



# Road to recovery?

## Aussie mine

November 2009

What would you like to change?

PRICEWATERHOUSECOOPERS 

# Foreward





As the global financial crisis unfolded, the world's financial super powers began to falter, and the Australian economy reeled. The mining sector in Australia was not immune, and the juniors were hit extremely hard. Survival became the only goal of many companies.

Towards the end of the 2009 financial year the storm seemed to subside with tentative signs emerging that the world economy had stabilised. Global trade and industrial production showed evidence of modest expansion, while developed economies lapped up the benefits of Government stimulus packages.

For the Australian mid-tier miners it was a story of riches to rags and first steps back to riches. With renewed economic optimism and demand for commodities from China and India poised to rebound, prospects are encouraging.

Against this backdrop, we welcome you to the PricewaterhouseCoopers' annual review of trends in the mid-tier Australian mining industry. This report focuses on the annual results of the largest 50 mining companies listed on the Australian Stock Exchange with a market capitalisation of less than \$5 billion at 30 June 2009 (the mid-tier 50).

We note that this report serves as an update to our May 2009 publication. Going forward the timing of this report will continue to be in the latter half of the calendar year to coincide more closely with the financial year-ends of the mid-tier 50.

Aussie mine provides an overview of the financial performance of the mid-tier mining industry and investigates significant areas of focus, specifically the implications of foreign investment on the mid-tier 50 and the relevance of customer credit risk to strategic planning.

Thank you for your interest in this publication. We trust you will find it informative.

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# Mid-tier 50 summary financial information

|  | 2009 A\$m | 2008 A\$m | Change % |
|--|-----------|-----------|----------|
| Revenue  | 11,150    | 10,283    | 8%       |
| Operating expenses                                       | (8,832)   | (6,875)   | 28%      |
| Impairment   | (3,949)   | (24)      | 16354%   |
| Return on equity %                                       | -2%       | 14%       | n/a      |
| Net profit/(loss)  | (636)     | 2,831     | -122%    |
| Proceeds from ordinary share issues                      | 3,599     | 2,833     | 27%      |
| Distributions to shareholders                            | (1,116)   | (2,633)   | -58%     |
| Net operating cash inflow                                | 2,747     | 2,745     | 0%       |
| Net financing cash inflow                                | 2,482     | 909       | 173%     |
| Net borrowing inflows/(outflows)                         | 314       | 874       | -64%     |
| Cash   | 4,462     | 4,442     | 0%       |
| Property plant and equipment and capitalised exploration | 21,207    | 16,291    | 30%      |
| Total borrowings   | 6,190     | 4,841     | 28%      |
| Net assets   | 26,533    | 19,575    | 36%      |
| Market capitalisation                                    | 52,196    | 77,137    | -32%     |
| Market capitalisation to net assets ratio                | 1.97      | 3.94      | n/a      |

# 2

## Executive summary

Financial year 2009 will be a hard year to forget. June through December 2008 left an enormous mark on the Australian mining mid-tier 50 and the broader economy as a whole. Share and commodity prices were in free-fall and mining was one of the most GFC-affected sectors. Balance sheet analysis moved from the back of monthly management accounts to comprehensive front and centre analysis. Debt became undesirable to those with too much and almost unobtainable to those with too little. Mines became unprofitable and activities were suspended or ceased.

The start of 2009 saw the end of broad brush market price reductions and by the middle of the year uncertain optimism prevailed. The appetite of equity investors at the top end of the mid-tier (and the wider market) for discounted rights issues and demand for greater access to upstream assets by Chinese companies has provided the financing solution required to shore up the mid-tier 50.

Since the start of the year \$2.7 billion has flowed in from overseas investors, with more than 80% coming from China. Whilst M&A has always been prevalent in the mid-tier 50, the level of interest has clearly increased. As the year progressed, we had expected greater clarity of the factors which the Foreign Investment Review Board (FIRB) considered of most importance, however significant uncertainty continues to dog foreign investors, particularly those owned or controlled by foreign governments. This uncertainty decreases Australia's competitiveness in the market for global capital funds.

The annual results of the mid-tier 50 were dominated by impairment charges and lower operating margins. Results of the mid-tier 50 were largely aligned with commodities mined – gold and energy companies delivered revenue growth of 60%, compared with a 24% revenue decrease by the base metal miners. Those in nickel and zinc were hardest hit.

From a cash flow perspective, a focus on debt refinancing prevailed as a key theme, as companies struggled to shore up their balance sheets and position themselves for the future.

Whilst operating costs grew 28%, revenue was down 10% – squeezing margins and making some mines unprofitable. Significant funding were pumped into the industry by way of capital raisings which were largely utilised to pay down existing debt and fund capital expenditure. Expenditure commitments also foreshadowed industry optimism.

As company share prices fell during 2008, mining companies presented prime pickings for cashed up foreign investors looking to penetrate the buoyant Australian resources market. Many of these companies had been considering investing for some time and the pull back in share price, allied with the exchange rate movements, made many assets cheap for those game enough to invest. In addition many Australian companies were in deep trouble and offered themselves up for purchase – a sight not seen for many years. With many deals complete and others still ongoing, it is worth noting that this occurred rapidly and dwelling now on commercial and tax opportunities could well be appropriate. Additionally, bridging the understanding gap with new shareholders may well be a significant task for the years ahead.

Uncertainty remains. Prior to September 2008 the belief was that China would insulate the mining industry from the worst of the global financial crisis. This was clearly not true! But, we now see the sector as one of the first to recover, once again off the back of China. It certainly looks and feels real but the industry will be more careful second time around. Debt will remain a four letter word and many long-term shareholders have seen their investment diluted as offshore entities have bought in at basement prices to save the company.

China's economy is growing rapidly again. In addition, the first signs of slow growth, or at least a pull-back in the contraction are being seen in OECD countries. Australia is, once again, experiencing growth. Many will be pleased to see the back of 2009 and be looking forward to 2010!

**We believe there are many reasons for the mid-tier to be optimistic, and ask each company whether they are on the road to recovery?**



# 3

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Commodity prices have improved and the market has started to turn. The rebound in the equities market opened up opportunities to raise much needed finance...companies are better positioned to fund projects and potentially undertake M&A.

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# Mid-tier industry in perspective

## 3.1 Movements in the mid-tier 50

There have been six new entrants to the mid-tier 50 since our May 2009 publication. All six of the exits come from companies that were in the bottom 15 at the time of the May 2009 publication.

The only exit due to M&A activity is Consolidated Rutile which was delisted on 2 July 2009 following its acquisition by Unimin Australia. In previous publications we have seen M&A activity affect the composition of the group, however this has not been the case for this publication. Deals have continued, as can be seen in the M&A activity section, although the majority of transactions involving the companies in the mid-tier 50 have been with companies outside the group.

BHP Billiton, Rio Tinto, Newcrest, Coal & Allied, Lihir Gold and Fortescue Metals continue to be excluded from the list on the basis that their market capitalisation exceeds the \$5 billion threshold.

In our May 2009 publication we noted the return of Alumina and OZ Minerals to the "under \$5 billion" fold. There has been no further movement in the top end of the list.

Four of the six new entrants to the current list have had previous appearances. The biggest movers are Pan Australian Resources which re-enters at number 20 and Mirabela Nickel which re-enters at number 22. In our May 2009 publication, we highlighted that the majority of entrants were gold and coal companies. These two commodities performed the strongest for the 2009 financial year. Gold, copper, iron ore, zinc, nickel and platinum are represented amongst the new entrants.

## 3.2 M&A – from opportunity to necessity

During the latter part of the 2008 calendar year, the global mining industry was in crisis. As commodity prices tumbled a number of small companies collapsed. Others were on the verge of bankruptcy and some large miners were under pressure to repay significant debts. These difficult market conditions, combined with the state of global financial markets, restricted the availability of debt and equity to finance M&A activity.

M&A activity shifted focus from being opportunity driven to being a necessity, at any price, to ensure survival. However, such market conditions did provide opportunities for companies with access to cash or financing, such as China Minmetals Nonferrous Metals Co Ltd (Minmetals) who acquired most of the assets of the debt challenged OZ Minerals Ltd (OZ Minerals) in June 2009 for \$1.9 billion.

Since 1 January 2009 commodity prices have improved and the market has started to turn. The rebound in the equities market opened up opportunities to raise much needed finance. Accordingly, we have seen a spate of capital raisings as companies have looked to shore up their balance sheets – better positioning them to fund projects and potentially undertake M&A.

The disastrous market conditions in early 2009 were manna from heaven for China. All of a sudden, assets were cheap, exchange rates were in their favour, there was no competition for assets and the Australian government needed foreign funds entering the market. The tap of Chinese investment was turned on and the Foreign Investment Review Board's (FIRB) approval was a key hurdle, with some deals being approved with conditions and others being politely requested to reapply.

### 3.2.1 Deals since January 2009

Since January 2009, the mid-tier 50 companies have been subject to 11 deals comprising \$8.9 billion of completed or announced transactions. Chinese companies have been prominent in these deals, representing \$6.2 billion or 70% of the total. Canadian company, Eldorado Gold, was also a significant investor through its proposal to acquire Sino Gold Mining Ltd for \$2.2 billion (Eldorado completed the first stage of this acquisition via a 20% ownership interest in Sino Gold Mining Ltd for \$0.4 billion in July 2009).

The most significant acquisitions of mid-tier 50 companies since January 2009 were Yanzhou's on-going \$3.0 billion acquisition of Felix Resources and China Minmetals acquisition of certain assets from OZ Minerals Ltd for \$1.9 billion.

Of all M&A activity greater than \$25 million since January 2009, there were no cases of mid-tier 50 companies acquiring other companies. This indicates that the mid-tier 50 did not have sufficient financing to complete acquisitions, that share prices were considered too depressed to perform a script deal, or that there was insufficient certainty for companies to participate in M&A activity.

### 3.2.2 Foreign investment in Australian mining companies

Conditions were ripe for Chinese investment in 2009, with Australian mining companies in search of capital to fund projects and repay debts. The deals came, and then came faster. Big deals by Chinalco (for a Rio Tinto investment/assets), Minmetals (refer above) and Hunan Valin (for 17% of Fortescue) in quick succession provided food for thought for the Foreign Investment Review Board (FIRB). Whilst the Australian government clearly has a preference for private investment, these transactions by State Owned Enterprises have required careful consideration of foreign government investment by FIRB. Whilst large investments like Minmetals, and more recently Yanzhou Coal's bid for Felix Resources, were approved with conditions other deals did not make it through. FIRB has tried to clarify its thoughts, but many believe they have only created further uncertainty. Together with rising asset prices and exchange rates, this may lead to the Chinese looking beyond our shores.

We urge the Australian government to supply clarity. Australian mining companies have been far more agile dealing with China than anyone else, and the Chinese like many aspects of Australia. Whilst we clearly all understand the economic importance of China in assisting the Australian economic recovery, we must also recognise that direct investment by China can go anywhere in the world. Australia needs to consider its position and clearly articulate it. There is a risk that uncertainty could turn China away particularly in an environment where Canadian companies are pursuing Chinese investment far more vigorously than before.

Given Australia's increased reliance on China to initiate deal activity in recent years, FIRB intervention and Western-Sino relations will be key factors impacting M&A activity in the coming years. India may also become a bigger player in M&A activity in Australia as we are already seeing in the coal sector. Sovereign wealth funds from other countries such as the Middle East, have also expressed interest in Australian mining assets.

Overall the strengthening of global commodity markets and recent signs of increased growth in the Chinese economy, indicate that Australia's need for foreign investment to fund future mining projects will continue. As a result, we expect high levels of M&A activity to continue in the short to medium term.

### 3.3 Market capitalisation

Between June 2008 and December 2008, the mid-tier 50 shed a significant portion of its overall market capitalisation: falling from a market capitalisation of \$77.1 billion, to a nadir in November of \$28.6 billion before a marginal uplift to December 2008 market capitalisation of \$31.4 billion. This 59.3% decline compared with the ASX All Ords decrease over the same period of 31.4%. As we noted in our previous publication, the mid-tier 50 had returned to levels similar to those at December 2005.

Since then however the mid-tier 50 has begun to claw back market capitalisation with an increase between December 2008 and June 2009 of 33.9% or \$20.7 billion. As of October, the aggregate market capitalisation of these companies has returned to 79% of June 2008 pre-GFC levels (compared with the All Ords which is back to 87%).

Over the period only nine companies had returned to market capitalisations similar to or in excess of June 2008. Only one of these, Extract Resources, increased market value by greater than \$1 billion dollars. This can be compared with the bottom nine companies of the mid-tier 50 which each wiped off in excess of \$1 billion dollars.

Of those nine companies with an increase in market capitalisation five were gold producers or explorers, three uranium and one iron ore explorer. Of the nine companies that lost the most market capitalisation, five have exposure to coal. If we separate out companies with either gold or uranium exposure, we see how these companies have pulled up the market caps of the mid-tier 50, their market capitalisations changing by 18% and positive 5% respectively.

Announced or completed M&A activity greater than \$25m involving Mid-tier 50 companies 1 January 2009 - 30 September 2009

| Target                              | Acquirer                                     | Acquirer country | Ownership interest | Approximate deal value (A\$m) | Status  |
|-------------------------------------|--|------------------|--------------------|-------------------------------|---|
| Felix Resources Limited             | Yanzhou Coal Mining Co Ltd                   | China            | 100%               | 3,043                         | Pending                                       |
| OZ Minerals                         | China Minmetals Non-Ferrous Metals Co Ltd    | China            | Certain assets     | 1,915                         | Completed                                     |
| Sino Gold Mining Limited            | Eldorado Gold Corporation                    | Canada           | 80%                | 1,806                         | Pending. Scheme Booklet released in October   |
| Gloucester Coal Ltd                 | Noble Group Ltd                              | Hong Kong        | 100%               | 547                           | Completed. As at 14 June, Noble had 80% stake |
| Straits Bulk and Industrial Pty Ltd | PTT Exploration and Production Public Co Ltd | Thailand         | 60%                | 475                           | Completed. 60% interest in coal assets        |
| Sino Gold Mining Limited            | Eldorado Gold Corporation                    | Canada           | 20%                | 371                           | Completed                                     |
| Aquila Resources Limited            | Baoshan Iron & Steel Co Ltd                  | China            | 15%                | 286                           | Pending. Approval from FIRB granted           |
| Pan Australian Resources            | Guangdong Rising Assets Management Co Ltd    | Hong Kong        | 20%                | 215                           | Completed. 19.9% stake by GRAM                |
| Mount Gibson Iron Limited           | Fushan International Energy Group Ltd        | Hong Kong        | 14%                | 176                           | Completed. 14.34% stake                       |
| Kagara Ltd                          | Goldsland Holdings Co Ltd                    | Hong Kong        | 15%                | 57                            | Completed. 15% stake                          |
| <b>Total</b>                        |  |                  |                    | <b>8,902</b>                  |   |

Table 1: Announced or completed M&A activity greater than \$25m involving the mid-tier 50 companies 1 January 2009 - 30 September 2009  
Source: mergermarket.com

Mid-tier market capitalisation at month ends index - by resource - 1 = 30 June 2008

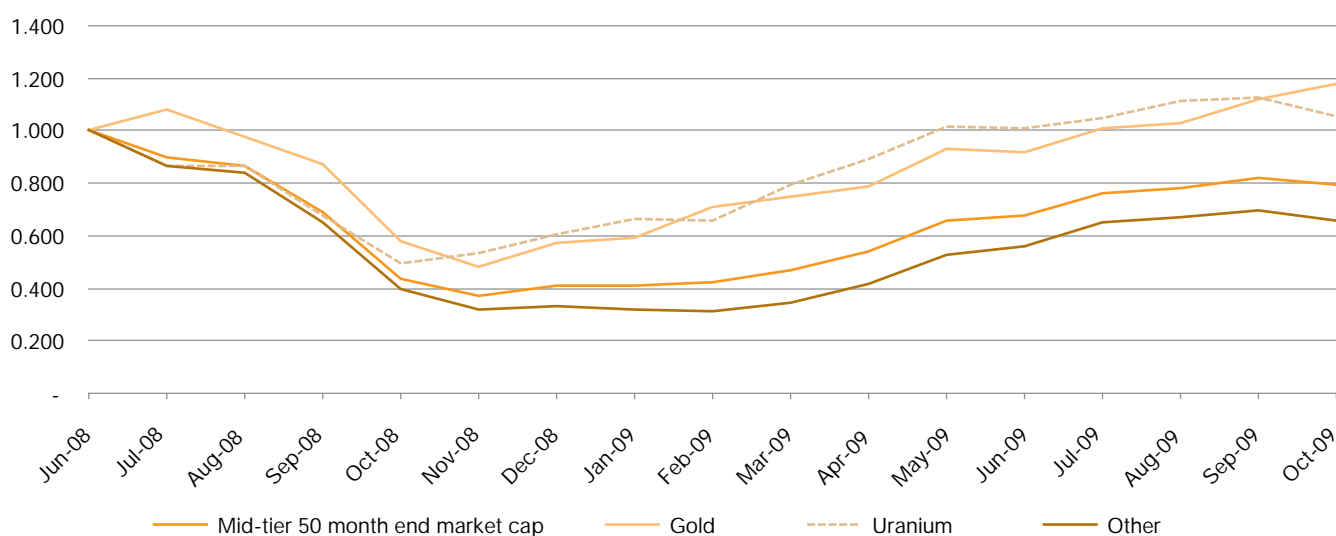


Table 2: Mid-tier 50 market capitalisation index - Month end information (30 June 2008 = 1)  
Source: Bloomberg



The cut-off point or floor market capitalisation for inclusion in our list of the mid-tier 50 also changed since our May publication. In this update's analysis, 50<sup>th</sup> place is filled by Bannerman Resources Limited, with a market capitalisation of \$227 million. The 50<sup>th</sup> company by market capitalisation in May was Platinum Australia Limited which had a 31 December market capitalisation of \$127m. This is a 79% increase.

The outstanding performer over the period in the mid-tier 50 from a market capitalisation point of view was Extract Resources, the Namibian Uranium explorer which gained 446% on its June 2008 position. This, following good drilling results and positive market sentiment for uranium assets.

The biggest losses in market capitalisation were largely consistent in percentage terms with the rest of the mid-tier 50. However, four of the ten companies with the largest market capital declines (in \$ terms) lost greater than 60% of their opening market capitalisation, three being coal companies. It is worth noting that we see a disconnect between the market capitalisation and the financial results of the coal miners. The strong financial results of the coal miners can be attributed to a fixed contract price for much of the period which has since been negotiated down. This is reflected in forward looking lower market capitalisations.

### 3.4 Comparison of the mid-tier 50 to other performance measures

In our May 2009 publication, we explored if significant fluctuations in the mid-tier 50 miners' market capitalisations were anomalies specific to the Australian economy. At the time, flailing market conditions resulting from the global economic downturn were impacting resource companies across the world, with the three comparative indices (ASX 300 Metals and Mining, FTSE Mining Index and TSX Mining Index) all virtually mimicking each other.

Recent data reveals that the trend between the ASX and TSX indices continued for the FY09 period, while towards the end of 2008, the FTSE index proceeded to deflate to approximately 20% of its original value, subsequently regaining almost all of that value.

The Chinese Government's economic stimulus package, targeted towards infrastructure development, was the likely underpinning cause of the steady recovery of the ASX and TSX toward the second half of the year. Similarly, economic stimulus packages and a return in equity market optimism in the respective countries would have assisted with this recovery.

The diverse spectrum of participants comprising the FTSE index (typically companies from numerous jurisdictions) is a likely cause of its turbulent journey during the year. Rampant fluctuations of approximately 160%, from open to close, also reflect the exposure of the British market to global economic pressures. A further point to consider is the possible inter-market influence between the FTSE index and other markets, such as the Dow Jones US Mining Index or JSE Mining Index.

The 9 mid-tier 50 companies with increased market capitalisation between 30 June 2008 and 30 June 2009

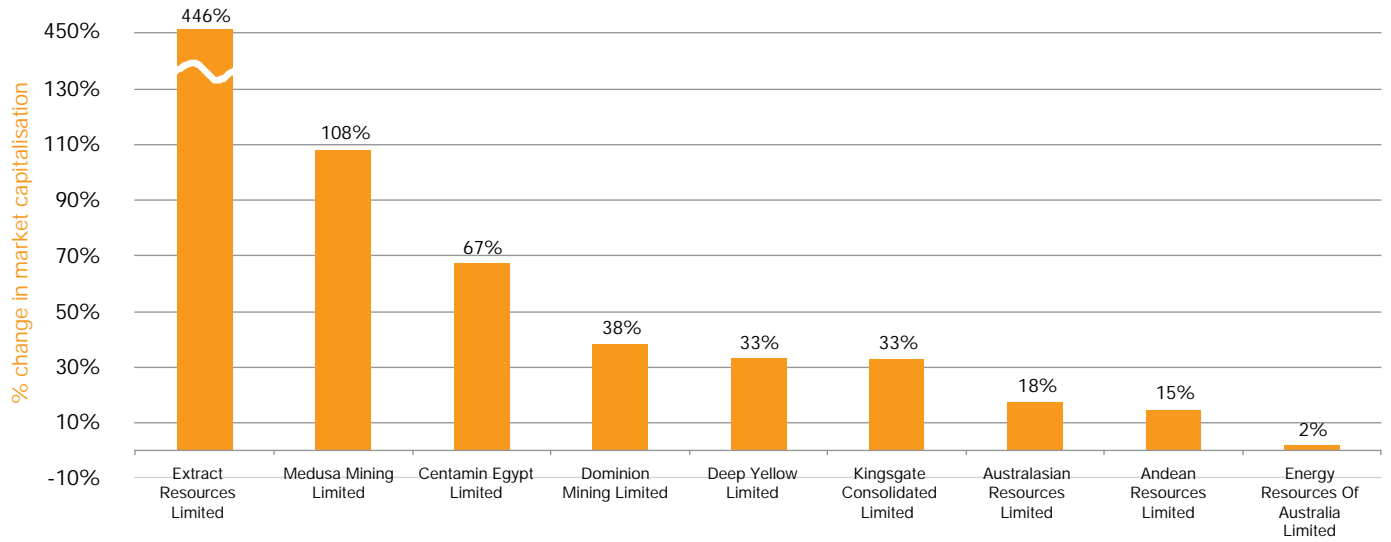


Table 3: Mid-tier 50 companies with increased market capitalisation between 30 June 2008 and 30 June 2009  
Source: Bloomberg

Comparison of key mining indices - July 2008 - September 2009

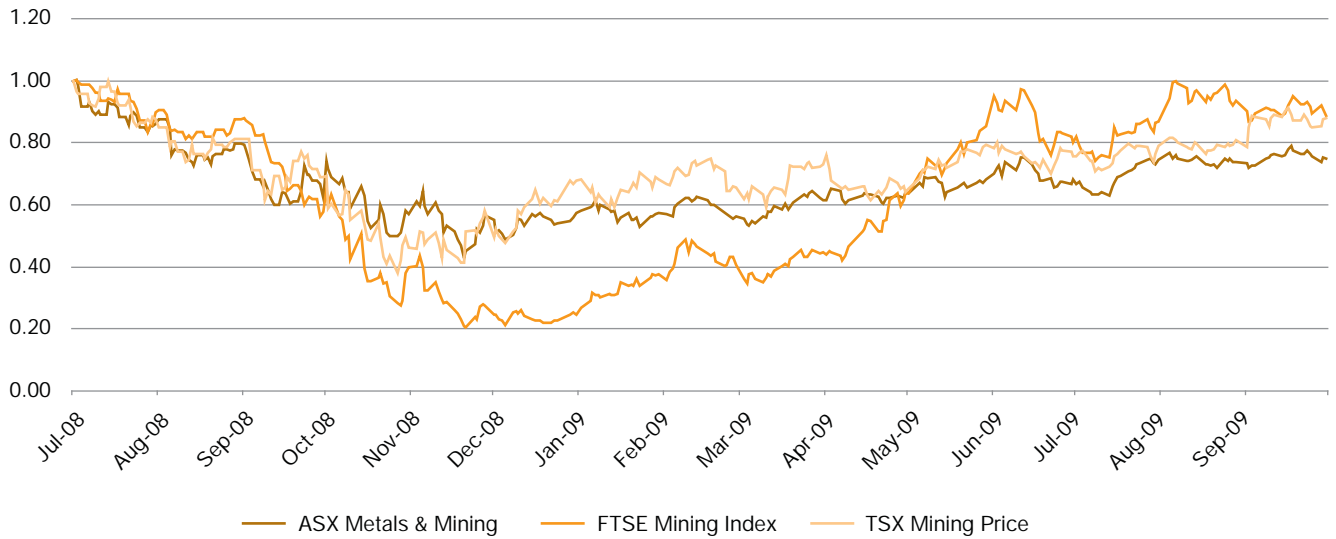


Table 4: Comparison of key mining indices (July 2008 =1) July 2008 – September 2009  
Source: Bloomberg



### 3.5 Gold – the backbone of the economy

Gold, as a safe haven investment, returned to favour during the financial turmoil of the global downturn. The gold price surged to over A\$1,500 per ounce at one point, largely thanks to a strong USD/AUD exchange rate. As a result, the ASX gold index managed to significantly outperform the ASX 300 M&M index for most of the year.

Of the 13 Australian gold miners in the mid-tier 50, 12 succeeded in increasing their earnings. Average operating revenues for gold producers increased by 86%, compared to the remaining group members which recorded only 1% growth in operating revenues.

There is little consensus over how the mid-tier gold miners will fare going forward, and their fortunes are intrinsically linked with the gold price, foreign exchange and the broader global economy.

### 3.6 Coal – the unexpected bread winner

Following the onset of the GFC, weakened demand for coal (primarily metallurgical coal), coupled with volatile market trading, saw a rapid deflation in the value of coal stocks.

Despite hefty contract coal prices, locked in for the majority of the financial year, speculation regarding industry outlook proceeded to wreak havoc. This wiped off 45% of the market capitalisation of the mid-tier 50 coal stocks at year end. Global markets experienced a similar fate with the Stowe Global Coal Index losing up to 70% of its value, before recovering in the second half of the year.

Despite adverse market forecasts, favourable coal prices coupled with a significant deterioration in the Australian dollar resulted in the total mid-tier coal company revenues and gross profits growing by 27% and 20% respectively. This can be attributed to contracted coal prices lagging the downward trend for broader commodity markets.

Looking ahead, the Australian Bureau of Agricultural and Resource Economics (ABARE) predicts 5% growth in the Australian mine production index, substantially driven by the production of metallurgical coal, and with demand growth now evident in China and India. Expectations are for a return to form for Australian mid-tier coal stocks.

Our experience would also suggest that coal assets, both metallurgical and thermal coal, will be in hot demand as the world recovers and industrialisation continues. Could coal be the next big thing?

ASX 300 Metals and Mining vs ASX Gold Index - January 2008 - September 2009



Table 5: ASX 300 Metals and Mining vs. ASX Gold Index (January 2008 =1) January 08 – September 09  
Source: Bloomberg

Stowe Global Coal Index - June 2007 - September 2009

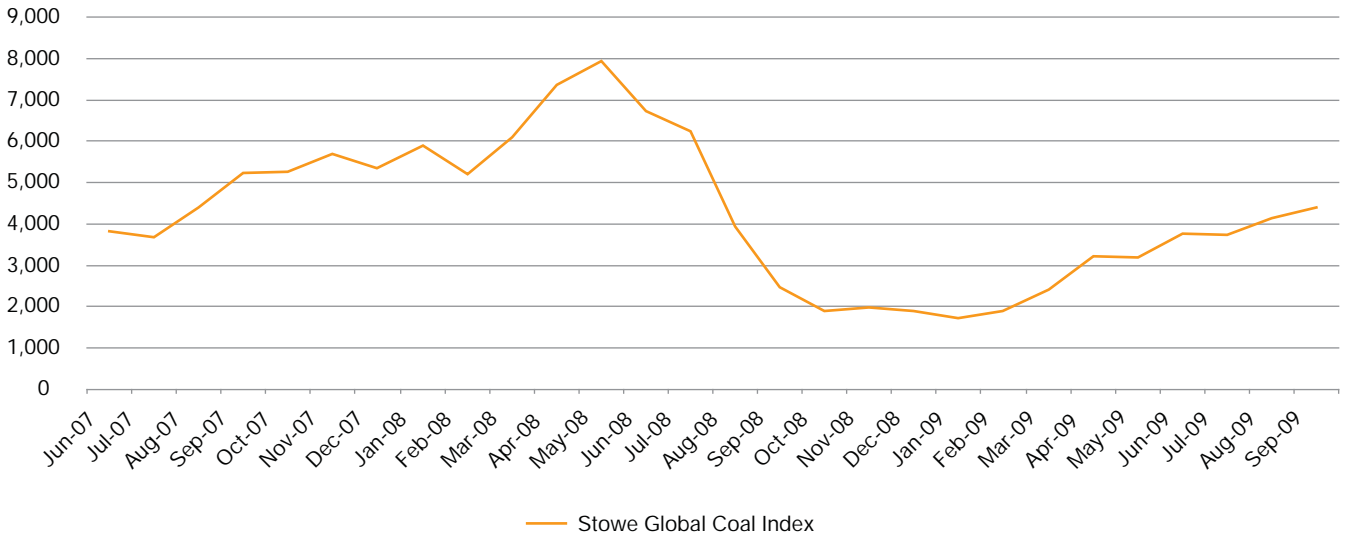


Table 6: Stowe Global Coal Index (June 07 = 1) June 07 – September 09  
Source: Bloomberg

The Stowe Global Coal Index is a modified capitalization weighted, float adjusted composite equity index designed to serve as an equity benchmark for globally traded stocks which are principally engaged in the Coal industry.

# 4



We spoke with Terry Burgess, Managing Director and CEO of OZ Minerals and sought his view on some of the current issues facing the Australian mid-tier mining industry and its future prospects. OZ has been through a period of significant change and has experienced some of the common themes of debt reduction and foreign investment. Relatively new to the position, we find Terry cognisant of current opportunities and focussed on long term success.



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There are gaps in the national infrastructure which need to be closed. We also need to think further ahead in decision making, knowing these are major projects which have a significant impact on industry.

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**Aussie mine (AM): What do you see as the major challenges that face the mid-tier?**

Terry: The type of commodity mined and location of operations give rise to different challenges and risks. For Australian miners, for example, I see foreign exchange as a significant challenge. Foreign exchange is an industry risk that I believe is not well understood, outside the institutional investor community, and as such not communicated or reported well. By investing in the mining industry you are intentionally gaining exposure to commodity prices and exchange rates and as such there is a view that hedging limits the potential upside to both of these variables. Our view is not to hedge currency or commodity prices.

For OZ Minerals infrastructure limitations have not been an issue, however I certainly understand the challenges this has given to other sectors in the Australian market, such as the coal industry.

**AM: Given the recent volatility in the market, what will be the growth story for mid-tier miners?**

Terry: Looking back at what has happened in the recent past will have an impact on growth ambitions in the short-mid term future. Uncertainty around commodity prices remains and therefore conservative assumptions are used in decision making, leading to less projects being approved and lower capital spend. In addition to this, availability of funding is still a challenge for the mid-tier sector and over time we may need to be more creative in the forms of funding obtained. As a result large, new projects are much harder to finance and as such will not come on-stream as quickly.

We also know that existing plants have been run at maximum production levels over recent years to capitalise on high prices. Couple this with low maintenance spend over the cycle and reliability becomes an issue. There are many examples of this in the sector and therefore I see supply being potentially under threat for the next 10 years, especially with a backdrop of a lack of funding, and therefore success, in exploration.

**AM: How do you see this tying to forecast production information?**

Terry: Boom time history over the past five years tells us that production targets are often not achieved. The pressure to hit these targets has lead to some stretching of assets, which can ultimately lead to more breakdowns. Many mines boast having the biggest unit or the biggest plant, but when these break down they also cause the biggest problems!

# The way I see it – Terry Burgess

## OZ Minerals

**AM: Commodity prices have rebounded in many cases. Do you see that the recent return to cost control and focus will evaporate?**

Terry: Anecdotally I don't hear that costs are tracking down as much as people thought they would. A larger proportion of variable costs appear to have actually become fixed into the base and are therefore much harder to remove. Therefore I don't think we will see as significant cost reductions as expected, given the rapid stand-still of the industry earlier this year.

In operating a mine, there are a number of different levers that should be managed – some times certainly call for cost minimisation per unit of production, however, we clearly went through a period where production maximisation was the correct approach. I think that as managers we need to remain open to different approaches and be agile enough to switch the levers that best maximise long term value for our shareholders and other stakeholders.

**AM: What are your views on foreign direct investment and, in particular, the recent Chinese investment in Australia?**

Terry: In our industry there is already a mix of local and foreign ownership of assets. I think that it is important that a country can ensure that its resources are prudently managed and therefore can be exploited to the benefit of its people. Therefore, while the operation remains in Australia, jobs, taxes, infrastructure and all of the other benefits from an operation also remain in Australia – this is the benefit of having such a large natural resource base. Therefore, where an asset would not otherwise be developed, we should definitely allow the investment, almost regardless of the funding sources.

The risk to Australia is more where assets are managed as part of a global portfolio, for example they may prioritise the development of mines elsewhere and warehouse the Australian mines. I understand that this was the concern in the Shell/Woodside transaction.

The mining industry is a very global industry and there is great competition for investments from other countries.

**AM: Strategically what is the future for the mid-tier?**

Terry: Our goal is simple – to create value for our shareholders. We don't know exactly where the world will go, so there is a need to retain a degree of flexibility.

The market hasn't recognised the value in the mid-tier mining sector over many years and as such, good companies have been taken out too cheaply, to the benefit of the acquirer.

**AM: What are your priorities for Oz?**

Terry: Still being new to the role, determining and clearly articulating our strategy is key initially. We will launch this in late November.

As mentioned previously, creation of value for shareholders is the focus. Whilst recognising that investors like rewards in the boom times, we also need to understand that they don't like the boom / bust cycle. However, as these cycles come and go it is essential that all stakeholders understand the nature of the industry, particularly the need for long-term focus. There is a need to draw breath when in the dark times and consider this.

Good governance is also essential, and with it comes the importance of maintaining a zero harm philosophy – with regard to safety, environmental and social considerations, which also returns benefits to the community.

**AM: If you were Minister for Resources what key changes would you make?**

Terry: I would replicate some of the South Australian government incentives which encourage exploration – this has been very successful and other regions may be able to learn from it. Australia has under-invested in exploration for some time now and these initiatives can encourage investment.

I have some concerns around the potential recommendations that may come out of the Henry Report on taxes, which are looking at further taxes on the mining industry to fund other commitments. Higher taxes make Australia less competitive on a global scale.

There are gaps in the national infrastructure which need to be closed. We also need to think further ahead in decision making, knowing these are major projects which have a significant impact on industry. History has shown that countries clearly don't take full advantage of boom times to invest in infrastructure. Australia unfortunately is not an exception to this.

Finally, harmonisation with global regulations, where possible, is desired. We are a global industry and as such compete with companies outside Australia. Often Australia is ahead of the pack, which is admirable, but can cause a competitiveness issue and we must make sure that we remain competitive as a country for both the exploration dollar and the investment dollar.

# 5



The global financial crisis has brought credit management practices onto the boardroom agenda of most large producers. Credit exposure to a single customer can be in the order of several hundred million dollars for large producers. Surprisingly many commodity producers still use unsophisticated credit risk management practices. Often the customer track record of payment is the only metric used to estimate the credit worthiness of that customer.

As prices and volumes rose steadily in the two years to June 2008, the credit exposure of the producers grew silently and massively. Masking this exposure was the very low incidence of payment default. The massive demand meant there were many sale options available to anyone with an unwanted cargo or excess stockpile.

Producers became more accustomed to huge credit exposures. They were also more relaxed about the financial standing of their customers as they vied to sell their product to both industrial sector customers and the increasing number of trading houses focused entirely on commodity speculation. For all but the most disciplined of producers, the pressure to produce and sell volumes at high prices overpowered the ability to manage credit risk at acceptable levels.

## Increasing default risk from buyers

From the middle of 2008, many customers began to aggressively negotiate the deferment and cancellation of shipments and also a reduction to contractually agreed prices. Producers began to quantify their credit exposures and realised the significant risk of payment default they faced from some of their biggest customers.

Banks and credit insurers also began to reduce recourse and limited recourse risk coverage for customers in many sectors and countries. This placed further pressure on the producers who were forced to make a decision about whether or not to trade without risk coverage. Customers without such arrangements still expected the producers to agree sale contracts, particularly longstanding customers with perfect payment records.

# The return of credit risk

Banking compliance procedures have been tightened severely particularly for banks operating in developing economies where many commodity customers are to be found. Many customers continue to find it impossible to arrange letters of credit guaranteeing payment to the producer. Producers in this situation face a difficult choice of either loading the cargo and accepting full open account payment risk or cancelling a sale to a customer at a time when supply is exceeding demand.

## Improving credit risk policy and processes

As we move towards the end of 2009, it seems that most major producers have managed to make it through the past twelve months without a significant level of payment defaults. However putting in place new credit risk governance procedures has become a priority for many. Good credit risk policy should result in the implementation of a system that encourages the measured and controlled risk necessary to sell target volumes at healthy prices.

Developing a good credit culture means embedding credit risk awareness and processes throughout the sales and finance functions. This is an important step to avoid the inevitable conflict between the sales team trying to sell the product and the finance team trying to manage debtors.

The prime symptom of an unhealthy credit risk culture is the situation where sales people view credit risk as the concern of the finance function and may even ignore clear warning signs of customer financial distress. When good credit culture and procedure is embedded into marketing and sales activities it has the effect of minimising short term credit risk and also steering business volumes to customers with stronger credit positions. This results in a much healthier customer portfolio in the longer term.

## The credit risk challenge

Typically, less than 20% of global commodity customers have an internationally recognised credit rating provided by a globally recognised rating agency. Instead, many customers rely on their reputation, the credit rating of one or more of their shareholding entities or even the sovereign credit rating of their country of domicile.

Even when ratings are available, they must be treated with caution. Credit ratings agencies are not watchdogs or auditors and are not responsible for verifying the accuracy of the financial data supplied to them. The recent financial crisis demonstrated that even accurate historical financial information is not always a good indicator of credit worthiness.

The challenge for the producers is to develop a reliable picture of the credit risk position of each customer. It needs to be consistent and comparable across the many different types of customer operating in different sovereign jurisdictions. This involves the development of robust tools and internal processes.

One company who has implemented a new approach to credit risk is Anglo American plc who implemented a completely new global credit risk process in June 2009. Francois Jacques, Global Head of Marketing for Anglo Coal was very clear about the need to adopt a portfolio view to assist management decision-making: "At the customer level, we had to introduce a robust set of tools and policies to cope with new world we now operate in. But without risk there is no return and it is vital that we also understand our exposure to each industry sector and of course each country that we sell to".

Adopting a portfolio view of credit risk allows customer comparison and also a measure of aggregate credit risk which can be segmented by geography, industry sector or risk category. The portfolio view of credit risk is typically the view that should be presented regularly to both board level risk committees and the executive management team.

The portfolio view of customer credit risk should highlight any imbalance of risk exposure to particular sectors and geographies or closely related customer entities in particular. Well presented portfolio summary data will help guide volume allocation decisions and ensure that the producer steers continually towards a well balanced portfolio credit risk position.

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# 6

## 6.1 Income statement

|   | 2009 A\$m      | 2008 A\$m      | Change %     |
|---|----------------|----------------|--------------|
| Revenue from ordinary activities                  |                |                |              |
| Operating revenue                                 | 10,584         | 9,813          | 8%           |
| Non-operating revenue                             | 565            | 470            | 20%          |
| <b>Total revenue</b>                              | <b>11,150</b>  | <b>10,283</b>  | <b>8%</b>    |
| Less expenses from ordinary activities            | (8,474)        | (6,604)        | 28%          |
| Exploration expenses                              | (357)          | (271)          | 32%          |
| <b>Operating expenses</b>                         | <b>(8,832)</b> | <b>(6,875)</b> | <b>28%</b>   |
| <b>Gross profit</b>                               | <b>2,318</b>   | <b>3,408</b>   | <b>-32%</b>  |
| Gain on sale of investments                       | 3,113          | 625            | 398%         |
| Other income                                      | 527            | 637            | -17%         |
| Impairment  | (3,949)        | (24)           | 16155%       |
| Depreciation and amortisation                     | (1,259)        | (774)          | 63%          |
| <b>EBIT</b>                                       | <b>750</b>     | <b>3,872</b>   | <b>-81%</b>  |
| Net interest expense                              | (326)          | (116)          | 181%         |
| <b>Profit from ordinary activities before tax</b> | <b>424</b>     | <b>3,756</b>   | <b>-89%</b>  |
| Income tax expense                                | (1,060)        | (925)          | 15%          |
| <b>Net profit</b>                                 | <b>(636)</b>   | <b>2,831</b>   | <b>-122%</b> |

# Aggregated industry financial statements

## Revenue

Despite the global financial crisis the revenue of the mid-tier 50 increased by 8%. This result masks the varying fortunes of the individual companies. Coal and iron ore producers were able to benefit from high contract prices until 31 March 2009 which positively impacted the overall sector result.

Of the mid-tier 50, the 27 companies with exposure to gold and energy (coal and uranium) accounted for 57% of the revenue generated in 2009. The revenue performance of the gold and energy companies outstripped the base metal miners delivering growth of 60% compared to a decrease in revenue of 24%. Driving the revenue growth of gold and energy companies were New Hope Corporation Ltd, Macarthur Coal Limited and Energy Resources of Australia increasing their revenue by 112%, 87% and 84% respectively. Those in nickel and zinc were hardest hit.

The contract coal prices negotiated in April 2008 – before the worst of the financial meltdown – coupled with a significant deterioration in the Australian dollar, provided the coal companies with a revenue bonanza. The April 2009 contract negotiations lead to significant falls across all coals of around 50%. The Aussie dollar strengthening against the USD has also not helped. This contributed to coal stocks' market capitalisation falling more than other sectors; however, as stated earlier, there are many positive points for future coal ambitions.

Nickel, copper and zinc producers have suffered with prices for these commodities plummeting. The average daily Australian dollar equivalent nickel spot price fell 43% during the financial year ended 30 June 2009. Average copper prices had also fallen 23% for the same period. The experience may have been more dire were it not for the weaker Australian dollar.

## Operating costs

Operating costs have increased by 28% and gross profits reduced by 32%. While cost containment and improved operational efficiency have more recently been a focus, the speed at which the market turned caught many off guard. Initial reactions generated one-off costs: redundancies, contract payouts, etc, and the anticipated savings from suspension of activities and deferral of projects are yet to be reflected in the results.

Of the 34 producers within the top 50, only nine managed to improve gross margins; five of which were gold miners, three were coal miners, and one was a uranium miner. This was an unsurprising result in light of the stellar revenue growth for this group.

Of the 34 producers within the top 50 only 9 managed to improve gross margins, five of which were gold miners, three were coal miners, and one uranium miner, an unsurprising result in light of the stellar revenue growth for this group.

## Impairments

With the decline in commodity markets, the considerable increase in impairment charges comes as no surprise. OZ Minerals and Paladin Energy alone account for \$3.5 billion of the total impairment charge.

Nineteen of the top 50 companies have booked impairments in the period. With the recent renewed world optimism, and the continued industrialisation and urbanisation of China and India, the rebound in commodity prices may well be sustained. This will provide a platform for impairment reversals in the forthcoming reporting season. Of course, as OZ Minerals sold most of its assets to Minmetals, we will not see impairment reversals for this in future reports.

## Gains on sale

The advent of the financial crisis placed great strain on the balance sheet for many of the mid-tier 50. Many companies of the 50 had some form of capital restructure by way of asset sale, debt or equity-raising.

However, the largest gain on sale was New Hope Coal's \$2.4 billion pre-GFC sale of New Saraji to BHP Mitsubishi Alliance (BMA).

## Income tax expense

The New Saraji sale transaction gave rise to an income tax charge of \$722m. Excluding this one off tax expense generated by this transaction the income tax expense and therefore government takings are vastly reduced from the prior years – a reflection of how quickly the change swept the industry.

## The two tiers of miners

The gross margin for the gold and energy miners increased from 27% to 31% in 2009. The other miners' margins were shattered from 36% to 11% further illustrating the varied fortunes between these two groups.

The recovery from the depths of the crisis has begun. The commodity price rebound for copper, nickel and zinc will come as a relief for those producers in the mid-tier 50. Only a sustained increase in the Australian dollar price will allow these miners to claw back the losses.

With some analysts forecasting the gold price to continue to hold at around the US\$1,000 per ounce level the strong results for these producers are expected to continue, again subject to exchange rate movements.

The renegotiated coal prices in April 2009 have only been reflected in the results for three months, although the market capitalisations have been severely hit. The continued industrialisation of the world's two most populous countries will continue to support demand for both coking and thermal coals. The impact of the lower contract prices and any sustained appreciation in the Australian dollar will bring challenges to the coal miners. The fog of the Emissions Trading Scheme continues to hang over all the mid-tier 50 and is especially thick around the coal miners.

## Foreign exchange

The volatility in foreign exchange is illustrated below. The significant depreciation in the Australian dollar during the 2009 financial year alleviated the revenue pressure for most in the mid-tier 50. The AUD to USD exchange rate has continued its closely negative correlation with commodity prices. Since June, however, the Aussie dollar has strengthened which could negatively impact those with long term fixed price contracts – such as coal and iron ore miners.

| Commodity | AUD average spot price movement | USD average spot price movement |
|-----------|---------------------------------|---------------------------------|
| Gold      | 28%                             | 6%                              |
| Cooper    | -23%                            | -33%                            |
| Nickel    | -43%                            | -51%                            |

Table 9: Commodity price movements  
Source: Bloomberg

Movement in Copper, Nickel and Gold prices (AUD) - July 2007 to September 2009 (July 2007 = 1)

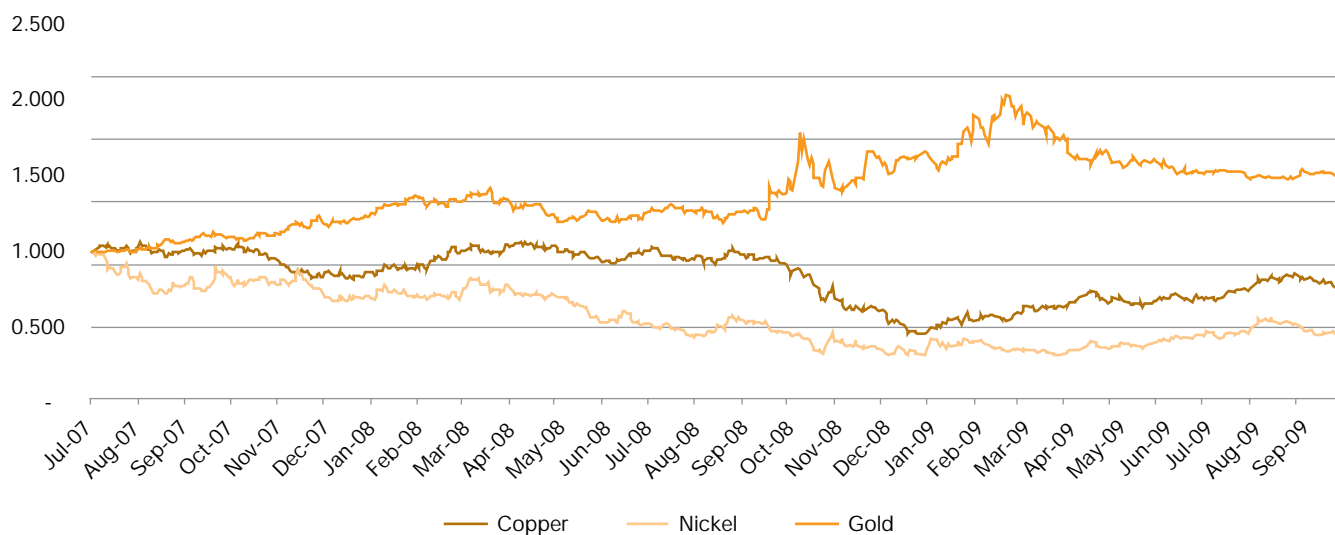


Table 7: Nickel, Copper and Gold prices indexed (July 07 = 1) July 07 – September 09  
Source: Bloomberg

Coal Contract Price versus Spot Price (\$/tonne) - July 2007 - September 2009

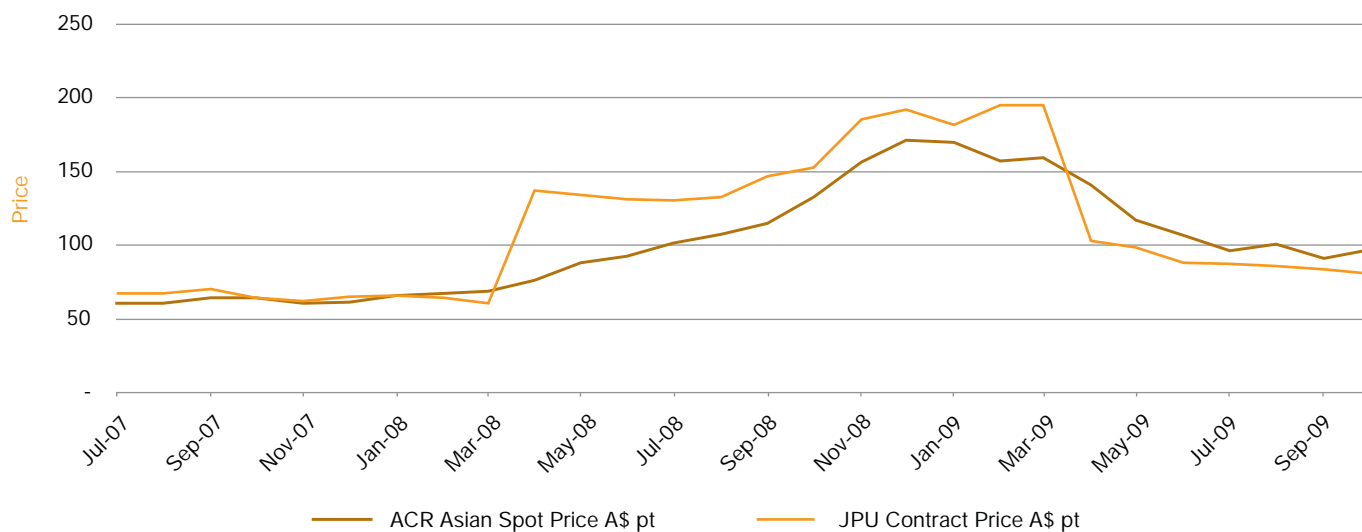


Table 8: Coal spot vs. coal contract prices (A\$/tonne and US\$/tonne) July 07 – September 09  
Source: Bloomberg

AUD/USD exchange rate - July 2007 - September 2009



Table 10: Australian dollar vs. United States dollar price fluctuations (July 07 = 1) July 07 – September 09  
Source: Bloomberg



### Top five mid-tier 50 companies by revenue

|                 | 2009 A\$m | 2008 A\$m | Change % |
|-----------------|-----------|-----------|----------|
| Iluka           | 1,069     | 956       | 12%      |
| OZ Minerals     | 971       | 653       | 49%      |
| Centennial Coal | 895       | 770       | 16%      |
| Felix Resources | 784       | 585       | 34%      |
| Macarthur Coal  | 757       | 405       | 87%      |

The top five companies account for 40% of the total revenue. Macarthur Coal and Felix Resources have joined the list with Coal companies now dominating it. Straits Resources have left the list following their divestment of their metals trading business and Aquarius Platinum has been overtaken by others.

### Top five mid-tier 50 companies by profit

|                               | 2009 A\$m | 2008 A\$m | Change % |
|-------------------------------|-----------|-----------|----------|
| New Hope Corporation Limited  | 1,950     | 90        | 2062%    |
| Felix Resources               | 268       | 188       | 42%      |
| Whitehaven Coal               | 244       | 49        | 399%     |
| Energy Resources of Australia | 222       | 76        | 191%     |
| Macarthur Coal                | 168       | 72        | 133%     |

There are three new entrants to the top five profits list: New Hope, Macarthur Coal and Whitehaven Coal have entered the list displacing Aquarius Platinum, Centennial Coal and Alumina. The top five by profit for 2009 is made up exclusively of energy companies. A combination of their size and the recent commodity prices sets them apart from their peers.

Divestments and asset sales have had a part to play in New Hope Coal who recorded \$2.4 billion profit on a transaction and also for Whitehaven following divestment of 15% of Narrabri.

## 6.2 Balance Sheet

| Current Assets  | 2009 A\$m     | 2008 A\$m     | Change %   |
|---|---------------|---------------|------------|
| Cash  | 4,462         | 4,442         | 0%         |
| Investments held to maturity                              | 2,487         | 172           | 1343%      |
| Debtors   | 1,750         | 1,766         | -1%        |
| Inventories   | 1,914         | 1,305         | 47%        |
| Other   | 769           | 894           | -14%       |
| <b>Total current assets</b>                               | <b>11,381</b> | <b>8,580</b>  | <b>33%</b> |
| Non Current Assets  |               |               |            |
| Investments in associates and joint ventures              | 4,586         | 3,370         | 36%        |
| Deferred taxation assets                                  | 543           | 251           | 116%       |
| Property, plant and equipment and capitalised exploration | 21,207        | 16,291        | 30%        |
| Intangible assets   | 431           | 508           | -15%       |
| Other   | 1,640         | 1,317         | 24%        |
| <b>Total non-current assets</b>                           | <b>28,406</b> | <b>21,738</b> | <b>31%</b> |
| <b>Total Assets</b>                                       | <b>39,788</b> | <b>30,317</b> | <b>31%</b> |
| Current Liabilities                                       |               |               |            |
| Accounts payable & accrued liabilities                    | 2,302         | 2,119         | 9%         |
| Taxes payable   | 1,283         | 402           | 219%       |
| Borrowings  | 2,417         | 1,538         | 57%        |
| Other   | 589           | 446           | 32%        |
| <b>Total current liabilities</b>                          | <b>6,591</b>  | <b>4,504</b>  | <b>46%</b> |
| Non Current Liabilities                                   |               |               |            |
| Borrowings  | 3,774         | 3,302         | 14%        |
| Deferred taxation liabilities                             | 1,317         | 1,632         | -19%       |
| Provision for environmental rehabilitation                | 1,247         | 871           | 43%        |
| Other   | 326           | 433           | -25%       |
| <b>Total non current liabilities</b>                      | <b>6,663</b>  | <b>6,238</b>  | <b>7%</b>  |
| <b>Total Liabilities</b>                                  | <b>13,254</b> | <b>10,743</b> | <b>23%</b> |
| <b>Net Assets</b>   | <b>26,533</b> | <b>19,575</b> | <b>36%</b> |

## Key balance sheet ratios

| Ratio   | 2009  | 2008  |
|---|-------|-------|
| Debt-to-equity ratio                                | 18.9% | 19.8% |
| Debt-to-equity ratio (leveraged companies only)     | 23.7% | 23.5% |
| Net debt to equity ratio                            | 6.1%  | 2.0%  |
| Net debt to equity ratio (leveraged companies only) | 9.3%  | 12.5% |
| Current ratio                                       | 1.73  | 1.90  |
| Quick ratio   | 1.44  | 1.62  |
| Net debt (borrowings less cash)                     | 1,728 | 398   |

Net Assets for the mid-tier 50 have increased by 36% since June 2008 to \$26 billion. Total assets increased 31% compared with an increase in total liabilities of only 23%.

## Property, plant and equipment and capitalised exploration expenditure

Total assets for the mid-tier 50 have increased 31% since 2008 to \$34.9 billion. This is primarily driven by further investment in property, plant and equipment (PPE) and capitalised exploration expenditure which increased by 30%. When we break this down further the amount of capitalised exploration and development expenditure is marginally lower (down 4%) whilst PPE has increased by 60%. The biggest increase comes from OZ Minerals as the Zinifex acquisition and development of Prominent Hill added an extra \$2.4 billion of PPE to their balance sheet. If this impact is removed there remains a 30% increase which is due to a handful of companies transitioning from explorer to producer and all increasing PPE by more than 100%. Interestingly, the lion's share of these developments was offshore.

## Investments in associates and joint ventures & investments held to maturity

Further investment related influences on the mid-tier 50 balance sheet were the increase of \$1.1 billion in the carrying value of Alumina's investment in the AWAC JV assets and the proceeds received by New Hope resulting from the sale of its New Saraji Project to BHP Billiton Mitsubishi Alliance (BMA) of \$2.4 billion.

## Gearing

Of the mid-tier 50, the debt-free proportion remained at nineteen companies, with three companies reducing debt levels to nil and three companies taking on debt from a nil balance. Debt to equity ratios for companies utilising borrowings during some or all of the period marginally increased, reversing the trend to lower levels of debt noted in our previous two updates.

Overall, borrowings increased in 2009 by \$1.3 billion. 94% of this increase can be explained by three companies: OZ Minerals, PanAZust, and Mirabela Nickel. Subsequent to its December year end OZ Minerals has paid down 100% of its debt, PanAust (another December year end) has also reduced its debt, whilst Mirabela increased debt to further establish its Brazilian mine. Other smaller instances of debt-raising were used principally to refinance debt and finance capital expenditure, while the cost of new borrowings increased.

There can be little doubt that whilst overall the gearing ratio looked on par, there were many nasty tales through the year that could be told. Banks were more risk averse, and significant debt refinancing was needed. This drove many companies to the precipice. We must learn the hard lesson from this episode and manage bank funding and relationships more carefully in future. It is also a challenge to bankers to see and understand the cyclical nature of this industry in their decision making.

## Equity raisings

Cash proceeds from the issue of ordinary shares were \$3.6 billion, an increase of 27% from 2008. Equity raisings were used primarily to fund capital expenditure investments and to pay down debt facilities, with excess cash balances being maintained to fund future development projects.

Top five mid-tier 50 companies, proceeds from share issuances were as follows:

| Company name             | 2009 \$Am |
|--------------------------|-----------|
| Alumina Limited          | 1,072     |
| Iluka Resources Limited  | 340       |
| Sino Gold Limited        | 312       |
| Minara Resources Limited | 210       |
| Macarthur Coal Limited   | 185       |

## 6.3 Cash flow statement

|   | 2009 A\$m      | 2008 A\$m      | Change %    |
|---|----------------|----------------|-------------|
| <b>CASH FLOWS GENERATED FROM OPERATIONS</b>                 |                |                |             |
| Cash generated from operations                              | 3,276          | 3,621          | -10%        |
| Net borrowing costs   | (373)          | (284)          | 31%         |
| Other   | 305            | 123            | 149%        |
| Income taxes (paid)/refunded                                | (462)          | (714)          | -35%        |
| <b>Net operating cash flows</b>                             | <b>2,747</b>   | <b>2,745</b>   | <b>0%</b>   |
| <b>CASH FLOWS RELATED TO INVESTING ACTIVITIES</b>           |                |                |             |
| Purchases of property, plant and equipment                  | (5,422)        | (2,926)        | 85%         |
| Exploration expenditure                                     | (860)          | (1,000)        | -14%        |
| Purchases of investments and intangibles                    | (34)           | (1,176)        | -97%        |
| Other   | (285)          | 22             | -1380%      |
| Proceeds from sale of property, plant and equipment         | 2,524          | 116            | 2072%       |
| Proceeds from sale of investments                           | 740            | 1,777          | -58%        |
| <b>Net investing cash flows</b>                             | <b>(3,338)</b> | <b>(3,186)</b> | <b>5%</b>   |
| <b>CASH FLOWS RELATED TO FINANCING ACTIVITIES</b>           |                |                |             |
| Proceeds from ordinary share issues                         | 3,599          | 2,833          | 27%         |
| Net borrowings  | 314            | 874            | -64%        |
| Distribution to shareholders                                | (1,116)        | (2,633)        | -58%        |
| Other   | (315)          | (165)          | 90%         |
| <b>Net financing cash flows</b>                             | <b>2,482</b>   | <b>909</b>     | <b>173%</b> |
| <b>Net increase/(decrease) in cash and cash equivalents</b> | <b>1,890</b>   | <b>468</b>     | <b>304%</b> |

Note: The main reconciling item between this cash flow statement is the effect of foreign exchange. We also note that the balance sheet item "Investments held to maturity" is a cash term deposit relating to proceeds from New Hope's New Saraji disposal the impact of which was passed through the proceeds from sale of property plant and equipment within New Hope's financial statements.

## Operating cash flows

The first half of the period saw a reduction in operational performance across the mid-tier 50 miners as a result of weakened commodity prices, falling demand and higher operating costs. A steady second half recovery, underpinned by renewed economic optimism and a recovery in commodity prices assisted to smooth the overall net operating position.

Net cash flow from operating activities remained constant in 2009 at \$2.7 billion. Cash generated from operations fell by 10%. This is consistent with the 9% decline in operating profit for the period. Growth from the key coal miners, specifically Felix Resources, New Hope Corporation, Macarthur Coal and Whitehaven Coal, resulting from high negotiated contract prices and production capacity expansions in 2007/08, helped to curb significant declines in the net operational performance of the sector. Interestingly it was only the gold, uranium and coal producers within the sector that actually contributed towards any positive operating cash flows.

Looking forward, operating cash flows in the industry may be reduced due to lower negotiated contract prices, entered into in the third and fourth quarters of FY09, and a strengthening Australian dollar. Demand for commodities, however, will remain strong on the back of robust economic growth in China and India, following the announcement of economic stimulus packages focusing on immediate infrastructure development. Further expansions of key mine production capacities, resulting from renewed equity market confidence and economic optimism, will further expand production capacity and supply into 2009/10, with a flow-on benefit evident on the bottom line of the sector.

## Investing cash flows

Despite the adverse economic conditions and reduced credit availability prevalent throughout the market, the net investing cash flows for the sector increased from \$3.1 billion in 2008 to \$3.3 billion in 2009, representing a growth of 5%. This small increase, however, masks an increase of 85% in outlays on the sector acquisitions of PPE, increasing \$2.5 billion year-on-year. The biggest investors were OZ Minerals, Mirabela Nickel, Paladin Energy and Centamin Egypt.

The high level of capital expenditure by and large reflects sector consolidations, particularly the Oxiana and Zinifex merger (\$1.4 billion) which represented 26% of the gross outlay on PPE during the year. Expenditure commitments entered into prior to the global downturn were also a significant driver for the positive movements. Paladin Energy was a prime example of this, commencing production at its African Kayalekera uranium mine in April 2009 after a long development process. Uptake of Government incentives offered under the National Stimulus Plan, incorporating the Small Business and General Tax Break (Investment Allowance), was also a likely influence on the growth.

Exploration expenditure investments varied within the sector: however, it was clear that the brunt of the tightened capital markets was borne predominantly by the explorers and junior miners, facing an average 42% contraction in their exploration spend. The cashed-up players, comprising the top half of the group, comparatively increased spending by 13%. Due to the necessity of feasibility projects for business continuance, and with little or no income producing developments, it begs the question as to how such companies will fare in time.

## Top five mid-tier 50 companies: growth in cash outflow from investing activities

| Company name             | 2009 A\$m | 2008 A\$m | Change % |
|--------------------------|-----------|-----------|----------|
| Felix Resources Limited  | 105       | 24        | 338      |
| Gloucester Coal Limited  | 35        | 9         | 285      |
| Mirabela Nickel Limited  | 513       | 178       | 188      |
| Gindalbie Metals Limited | 84        | 30        | 183      |
| Lynas Corp Limited       | 105       | 39        | 169      |

Cash flow from investment sale proceeds reduced during the period by 58% reflecting a general reduction in market values across the sector, and directing companies to retain rather than divest company assets. An obvious exception to this however, was the New Hope Corporation sale of the New Saraji mining tenement to BMA coal for \$2.4 billion.

With the prevalence of low credit availability continuing and market conditions strengthening, companies will look for equity partners to fund development and exploration. Infrastructure deficiencies in key development areas, such as the Northern Bowen Basin, Pilbara and Hunter regions, will continue to prevail as a major constraint to the forecast growth of the sector. Industry consortiums will rally to lobby Government's to expedite infrastructure projects, with proportional private equity investment used as a sweetener to firm up Ministerial commitment.

## Small Business and General Tax Break (Investment Allowance)

On 12 December 2008, the Federal Government announced the introduction of a temporary tax concession for small and large businesses, providing a significant one off benefit, by way of tax deduction, to those taxpayers committed to the acquisition of qualifying tax depreciable assets for the period to 31 December 2009.

The Investment Allowance measures were introduced as an incentive for businesses to help boost economic activity. Whilst the immediate effects of the measures are not certain most businesses within the sector implemented planning strategies to maximize their exposure to the available incentives.

Credit shortages and an unachievable time frame, however, adversely impacted the uptake of the allowance. Nevertheless, investment cash flows will see extended growth as the uptake of the reduced allowance benefit (10% tax deduction) continues to 31 December 2009.

## Financing cash flows

The net increase in financing cash flows of 173% for the period was underpinned by share issues and a reduction in share buy-back arrangements.

Overall payments to shareholders decreased by 58%. Cessation of share buy-back arrangements contributed \$1.5 billion of the reduction, and dividends remained relatively stable year-on-year. Pressure to retain cash has put increased strain on all discretionary expenditure, which resulted in a number of companies announcing a suspension of their dividends in the first quarter.

## Top mid-tier companies – December year-ends

Overall, the December year-end participants tended to follow a similar path to that of the aggregated sector. It is worthwhile to note that the cash flows resulting from share issuances within the group accounted for 59% of the total sector. The majority of this capital was used to finance capital expenditure and investment acquisitions.

The December year-end participants, however, also make up a significant proportion of the total market capitalisation value of the sector. Large capital raisings, by way of share issuance or debt finance, are commonplace as an ongoing means of funding capital intensive operations and growth strategies.



## Tax and other considerations – inbound investment in Australia's mining industry

### Background

The following discussion provides an overview of just some of the taxation and other considerations which should be taken into account by an Australian entity (which we will refer to as 'Target Entity' or 'Target') during transaction negotiations. Specifically, this article focuses on the implications of an issue of debt or equity, or a disposal of a minority interest in underlying project assets to an offshore investor. This can be contrasted with the situation where a change of control occurs as a consequence of a takeover.

### Repatriation of profits – debt versus equity funding

Whilst commercial factors such as cost of funding and risk profile will tend to dictate the form of any inbound investment, significant value can be created for the investor through appropriate management of tax exposures on repatriation of the returns paid in respect of the investment.

The financing instruments employed to fund an investment will typically be determined based on a mix of factors including for example the tax deductibility of returns paid by the Target and the long term objectives of the party seeking to invest. For example whilst debt finance will generally give rise to tax deductions for interest paid in Australia, the longer term benefits of ownership will obviously not accrue to the investor (this may be acceptable where, for example, the investor is simply seeking an off-take arrangement). Conversely, dividend payments will generally not be tax deductible, yet the investor will likely have a voting interest and be exposed to greater upside or downside risk.

The Australian tax regime also seeks to levy tax on distributions made to non-residents. This is typically achieved through the withholding tax regime. While the withholding tax rate applied to any returns may be reduced under Australia's Double Taxation Agreements (DTA), careful consideration of the funding structure employed in the context of the broader commercial transaction, may serve to reduce the overall Australian tax burden.

Where cash is repatriated by way of a return of capital or the repayment of loan principal (generally not subject to withholding tax), specific considerations will need to be addressed to ensure no part of that return triggers untoward tax or other consequences.

In addition, factors such as the thin capitalisation regime (which may operate to cap the amount of interest and other costs able to be claimed as a deduction) and any capital gains tax (CGT) implications arising as a result of the chosen funding mix will be

of particular concern for the Target Entity. Careful planning and consideration of these factors in advance of any investment from offshore will assist the Target Entity to mitigate any potentially adverse tax consequences.

### Transfer Pricing

With increases in cross border investment, and the international trade in goods and services becoming more and more prevalent, governments around the globe have sought to protect their existing tax base by implementing transfer pricing legislation. In this regard, transfer pricing consistently ranks as a key tax risk for international tax directors, and must be considered as part of any inbound investment structure.

The current transfer pricing rules contained in Australia's taxation regime are designed to address the potential under-payment of Australian tax by enterprises involved in cross-border related party transactions. The rules require that any such transactions take place on an arm's length basis with appropriate documentation in place as evidence of this approach – a requirement which is becoming increasingly difficult and complex.

For the Target Entity, care must be taken to ensure that transactions with foreign related parties (e.g. the sale of commodities or loans) are regarded as commercial and carried out at arm's length, to ensure that transfer pricing requirements are adhered to.

### Formation of joint ventures

From an investment point of view, the Australian tax consolidation regime attempts to ensure that little difference exists between purchasing the underlying project assets held by a company and a purchase of the shares in that company. The regime can offer benefits to investors seeking to obtain interests in Australian resident companies through potential uplifts to the tax cost of underlying assets, as well as streamlining the compliance burden of Australian corporate groups. In general terms however, these outcomes will only arise where 100% of the shares in a company are held.

Depending on the financing structure employed for an inbound investment and the original holding structure of the Australian assets, a Target Entity may face a significant tax impost by way of the "deconsolidation" of a wholly owned subsidiary, resulting in a potential CGT exposure. This situation will typically arise where a decision is taken to form an incorporated joint venture using a subsidiary which is presently a wholly owned member of the corporate group. This could be achieved via a sale of existing shares or an issue of new shares in the subsidiary. Appropriate structuring of group assets and negotiation of transaction details

# Foreign investment – implications for Australian companies

by the Target Entity, may serve to limit the potential Australian tax exposure encountered by the Target as a result of an inbound investment in this form.

Similar taxation exposures can also arise where an Unincorporated Joint Venture is formed with an investor via a sell down or farm-out of underlying project assets. In this regard it should be noted that significant uncertainty presently exists in relation to the appropriate taxation treatment of farm-out arrangements.

## Inbound Capital Gains Tax (CGT)

To encourage foreign investment into Australia, a range of concessions were implemented to reduce the potential CGT exposure of non-resident investors disposing of assets located in Australia. Specific rules now allow foreign tax residents an exemption from Australian CGT on a disposal of Australian assets in many circumstances.

However, there are circumstances where a foreign resident investor would be subject to Australian CGT. This will be where the underlying asset is classed as 'Taxable Australian Property' (TAP). Broadly, TAP includes:

- Real property assets (i.e. mining rights, land and buildings located in Australia);
- Shares in an Australian company holding predominantly real property assets; or
- Either of the above held by an Australian permanent establishment of a foreign resident.

The underlying Australian assets of a resource company would generally comprise real property assets. Hence, a disposal of shares in a Target Entity by a foreign investor would typically create an exposure to Australian CGT for that investor. However, depending on the specific circumstances surrounding the investment there may be opportunities for non-resident investors to gain access to the CGT concessions.

An understanding of a foreign investor's tax drivers given the above rules will assist a Target Entity during the negotiation of a final investment structure.

## Tax losses

As a result of the economic downturn, dwindling tax revenues have triggered renewed interest by the Australian Taxation Office (ATO) in the tax losses held and carried forward by Australian companies, particularly small to medium enterprises. Broadly, tax losses may be offset against future assessable income, to

the extent that certain loss integrity rules continue to be satisfied, namely the Continuity of Ownership Test (COT) and the Same Business Test (SBT). The acquisition of interests in a Target Entity by foreign residents may see significant changes to its shareholder base, thereby jeopardising the value of carried forward tax losses.

Due to the strict application of these rules, concerns over the future availability of losses can arise where an interest in the Target Entity is transferred. In situations where tax losses are recorded in the accounts of an entity as deferred tax assets or used to offset existing tax liabilities, a cancellation of these losses will result in the derecognition of any such assets with a corresponding negative profit and loss impact.

A cancellation of losses combined with the potential to generate taxable gains (described above), can rapidly lead to a cash tax cost for the Target Entity.

Due to the inherent uncertainty concerning the availability of tax losses, investors tend to attribute little or no value to them. Notwithstanding this, with significant potential benefit available from such losses, the Target Entity should seek certainty about respect to the integrity of their carry-forward loss balances

## Looking forward

The Australian taxation system is poised for a major overhaul. Australia's Future Tax System Review, or as it is popularly called, the Henry Review, will look to propose reform based on experiences learned from the recent period of intense macroeconomic challenge and global upheaval resulting from the global financial crisis. A notable outcome of this review being a potential revision of taxes levied upon the Australian resources sector. It seems likely that this will include a federal 'resource rent tax' (i.e. a tax on "super-profits") combined with a continuation of income tax albeit at a lower corporate tax rate. The hope is that these amendments will result in more equitable returns to the community and investors based on earnings generated from the exploitation of natural resources.

The valuable opportunities that have arisen as a result of the current economic climate, combined with the perceived political stability of Australia, are likely to stimulate ongoing interest in the Australian resources sector from offshore. Therefore, the time is right for Australian companies to prepare themselves well for the opportunities presented by the renewed interest in inbound investment.

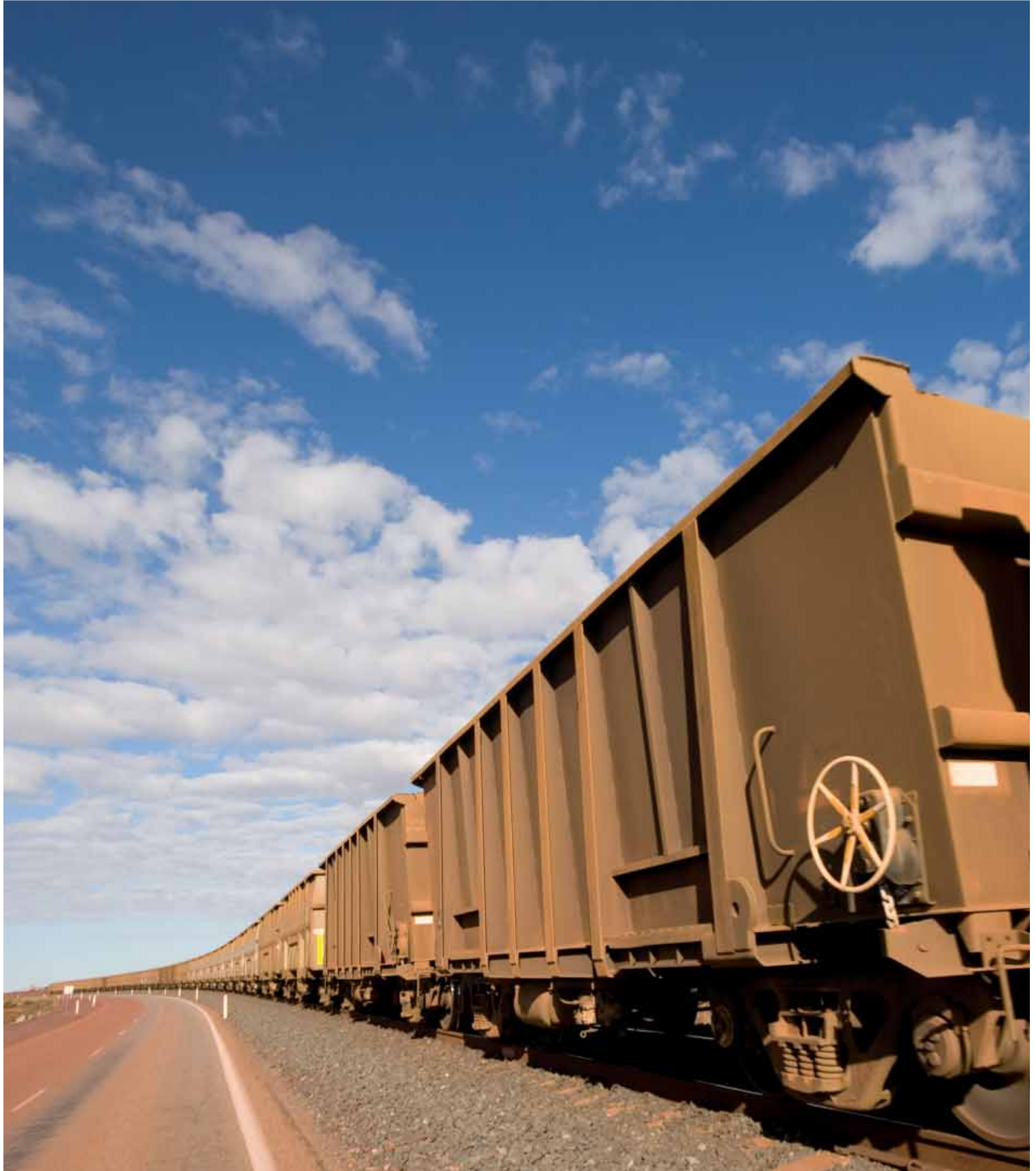
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# 8



# Glossary

## ABARE

The Australian Bureau of Agricultural and Resource Economics

## AIFRS

Australian equivalent to International Financial Reporting Standards

## Current ratio

Current assets divided by current liabilities

## EBITDA

Earnings before interest, tax, depreciation and amortisation

## Debt to equity

Borrowings divided by borrowings plus shareholders equity

## Gross profit

Revenue minus expenses from ordinary activities and exploration

## Gross margin

Gross profit divided by revenue

## Market capitalisation

The market value of the equity of the company, calculated as the share price multiplied by the number of shares outstanding

## Net borrowings

Total borrowings less cash and cash equivalents

## Net debt to equity

Net borrowings divided by net borrowings plus shareholders equity

## Quick ratio

Current assets less inventories divided by current liabilities

## Return on equity

Net profit divided by total closing equity

# 9

| Symbol | Entity Name                           | Year end  | Market Capitalisation<br>as at 30/06/09 A\$m | Rank by Market<br>Capitalisation | Producer (P)/<br>Non-Producer (N) |
|--------|---------------------------------------|-----------|--|----------------------------------|-----------------------------------|
| AGO    | Atlas Iron Limited                    | 30-Jun-09 | 570.7  | 27                               | N                                 |
| AND    | Andean Resources Limited              | 30-Jun-09 | 705.3  | 23                               | N                                 |
| AQA    | Aquila Resources Limited              | 30-Jun-09 | 1,434.4                                      | 12                               | P                                 |
| AQP    | Aquarius Platinum Limited             | 30-Jun-09 | 2,332.6                                      | 7                                | P                                 |
| ARH    | Australasian Resources Limited        | 30-Jun-09 | 238.9  | 49                               | N                                 |
| AVO    | Avoca Resources Limited               | 30-Jun-09 | 453.3  | 32                               | P                                 |
| AWC    | Alumina Limited                       | 31-Dec-08 | 3,526.1                                      | 3                                | N                                 |
| BMN    | Bannerman Resources Limited           | 30-Jun-09 | 226.9  | 50                               | N                                 |
| CDU    | Cudoco Limited                        | 30-Jun-09 | 346.2  | 41                               | N                                 |
| CEY    | Centennial Coal Company Limited       | 30-Jun-09 | 919.5  | 19                               | P                                 |
| CGX    | CGA Mining Limited                    | 30-Jun-09 | 390.3  | 36                               | N                                 |
| CNT    | Centamin Egypt Limited                | 30-Jun-09 | 1,774.4                                      | 8                                | N                                 |
| CZA    | Coal of Africa Limited                | 30-Jun-09 | 659.0  | 25                               | P                                 |
| DOM    | Dominion Mining Limited               | 30-Jun-09 | 474.8  | 30                               | P                                 |
| DYL    | Deep Yellow Limited                   | 30-Jun-09 | 376.3  | 37                               | N                                 |
| ERA    | Energy Resources of Australia Limited | 31-Dec-08 | 4,463.3                                      | 1                                | P                                 |
| EXT    | Extract Resources Limited             | 30-Jun-09 | 1,487.5                                      | 11                               | N                                 |
| FLX    | Felix Resources Limited               | 30-Jun-09 | 2,789.5                                      | 6                                | P                                 |
| GBG    | Gindalbie Metals Limited              | 30-Jun-09 | 396.2  | 35                               | N                                 |
| GCL    | Gloucester Coal Limited               | 30-Jun-09 | 426.2  | 34                               | P                                 |
| GNM    | Gujarat Nre Minerals Limited          | 31-Mar-09 | 449.6  | 33                               | P                                 |
| IGO    | Independence Group NI                 | 30-Jun-09 | 526.0  | 28                               | P                                 |
| ILU    | Iluka Resources Limited               | 31-Dec-08 | 1,197.5                                      | 14                               | P                                 |
| KCN    | Kingsgate Consolidated Limited.       | 30-Jun-09 | 644.1  | 26                               | P                                 |
| KZL    | Kagara Limited                        | 30-Jun-09 | 303.5  | 46                               | P                                 |
| LYC    | Lynas Corporation Limited             | 30-Jun-09 | 304.5  | 45                               | N                                 |

# Mid-tier 50 companies analysed

| Symbol | Entity Name                  | Year end  | Market Capitalisation<br>as at 30/06/09 A\$m | Rank by Market<br>Capitalisation | Producer (P)/<br>Non-Producer (N) |
|--------|------------------------------|-----------|--|----------------------------------|-----------------------------------|
| MBN    | Mirabela Nickel Limited      | 30-Jun-09 | 730.2  | 22                               | N                                 |
| MCC    | Macarthur Coal Limited       | 30-Jun-09 | 1,610.3                                      | 9                                | P                                 |
| MCR    | Mincor Resources NI          | 30-Jun-09 | 308.5  | 44                               | P                                 |
| MDL    | Mineral Deposits Limited     | 30-Jun-09 | 349.3  | 40                               | P                                 |
| MGX    | Mount Gibson Iron Limited    | 30-Jun-09 | 967.7  | 18                               | P                                 |
| MML    | Medusa Mining Limited        | 30-Jun-09 | 374.5  | 38                               | P                                 |
| MMX    | Murchison Metals Limited     | 30-Jun-09 | 693.9  | 24                               | N                                 |
| MRE    | Minara Resources Limited     | 31-Dec-08 | 975.1  | 17                               | P                                 |
| NHC    | New Hope Corporation Limited | 31-Jul-09 | 3,721.5                                      | 2                                | P                                 |
| OZL    | Oz Minerals Limited          | 31-Dec-08 | 2,871.6                                      | 5                                | P                                 |
| PAN    | Panoramic Resources Limited  | 30-Jun-09 | 463.1  | 31                               | P                                 |
| PDN    | Paladin Energy Limited       | 30-Jun-09 | 3,073.8                                      | 4                                | P                                 |
| PLA    | Platinum Australia Limited   | 30-Jun-09 | 267.5  | 48                               | N                                 |
| PNA    | PanAust Limited              | 31-Dec-08 | 845.4  | 20                               | P                                 |
| RIV    | Riversdale Mining Limited    | 30-Jun-09 | 1,004.5                                      | 16                               | P                                 |
| SBM    | St Barbara Limited           | 30-Jun-09 | 343.6  | 42                               | P                                 |
| SDL    | Sundance Resources Limited   | 30-Jun-09 | 325.8  | 43                               | N                                 |
| SGX    | Sino Gold Mining Limited     | 31-Dec-08 | 1,514.6                                      | 10                               | P                                 |
| SLV    | Sylvania Resources Limited   | 30-Jun-09 | 290.7  | 47                               | P                                 |
| SMM    | Summit Resources Limited     | 30-Jun-09 | 368.4  | 39                               | N                                 |
| SRL    | Straits Resources Limited    | 30-Jun-09 | 518.1  | 29                               | P                                 |
| WHC    | Whitehaven Coal Limited      | 30-Jun-09 | 1,278.7                                      | 13                               | P                                 |
| WSA    | Western Areas NI             | 30-Jun-09 | 1,053.6                                      | 15                               | P                                 |
| ZIM    | Zimplats Holdings Limited    | 30-Jun-09 | 828.8  | 21                               | P                                 |



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## Explanatory notes




We have analysed the largest 50 mining companies listed on the ASX with a market capitalisation of less than \$5 billion at 30 June 2009. The results aggregated in this report have been sourced from publicly available information, primarily annual reports and financial reports available to shareholders. Companies have different year-ends and report under different accounting regimes.

Information has been aggregated for the financial years of individual companies and no adjustments have been made to take into account different reporting requirements and year-ends. As such, the financial information shown for 2009 covers periods between 1 January 2008 and 30 June 2009, with each company's results included for the 12-month financial reporting period that falls into this timeframe.

All figures in this publication are reported in Australian dollars, except where specifically stated. The results of companies that report in currencies other than the Australian dollar have been translated at the average Australian dollar exchange rate for the financial year, with balance sheet items translated at the closing Australian dollar exchange rate.

Some diversified companies undertake part of their activities outside of the mining industry. No attempt has been made to exclude such non-mining activities from the aggregated financial information.



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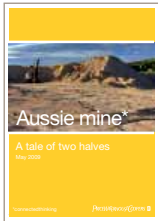
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## Other Mining Publications



### **Aussie Mine\* A tale of two halves** *May 2009*

Annual review providing a comprehensive analysis of the financial performance and position of the Australian mining industry.



### **Mining Deals\*** *2008 Annual Review*

Mining Deals 2008 reviews deal activity in the mining industry including industry trends.



### **Mine When the going gets tough** *A review of global trends in the mining industry* *June 2009*

Annual review providing a comprehensive analysis of the financial performance and position of the global mining industry.



### **Global Mine\* Bulletin**

Occasional e-newsletter focusing on current issues and emerging trends within the global mining industry.



### **Total Tax Contribution** *Study of the Global Mining Industry* *March 2009*

Study analysing the total taxes of fourteen of the world's largest mining companies, focusing on their largest operations in a variety of countries.



### **Improving safety performance in the Australian mining industry through enhanced reporting** *August 2008*

PwC believe that further progress can be achieved by improving the processes involved in capturing, analysing and sharing safety data. This paper outlines how this can be achieved by addressing 12 improvement opportunities in three main areas.



### **Finding cost efficiencies in mining operations through effective value driver modelling** *February 2009*

This paper highlights Australian mining best practice in both operations cost management and production value maximisation through robust modelling of operational value drivers.



### **Monetisation of Coal Assets Briefing Paper**

This briefing paper describes the alternative methods for creating value from coal assets, with particular focus on coal bed methane and coal to gas technologies.



### **Mining capital projects through effective project stage gating** *November 2008*

This paper highlights Australian coal mining industry best practice in major capital project management.



### **Global Mining Capability Statement 2009**

This publication discusses the key challenges mining companies face today and how PwC is helping them identify and implement solutions.

