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张百善律师事务所

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‘Financing Projects Using Off-take Deals’

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Introduction

- China's 12th Five Year Plan
 - Utilization of much of China's \$3trillion foreign currency reserves
 - Push for outbound investment in resources around the world but especially Australia
 - Securing long term supply of strategically important resources, often via project financing
 - China is setting global prices for all major minerals required to support its massive expansion

When did China's boom start?

- 2003 was the turning point when China's iron ore imports surpassed Japan's
- China also became the world's largest steel producer
- Initially China guaranteed iron ore sales

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Channar Mine and
Signing Ceremony

China's Special Demand for Key Commodities

- China is the world leader in commodity imports, especially iron ore and coal
- China's steel production in 2010 of 625 million tonnes represented around 45% of the world's production
- Chinese steel production has increased almost 300% in 7 years
- China's steel production in 2015 is expected to be 800 Million tonnes

Global Production STEEL	2003	2004	2005	2006	2007	2008	2009	2010e	2011e	2012e	2013e	2014e	2015e	2016e
% change Y-o-Y														
World ex-China	747	786	792	830	857	829	659	781	838	887	930	965	999	1033
% Change	3.7	5.1	0.8	4.8	3.2	-3.3	-20.5	18.6	7.3	5.9	4.8	3.8	3.5	3.4
China	222	283	353	419	489	500	568	627	666	698	725	753	762	769
% Change	21.9	27.2	24.9	18.7	16.7	2.3	13.5	10.4	6.2	4.8	3.9	3.8	1.2	1
Source: Steel Business Briefing, World Steel Institute, Morgan Stanley Research									e = Morgan Stanley Research estimates					

Global Production	2003	2004	2005	2006	2007	2008	2009	2010e	2011e	2012e	2013e	2014e	2015e	2016e
IRON ORE	1093	1200	1394	1572	1699	1680	1582	1778	1859	1970	2084	2265	2420	2542
Seaborne Iron Ore														
Demand by China	148	208	275	326	383	444	628	613	746	807	866	920	945	958
Source: CRU, UNCTAD, Tex Report, Steel Business Briefing, Morgan Stanley Research							e = Morgan Stanley Research estimates							

Project Financing of Overseas Chinese Projects

- First project financing in Australia dates back to iron ore export industry development in the 60's & 70's
- Japan acquired equity in iron ore projects to ensure supply sources
- China now uses project financing to underpin its massive investment in overseas projects

Project financing: Chinese overseas investments

- As a net importer of many commodities China's global efforts to secure product have facilitated the development of many overseas resources projects, especially in Australia.
- Recent trend for Chinese banks to fund Australian resource projects with JV assets and production providing the security via a Chinese JV partner

Sales Contracts to Underpin Project Financing

- Equity or contractual joint ventures
- In Australia, under a contractual JV, each party is entitled to take its own joint venture % share of the off-take to sell independently
- Requirement for separate sales contracts

The Iron Ore Pricing Mechanism

- Japanese used benchmarking to price contracts for ensuing 12 months until 2009
- In 2009 Chinese steel mills rejected the benchmark pricing system which has led to three big producers remodelling their pricing structures to indexed pricing

Future Pressures on Demand and Supply

- West Africa and Brazil ramping up supply
- Predicted that by 2015 world wide iron ore supply will exceed demand
- Prices expected to fall as a result
- Viability of new mine start-ups will be challenged

Conclusion

- The reliance on traditional bank funding for project financing is being replaced by Chinese investment
- Long term sales contracts remain valuable to provide security for project financing and ensure long term commodity supply

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