Analyst Comment: ***Dennis Ng***

- Share Price at Valuation Date
$30.79

- Discount
-20.67%

- Lincoln Valuation at Valuation Date
$38.81

BHP BHP Billiton Limited

June quarterly production - Solid but disappointing outside of copper

Valuation Date: 18 Jul 12 | **Publish Date:** 18 Jul 12

BHP Billiton (BHP) produced a solid operational result in light of challenging operational conditions. Key divisions have met management's conservative targets but fell marginally short of our expectations. In recognition of increasing risks, margin pressure and a potential writedown of BHP's shale gas assets in the wings, we have adjusted our estimates accordingly. This has resulted in a decrease of our Lincoln Valuation from $47.03 to $38.81.

Iron ore operations which roughly account for half of BHP's earnings, finished the year well with production levels recovering to 40.89 million tonnes this quarter. BHP has successfully hit its FY12 production guidance of 159 mtpa this year, benefiting from infrastructure expansion this financial year. The total production of 159.48 million tonnes is a record result, but we note that cyclone activity this year was significantly less severe than FY11 and like RIO this result fell short of our expectations. Management has indicated guidance of 5% production growth in FY13 which we believe is conservative based on current projects underway but note the risks of weather related issues in the third quarter.

Petroleum has disappointed for the quarter, with liquids volume falling 10% on the March quarter. This was largely due to Atlantis, which was shut-in for an extended period of maintenance. That said, production going forward should improve considerably with recommencement of operations at Mad Dog and Atlantis. Natural gas production unsurprisingly generated a record level this year due to contributions from acquisition of the troubled US shale gas assets. We remain concerned about a potential writedown for these assets given the decline of Henry Hub gas prices in the US.

Coal production for both metallurgical and thermal coal have strengthened on the March quarter due to the commissioning of the West Cliff coal preparation plant upgrade (metallurgical) and first production from RX1 (Energy). However, production decline of other assets over the year meant overall production is only in line with levels earlier this financial year. We believe there is some potential for upside in the next quarter for metallurgical coal operations going forward, as production of Queensland Coal and BMA have been constrained by industrial action.

Base metal production whilst only contributing around 12% to BHP's earnings was the highlight for the quarter. Copper production in particular was the highlight, with production at Escondida (as discussed for RIO) benefiting from higher grades. Production is expected to increase further in the next financial year as this mine benefits from the Escondida ore access and Laguna Seca debottlenecking projects. Lead, zinc, nickel, silver, manganese and uranium production were broadly in line with previous periods.

Diamond production remains weak and is expected to remain constrained as operations extract lower grade material. Aluminium continues to be plagued by operational problems in addition to the weak demand environm ent. That said, both these divisions are negligible contributors to BHP's earnings. We also believe both are flagged for potential divestment by the company.

Overall, BHP produced a solid operational result. However, its two largest divisions, iron ore and petroleum have fallen marginally short of our expectations. Whilst this was partially offset by a strong copper performance, we believe the risks particularly for petroleum and metallurgical coal have risen. Curiously like RIO, exploration expenditure this quarter has increased notably from US$1.71 billion to US$2.5 billion. Similarly, we have accommodated for these risks and expenditure levels in our estimates. This is further exacerbated by what we view as a likely writedown of the company's US shale gas acquisition. As such we have lowered our Lincoln Valuation to 38.81.

Analyst Comment: ***Dennis Ng***

- Share Price at Valuation Date
$54.44
- Discount
-25.10%
- Lincoln Valuation at Valuation Date
$72.68

RIO Rio Tinto Limited

June quarterly production - Solid production with few surprises

Valuation Date: 17 Jul 12 | **Publish Date:** 17 Jul 12

Rio Tinto (RIO) released a solid but uninspiring June quarterly production report, meeting or marginally falling short of expectations. Most importantly, the company's key iron ore production which contributes the lion's share of the company's profits largely met expectations. However, our estimates for the company have been marginally curtailed in light of weaker guidance, softer metallurgical coal production expectations and a more conservative outlook on expansion plans. Our Lincoln Valuation has been reduced from $81.93 to $72.68.

Pilbara iron ore, which constitutes the majority (96%) of RIO's iron ore operations performed well as a whole, recovering from weather conditions in the March quarter and achieving overall production levels in line with previous quarters. This was a slight disappointment to our estimates, as we were anticipating a small contribution from the company's 230 million tonnes per annum (mtpa) Dampier incremental expansion. Otherwise, the company's expansion plans to 283 mtpa by the end of 2013 and more recently, 353 mtpa by first half 2015 appear to be on track. In addition, plans for the promising Simandou iron ore project in Guinea is targeting production in mid-2015. Management has also reiterated iron ore production guidance of 250 mtpa for 2012.

Copper production has been mixed. Kennecott Utah operations disappointed due to lower grade ore and scheduled maintenance and sequencing activities. However, this was offset by higher grades and hence production levels at Escondida. Amongst the smaller copper mine exposures, it is noteworthy that an operational issue at Palabora will impact production next quarter. In regards to the promising Oyu Tolgoi copper gold project in Mongolia, production and phase 2 feasibility studies are expected to commence in the next quarter. We note that management has marginally reduced copper production guidance from 600,000 tonnes to 580,000 tonnes mined for 2012.

Coal production has improved significantly from the wet weather issues in Queensland and New South Wales in the previous quarter. Whilst production has recovered to levels in line with previous quarters, we regretfully note that the quality of coal produced has fallen. This is reflected by a downgrade of management production guidance for hard coking coal (9mt to 8.5mt) and the consequential upgrade of semi-soft coking coal (3mt to 3.5mt). Management has also guided for weaker thermal coal production (from 20mt to 19.5mt) for 2012.

Operationally, the highlight for aluminium operations was bauxite demand. As expected aluminium production continues to struggle in this environment. Despite being a medium sized division, this is currently a marginal operation for RIO and hence will have little overall impact. Investors should note that RIO is still seeking a purchaser for its Pacific Aluminium asset..

In a similar vein, uranium production recommenced at the Ranger mine and Rossing operations had a good quarter, but this division will have little impact on the company's figures. Finally, the company's diamond and minerals division performed reasonably, but are very minor contributors to the company's overall results.

Overall, whilst the company's key iron ore figures are broadly in line with our expectations, when looking at the company's divisional contributions we note that RIO has fallen marginally short of our expectations on a few fronts. The most notable of which was metallurgical coal production. We also interestingly note that exploration expenditure has doubled this quarter to $1.025 billion which will be factored in our forward looking estimates. We have adjusted our expectations downwards accordingly and correspondingly lowered our Lincoln Valuation to $72.68.

Analyst Comment: ***Dennis Ng***

- Share Price at Valuation Date

$4.64

- Discount

-25.34%

- Lincoln Valuation at Valuation Date

$6.21

FMG Fortescue Metals Group Ltd

June quarterly production - Strong operational performance overshadowed by capital expenditure expansion

Valuation Date: 17 Jul 12 | **Publish Date:** 17 Jul 12

Fortescue Metals (FMG) released a strong June quarterly production result, reaching an annualised production rate of 71 million tonnes per annum (mtpa), inclusive of BCI's share of production. Unfortunately, development costs for the 155mtpa expansion plan have had to be revised upwards by US$600 million and the Solomon ramp up delayed by around a month due to required repairs. The company remains committed to reaching its longstanding target run rate of 155 mtpa by the end of FY13. We have revised our expectations to account for the increased capital expenditure, unlikelihood of major developments post the 155 mtpa and increased risk of missing scheduled targets. This is reflected in a downward revision of our Lincoln Valuation from $6.60 to $6.21.

Production during the quarter has been strong, and was ahead of our more conservative expectations. Mining activity increased to record levels, more than recovering from the weather ravaged March quarter. A significant contributor to this production result is the ramp up of the company's Christmas Creek ore processing facility which processed 6.2 million tonnes in the quarter. With strip ratios in line with previous quarters, Fortescue processed a record level of iron ore this quarter culminating in total production this financial year of 55.8 million tonnes, slightly ahead of our expectations of 55 million tonnes.

Cash costs of production benefited from the increased production volume and the weaker Australian dollar, recovering to US$46.04 per tonne. Coupled with an average realised iron ore price of US$125 per tonne, FMG has performed strongly operationally. Investors should note that this result was achieved whilst development of infrastructure (port, rail, ore processing facilities) were underway, which increases the complexity substantially.

Overall this was a strong result, and production going forward is expected to continue to increase in leaps and bounds. Commissioning for the second ore processing facility at Christmas Creek is still planned for the September quarter, and contributions from Solomon will commence with Firetail targeting contributions in the March quarter and Kings in the June quarter. The schedule for the 155 mtpa expansion plan appears resilient as a whole with continued progress of port and rail development evident. However, we remain cautious regarding risks of Solomon falling further behind schedule (currently about a month) and the decreasing likelihood of FMG obtaining its fifth berth at Herb Elliot Port.

Unfortunately, our prior concerns for FMG's ability to meet its ambitious expansion plans appear well founded. Management have revised the costs of the 155 mtpa expansion up by 7% or US$600 million. This was largely due to a revision to the costs for the Solomon Hub project, but we note port and rail expenditure has been upwardly revised as well. We believe that this is an indication of increased risk of capital expenditure cost and schedule blowouts and have adjusted our estimates accordingly. Likewise, management appears increasingly conservative of plans post-155 mtpa and as such we have removed the impact of future projects like the Western hub and Port Anketell from our assumptions. This resulted in a lower Lincoln Valuation of $6.21.