubeni Corp, POSCO, STX Corp	Japan	Incomplete	3,600.00	30
26-Mar-12	First Iron Group	Channel Islands	China Goldcorp Ltd.	Canada	Incomplete	53.03	100
26-Mar-12	Daltons Joint Venture	Australia	Atlas Iron Limited	Australia	Incomplete	31.00	25
17-Mar-12	Shandong Jinding Mining Co Ltd	China	Shandong Jinling Mining Co Ltd	China	Complete	167.22	40
16-Mar-12	CMC Guernsey Limited	UK	West African Minerals Corporation	Channel Islands	Incomplete	28.55	34.51
29-Feb-12	Scandinavian Resources Ltd	Australia	Hannans Reward Limited	Australia	Incomplete	34.56	82.86
13-Feb-12	Aurium Resources Limited	Australia	Padbury Mining Limited	Australia	Incomplete	-	100
3-Feb-12	Magma Metals Limited	Australia	Panoramic Resources Limited	Australia	Incomplete	36.58	100
11-Jan-12	African Iron Limited	Australia	Exxaro Resources Limited	South Africa	Complete	254.49	100
11-Jan-12	Tivani Iron Ore Project	British Virgin Islands	Tito Mboweni and his brother	South Africa	Complete	32.00	20
3-Jan-12	King X Pty Ltd	Australia	Coziron Resources Limited	Australia	Incomplete	5.05	100
3-Jan-12	Buddadoo Metals Pty Ltd	Australia	Coziron Resources Limited	Australia	Incomplete	5.05	100
3-Jan-12	Zanthus Resources Pty Ltd	Australia	Coziron Resources Limited	Australia	Incomplete	5.05	100

Source: Intierra, Merger Markets, KPMG Analysis

Regulatory Updates

In Q1 2012, the governments introduced new regulations and hiked tariffs and royalties, in order to maintain strict control over mining activities in the industry and increase their profit share from iron ore mining.

Table 2: List of recent regulations regarding iron ore industry

Country/ Area	Regulation/ topic	Description
Brazil	Dispute over unpaid royalties	Vale received an extra 60 days to negotiate with Brazil's National Mineral Production Department over the amount of royalties owed by the company to the department.
China	Physical Iron ore trading platform	China launched first physical iron ore trading platform on 16 January 2012 with an aim to strengthen its pricing power and wrest control from Vale, B HP and Rio.
China	Resources Tax	China raised resources tax on iron ore production from 60 percent to 80 percent of the base rate. The base rate varies from US\$0.32 to US\$4.76 a tonne depending on the ore grade.
India	Resuming iron ore exports	Indian government is looking to resume iron ore exports to Japanese and South Korean steelmakers. In the second half of March, 2012, it granted approval to state-owned trader MMTC to export 3.8-5.5Mt per year of ore until March 2015.
Indonesia	Foreign investments in mining projects	According to a decree signed by President Susilo Bambang Yudhoyono of Indonesia, foreign holders of mining licenses would be required to cut their stakes to 49 percent within 10 years of starting production.
Iran	Embargo on trading	Due to US financial sanctions on Iran, iron ore traders and dry bulk ship owners in Europe are pulling back from deals with Iran.
India	Export duty tax	India's Ministry of Commerce hiked the export duty on export of iron ore from current 20 percent to 30 percent on both fines and lumps

Future projects updates

Table 3: Major iron ore projects

Project	Country	Owner/ Operator	Capex (US\$M)	Potential Start Year	Full Capacity (Mtpa)	Type	Progress and Updates
WAI0 Jimblebar Mine Expansion	Australia	BHP Billiton (96%)	3,440	1Q14	20	Brown	Project is on schedule and budget and overall it has progressed from 21% to 27% completion. The capacity will increase further by 20Mtpa by debottlenecking the infrastructure constraints
WAI0 Port Hedland Expansion	Australia	BHP Billiton (85%)	2,235	2H12	70	Port Capacity	Project is on schedule and budget and overall it has progressed from 42% to 49% completion. The capacity will increase further by 20Mtpa by debottlenecking constraints
WAI0 Orebody 24	Australia	BHP Billiton (85%)	820	2H12	-	Brown	Project is on schedule and budget and overall it has progressed to 12% completion. It is expected to maintain the iron ore production output from Newman JV operation
Samarco Fourth pellet Plant	Brazil	BHP Billiton (50%) Vale (50%)	3,500	1H14	8.3	Brown	Project is on schedule and budget and overall it has progressed from 18% to 30% completion.
Hope Downs 4	Australia	Rio Tinto (50%) Hancock Prospecting (50%)	1,925	2013	15	Brown	Leighton Ngarda JV was awarded a year contract to perform civil and mining earthworks before starting of the operations
Orissa Mining Project	India	Rio Tinto (51%) Orissa Mining Corporation (44%) NMDC (5%)	2,000	-	15	Green	Rio Tinto announced an investment of US\$2 billion in the project
Simandou	Guinea	Rio Tinto (95%) IFC (5%)	>10,000	2015	70	Green	Construction is going on with first mined ore expected by mid-2015. Infrastructure investment framework expected to get completed by mid 2012
Carajás	Brazil	Vale (100%)	2,968	2H13	40	Brown	Earthwork services and civil engineering work commenced. 43% physical progress completed
Vargem Grande - Itabirito	Brazil	Vale (100%)	1,259	1H14	10	Brown	38% of physical progress completed
Conceição Itabirito	Brazil	Vale (100%)	1,174	2H13	12	Brown	On time and budget. 79% of physical progress completed
Carajás Serra Sul (mine S11D)	Brazil	Vale (100%)	8,039	2H16	90	Green	Vale got environmental clearance for the project, but the project is expected to get delayed to 2016, 22% of physical progress completed
Apolo	Brazil	Vale (100%)	2,509	1H14	24	Green	Project is subject to approval of the board
Simandou I – Zogota	Guinea	Vale (51%) BSG Resources (49%)	1,260	1H12	15	Green	In early stage of development, production expected in 2012
Christmas Creek Phase 2	Australia	Fortescue Metals (100%)	1,100	2013	40	Brown	On time and budget
Solomon	Australia	Fortescue Metals (100%)	2,700	2014	60	Green	On time and budget
Port Herb Elliot expansion	Australia	Fortescue Metals	2,400	2013	100	Port capacity	Committed contract worth US\$1,600 million
Rail expansion	Australia	Fortescue Metals (100%)	2,200	2012	100	Rail capacity	Expected to be completed by last quarter of 2012

Source: Intierra, Company data, KPMG analysis

The above analysis include projects of BHP Billiton, Rio Tinto, Vale and FMG.

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Publication number: 120505
Publication date: April 2012