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Factors influencing the Iron Ore Market

The Ferrexpo View

19 September 2008

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SPOT PRICES vs FREIGHT

Metal Bulletin Spot Pellet Price

- Market thin - not very transparent
  - ‘Spot’ trades unreliably reported
  - Vary by both customer and producer
  - Our information suggests current pellet spot ~$230-$255/t CFR
- Summer/Olympics slowdown – c.12% July to August 2008
  - Now signs of stabilising
- Pellets correction / new level supports value of pellets to productivity relative to fines
- CFR price drop largely freight driven

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Metal Bulletin Spot Fines Price

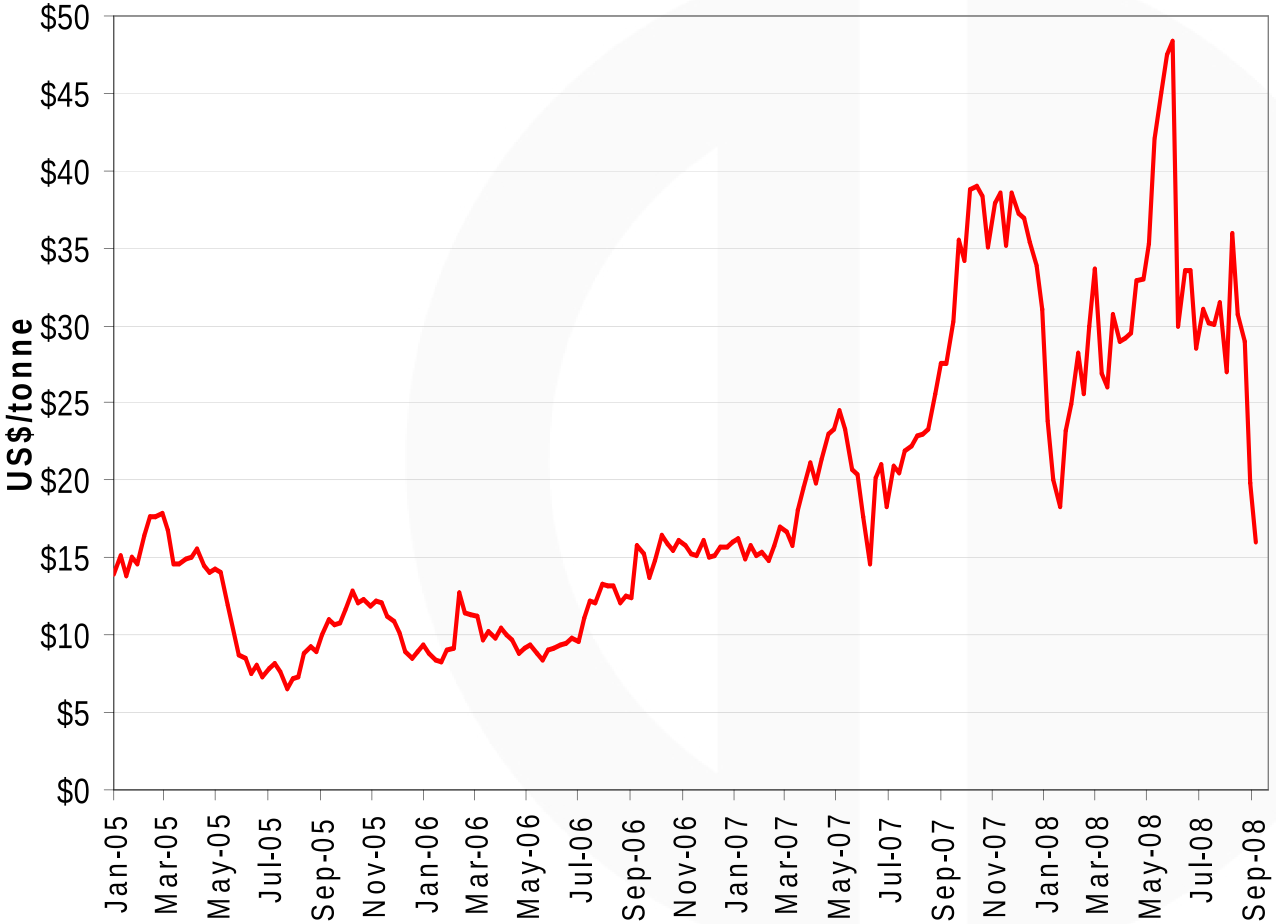
- Visibility on data better, but still not good
  - MB main source
  - Reporting lag
- Our information indicates spot now \$135-\$155/t CFR
- Summer/Olympics slowdown – c.25% July to Sept 2008
  - Now signs of stabilising
- CFR price drop largely driven by freight

Capesize Rates: Tubarao to Beilun, China

Source: SS&Y, Sept 2008

- Steep decline trend since Q2 2008
  - Summer / Olympics period
- Rates down c. 40% in July – Sept 2008

Capesize Rates: W. Australia to China



Source: SS&Y, Sept 2008

- Steep decline trend since Q2 2008
  - Stabilised around Benchmark price settlement in June
  - Summer / Olympics impact
- Rates down c. 55% in July – Sept 2008

So what is going on in the freight market?

Likely causes of current fall in rates:

- Slowdown in Chinese demand during summer/Olympics (managed?)
  - August imports 37mt - lowest since Q1 2008
- Approach of record new building program and tanker conversions (47 Capesize vessels in 2008)
- Significant decrease in port congestion due to better scheduling/nominations - an estimated additional 5pct of the cape fleet 'released'/trading
  - ~38 Capesize vessels queuing off Australia in mid 2008 - now ~25
  - Brazil - was ~50 in mid 2008, now ~33 vessels
- Cargo supply constraints: Chinese coal and steel / South African coal / US grain – etc
- Lower oil / bunker prices means lower freight rates ($700/t down to $550/t since July 2008)
- Brazil reportedly upset by Australian 'freight equalization' pricing. Was there deliberate ‘slowing‘ of Brazil loadings in H1 2008?
  - Australia - 103.2mt up 23% yoy
  - India - 63.0mt up 22% yoy
  - Brazil - 59.2mt up 9% yoy - significant impact on tonne miles
  - Other - 44.5mt up 40% yoy

Observations:

- Current turmoil in equity/financial markets will probably impact negatively on shipping sector but may also cause some building yards financing issues and/or cancellations (up to 20%?) of new vessels coming onto market – may be a positive for owners, and should temper shipping sector weakness

The Freight Effect

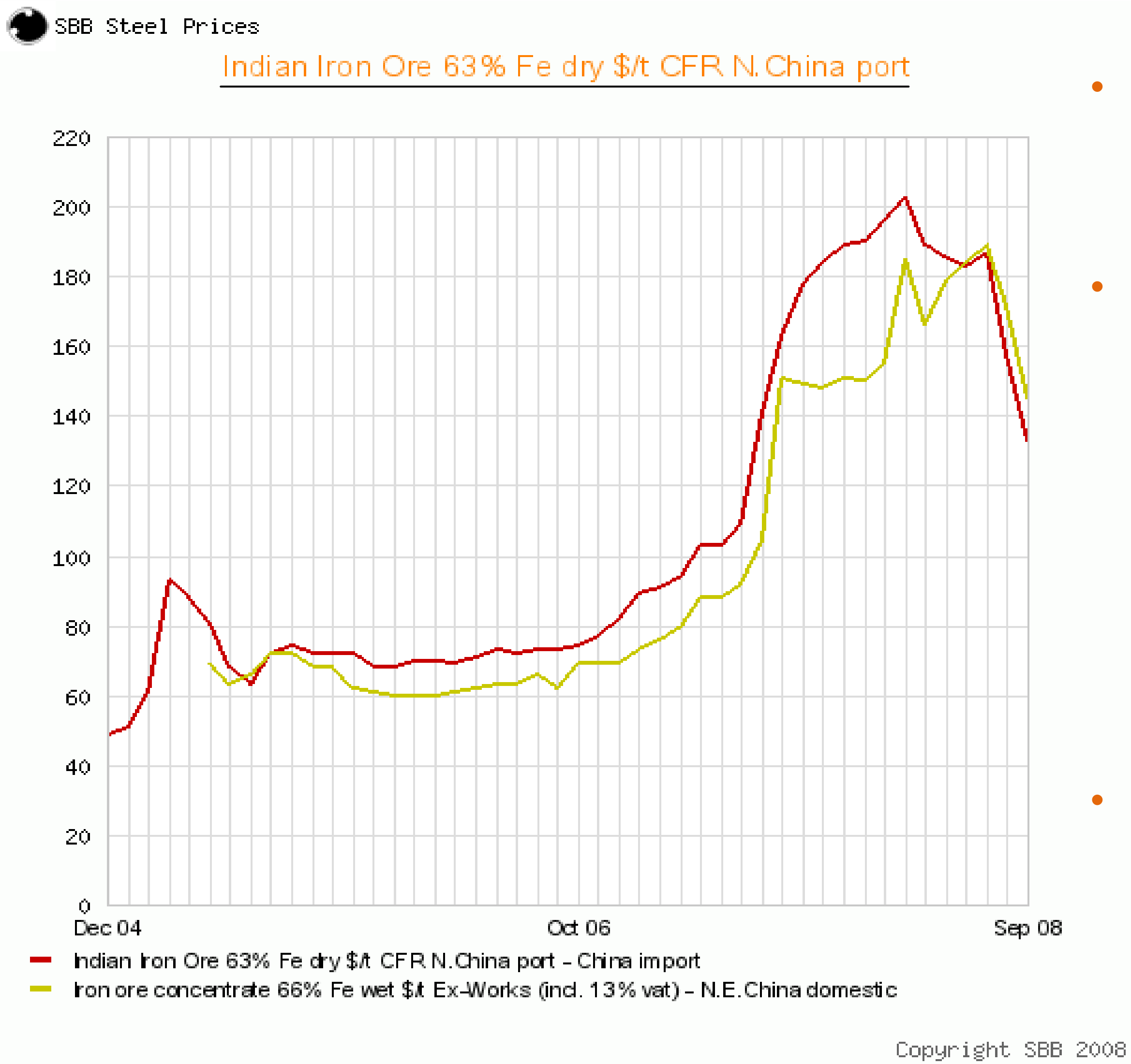
- Raw material ocean freight rates have moved down significantly since Q2 2008
- It is therefore to be expected that spot CFR prices for iron ores have 'fallen‘
  - In fact over the past 3 months spot iron ore CFR prices have fallen by ~22%
  - Over the same period freight rates for Panamax and Capesize vessels have fallen by ~30 to 55%
- Bottom line: spot prices being paid now, although at lower than all time record levels in June, are still some $20-$40/t CFR higher than base supply tonnage delivered by major suppliers under annual long term contract pricing
  - At present spot levels for pellets in China, Ferrexpo estimated spot FOB would be ~$170 to $180/t.
  - In May, we sold spot to China at peak of market at similar levels
- Notably, mid 2007 Indian fines was ~$145/t CFR China
  - This spot price peaked at ~$220/t CFR in Q1 2008

CHINA

China – what about inventories

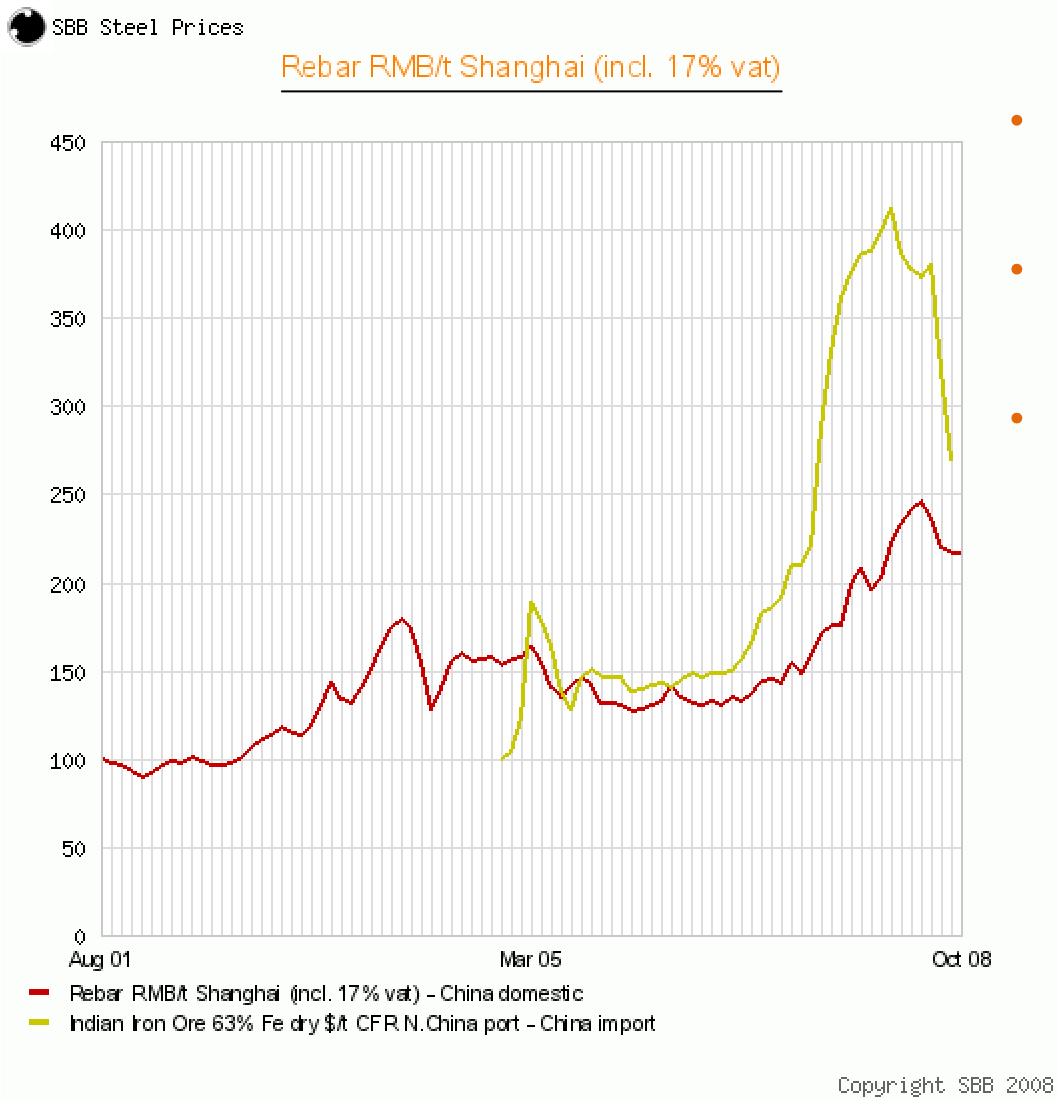
- In China, which represents ~38% of world steel production, and consumes ~51% of global seaborne iron ore, imported iron ore stocks have reportedly risen significantly this summer to 60-78mt.
- However - China is importing approximately 38mt/month, so these “higher” stock levels still only represent ~7 weeks of total import demand for the steel industry
  - Whilst not all stocks being held, it represents about 7 weeks of imported ore demand
  - Typical steel mills have 4 to 8 weeks stock in supply chain at any time
  - In 2007, port stocks were about 40mt. If you factor up for annual imports increase from 2007 to 2008; then stocks in mid 2008 should have been about 55mt.
- China produced 308mt of steel in Jan-July 2008; c. 26mt higher than the same period in 2007
- China's crude steel output this year is forecast to rise c. 10% to 550mmt
- China imported c. 270mt of iron ore in Jan-July 2008 - a significant c. 49mt higher than in the same period in 2007 - almost an additional 2mt per week
  - Take-away rates from ocean ports to steel mills may have been stretched at points in 2008, and forced to slow during Olympics
  - Traders pre-purchased / speculated in April-June in anticipation of price increase
  - Government summer priority on moving coal for power generation
- And………Australian and Brazil iron ore loading is running at record levels

China iron ore pricing



- Domestic / Spot Indian ore mirror trend except in H2 2007
- Price topped out - likely combination of:
  - Freight
  - Weaker summer / Olympics period demand
  - VIU (vs pig iron) ceiling reached
- Rates down c. 35-40% in July – Sept 2008

China iron ore pricing: Indian ores



- Indian CFR overshot margins on domestic rebar?
- Approx 90% of India exports go to China
- India exports down significantly now, driven by:
  - Monsoon season in west
  - Reduced trader liquidity
  - Lower China summer demand
  - Higher export tax in India
  - Competition from other options:
    - Brazil, Australia on CFR basis

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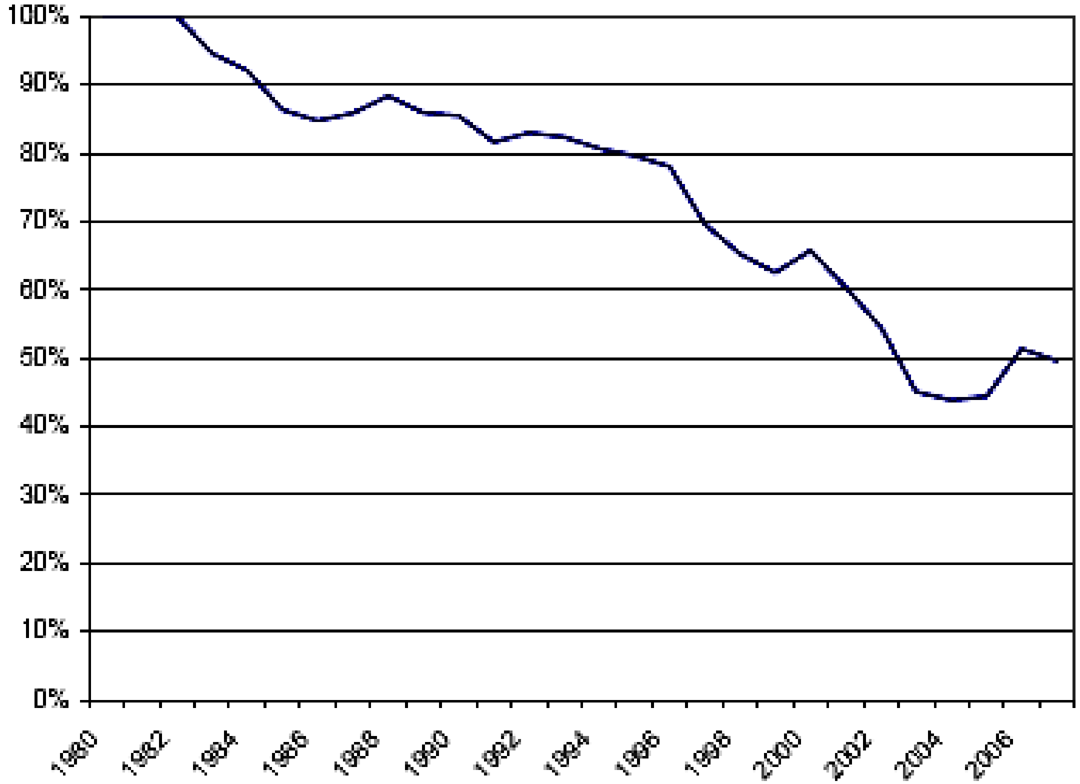
Chinese domestic ore not keeping pace

Domestic Chinese Iron ore as percentage of demand

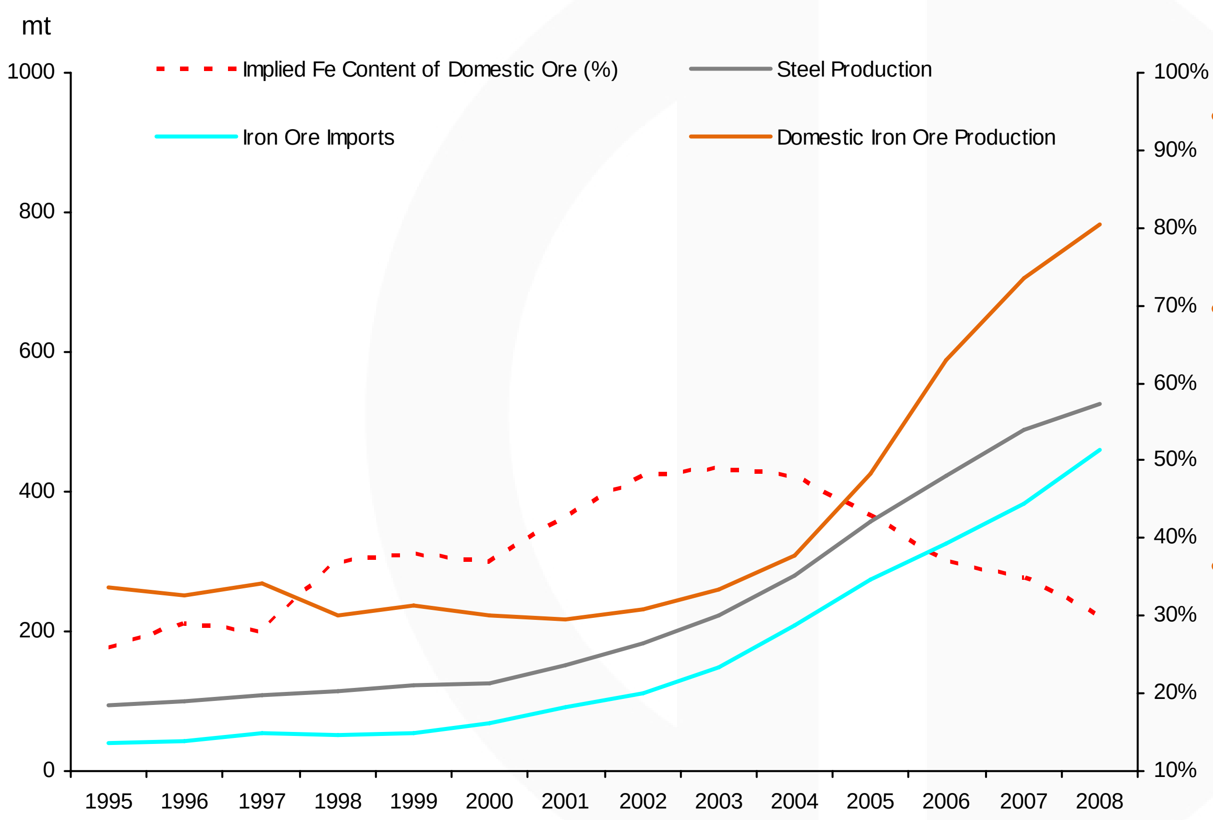


Source: IISA, Citi Investment Research

- Ore quality reported to be falling in last few years
- Essentially China not keeping up with own demand
    - No Tier-1 assets discovered in-country
- Evidence has been rush to buy into offshore iron ore assets

Patterns in Chinese steel production

Evolution of Chinese Steel Production



Source: Howe Robinson & Co Ltd

- Steel production and iron ore imports have increased every year except 1995
- During years of cheap international ore, clear import substitution policy
- In 2002 domestic production rose to meet absolute shortfall in iron ore supply
    - Shortfall remains
- Chinese ore run-of-mine continues to increase, but iron units produced is in decline

DEMAND AND SUPPLY

Demand Observations

- General steel demand has followed usual quieter summer seasonal trend for the past 2 months, and spot steel prices have fallen from record highs in response to this
- Steel prices are anticipated to stabilize in many regions at this new equilibrium for the balance of Q3 and into Q4 as sentiment has been toward a less aggressive demand picture for the balance of 2008 in northern Europe
- Flat steel stocks are reportedly relatively low in much of Europe
  - Eyes will continue to be on China's steel exports, particularly to Europe
  - China's higher exports in July 2008 were only a reaction to lower domestic summer demand, however, and likely government enforced reduced production during the Olympics in the industrial north of the country
- In Eastern / Central Europe we have seen greater prudence to slower demand during this summer and some producers have acted responsibly to manage down supply to the market during August in Ukraine
- Long product demand and price sentiment has been weaker, off record highs, as we move toward the end of the northern summer, with a flow through to scrap and to billet prices

Demand Observations (cont'd)

- In domestic China, flat products prices are reported to have started to rise in late August as the end of summer is in sight
  - On this basis, sentiment is for flat prices (or even higher?) for Q4 2008
- A similar situation is reported for long products
  - Interestingly, China's steel production fell about 2mt from June to July, amid speculation that the government's environmental targets for the Olympic period actually had quite some influence on iron and steel output and transportation of industry materials
- Overall the initial northern summer period steel production data is indicating flat global steel output; which is still ~ +6% higher than summer 2007
- In China initial 2008 summer period data indicates that it is some +4% higher than the same period in 2007. China now 'cleaning out' steel stock backlog?
- The correction we had to have?

Supply Observations

- Supply-side response to iron ore demand likely to remain muted, impacted by the credit crunch
  - Greenfield iron ore projects massively capital intensive, generally far from markets/coast – e.g. proposed magnetite projects in West Australia
- Even a conservative view of global iron ore demand growth (c.2-3% pa) requires an incremental c.50mt additional ore supply each year
  - Cannot all be met by projects announced by majors
  - Marginal tonnes to come from remote high-cost magnetite projects – now with no funding
- Proposed African and inland Indian export-focused projects increasingly unlikely to come to market

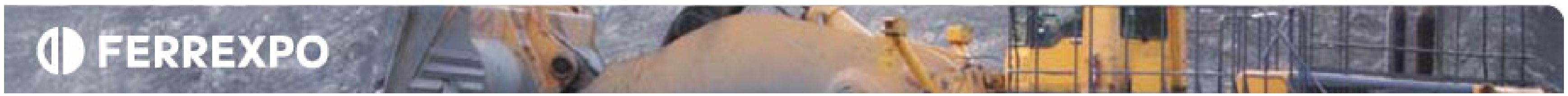
Supply Observations (cont'd)

- **Australia**
  - Reliance by China is growing - may hit 40% of China imports in 2008 (highest since 2005)
  - Closest supplier should obtain highest share due to lower CFR than long-haul competitors
- **Brazil**
  - Estimated +10mt increase in imports by China, but this is less than half (20-22mt) annual yoy increase seen in 2006 and 2007
  - Losing share to Australia
- **India**
  - FOB price and tonnage shipped to China has declined last few months
    - Monsoon season has started
    - Reduced frenetic spot demand plus:
      - Olympic slow down / closures by Chinese steel mills
      - Higher port stocks in China
    - Increased Indian export taxes
    - Competition from other exporters – e.g. Australian spot sales by majors
  - Remember - China warned India in early 2008 that its high spot priced supply would be first to go if demand eased in China

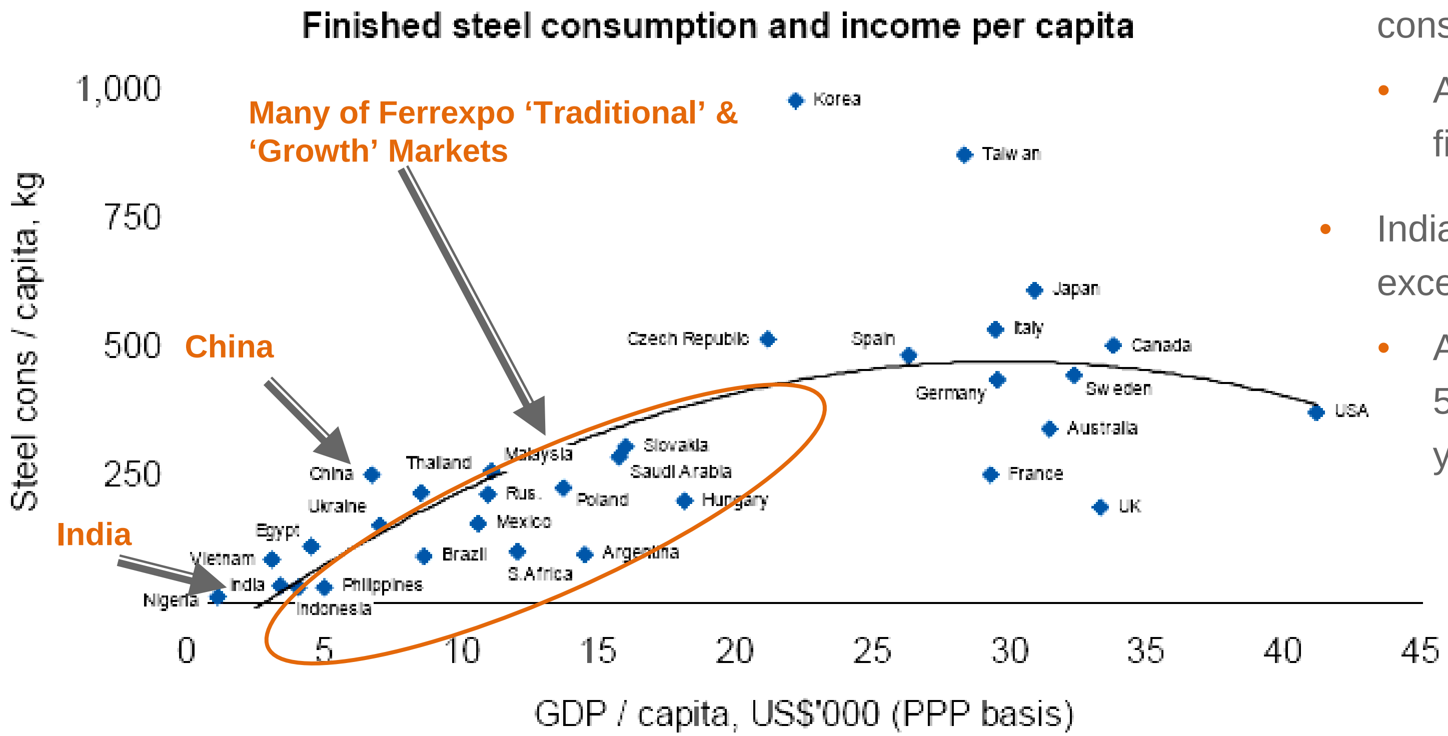
The Steel ‘Super-cycle’

So what has changed from past decades of cyclicality?

- Structural demand growth explosion
  - China !!!
  - India
  - Central / Eastern Europe re-industrialisation
  - Russia
  - Latin America
  - Asia
- Significant reduction in government ownership of global steel capacity - managing the micro-cycles
- Iron ore industry highly consolidated – profit-driven players
- Dramatic change to cost curve in last 5 years as China demand exploded - flatter on low end, steeper on high end driven by high cost new supply
- Next generation Tier-1 iron ore assets will be slow and high cost to commercialise….and possibly fewer than we think



Per capita finished steel consumption



Data: Hatch Beddows, IISI, IMF. Note: 2005 data

In 2007

- China's per-capita steel consumption was 291kg
  - An 82% increase in last five years
- India's consumption exceeded 42kg per person
  - An increase of more than 50% over the last five years

So, where are price relativities up to now?

Recent data* suggests the following:

- Current India Spot Fines (~$135-$155/t CFR, and ~$113-$133/t FOB) compared with:
  - Brazil ‘Benchmark’ Fines:
    - CFR: Indian Fines still substantially above Vale asian benchmark + spot freight: ~$22/t
    - FOB: Indian Fines ~$45/t above Vale benchmark
  - Australian ‘Benchmark’ Fines:
    - CFR: Indian Fines ~$39/t above Australian benchmark + spot freight
    - FOB: Indian Fines ~$31/t above Australian benchmark
- Still a lot of headroom on ‘spot’ versus ‘term’

**Trade data, MB, Ferrexpo analysis*

Demand remains strong for Ferrexpo products

- Ferrexpo sells iron ore blast furnace pellets globally to iron and steel mills typically under long term contracts and also a small proportion to spot customers
- Global demand remains strong for Ferrexpo pellets as customers continue to use pellets to push productivity from blast furnaces
- Demand for Ferrexpo pellets remains firm in all sectors and is expected to continue well into 2009
- The significant raw material price increases have already flowed through to the iron and steel industry and 2008 year to date profitability has remained high

IRON ORE PELLETS

Reiterating the Case for Pellets

Pellet consumption rate will increase in Blast Furnaces because:

- High quality, direct charge lump supply is declining
  - Lump quality also reportedly declining rapidly
- Direct charge materials will increase as iron makers pursue
  - Lower coke rates
  - Greater BF productivity
- Sinter Plants are an environmental problem with high SOx, NOx, CO2 output
  - Increased usage of pellets can make it possible to reduce total impact of emissions of SOx, NOx and CO2 on the environment (major Chinese mills are pursuing this)
- Rapidly growing DR demand
  - Major producers are focusing to produce high ratios of DRP and less BFP

What we are staying focused on

- Demand fundamentals
  - Especially China / Asia steel demand per capita
- Type of iron/steel being produced in high per-capita demand regions:
  - BF/BOS in China (scrap deficient), Russia / Central Europe, India, South America
  - All have need of iron ore based processes
- Industry consolidation: both in steel and iron ore / minerals
- The case for pellets
- Getting used to living in a multi-speed world?
  - East-West decoupling – different growth rates and economic fundamentals
  - Developed / Developing decoupling – especially relevant to iron ore and steel given correlation to infrastructure and basic construction
- Financial market turmoil and equity market perception / panic kept in context