The brave new world where emerging regions begin jostling with Australia, Brazil or Canada as significant exporters of iron ore and coal appears a long-time coming, with the future of some flagship projects hanging in the balance and production timelines pushed way back.

Troubles at two of Rio Tinto’s projects this year appear emblematic of the challenges facing companies trying to develop untapped resources in emerging markets. Firstly, the Anglo-Australian miner announced a $3 billion writedown of its coking coal assets in Mozambique – a move which precipitated then-CEO Tom Albanese’s resignation in January. Then news broke that Rio was considering mothballing its $10 billion Simandou iron ore project in Guinea should the government of the West African country be unable to fund its share of finance required to build new port and rail infrastructure.

West Africa had been widely touted as “another Pilbara” – a reference to the resources-rich region of Western Australia – with Simandou set to be a jewel in the region’s newly polished iron ore crown. Rio insisted it could develop the African project in tandem with its capacity expansion program now underway in the Pilbara, believing crude steel production growth in China would justify the huge new volumes of iron ore the combined regions would produce. Though Rio has since adopted a more cautious outlook on China, unlike its major Australian rival BHP Billiton, the company remains a believer in Africa. However, with Rio’s Pilbara mines on track to produce 360 million mt/year of iron ore by 2015, and Chinese crude steel production starting to plateau, some industry watchers question whether a new 100 million mt/year supply hub in Africa is really necessary.

Among them is former BHP Chief Executive Marius Kloppers. “We believe production in Brazil and in Australia will be sufficient to meet [iron ore] demand,” he said in late 2012. Indeed, BHP wants to offload its Mount Nimba iron ore project in Guinea. Meanwhile, Brazilian mining giant Vale has put development of its portion of the Simandou deposit on

MINING
PAUL BARTHOLOMEW
Managing Editor
the back-burner, as agreement has yet to be reached with the Guinean government on logistics and other issues.

Along with large mining houses and a plethora of smaller or ‘junior’ explorers, China is expected to continue investing heavily in Africa and other emerging regions, particularly as getting projects off the ground in countries such as Canada and Australia has become so expensive. Central China’s Wuhan Iron & Steel has been an active investor in African iron ore projects; while Shandong Iron & Steel, CITIC and Aluminum Corporation of China Limited (Chalco) all own interests on the continent. The Beijing government, represented through the National Development and Reform Commission and other bodies, appears keen to encourage overseas investment in resources, despite China’s patchy track record of developing such projects to date.

But some industry experts in China warn that large-scale projects may be best left to the large international miners. They argue that new Australian iron ore supply coming this year provides a less compelling case for making potentially risky investments.

Wang Fuliang, vice president of Toronto-listed MagIndustries Corp, says Africa’s iron ore resources have great potential, “but political stability and huge infrastructure construction costs are major obstacles.”

Perth-headquartered Sundance Resources knows this only too well. The cost of developing its prospective 30+ million mt/year capacity Mbalm iron ore project – which borders Cameroon and the Republic of Congo – is what seems to be delaying Chinese investor Hanlong Mining’s long-held plan to acquire the Australian company. Hanlong is trying to enlist Chinese steel mills to help fund the $5 billion project, which requires 500 km of new railway and a new port. At this point, Mbalm’s 2016 production start-date seems optimistic.

The Australian government commodity forecaster, Bureau of Resources and Energy Economics, predicts South Africa will produce 50 million mt of iron ore in 2013 compared with 48 million mt last year. It sees little volume coming out of West Africa (Guinea and Mauritania) in the short-term, forecasting output of 12 million mt/year in 2013, up just 1 million mt/year from 2012.

The consensus among analysts is that Africa will become a major supplier of iron ore, but it will take much longer than previously estimated. Once feverish expectations have had to be tempered. But many, including Shanghai-based CLSA analyst Ian Roper, remain bullish on long-term
African supply: “There’s probably a bit of downside to my longer term forecasts given some of the project delays, but I’d still be confident in Africa producing 150-200 million mt (of iron ore) by 2016,” he told Platts.

It is not just African projects that are experiencing problems. Elsewhere, development of Mongolia’s coal and iron ore sectors appears to hinge on the outcome of new mining laws in the landlocked central Asian country. Among the draft proposals are plans to raise the tax rate on strategic deposits to beyond 50%, and to award the Mongolian government mandatory ownership of up to 34% of the country’s resources projects.

Sam Spring, head of corporate development for Mongolia-focused Vancouver-based Kincora Copper, fears exploration and development activity could slow dramatically if the draft minerals law is passed in its current form.

“It’s hard enough for explorers to raise money at the moment. When you overlay these new minerals laws, the impact on development of these resources projects could be significant,” he said.

Progress in Mongolia has already been slow enough. The country’s widely-touted Tavan Tolgoi coal deposit purportedly holds the world’s largest coal reserves at 6 billion mt, of which metallurgical coal comprises 1.2 billion mt. But little has happened since mid-2011 when the Mongolian government unofficially chose a consortium of several diverse firms – Chinese coal giant Shenhua Group and Mitsui & Co (40%), Peabody Energy (24%), and a Russian-Mongolian partnership (36%) – to jointly develop Tavan Tolgoi, 240 km from the Chinese border.

Indonesia has already introduced new mining regulations in a bid to retain greater ownership of the country’s resources and extract more value from its commodity exports. The country is the world’s largest exporter of thermal coal but it produces less than 10 million mt/year of coking coal. This could potentially rise to 40 million-50 million mt/year but will depend largely on whether companies have the confidence to develop the sector. Australia is on Indonesia’s doorstep and hosts the world’s most active explorers, but the country is generally wary of Indonesia and the latest raft of mining legislation has not helped alter this view. Most market watchers believe the changes to mining laws in Indonesia and Mongolia are politically motivated. Mongolia in particular is determined not to blow the one massive economic opportunity that developing its resources sector presents, and understandably Ulan Bator is obsessed with not ceding too much control to its neighbor China. But it needs to strike the right balance to encourage the investment that will see its assets developed.

Western companies balancing risk

For Western companies investing in overseas projects, it is also a “balancing act,” Perth-based RBS Morgans analyst James Wilson says.

“In jurisdictions such as Mongolia, Indonesia and Africa, there are rich untapped deposits, but they come with the associated risk of dealing with primitive mining codes, changes of government and political flashpoints,” he told Platts.
Along with sovereign risk, the other major factor determining the viability of new projects is the price of raw materials. Mining companies and investors need to know prices will stay strong over the longer-term to justify their investment. As prices slip and bring margins down with them, investors worry the commodity market is not as robust as previously believed and hold off making funding decisions. Price volatility – such as that seen in iron ore over the past 18 months – obliges companies seeking finance to present a more cautious long-term price outlook, which in turn can deter investors hoping for higher returns.

Despite the more circumspect financial environment, a PricewaterhouseCoopers mining report released late last year found exploration spend in emerging markets by the world’s top 40 mining companies was at record levels, while capex spend was also rising. The firm noted that 38% of these companies now have the bulk of their operations in emerging markets.

While PwC expects this trend to continue over the longer-term, Jock O’Callaghan, the firm’s Melbourne-based industry leader for Energy, Utilities & Mining, expects 2012 data to show a slowdown in investment activity. But he said assets in these regions require a long-term perspective, and therefore one year is a “very short period in trying to gauge overall confidence in a particular mining region.”

“It’s very much about the pace of which assets in these regions can be developed. No one has really challenged the geological aspects of these opportunities,” O’Callaghan said.

He expects China to continue investing in overseas projects. “Like the rest of the industry the Chinese won’t always get it right, but we’re not seeing any signs to suggest they’re turning around and saying ‘it’s all too hard.’ While that appetite remains it provides another wild card in the pack for the global miners, because if they choose not to support a project in an emerging market they may find they’ve lost it (to Chinese interests).”

Before it scaled back work at Simandou, Rio said it planned to take a “phased approach” to bringing on iron ore production at the project – which requires 650 km of new railway and a port – with a view to starting small-scale exports in 2015. Many analysts expect such a strategy to be adopted by other developers while market conditions remain uncertain.

There has been a tendency in a bull market for companies to plan large projects requiring suitably large capex, elevating the risk if prices slump. While the world’s major mining companies are only interested in developing sizeable projects, juniors could be better off getting their projects into production to generate cash flow to fund a phased expansion.

“Companies are cutting back their growth ambitions and focusing on cutting costs, so you’re probably going to see smaller projects coming on stream. I think the theme is low risk incremental expansion,” RBS Morgan’s Wilson says.

But PwC’s O’Callaghan notes that building a project in smaller chunks “doesn’t change the fundamentals of sovereign risk” in emerging regions.