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BHP, Vale Shift to Quarterly Iron Ore Prices

By REUTERS

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RIO DE JANEIRO/TOKYO/SYDNEY, March 30 (Reuters) - Vale and BHP Billiton (NYSE:BHP) have persuaded Japanese steel mills to buy iron ore based on a quarterly pricing system as of April 1, signalling the demise of annual fixed-price contracts analysts said were costing miners billions of dollars in lost revenue.

A final shift to quarterly pricing requires World No. 2 producer Rio Tinto to also replace annual prices, which it has said it hopes to do this year, with China's continued support for the benchmark unlikely to stem the move to more flexible pricing.

"The big one will be if Rio decides moving away to quarterly index pricing," said James Wilson, resource analyst for DJ Camichael & Co.

"That will be the end of (annual) benchmarking because Rio has almost all its sales on benchmark contracts," Wilson said.

BHP Billiton, the world's No. 3 iron ore producer, said on Tuesday it had agreed with Asian customers to shift pricing for the majority of its iron ore to shorter term contracts that would see sales based on market-cleared prices.

Vale has approved a tentative quarterly iron ore price deal with Asian steel companies that would boost prices by 90 percent.

It would mark the first quarterly deals for Vale, while BHP has long employed hybrid contracts for its customers.

The hike by Vale puts the price of ore at \$105 per tonne for Japan's Nippon Steel and South Korea's Posco (NYSE:PKX) versus the current benchmark, due to expire on Wednesday, of around \$62 a tonne.

"If that's the case, it's excellent, even though the market was already expecting \$100 to \$110. This will strongly increase revenues," said Pedro Galdi, an analyst with SLW Corretora. Spot iron ore

has more than doubled in price since September as steelmaking worldwide recovers from the financial crisis.

"That's good news for us because, like most iron ore producers, we are price takers and ride on the back of what the big boys' negotiate," said Garret Dixon, managing director of Gindalbie Metals, which next year will mine 10 million tonnes of iron ore in Australia for sale to China's Ansteel.

BHP chief Executive Marius Kloppers has pushed to change the rigid benchmark into a derivative-driven system similar to other global commodities such as oil. Vale Chief Executive Roger Agnelli is a more recent convert after defending the four-decade-old annual pricing system as the industry staple.

Some steel mills have resisted the call to move toward spot pricing, particularly in Europe and China, where they say recoveries in steel demand are tentative.

China's government has also thrown its weight behind the annual benchmark, with a Ministry of Industry and Information Technology official on Tuesday reiterating Beijing's opposition to flexible pricing.

But the acceptance by relatively conservative steel mills such as Nippon and POSCO shows the growing strength of the trend away from annual pricing.

CONTRACT? WHAT CONTRACT?

"The long-term contract worked for 90 years very well for both sides, for both the client and the miner," Agnelli told reporters in Sao Paulo.

"I think that model that we are proposing and talking about with clients, of quarterly averages, is helpful for us to be able to complete our investment projects."

China began buying on the spot market when prices fell below the benchmark when the financial crisis broke out but insisted miners honor the benchmark as spot prices soared.

"Last year when we thought we had a contract, most of our clients just looked at us and said 'Contract? What contract?'" Agnelli said.

Vale insists that benchmark prices informally agreed upon last year no longer reflect the reality of supply and demand.

Mills argue steel prices are too low and demand is too weak to pass on increased costs of iron ore.

CHINA TALKS, CHINA RISK

An acceptance of the aggressive price-hike in Japan and South Korea suggests that price may

become a baseline for purchases of iron ore by China, now (OTC:CINW) supplying some 70 percent of the world's iron supply and comprising the bulk of Rio and BHP's sales.

"We also anticipate that Chinese iron ore prices will settle at least as high, if not higher than other Asian players," said Steel Market Intelligence in a research note.

China will likely pay a premium for buying ore given the perceived political risks of doing business there, it added.

A Shanghai court on Monday sentenced four Rio Tinto executives to prison terms of seven to 14 years on charges of accepting bribes and stealing commercial secrets, ending a saga that began in the middle of tense 2009 iron benchmark talks that unravelled without a formal agreement.