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Iron ore
A rollercoaster ride...

November 2014

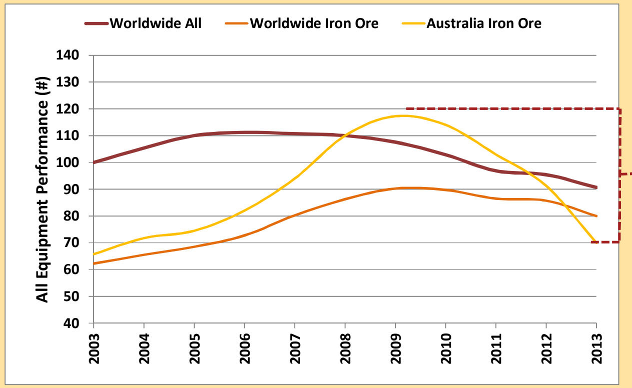
Asset owners... a race to the bottom

In a very short space of time, the market has moved from cheering the development of new magnetite mines to questioning the merits of expansions in production from DSO mines with operating costs under US$30/ tonne. This change has been caused by a sharp 40% decline in iron ore prices since the beginning of 2014. This has resulted in a sense of urgency among producers to find opportunities to move down the cost curve and ensure their projects remain viable.

Some issues and opportunities we've been working on with industry players:

Key issue	*What's happened?*	*Opportunities*
Spare capacity within infrastructure	• Changing production profiles may create infrastructure capacity which may no longer be required by existing users (eg delay of Iron Valley by Mineral Resources shipments through Utah Point) • The development of a common user rail network in the west Pilbara and the Port of Anketell appears more likely to go ahead, given the take-over of Aquila by Baosteel and Aurizon.	• Better alignment of the supply of infrastructure capacity with production profiles to minimise inefficient use of capital through **lower capex or a release of capital**. • Where excess capacity exists, infrastructure sharing arrangements are being considered.
Alternative financial structures	• There is an increased appetite from EPC companies to adopt build-own-operate (BOO) models. • Service companies are also looking to acquire site infrastructure from miners in exchange for contracts to operate these assets.	• **Reduced capital requirement** • Ability to focus on core mining operations • Greater clarity on costs
Operational efficiency	• Between 2006 and 2012, equipment costs in the Australian iron ore industry increased by 53%, which partly explains the decline in productivity shown below.	• Potential for immediate release of capital through **sale of surplus equipment**. • Reduction in ongoing associated cash costs.

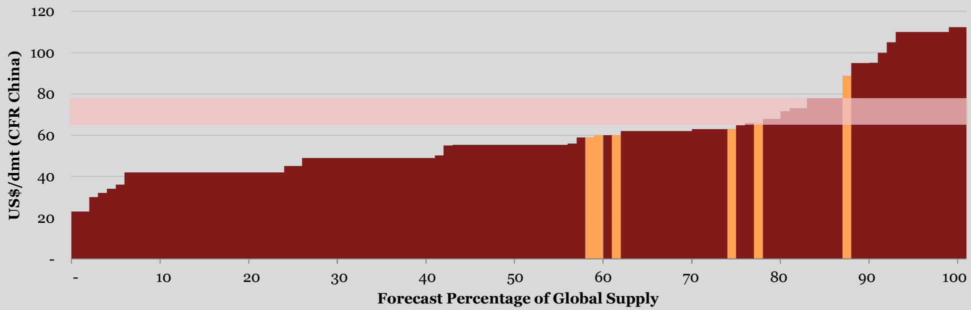
PwC's Mining Productivity Index



The Australian iron ore industry equipment usage efficiency has declined by 40% between 2009 and 2013...

Source: PwC Benchmarking database

Global Iron Ore Cost Curve



Source: Bloomberg, Brokers reports, Company presentations, PwC Analysis

Global iron ore supply

The chart above highlights where the Australian mid cap miners sit on the cost curve (shaded in orange). The cost curve includes the impact of the major global development projects, including ongoing expansions by the major Australian iron ore producers, which has flattened the cost curve, and highlights the concerns over the ability of Australian mid cap miners to compete in the long term.

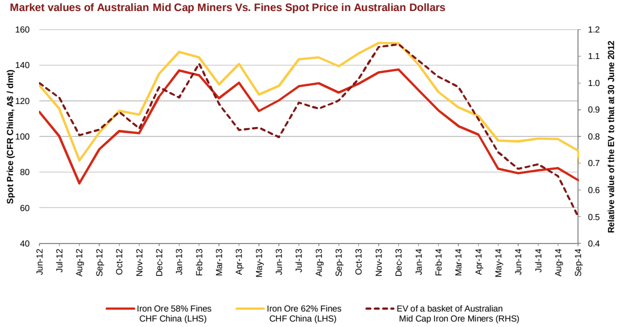
The area shaded in pink represents the current long term iron ore price forecasts relevant to the Australian mid cap miners. This band shows the current consensus long term price forecasts (fines - 62% Fe, real 2014 terms) and the implied forecast for 58% grade products assuming current discounts hold (c.18%). Potential upside for Australian producers is a faster and more pronounced depreciation in the Australian dollar, which does not appear to be priced into current valuations of these companies.

Investors... finding the diamonds in the rough

The chart below shows the relative movement in the enterprise value (EV) of a basket of Australian mid cap miners from June 2012 and the spot price of iron ore in AUD terms. At September 2014, AUD iron ore prices were at or marginally above the lows of August 2012, yet the EV of these companies was 50% lower than at June 2012.

Falling iron ore prices and market values of Australian mid cap miners present an opportunity for investors to acquire large stakes in operating projects at values not seen for over a decade.

Market values of Australian Mid Cap Miners Vs. Fines Spot Price in Australian Dollars



Source: Bloomberg, CapitalIQ, PwC Analysis

The best opportunities for investors are likely to come from:

- Capitalising on ***funding shortfalls*** for miners which have limited access to cash or those with upcoming debt repayments.
- Projects that can ***access infrastructure*** on commercial terms. Selected opportunities are likely to come from projects in the west Pilbara or near Anketell Port, the Mid-West and Yilgarn regions.
- Companies which can ***operate at more efficient rates*** than historical levels, or those able to ***redeploy capital*** (such as through sale of surplus equipment or non-process infrastructure including camps).
- Development projects which are able to shift the financing burden to service providers through ***BOO financing structures***.