

ACCOUNTING TREATMENT FOR INVENTORY MOVEMENTS

NOVEMBER 2012

INTRODUCTION

The following is an edited transcript from a teleconference Iluka held after its 2012 half year results in relation to the manner in which Iluka accounts for inventory movements as part of its financial reporting. The transcript extracts relate to commentary provided by Simon Green, General Manager, Finance, in relation to Iluka's first half 2012 inventory movement of \$181 million. The full transcript is available at <http://iluka.com/docs/financial-results/teleconference-transcript--accounting-treatment-for-inventory.pdf>. Details on inventory movement in the financials can also be obtained from the ASX 4D document <http://www.iluka.com/docs/asx-releases/iluka-2012-4d-financial-commentary.pdf?sfvrsn=6> and from the slide presentation associated with Iluka's half year results <http://www.iluka.com/docs/asx-releases/iluka-2012-half-year-results-presentation-slide-pack.pdf?sfvrsn=9>

TELECONFERENCE EXTRACT

Simon Green: In very simple terms, Iluka incurs costs to mine, transport, separate and ultimately produce finished products: that is the cash cost of production. All of those costs go to the balance sheet as inventory as does depreciation of assets that are used through that process, be they ore bodies mined, the separation plants or the synthetic rutile kilns.

When Iluka comes to sell material it is recognised as revenue based on what is sold; that material has a cost in inventory. It is that cost that comes through to the profit and loss account as cost of goods sold. The way that Iluka chooses to report inventory movements in the profit and loss – Australian accounting standards basically provide two options - is that Iluka provides the details of what the cost structure is and then shows the inventory movement. Equally, the cost of goods sold number could be shown but then the question arises, what is the composition of cost of goods sold?

Under accounting standards, inventory is accounted for on a first in, first out basis. If we look at what happened this half [1st half 2012], Iluka sold very little of what it produced. Most of the sales came from opening inventory and production replenished inventory. In fact, production across zircon, rutile and synthetic rutile (Z/R/SR) was 444 thousand tonnes for the half compared with sales volumes of 274 thousand tonnes. Finished goods (the difference between production and sales in the period) grew by 170 thousand tonnes of Z/R/SR.

The reference I'll draw you to take note of is on page seven of the ASX 4D report under balance sheet which highlights the increase in finished product stocks of \$188.4 million up to \$349.3 million. 170 thousand tonnes have been added to stockpiles and the inventory value for finished goods has gone up by \$188 million. The simple mathematical average is approximately \$1,100 per tonne. .

Iluka has reported that the average cost for zircon, rutile and synthetic rutile produced was \$710 per tonne, that is the overall cost of production divided by 444 thousand tonnes of product produced. The depreciation charge for the half was \$105 million. Across 444 thousand tonnes, that is about \$290 per tonne.

The cash and non-cash cost per tonne of what sits in inventory, using the above numbers is therefore ~\$1,000 per tonne. So you can see it is at a similar level to that \$1,100 increase previously referred to.

The two numbers are not the same due to the mix of sales which determines what actually gets realised as the cost of sales. Production from different mines has different cash cost structures and very different depreciation structures depending on where the original ores come from; zircon for example from Jacinth has a very different carrying value to zircon from the Murray Basin, yet they both the final product sells for the same amount.

Similarly, for synthetic rutile. Production in the Mid West [Western Australia] from SR3 [synthetic rutile kiln 3] fundamentally uses Iluka-sourced ilmenite, which is low cost, so the accounting value sitting in inventory is mainly the upgrading cost.

Whereas the material that runs through SR2 in the South West, that is the kiln that we are de-rating in the second half, uses ilmenite from our Tutunup South mine but also uses material that we purchase from third parties.

So feedstocks costs for those kilns are different and that flows through to different carrying values of stock.

So whilst we give an overall figure of the amount of synthetic rutile we are producing and the amount of synthetic rutile we are selling, the mix within that product group can vary quite significantly in terms of what that means to realised margins both from a cost and sales pricing level.

So, in overall terms, while average numbers are what we quote, the actual components within that are quite different. The final thing to illustrate using the slides that we have at the back of the results pack which picks out Australian operations and breaks that down into Eucla/Perth and the Murray Basin, and also the US. The maths here in taking synthetic rutile, rutile, and zircon in the Australian Operations as an example, the average cash cost is \$693 per tonne and the non-cash cost is \$240 per tonne which gives \$933 per tonne. But in terms of the split between Eucla/Perth and the Murray Basin, Eucla/Perth total is \$899 compared to the average of \$933 per tonne. Murray Basin is \$939 per tonne.

But the cash costs, as you can see on slides 43 and 44, are very different. They are \$778/tonne in Eucla/Perth and \$531 in the Murray Basin. Similarly, the D&A charges are reversed. They were about \$120/tonne in Eucla/Perth and over the \$400/tonne in the Murray Basin. So the mix between cash and non-cash costs is different and that serves to highlight the different elements that we have within the portfolio.

For further information, please contact:

Dr Robert Porter, General Manager, Investor Relations

Phone: +61 3 9225 5008

Mobile: +61 (0) 407 391 829

Email: robert.porter@iluka.com

Disclaimer

This briefing paper contains information that is based on projected and/or estimated expectations, assumptions and outcomes.

These forward-looking statements are subject to a range of risk factors associated, but not exclusive, with potential changes in:

- Exchange rate assumptions
- product pricing assumptions
- mine plans and/or resources
- equipment life or capability
- current or new technical challenges
- market conditions
- management decisions

Iluka makes no representation that any or all of the production options referred to in this briefing paper will occur nor that the indicative cash and capital costs will apply, being subject as indicated to further evaluation and ultimate investment decision making. While Iluka has prepared this information based on its current knowledge and understanding and in good faith, there are risks and uncertainties involved which could cause results to differ from projections. Iluka shall not be liable for the correctness and/or accuracy of the information nor any differences between the information provided and actual outcomes, and furthermore reserves the right to change its projections from time to time. Except for statutory liability which cannot be excluded, Iluka, its officers, employees and advisers expressly disclaim any responsibility for the accuracy or completeness of the material contained in this presentation and exclude all liability whatsoever (including in negligence) for any loss or damage which may be suffered by any person as a consequence of any information in this presentation or any error or omission there from.

Iluka accepts no responsibility to update any person regarding any inaccuracy, omission or change in information in this presentation or any other information made available to a person nor any obligation to furnish the person with any further information.

All currency referred to is Australian denominated unless otherwise indicated.