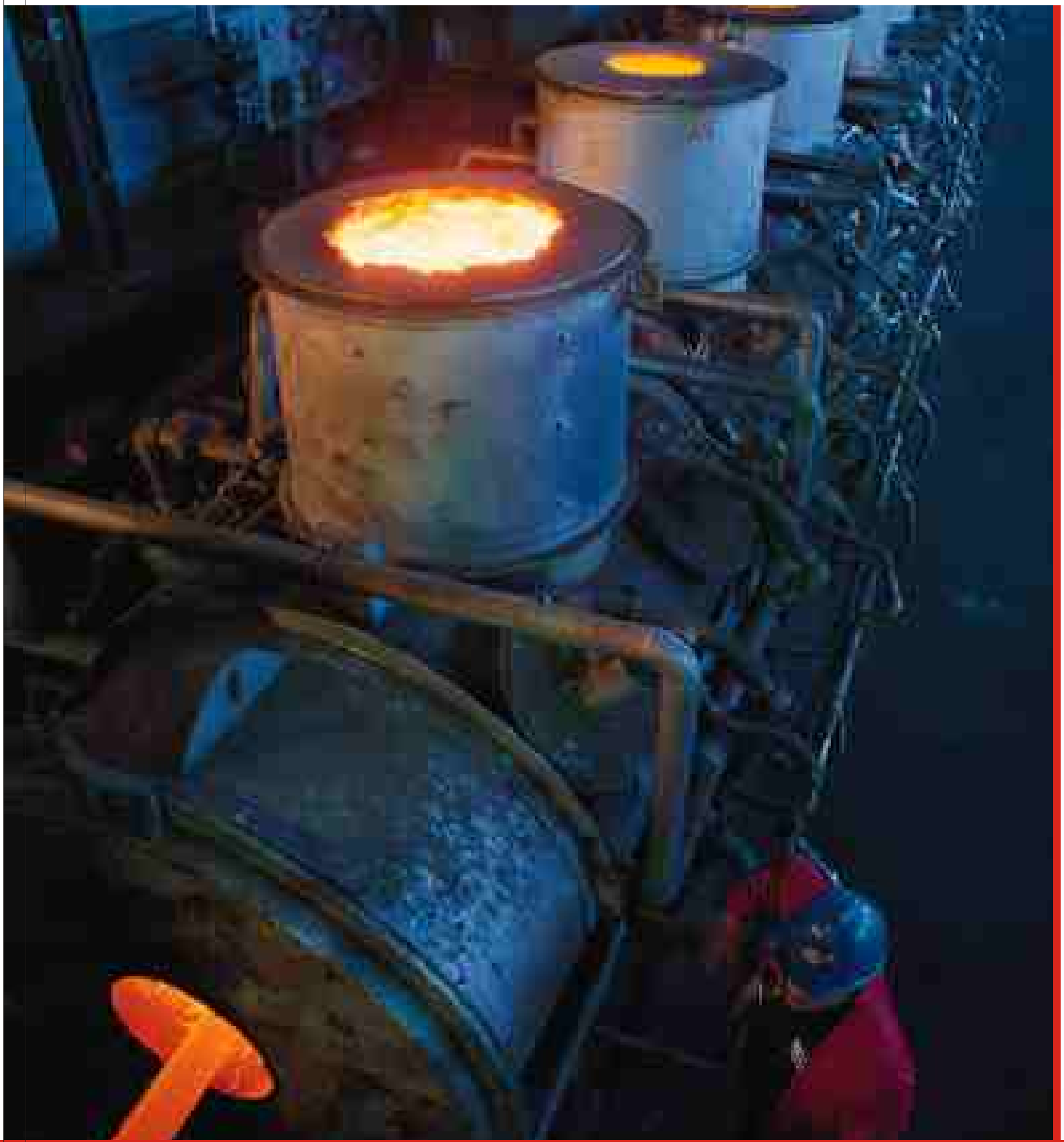
Higher Treatment and Refining Charges to benefit Copper Smelters

- Metalworld Research Team



At a time when consumer industries across the globe are struggling to overcome the financial crisis, copper smelters have a reason to breathe a sigh of relief. World miners have accepted their proposal for a hike in treatment and refining charges (Tc/Rc) for 2012. The rise is expected to compensate partly the dwindling demand from consumer sectors. TC/RCS are paid by miners to smelters to refine concentrate into metal and are a key part of the global copper industry's income. In the mining sector, Tc/Rcs are the main costs of extracting metal from ore. Treatments costs are those of the smelting process which uses heat to melt metal in order to extract it mechanically from the ore. Refining costs are those of electro-refining processes, the output of which is metal that is pure enough to be sold for most purposes. Treatment and refining costs are an important component of the cash cost of mining.

The Breather

Leading Chinese smelter Jiangxi Copper Corp and Freeport-McMoran Copper Gold have agreed to raise Tc/Rcs for 2012 at $63.5 a tonne and 6.35c/lb respectively. This sets the benchmark for global copper smelters and mining companies. Germany's Aurubis, Europe's biggest copper producer, has also agreed for the similar hike in Tc/Rcs for 2012. Strikes at copper mines including one which has just ended at Freeport McMoRan's Grasberg mine in Indonesia have put downward pressure on global spot Tc/Rcs in past months. When smaller volumes of copper concentrate are available on the global market, refiners have to offer lower Tc/Rcs to attract material. "The situation should be calmer and production should return to a normal level now that the labour conflicts have ended," an analyst said. "Accordingly, Tc/Rcs should increase

again in the spot market for copper concentrates." Meanwhile, the copper scrap market is under the influence of the seasonal Christmas slowdown. Scrap supplies are at a lower level than in the summer and some sellers are waiting for higher copper prices. Risk aversion prevails among investors and some copper consumers will wait on the sidelines for further market developments.

Economic Scenario

The year 2011 has been witness to a host of factors from the macroeconomic to the geo-political front, which affected global financial markets. The debt crisis in the euro zone has been the highlight of this year as policymakers continue to battle with the crisis. No final solution for the lingering debt issues has been churned out yet and the whole year has passed-by with bouts of optimism every now and then, that the leaders will chalk out a one-point strategy that will not only help the euro area recover, but will also help ease weak market sentiments.

Taking cues from the current state of affairs in the global economy, the International Monetary Fund (IMF) has lowered growth forecasts for 2011 and 2012. World copper output is expected to grow at a pace of 4 percent in 2011 and 2012 as against 5.1 percent in 2010. Growth in the advanced economies is forecast to witness sharp slowdown from 3.1 percent in 2010 to an expected 1.6 percent in 2011 and 1.9 percent in 2012. The emerging and developing economies are expected to grow at 6.4 percent in 2011, slowing from a pace of 7.3 percent in 2010. Country-specific growth forecasts by the IMF show that the European countries and Japan will show poor economic performance for the year 2011, with Japanese GDP growth for the current year expected to decline by 0.5 percent. The US, world's largest economy witnessed growth of 3 percent in 2010, and 2011 forecasts indicate a slowdown in growth at 1.5 percent. Germany, euro zone's largest economy is forecast to grow at 2.7 percent in 2011, as compared to 3.6 percent in 2010.

As far as the emerging and developing economies are concerned, it is inflation which has become a major economic problem this year around. World inflation grew at 3.7 percent in 2010 and for the whole of 2011; estimates by the IMF indicate a sharp increase to 5 percent. However, for 2012, the IMF expects world inflation to fall to 3.7 percent. Central banks in China and India have tightened monetary policy during the year in order to keep a check on inflation. This increase in borrowing costs at a time when input costs are high, has affected profitability margins of companies. Economic growth in China and India has also seen slow growth, thus showing the impact of the global crisis and a tight monetary policy. Performance of equities this year has been grim as investors become risk averse. Expectations of the euro zone debt crisis worsening further has led to investors moving away from riskier and higher-yielding investments. Major global equities have given negative returns of an average of more than 17 percent on a year-to- date basis.

Domestic Scene

The public sector Hindustan Copper produces between 20,000 - 30,000 tonnes of copper cathode and bars annually by excavating concentrate from domestic mines. India's copper production is estimated at 680,000 tonnes of which Hindalco Industries shares around 340,000 tonnes and Sterlite Industries contributes 310,000 tonnes. Both these leading copper smelters do not have any copper mine in India and hence, remain dependent upon imported copper concentrates. The financial performance of these two companies, therefore, largely depends upon the prevailing quality of ore in overseas mines and rupee movement against dollar. Debu Bhattacharya, managing director of Hindalco Industries, had recently raised concerns over falling ore grade globally. "The fall in rupee this year would certainly benefit these smelters in terms of higher realisation. But, the ongoing fiscal condition in the country remains a major concern on overall demand. There are apprehensions that copper demand may continue to remain under pressure in coming months due to unfavorable economic conditions," said Bikash Bhalotia, an analyst with Pinc Research.

The quantum of concentrate import, however, depends upon the quality of ore and copper content in it. Industrial activity has witnessed a decline in the second quarter of the current fiscal which gives a signal of a slowdown in economic activity. Against the earlier estimates of a recovery in consumption in the second half of the current financial year, the demand continued to remain under pressure. Total copper consumption in India stands today at around 620,000 tonnes, equivalent to production. Both private copper producers i.e. Hindalco and Sterlite also export nearly 95,000 tonnes of refined copper each every year. India's total copper import stands at around 120,000 tonnes

Benefit to Domestic Smelters

The upward revision in TC/RCS will benefit Indian smelters in two ways. First the normal 12.4 per cent rise in income and then, the benefit of rupee depreciation. Domestic copper producers including Hindalco Industries and Sterlite Industries are also expected to gain from rupee depreciation being all these charges settled in dollar. "Increase in refining charge and treatment charge for copper will improve the top line of the processing companies but it would be limited to processing charges only as largely the copper concentrate in India is imported," said Pukhraj Sethiya, Senior Consultant, PwC.

Sterlite and Hindalco, which smelt concentrate mined mainly in Chile, Peru and Australia, had won a 20 percent increase in fees for 2011. Treatment fees are expressed in dollars per ton of concentrate received and refining fees in cents per pound of copper in the ore. The fees are deducted from the price paid by smelters to mining companies for the raw material. Pan Pacific Copper Co., Japan's largest producer, won a similar increase in fees from Freeport for next year, two industry executives familiar with the matter said. Smelters in Japan, China and India are seeking higher treatment and refining fees in anticipation of greater production as new projects start production and strikes end at copper mines in Indonesia, Peru and Chile. Workers at Freeport's Grasberg mine in Indonesia agreed to end a three month strike on December 14. Miners at the Collahuasi copper mine, a venture between Anglo American Plc and Xstrata Plc in northern Chile, last month agreed to end a strike over job dismissals, while Grupo Mexico SAB's unit in October began talks with Peru's government to restart its Tia Maria copper project.

Movement in Copper Prices

Copper, which is regarded as an indicator of economic growth is also called as the leader of the base metals pack. Its performance during the year has been very volatile, as on one hand it tested an all-time high of $10,190/tonne, supported by supply-side worries; and on the other hand the red metal slipped to a low of $6635/tonne on account of global economic concerns and its impact on consumption growth of industrial metals. Estimates by the EIU indicate that world copper consumption growth slowed to 2.8 percent in 2011 as a result of weak demand in the EU and the US coupled with the impact of monetary policy tightening in China, the country that accounts for 47 percent of world copper consumption. High borrowing costs in China led to slowdown in manufacturing and construction activities. Lack of access to credit had a major impact on copper fabricators as they struggled to finance working inventories. Since the start of the third-quarter this year, there has been an improvement in Chinese demand, but this does not indicates real consumption as it is backed by restocking at lower price levels.

Fabricators in China continue to rely on hand-to-mouth strategies in the current market scenario as borrowing costs have become a big concern. EIU expects a bounce back in world copper consumption growth by 3.2 percent in 2012 on account of expected loose monetary policy in China and the restocking cycle. In 2010, it has been seen that Chinese copper buyers did not venture into restocking activity despite a decline in inventories as manufacturers adopted hand-to-mouth strategies. With this background imports which usually rise in the second-quarter (April to June) witnessed slow growth. But increase in copper imports has been seen in the second-half of this year in China as it touched 275,499 tonnes in September, marking the highest level in 16 months.

After a sharp fall in copper prices in August and September, copper prices on the London Metal Exchange (LME) slipped more than that on the Shanghai Futures Exchange (SHFE). This resulted in price differential, thus making copper imports more viable into China. But this increase in imports cannot be regarded as a rise in direct consumption as the current rise in Chinese copper imports is more of bargain hunting, where Chinese merchants basically exploit price decline and arbitrage opportunities. Apparent demand for refined copper in China stood at 5.82m tonnes in January'11 to September'11. The EIU expects Chinese refined copper consumption to increase 6 percent in 2012 and around 8 percent in 2013. In the coming year, China is expected to loosen its monetary policy, thus leading to a return of credit to fabricators. Although demand in the Euro Area is expected to witness slowdown, China may not necessarily get impacted from the same as a major part of China's copper demand is mainly driven by the domestic economy.

Demand Scene

Although economic growth in Japan is expected to contract this year, data on the copper front has been on the

positive side. The country accounts for 7 percent share in total world consumption and copper-specific data shows indications of a swift recovery post the devastating earthquake and tsunami. Many copper fabricators in Japan have returned to full production by the end of March. World Bureau of Metal Statistics (WBMS) data suggests that in the first eight months of the year, consumption growth was down 1.7 percent year-on-year. EIU estimates copper consumption growth in Japan at 1.2 percent in 2011 and expects it to accelerate in 2012-13 by an average 2.5 percent, backed by reconstruction spending. The Euro Area accounts for 22 percent of world copper consumption but demand growth in copper has witnessed a slowdown in this year due to escalating economic concerns. WBMS data indicates that copper consumption growth in the EU rose at 1.4 percent in the first eight months of 2011. The month of August alone saw an increase in demand growth by 2.7 percent. But for the whole of 2011, EIU expects refined copper consumption growth of just 0.8 percent as confidence across the Euro region falls and as reports indicate that since September consumers have postponed orders of cathode from refineries.

On the supply front, world production of refined copper increased 3.1 percent in 2010, but issues such as tightness in the global concentrate market due to lower ore grades and ageing mines capped production increases. Production growth is expected to be slower than rise in consumption on account of rise in labor disputes in the world's largest copper mines in Chile, Indonesia and Peru. For 2011, EIU expects world copper supply to increase 2.3 percent. Since risks associated with supply of concentrates has increased, smelters and refineries have now increased their dependence on scrap as the raw material. China is not only a major consumer of copper but also accounts for a whopping 33 percent in world copper production.

Data by the China Nonferrous Metals Industry Association (CNIA) for September showed that the country's output for refined copper remained at a high of 457,595 tonnes, but lower than its record high achieved in August. For 2011, the EIU expects Chinese copper production to grow by 10.4 percent, down from growth of almost 13 percent seen in 2010. For 2012-13, EIU forecasts a further slowdown in growth to 8 percent. It has been noted that the global production of copper scrap has increased sharply and secondary refined copper production is growing at a faster pace that primary production. Data from the International Copper Study Group (ICSG) indicates that global secondary production rose by 18.3 percent year-on-year in 2010. For the first six months of the year, secondary copper smelters witnessed growth in output by 8.1 percent to 1.76m tonnes, while primary smelters recorded growth of just 1.3 percent to 7.36m tonnes. Copper production from secondary sources accounts for around 19 percent of total copper production, which is up from 17.6 percent in 2010.

Outlook

Concerns over the supply front in case of copper remain and this factor coupled with an improving economic scenario in the US will be supportive for copper prices after the second-quarter of 2012. China is expected to loosen its monetary policy in the coming year and the return of credit in the market will also help support demand from the end of fabricators. But until then, we cannot ignore developments on the Euro Zone front, which have been a major influence to prices in 2011. Any further negativity with respect to the same can act as a deterrent to upside in prices in the next 3-4 months.

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