CRITICAL STRATEGIC METALS

Volume 1 - Issue #9 November ~ 2010

Your monthly guide to the latest information on the world's strategic metals

JV Abandonment Benefits Chinese

The fate of the proposed $116 billion Pilbara iron ore joint venture between global mining giants BHP Billiton and Rio Tinto has finally been sealed, 16 months after the proposal was first announced. In view of the increasing possibility of not obtaining the necessary regulatory approvals, the two companies have decided to abandon the proposal. CEO Marius Kloppers of BHP Billiton said, "With the termination of the joint venture, this focus on efficiently growing and operating our Western Australian Iron Ore business through our existing Perth-based iron ore management team will continue".

The decision to cancel the proposal was not entirely unexpected, given the sharp opposition to the deal from regulators, investors and steel makers. Consequently, the effect on the share prices was not noteworthy. CEO Tom Albanese of Rio Tinto said, "The full value of the synergies on offer from a 50:50 joint venture was a prize well worth pursuing."

Analyst Bill Lyons at ATI Asset Management said, "The failure of the joint venture will be slightly more positive for Rio than BHP, but it's important to remember it's actually a negative for both companies."

The Australian Competition & Consumer Commission (ACCC), the European Commission, the German Federal Cartel Office, the Japan Fair Trade Commission and the Korea Fair Trade Commission have all expressed their disapproval of the deal in the current form. An informed source said, "Extensive discussions with the European Commission indicated the companies would not be able to go ahead with the joint venture without large divestments, which would have destroyed the synergies and eroded long term growth options. With that in mind, both parties didn't think that was acceptable."

Under a recent agreement with the state government, the two companies could still attempt to share infrastructure and blend iron ore in Western Australia and earn at least half of the projected savings of $10 billion each. However, before undertaking any collaboration, the two companies would have to review the objections raised by the regulators. Portfolio Manager James Bruce of Perpetual commented, "It's likely that both companies will continue to invest heavily in the Pilbara. Both iron ore businesses will continue to generate significant cash flow and returns for shareholders in both companies. It would have been better in a combined joint venture but regardless, with iron ore prices where they are today, both businesses are earning very high levels of return."

The decision to abandon the proposal has been heartily welcomed by the World Steel Association and the global steel industry. Director General Ian Christmas of World Steel said, "We are obviously pleased that this joint venture is no longer going ahead. We have long argued that allowing BHP Billiton and Rio Tinto to merge their Western Australia iron ore businesses was not in the public interest."

Portfolio Manager Ric Ronge of Pengana Capital said, "Both companies have a very disciplined capital management and are chasing organic growth. As for the JV, the writing was on the wall for quite some time with antitrust issues. There were headwinds and enough rumors to take away any surprises from investors."

The amalgamation of the two giants would have eclipsed Vale, the global leader in iron ore production. Further, the joint venture would have caused quite an upheaval in the iron ore market in terms of price. The failure of the proposal will now ensure that 30% of the sea borne iron ore trade remains with Vale, 25% with Rio Tinto and 15% with BHP.

Speaking of domination, the Chinese state owned steel sector has reached new heights of global domination accounting for 46% of the world's steel production. The nation's "Going Abroad" program is aimed at expanding its presence in the global steel market. According to an analysis carried out by the American Iron and Steel Institute and the Steel Manufacturers Association, "After creating, developing and nurturing massive 'national champions,' the Chinese government is now strategically deploying these entities overseas to execute the government's agenda: to acquire natural resources and raw materials, obtain technology and expertise, gain entry into new markets and increase China's economic and political influence on a global scale."

The Chinese steel industry's unprecedented growth and future plans has created quite a stir in the rest of the world. Privately run US steel companies will find it next to impossible to compete with Chinese players that are supported by heavy subsidies from the Chinese government. The US market is likely to witness a severe imbalance in the future.

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Molycorp CEO Treads Carefully In Regards To Chinese Rare Earths Monopoly

Rare earth metals company Molycorp, Inc. (MCP) owns the largest deposit of rare earth minerals outside of China and its Mountain Pass deposit in California is the only deposit of any significance in the western hemisphere. MCP is one of the two companies that plan to operate rare earth mines within the next two years in an effort to meet the huge demand expected. MCP's announcement to reopen its mines has more than doubled its share prices over the second half of this year.

Analyst Hunter Hillcoat at Investec Bank Australia Ltd said, "There're only two genuine new companies coming on-stream that can offer a meaningful level of production and that's Molycorp in the States and Lynas in Australia." He opined that the only risk is that "you have to assume they can bring on production seamlessly and that the price is still at the same level by the time they're in production."

Mark A. Smith - CEO Molycorp, Inc.

China produces almost 97% of the world's rare earth metals and the continuous tightening of its export quota has nations scrambling to find alternative sources. In such a scenario, companies such as MCP stand to make tremendous gains if they play their cards rights. MCP plans to produce 20,000 tonnes per year of rare earth metals from 2012 and may even raise that capacity to 40,000 tonnes per year.

Speaking at a recent conference in China, Shigeo Nakamura, President of Advanced Material Japan Corp., said that China might further restrict its export quota next year, contributing to an already rising price curve. The primary concern now is the short and medium term supply since no other major project is likely to begin production before 2015–16.

Amidst global criticism of China's increasing supply restrictions, CEO Mark A. Smith of MCP played down China's role and commented, "There's enough reason for what they're doing that one could argue they aren't using it as a weapon." He said that China has been reducing its export quota by an average 6% over the last nine years and although this year's quota has been stricter than earlier years, the move is not a new one. He appreciated the fact that China is making every effort to regulate production and prevent smuggling while trying to meet its domestic demand. Smith said, "I really admire what they are trying to do to correct the industry as a whole."

Reacting to international concerns, spokesman Zhu Hongren of China's Ministry of Industry and Information Technology said, "China will not use rare earths as an instrument for bargaining. Instead, we hope to cooperate with other countries in the use of rare earths on the basis of win-win outcomes and jointly protecting this un-renewable resource."

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The Critical Crystal Ball

On-going Influences on Prices for Molybdenum, Manganese & Magnesium

The global steel industry has had to bear the brunt of the uneven global economy and quite unlike the upbeat expectations harbored at the beginning of the year, both sale and price of steel is on the decline while raw material cost is on the upswing. The failure of the construction industry to regain its pre-recession status is adversely affecting the steel market although the auto and appliance industries have reflected a surge in growth. Global leader ArcelorMittal's Q3 results reported a drop of 21% from Q2, although it reflected a 48% jump in profits YoY. The company expects steel shipments to increase in Q4 but selling prices are expected to fall.

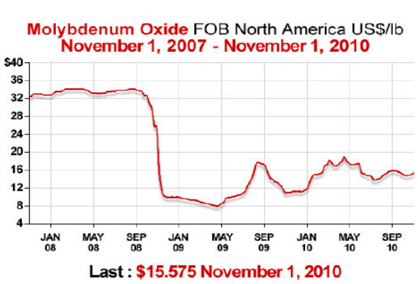
In its October 2010 short-range outlook (SRO) for 2010 and 2011, the World Steel Association forecasts that apparent steel use will go up by 13.1% to 1,272 million tonnes in 2010 after dropping by –6.6% in 2009. The new number is 35 million tonnes higher than the April SRO for 2010. The association expects world steel demand to peak at a record 1,340 million tonnes in 2011, a growth of 5.3%.

The growth of the steel market cannot be disconnected from China's GDP growth, since it is connected to the country's large-scale infrastructure projects catering to a rapidly urbanizing society. And this directly affects the molybdenum market as well. China spent all of 2009 building its stocks of molybdenum. The trend declined in 2010 when the nation gradually worked down the stockpiles. In fact, in Q2 of 2010, China became a net exporter of the metal. As a reflection of this trend, analysts expect the demand for molybdenum to start increasing in Q2 of 2011. Molybdenum prices have fallen to about $15 a pound from $18 a pound in April, but demand has not declined enough to create worry lines.

The West African nation of Gabon is the second largest producer of manganese, another critical ingredient of the steel industry, but declining demands saw production fall to 2.2 million tonnes in 2009 after touching a peak of 3.1 million tonnes before the recession. The country has now joined hands with Chinese mining company CITIC Dameng and plans to mine over 26 million tonnes of the metal over the next 25 years from Gabon's M'Bembele mine.

Meanwhile, South Africa's Exxaro Resources Limited has announced a partnership with compatriot manganese mining company Assmang Limited to commercialize its AlloyStream technology that is aimed at the beneficiation of manganese ore into high-carbon ferromanganese. The technology, if found commercially feasible, would significantly lower power consumption and the need to use discrete fine feed materials. The technology would also allow the use of lower quality coal as a reducing agent. General Manager Ernst Venter of Exxaro said, "We are of the opinion that massive value-unlocking potential exists within South Africa and the rest of the world with the application of this technology."

At the InCar Project for automotive innovations, ThyssenKrupp demonstrated that a magnesium car roof was 62% lighter than one made from conventional steel. The lighter weight would consequently bring down carbon dioxide emissions by over 50% as well. For such an innovation to be effective, large size magnesium sheets must be made available at affordable rates. Perhaps, as a small step in this direction, ThyssenKrupp subsidiary Magnesium Flachprodukte GmbH has signed an agreement of cooperation with South Korean steel maker POSCO in the production of magnesium sheets. The purpose of the partnership is to ensure security of supply for the auto industry.



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