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Fortescue Metals Group Ltd. - June 2014 Quarterly Report. Successful ramp-up of the Kings Valley project delivered the targeted 155 **million** tonne annualised run rate in the June 2014 quarter and a record 160 **million** tonnes annualised shipping rate for the month of June.

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Fortescue remains absolutely focused on continuing to improve shareholder value through identification of additional operating efficiencies and disciplined capital management.

HIGHLIGHTS

Record shipments of 38.7 **million** tonnes (mt) achieved during the June 2014 quarter

Total FY14 shipments were 124.2mt, 53 per cent greater than the prior financial year and within two per cent of full year guidance of 127mt

C1 costs for the June 2014 quarter were US$34.03/wet metric tonne (wmt) bringing full year C1 cost to US$33.84/wmt, a reduction of 23 per cent compared to the prior financial year and below guidance Delivered cost to customers was US$49/wmt (US$53/dmt) for the June 2014 quarter inclusive of C1, shipping, royalties and administration

CFR prices realised for the June 2014 quarter were US$82/dry metric tonne (dmt) based on an average 62% Platts CFR index of US$103/dmt

Cash on hand was US$2.4 **billion** at 30 June 2014 reflecting the continued strength of operational cashflows, reduced capital expenditure and lower finance costs

Net debt at 30 June 2014 was US$7.2 **billion**

All T155 expansion projects have been completed at a total cost of US$9.2 **billion**, US$92 per annual production tone

OPERATIONS

Safety

Fortescue has taken decisive actions to reinforce that safety is the highest priority for everyone on a Fortescue site. The drive towards world class performance in safety continued during the June 2014 quarter with the Safety Excellence project focusing on enhancing safety leadership. The project is delivering results with improvements to safety outcomes among contracting partners and the sharing of incident lessons.

The total recordable injury frequency rate per **million** hours worked was 6.0 in the June 2014 quarter, a five per cent improvement over the previous quarter and 21 per cent lower than the prior comparable period.

Aboriginal Engagement

Fortescue's vision to create partnerships which deliver lasting benefits to Aboriginal Communities through the provision of training, employment and economic development opportunities continued in FY14 with a number of significant achievements.

In the June 2014 quarter, contracts and sub-contracts valued at A$40 **million** were awarded to Aboriginal businesses and joint ventures, bringing the total awarded contracts value to A$497 **million** in FY14 and the total value under the **Billion** Opportunities program to A$1.58 **billion**. There was also a significant increase in the commitment of Fortescue's contracting partners to provide second tier contract opportunities, with sub-contracts worth A$233 **million** awarded to Aboriginal businesses and joint ventures in FY14.

In FY14, Fortescue's Vocational Training and Employment Centres (VTECs) trained and provided jobs for 122 people. Aboriginal people represent more than 12 per cent of Fortescue's direct workforce and over 1,100 Aboriginal people are employed through our **operations**.

Mining, Processing and Shipping

The June 2014 quarter delivered a seventh consecutive shipping record with 38.7mt of **ore** shipped, a 23 per cent increase over the previous quarter and a 55 per cent increase over the prior comparable period. Shipments included 37.6 **million** Fortescue **equity** tonnes and 1.1 **million** third party tonnes.

During the June 2014 quarter, Fortescue mined 43.8mt of **ore**, 48 per cent higher than the previous quarter. This increase was largely due to the combination of increased performance in **operations** through efficiency initiatives as well as the continuity of work achieved through the dry season. **Ore** mined in the June 2014 quarter was 28 per cent higher than the prior comparable period. Fortescue drew down ROM **iron ore** stocks by six per cent in the June 2014 quarter and aims to continue reductions in the September 2014 quarter.

Strip ratios at the Chichester Hub averaged 3.2 for the June 2014 quarter, slightly below the five year mine plan of 3.5 due to the nature of the **mining** areas. The strip ratio across the Solomon Hub was 1.3 during the June 2014 quarter as **mining** moved closer to a steady state, following the ramp up of **operations** at the Kings Valley project.

The operation of the Kings Valley **Ore** Processing Facility (OPF) through the June 2014 quarter lifted Fortescue's production capacity beyond 155 **million** tonnes per annum (mtpa). Fortescue's total output from all processing facilities increased to a record 41.1mt in the June 2014 quarter, 32 per cent higher than the prior quarter and work continues allowing transition to our steady state product mix.

During the June 2014 quarter the Kings Valley OPF has been used to process detrital **ore** overlying the main Kings CID **ore**. Kings CID has now commenced to form a core product and provide the planned product mix grades.

Over the June 2014 quarter, Fortescue and Leighton

Contractors completed a successful transition of full operational responsibility for the two Solomon Hub OPFs and the train load out facility to Fortescue. This strategic business decision now gives Fortescue operational responsibility over all five of its OPFs, enabling shared learnings, synergies, economies of scale and efficiency increases across the business.

Port and Rail **operations** continued to operate consistently at and above an annualised run rate of 155mtpa during the June 2014 quarter. Further optimisation work continues to deliver increased productivity and efficiency.

Production Costs

C1 costs for the June 2014 quarter were US$34.03/wmt, a two per cent improvement over the prior quarter and lower than guidance. The improved performance was due to lower strip ratios at the Solomon and Chichester Hubs together with operational improvements at the OPFs. Full year C1 costs were US$33.84/wmt, below guidance and 23 per cent lower than the previous financial year.

This improvement reflects the benefit of lower cost Solomon **operations**, improved processing capacity lowering strip ratios at the Chichester Hub, operational efficiencies and a lower Australian dollar. Fortescue continues to focus on costs in order to move down the global cost curve. In the June 2014 quarter, total delivered costs to customers were US$49/wmt inclusive of C1 costs and shipping, royalty and administration costs, eight per cent lower than the prior quarter. Total delivered costs to customers for the full year were US$52/wmt.

The US to Australian dollar exchange rate averaged 0.93 for the June 2014 quarter (0.90 in the March 2014 quarter). Fortescue remains sensitive to movements in exchange rates with C1 costs impacted by US$0.25/t to US$0.30/t for every one cent movement in the US to Australian dollar.

Forecast Production and Costs

Forecast shipping volumes for FY15 are 155-160mt at a C1 operating cost of US$31-32/wmt. This guidance reflects a full year of **operations** from the Kings Valley project, operational cost efficiencies and an average US to Australian dollar exchange rate of 0.90.

MARKETING

The key **iron ore** pricing references applicable to major Australian producers are the 62% Platts and MBIO 58% indices. These indices are essentially determined by reference to the spot market created by the sales price achieved for Rio Tinto's Pilbara Blend, BHP's MAC and Newman Fines (62% Platts), and BHP's Yandi (MBIO 58% + Premium).

Fortescue's suite of products is sold with reference to the 62% Platts index with a market price comparable to other products which have similar value-in-use properties for steel production.

The graph below sets out price relativities between the 62% Platts index, Fortescue Blend, Fortescue Super Special Fines, Metal Bulletin 58% Premium index and the Metal Bulletin 58% index. The graph shows that while there have been variations in prices across the year, Fortescue's major products have consistently priced in line with similar products relative to the 62% Platts index.

Over the June 2014 quarter **iron ore** prices have traded lower and at a wider spread which has historically been the case in a low price environment. This reflects the significant increase in new seabourne **iron ore** supply, tighter credit conditions in **China** and relatively high **Chinese** port stocks. During the June 2014 quarter **iron ore** prices have been volatile resulting in a price realization of 80 per cent comparted to the average 62% Platts index.

In FY14 Fortescue's average price realisation was 86 per cent compared to the average 62% Platts index. Fortescue expects supply to re-balance in the short term as port inventories are drawn down, steel mills re-stock and higher cost **iron ore** production leaves the market. As this occurs and Fortescue transitions to a product suite dominated by the high quality Fortescue Blend and Kings CID products, realised prices are expected to range between 85 and 90 per cent of the 62% Platts price index going forwards.

CORPORATE

Balance Sheet

Fortescue's net debt position at 30 June 2014 was US$7.2 **billion**, including finance leases of US$0.3 **billion** and cash on hand of US$2.4 **billion**. Fortescue's flexible debt profile facilitates additional repayments and the ability to deliver on the strategy to further debt reduction and move towards an initial targeted gearing level of 40 per cent.

As noted in the debt maturity profile below Fortescue's earliest debt maturity is in 2017. Further, a total of US$5.8 **billion**, or in excess of 60 per cent, of the **company**'s long term debt is available for voluntary repayment in advance of maturity and at Fortescue's option.

Capital Expenditure

Capital expenditure in FY14 was US$1.9 **billion**, slightly below guidance due to the deferral of approximately US$100 **million** into FY15. As a result, FY15 expenditure is now estimated to be US$1.3 **billion**, excluding any capital expenditure associated with the **Iron** Bridge joint venture, which is fully funded by the Formosa Plastics Group.

All T155 expansion projects have been completed and US$9.2 **billion** was capitalised during FY14. Based on the current fixed asset base, Fortescue estimates its depreciation and amortisation expenditure to be US$8.50/wmt shipped.

Ship Construction

Fortescue has entered into arrangements for the construction of four highly efficient very large **ore** carriers (VLOCs) for a total investment value of US$275 **million**.

Construction is expected to commence in the second half of 2014 and delivery is scheduled for November 2016 through to May 2017 with the majority of payments due on delivery.

In addition, advanced negotiations are underway to secure four additional VLOCs with another major **Chinese** ship builder. These ships are expected to be delivered in late 2017 and early 2018 with the majority of payments also due on delivery.

Fortescue's shipping strategy is to lock in construction of these VLOCs which are being designed to complement the port infrastructure to improve load rates, efficiencies and reduce operating costs. Flexibility has been built into the ownership structure of these VLOCs which will allow Fortescue to explore alternative financing structures at a later date. The investment will initially be funded by existing operating cash flows and due to the timing of cash payments, is not expected to impact Fortescue's debt repayment strategy.

Fortescue expects the operating cost of these vessels to be well below the current forward market rates for large capesize vessels. This, together with expected through put benefits and operational savings at the port, support the investment in these vessels.

DEVELOPMENT

Fortescue River Gas Pipeline

Fortescue is executing a plan to lower **energy** costs and reduce its carbon footprint by transitioning its Pilbara **operations** from diesel to natural gas. As a first step, the Fortescue River Gas Pipeline will deliver gas from the Dampier to Perth Pipeline to the Solomon Power Station with completion scheduled in the March 2015 quarter.

Compressed Natural Gas (CNG)

As an interim step in advance of completion of the natural gas pipeline, Fortescue will truck compressed natural gas (CNG) from facilities in Port Hedland to gas receiving facilities installed at the Solomon Power Station. Deliveries are scheduled to commence in August 2014 and will run until the Fortescue River pipeline is fully commissioned.

AP5 Project

The project to build the fifth wharf at Anderson Point, AP5, remains on schedule and on budget for completion in the March 2015 quarter. Dredging was completed in the June 2014 quarter and installation of wharf piles has commenced. All major contracts have been awarded and fabrications of wharf modules are under way in **China** and Western Australia.

Detrital Processing Plant

Construction of a 5mtpa detrital processing plant at Solomon was approved at the end of May 2014. This facility will allow detrital **ore** to be processed, eliminating the need for an expensive wet plant addition to the Firetail OPF and freeing the Kings Valley OPF to process Kings CID **ore**. Early contractor involvement is underway and an award for the core processing facility is expected in July 2014. Project duration is estimated at 55 weeks at a cost of approximately US$105 **million**.

Iron Bridge Project

Construction activities continue to achieve planned milestones. The main construction camp is complete, access roads and earthworks at the Northstar OPF are nearing completion and pre-strip activities are progressing. Concrete works at the OPF are well advanced with commencement of structural, mechanical and piping works. The electrical and instrumentation package of works has been tendered and a contract award is expected in July 2014. First production from the 1.5mtpa OPF is expected in the March 2015 quarter.

Incremental Train Control System (ITCS)

ITCS has been implemented across Fortescue's rail system and is now fully operational. The system is delivering improvements in train scheduling, **operations** and optimisation of the network.

EXPLORATION AND FUTURE STUDIES

The 2014 exploration drilling program continued throughout the June 2014 quarter. Of note the Cloudbreak brownfield drilling program has shown useful zones of Mineralization. The Christmas Creek brownfield drilling program will be completed in the September 2014 quarter. A diamond rig also began work in the Western Hub to provide core samples for metallurgical analysis.

Work continues on identifying and defining new targets for bedded Mineralization in and around the existing Chichester and Solomon hubs. An updated Reserve and Resource Statement incorporated in the FY14 Annual Report will further define long term production potential from our extensive resource base.

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