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Whitepaper: Steel raw materials

More iron ore supply displacement expected

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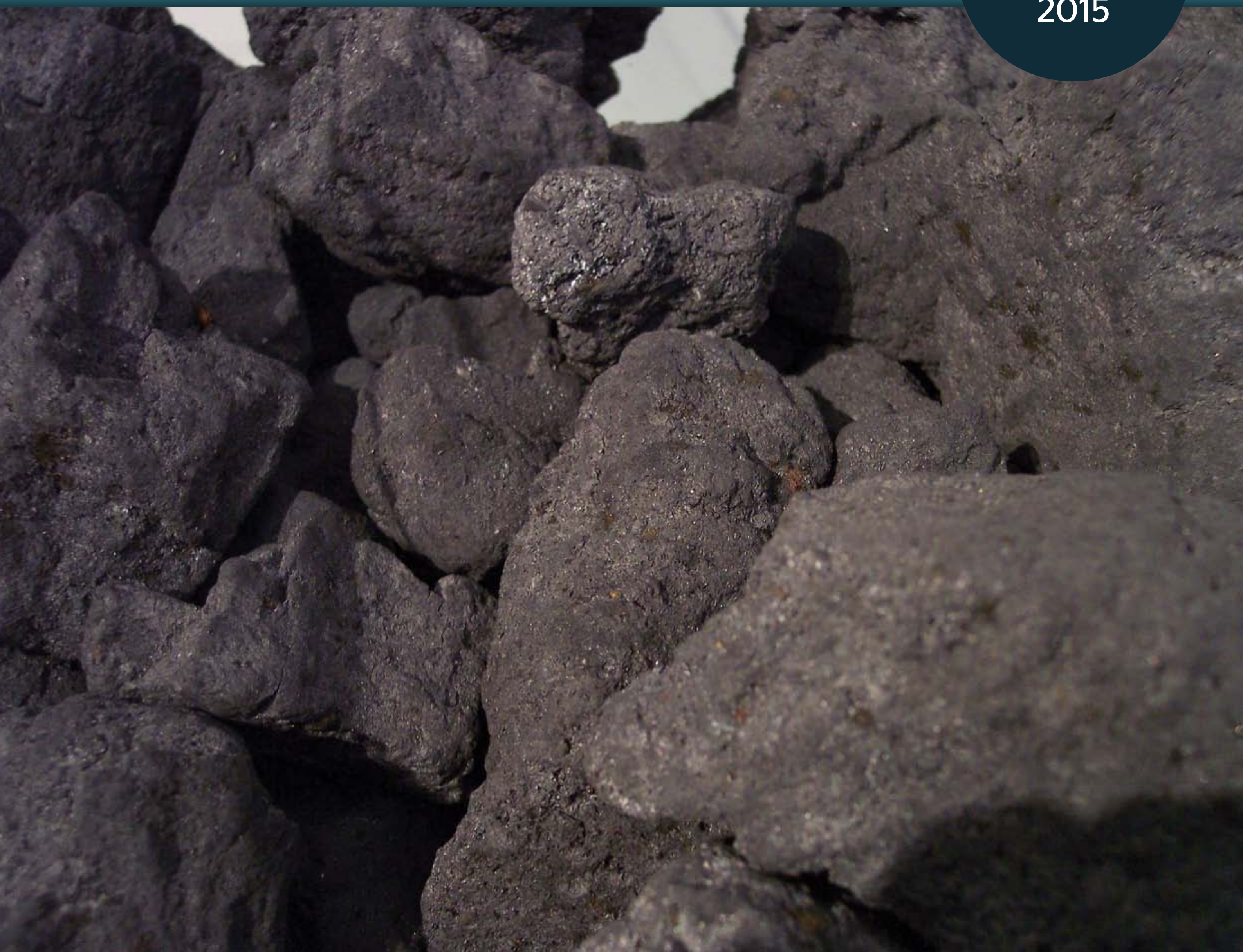


More iron ore supply displacement expected

16th April – Ginger Ding, Industry analyst, Metal Bulletin Research

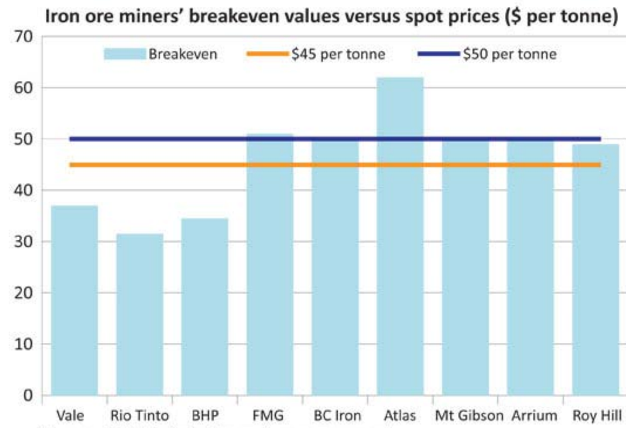
This week, Metal Bulletin Research (MBR) takes a look at the intensified competition among iron ore suppliers, and their future prospects.

Although spot prices have recovered slightly since then, they remain more than 30% below the prices seen at the beginning of the year, and have plunged by more than 70% since the peak recorded in 2011.

The extent of this price erosion was not expected. The rate at which the large miners are adding iron ore to the global marketplace is outpacing the rate at which smaller miners are cutting back their output under pricing pressure.

MBR believes that this supply displacement has come more slowly than was expected, at the same time as demand has underperformed.

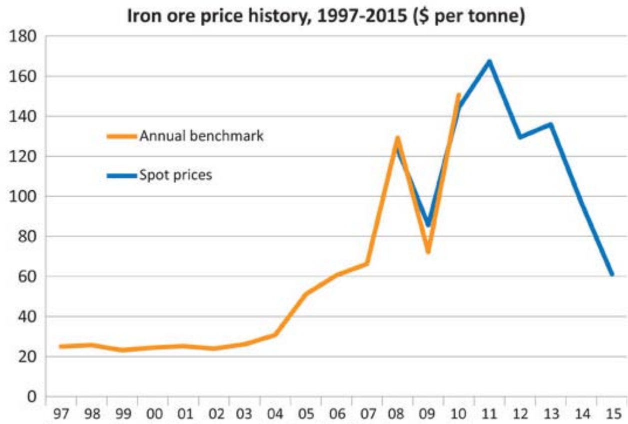
Poor demand was also reflected in the negligible growth in pig iron production in China and elsewhere. But we continue to expect that output cuts will come both from iron ore miners in China and from the international market.



Sources: Metal Bulletin Research, company reports.

Now that spot prices have cut into most miners' profits, difficulties are increasing across the mining sector. The big three miners (see chart, above) are still positioned relatively comfortably, thanks to their low costs, but smaller miners are engaged in a battle for survival.

The major miners are pursuing a strategy that does not support prices, but instead is intended to sustain production for as long as possible, and longer than their rivals can achieve. Ultimately, it is a strategy intended to grow market share.



Sources: Metal Bulletin Research, Metal Bulletin Iron Ore Index.
Note: annual benchmark refers to Hamersley fines plus freight cost to China.

The market is witnessing a shift of focus from cost to cash flow, after prices started to approach a level that many market participants have predicted will be the so-called "hard" floor – $45 per tonne, below the breakeven cost of many suppliers.

Cash is king

In fact, based on their total costs, some iron ore miners – including Fortescue Metals Group (FMG), Atlas Iron, Arrium, Mount Gibson and Gindalbie – can hardly make money at $50 per tonne, but stoppages or suspensions do not come immediately after losses are incurred.

Among those who have run into losses, cash flow has become the lifeline.

Mount Gibson and Gindalbie are relatively better off because they are financially backed by Chinese partners – Shougang and Anshan Steel, respectively.

Mount Gibson's negligible debt is also buying time for the miner during this industry reshuffle.

But any withdrawal of finance will create major risks for these two miners, similar to what has happened at African Minerals, whose operations have been crippled by a funding crisis after disputes with its Chinese partner, Shandong Steel.

Atlas Iron, with production capacity of 13 million tpy of iron ore, has chosen to suspend production this month.

MBR understands that Atlas Iron's operations are no longer viable as its breakeven cost is higher than $60 per tonne, but the levels of its net debt and cash reserves are similar, which has allowed the miner to stop operations without incurring further losses.

The rest of the mining sector survivors have run up huge debts and are busy seeking ways to generate more cash. Meanwhile, they continue to look for ways to cut costs, which will be extremely difficult.

FMG failed to refinance its debt in mid-March, and other similar refinancing plans are unlikely to go ahead.

Acquisition opportunities

Asset divestment will be miners' last resort as they seek an effective way to resolve the cashflow issue.

Inevitably, however, any divestment made in the current market conditions will require the offer of a significant discount. But the first requirement is to have attractive assets to put up for sale.

FMG has less to worry about it, because it owns a 160 million-tpy port facility at Port Hedland in Western Australia, and rail infrastructure that connects its mining operations.

Other smaller miners, if they cannot find refinancing or have no attractive assets to sell, will need to suspend production eventually.

Because of steel mills' willingness last week to partly replenish their inventories, at the same time as the stoppages at Atlas Iron began to take effect, MBR expects a small degree of support for prices.

But given how steel mills have consistently failed to find the price floor in earlier, temporary replenishment phases, we believe that it is still too early to say what the bottom for iron ore will be.

The iron ore price war has just moved into the displacement phase, but there are still more output capacities to come onstream in the next two years.

Meet the Editor

Ginger Ding joined Metal Bulletin Research (MBR) in 2014 as an industry analyst, focusing on steelmaking raw materials, with specialty in China-related markets.

She's one of the contributors of MBR's weekly publications on Steel Raw Materials and monthly publications on Steel Scrap and Metallics Forecaster.

Prior to joining MBR, she worked the previous five years as a senior reporter and analyst at Metal Bulletin's editorial team. She has a broad understanding of the steel industry chain, especially from the raw materials perspective. As such, she has extensive knowledge of the supply and demand of key raw materials, such as iron ore, coking coal, and scrap.

She holds a Master's degree in English Literature from the Shanghai International Studies University and a minor in Finance and Economics from the Fudan University.

Have a question about the iron ore market? Email gding@metalbulletinresearch.com

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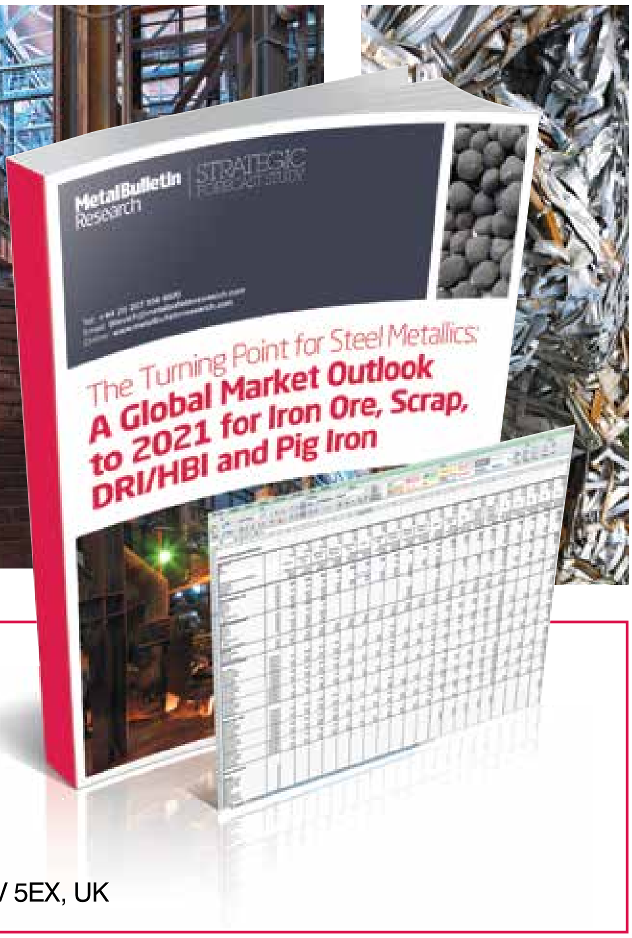

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