

## BRIEFING PAPER MINING AREA C IRON ORE ROYALTY

OCTOBER 2014

### BACKGROUND

Iluka Resources (Iluka) holds an in perpetuity royalty over iron ore produced from specific tenements of BHP Billiton's Mining Area C, Pilbara, Western Australia. In 2010 Iluka published a briefing paper on the royalty and BHP Billiton's iron ore operations. This included analysis undertaken on Iluka's behalf by the Cambridge Research Unit. This paper provides additional information based on recent disclosures by BHP Billiton in relation to its plans relating to iron ore production levels in its Western Australian iron ore operations.

Iluka's Mining Area C iron ore royalty is based on:

- 1.25 per cent free on board (FOB) Australian dollars sales revenue (less export duties and taxes).
- A\$1 million one-off payment per 1 million tonnes increase in annual production.

It should be noted that the Iluka royalty is based on dry metric tonnes (DMT), while BHP Billiton's reporting is in wet metric tonnes<sup>1</sup> Iluka is eligible for royalty based on 100 per cent of relevant Mining Area C production (BHP Billiton 85 per cent interest).

### Location of BHP Billiton's Pilbara, Western Australian Iron Ore Operations



Source: BHP Billiton Investor Briefing: Iron Ore, October 2014

<sup>1</sup> Conversion of WMT to DMT based on average moisture content of 6.7 per cent

## **The Characteristics and Quality of the Mining Area C Royalty**

- Mining Area C is a core component of BHP Billiton's Western Australian Iron Ore assets.
- BHP Billiton describes its Western Australian iron ore assets as "our flagship iron ore asset".<sup>1</sup>
- The Western Australian iron ore assets comprise 4 substantial mining hubs (including Mining Area C), connected to an integrated supply chain.
- Mining Area C is an internationally low cost, long resource life, high Fe quality component of BHP Billiton's Western Australian iron ore assets.
- There is significant expansion potential for these operations.
- The Western Australian iron ore assets are expected to be sustained over at least 30 years.

## **Context in the Iluka Portfolio**

Iluka gained the iron ore royalty on the basis of the conversion of a previous direct interest by a predecessor company in the Mt Goldsworthy Joint Venture into an in-perpetuity royalty.

Iluka considers the Mining Area royalty to be a unique and high quality royalty stream, in that:

- Iluka has exposure to Tier 1 iron ore royalty stream operated by a recognised experienced operator.
  - Iluka has no exposure to capital costs, State royalties and so on.
- The royalty provides diversification of cash flow to Iluka's core mineral sands business.
- The royalty provides portfolio optionality, including:
  - efforts by Iluka to create an option to unlock value for shareholders by a potential demerged royalty business; and
  - it is unlikely that a direct sale of the royalty would be in shareholder interests as it is currently held on Iluka's balance sheet at \$5.9 million dollars.
- Mining Area C is a long-dated royalty.
  - It is also unusual as a royalty in that it has a clear growth element.
  - The history has been one of expanding production
    - for example from 20 million dry metric tonnes (MdmT) in 2005 to 50 MdmT in 2013.
  - Associated with this there has been a growing financial contribution (see below).
- In Iluka's estimation the Mining Area C iron ore royalty presents the potential for valuation uplift in the Iluka portfolio.

## **Mining Area C Expansion Potential**

BHP Billiton's most recent iron ore presentation (October 2014) provided the following information regarding potential expansion of Mining Area C:

- The Western Australian Iron ore assets' financial year 2014 production was 225 Mt.
- BHP Billiton has announced expansion plans of 20 Mt to 245 Mt in financial year 2015
  - future projects (subject to BHP Billiton Board approval) could see expansions from 270 Mt up to 290 Mt.
- According to BHP Billiton, Mining Area C volumes are expected to increase by 8 Mt per annum beyond 2015.
- According to a BHP Billiton reference, Mining Area C volumes may be potentially expandable up to 120 Mt per annum (Iluka estimates Mining Area C current production at ~ 52 million dry metric tonnes per annum).

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<sup>1</sup> Refer BHP Billiton Investor Briefing: Iron Ore, October 2014

## Mining Area C Contribution to Iluka

A\$ million	H1 2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Sales MDMT <sup>1</sup>	25.9	52.5	47.4	44.6	43.3	40.3	36.8	23.2	20.3	20.5
Annual Production to 30 June	51.7 <sup>2</sup>	50.5	46.9	43.1	42.5	37.8	29.3	24.0	22.0	19.0
Royalty Income	37.0	84.3	69.7	87.5	71.3	42.6	50.8	17.9	16.1	11.5
Capacity Payments to Iluka	1.0	4.0	3.0	1.0	5.0	8.0	6.0	2.0	3.0	12.0
Mining Area C EBITDA	38.0	88.3	72.7	88.5	76.3	50.6	56.8	19.9	19.1	23.5

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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

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<sup>1</sup> Sales and production shown in million dry metric tonnes (MDMT), which reflects the basis of the royalty to Iluka

<sup>2</sup> Production MDMT for the 12 months to June 2014