CLIFFS NATURAL RESOURCES INC.
Form 10-Q
April 25, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .
Commission File Number: 1-8944

CLIFFS NATURAL RESOURCES INC.
(Exact Name of Registrant as Specified in Its Charter)

Ohio	34-1464672
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
200 Public Square, Cleveland, Ohio	44114-2315
(Address of Principal Executive Offices)	(Zip Code)

Registrant’s Telephone Number, Including Area Code: (216) 694-5700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

The number of shares outstanding of the registrant’s common shares, par value $0.125 per share, was 153,181,056 as of April 21, 2014.

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DEFINITIONS

The following abbreviations or acronyms are used in the text. References in this report to the “Company,” “we,” “us,” “our” and “Cliffs” are to Cliffs Natural Resources Inc. and subsidiaries, collectively. References to “A$” or “AUD” refer to Australian currency, “C$” to Canadian currency and “$” to United States currency.

Abbreviation or acronym	Term
Amapá	Anglo Ferrous Amapá Mineração Ltda. and Anglo Ferrous Logística Amapá Ltda.
ArcelorMittal	ArcelorMittal (as the parent company of ArcelorMittal Mines Canada, ArcelorMittal USA and ArcelorMittal Dofasco, as well as, many other subsidiaries)
ASC	Accounting Standards Codification
Barrick	Barrick Gold Corporation Inc.
Bloom Lake	The Bloom Lake Iron Ore Mine Limited Partnership
Chromite Project	Cliffs Chromite Ontario Inc.
CLCC	Cliffs Logan County Coal LLC
DD&A	Depreciation, depletion and amortization
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EBITDA	Earnings before interest, taxes, depreciation and amortization
Empire	Empire Iron Mining Partnership
EPA	U.S. Environmental Protection Agency
EPS	Earnings per share
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
Fe	Iron
FMSH Act	U.S. Federal Mine Safety and Health Act 1977, as amended
GAAP	Accounting principles generally accepted in the United States
Hibbing	Hibbing Taconite Company
ICE Plan	Amended and Restated Cliffs 2007 Incentive Equity Plan, as amended
Ispat	Ispat Inland Steel Company
Koolyanobbing	Collective term for the operating deposits at Koolyanobbing, Mount Jackson and Windarling
LIBOR	London Interbank Offered Rate
LTVSMC	LTV Steel Mining Company
MACT	Maximum Achievable Control Technology
MMBtu	Million British Thermal Units
Moody's	Moody's Investors Service, Inc., a subsidiary of Moody's Corporation, and its successors
MRRT	Minerals Resource Rent Tax (Australia)
MSHA	U.S. Mine Safety and Health Administration
n/m	Not meaningful
Northshore	Northshore Mining Company
Oak Grove	Oak Grove Resources, LLC
OCI	Other comprehensive income (loss)
OPEB	Other postretirement benefits
Pinnacle	Pinnacle Mining Company, LLC
S&P	Standard & Poor's Rating Services, a division of Standard & Poor's Financial Services LLC, a subsidiary of The McGraw-Hill Companies, Inc., and its successors
SEC	U.S. Securities and Exchange Commission
Severstal	Severstal Dearborn, LLC
Substitute Rating Agency	A "nationally recognized statistical rating organization" within the meaning of Section 3 (a)(62) of the Exchange Act, selected by us (as certified by a certificate of officers confirming the decision of our board of directors) as a replacement agency of Moody's or

	S&P, or both of them, as the case may be
Tilden	Tilden Mining Company
TSR	Total Shareholder Return
United Taconite	United Taconite LLC
U.S.	United States of America
VNQDC Plan	2005 Voluntary NonQualified Deferred Compensation Plan
VWAP	Volume Weighted Average Price
Wabush	Wabush Mines Joint Venture
WISCO	Wugang Canada Resources Investment Limited, a subsidiary of Wuhan Iron and Steel (Group) Corporation
2012 Equity Plan	Cliffs Natural Resources Inc. 2012 Incentive Equity Plan

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PART I
Item 1. Financial Statements
Statements of Unaudited Condensed Consolidated Operations
Cliffs Natural Resources Inc. and Subsidiaries

	(In Millions, Except Per Share Amounts) Three Months Ended March 31,	
	2014	2013
REVENUES FROM PRODUCT SALES AND SERVICES		
Product	$ 860.9	$ 1,082.6
Freight and venture partners' cost reimbursements	79.1	57.9
	940.0	1,140.5
COST OF GOODS SOLD AND OPERATING EXPENSES	(876.8)	(902.6)
SALES MARGIN	63.2	237.9
OTHER OPERATING INCOME (EXPENSE)		
Selling, general and administrative expenses	(51.1)	(48.4)
Exploration costs	(4.2)	(22.7)
Miscellaneous - net	(58.6)	1.5
	(113.9)	(69.6)
OPERATING INCOME (EXPENSE)	(50.7)	168.3
OTHER INCOME (EXPENSE)		
Interest expense, net	(42.7)	(49.1)
Other non-operating income	1.2	1.1
	(41.5)	(48.0)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY LOSS FROM VENTURES	(92.2)	120.3
INCOME TAX BENEFIT	21.8	6.0
EQUITY LOSS FROM VENTURES, net of tax	(0.3)	(5.5)
NET INCOME (LOSS)	(70.7)	120.8
LOSS (INCOME) ATTRIBUTABLE TO NONCONTROLLING INTEREST	0.4	(13.8)
NET INCOME (LOSS) ATTRIBUTABLE TO CLIFFS SHAREHOLDERS	$ (70.3)	$ 107.0
PREFERRED STOCK DIVIDENDS	(12.8)	(9.9)
NET INCOME (LOSS) ATTRIBUTABLE TO CLIFFS COMMON SHAREHOLDERS	$ (83.1)	$ 97.1
EARNINGS (LOSS) PER COMMON SHARE ATTRIBUTABLE TO CLIFFS SHAREHOLDERS - BASIC	$ (0.54)	$ 0.66
EARNINGS (LOSS) PER COMMON SHARE ATTRIBUTABLE TO CLIFFS SHAREHOLDERS - DILUTED	$ (0.54)	$ 0.66
AVERAGE NUMBER OF SHARES (IN THOUSANDS)		
Basic	153,040	147,827
Diluted	153,040	148,081
CASH DIVIDENDS DECLARED PER DEPOSITARY SHARE	$ 0.44	$ 0.34
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.15	$ 0.15

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Statements of Unaudited Condensed Consolidated Comprehensive Income
Cliffs Natural Resources Inc. and Subsidiaries

	(In Millions) Three Months Ended March 31,	
	2014	2013
NET INCOME (LOSS) ATTRIBUTABLE TO CLIFFS SHAREHOLDERS	$(70.3)	$107.0
OTHER COMPREHENSIVE INCOME		
Pension and OPEB liability, net of tax	3.4	6.5
Unrealized net gain on marketable securities, net of tax	3.9	2.6
Unrealized net gain on foreign currency translation	40.5	3.3
Unrealized net gain (loss) on derivative financial instruments, net of tax	10.5	(7.0)
OTHER COMPREHENSIVE INCOME	58.3	5.4
OTHER COMPREHENSIVE INCOME ATTRIBUTABLE TO THE NONCONTROLLING INTEREST	(0.5)	(1.2)
TOTAL COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO CLIFFS SHAREHOLDERS	$(12.5)	$111.2

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Statements of Unaudited Condensed Consolidated Financial Position
Cliffs Natural Resources Inc. and Subsidiaries

	(In Millions) March 31, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 364.0	$ 335.5
Accounts receivable, net	130.6	270.0
Inventories	609.8	391.4
Supplies and other inventories	204.9	216.0
Other current assets	363.0	347.1
TOTAL CURRENT ASSETS	1,672.3	1,560.0
PROPERTY, PLANT AND EQUIPMENT, NET	11,086.0	11,153.4
OTHER ASSETS		
Other non-current assets	444.5	408.5
TOTAL OTHER ASSETS	444.5	408.5
TOTAL ASSETS	$ 13,202.8	$ 13,121.9

(continued)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Statements of Unaudited Condensed Consolidated Financial Position
Cliffs Natural Resources Inc. and Subsidiaries - (Continued)

	(In Millions) March 31, 2014	December 31, 2013
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	$ 329.2	$ 345.5
Accrued expenses	363.5	392.7
Short-term and current portion of long-term debt	96.9	20.9
Other current liabilities	253.5	326.4
TOTAL CURRENT LIABILITIES	1,043.1	1,085.5
PENSION AND POSTEMPLOYMENT BENEFIT LIABILITIES	285.0	294.0
ENVIRONMENTAL AND MINE CLOSURE OBLIGATIONS	300.7	309.7
DEFERRED INCOME TAXES	1,195.7	1,146.5
LONG-TERM DEBT	3,194.8	3,022.6
OTHER LIABILITIES	347.9	379.3
TOTAL LIABILITIES	6,367.2	6,237.6
COMMITMENTS AND CONTINGENCIES (SEE NOTE 18)		
EQUITY		
CLIFFS SHAREHOLDERS' EQUITY		
Preferred Stock - no par value		
Class A - 3,000,000 shares authorized		
7% Series A Mandatory Convertible, Class A, no par value and $1,000 per share liquidation preference (See Note 14)		
Issued and Outstanding - 731,233 shares (2013 - 731,250 shares)	731.3	731.3
Class B - 4,000,000 shares authorized		
Common Shares - par value $0.125 per share		
Authorized - 400,000,000 shares (2013 - 400,000,000 shares);		
Issued - 159,546,224 shares (2013 - 159,546,224 shares);		
Outstanding - 153,181,056 shares (2013 - 153,126,291 shares)	19.8	19.8
Capital in excess of par value of shares	2,321.1	2,329.5
Retained earnings	3,300.9	3,407.3
Cost of 6,365,168 common shares in treasury (2013 - 6,419,933 shares)	(298.5)	(305.5)
Accumulated other comprehensive loss	(55.1)	(112.9)
TOTAL CLIFFS SHAREHOLDERS' EQUITY	6,019.5	6,069.5
NONCONTROLLING INTEREST	816.1	814.8
TOTAL EQUITY	6,835.6	6,884.3
TOTAL LIABILITIES AND EQUITY	$ 13,202.8	$ 13,121.9

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Statements of Unaudited Condensed Consolidated Cash Flows
Cliffs Natural Resources Inc. and Subsidiaries

	(In Millions) Three Months Ended March 31,	
	2014	2013
OPERATING ACTIVITIES		
Net income (loss)	$ (70.7)	$ 120.8
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation, depletion and amortization	141.1	140.6
Deferred income taxes	15.1	(46.3)
Other	3.2	(10.0)
Changes in operating assets and liabilities:		
Receivables and other assets	161.5	102.7
Product inventories	(214.5)	(194.0)
Payables and accrued expenses	(117.7)	(139.2)
Net cash used by operating activities	(82.0)	(25.4)
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(103.3)	(230.4)
Other investing activities	12.6	2.0
Net cash used by investing activities	(90.7)	(228.4)
FINANCING ACTIVITIES		
Net proceeds from issuance of Series A, Mandatory Convertible Preferred Stock, Class A	—	709.4
Net proceeds from issuance of common shares	—	285.6
Repayment of term loan	—	(847.1)
Borrowings under credit facilities	225.0	297.0
Repayment under credit facilities	—	(72.0)
Common stock dividends	(23.0)	(22.9)
Preferred stock dividends	(12.8)	—
Other financing activities	8.7	(4.1)
Net cash provided by financing activities	197.9	345.9
EFFECT OF EXCHANGE RATE CHANGES ON CASH	3.3	(0.1)
INCREASE IN CASH AND CASH EQUIVALENTS	28.5	92.0
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	335.5	195.2
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 364.0	$ 287.2

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.
See NOTE 19 - CASH FLOW INFORMATION.

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Cliffs Natural Resources Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements
NOTE 1 - BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES
The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with SEC rules and regulations and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments) necessary to present fairly, the financial position, results of operations, comprehensive income and cash flows for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management bases its estimates on various assumptions and historical experience, which are believed to be reasonable; however, due to the inherent nature of estimates, actual results may differ significantly due to changed conditions or assumptions. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of results to be expected for the year ending December 31, 2014 or any other future period. These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2013.
Basis of Consolidation
The unaudited condensed consolidated financial statements include our accounts and the accounts of our wholly-owned and majority-owned subsidiaries, including the following operations:

Name	Location	Ownership Interest	Operation
Northshore	Minnesota	100.0%	Iron Ore
United Taconite	Minnesota	100.0%	Iron Ore
Wabush	Newfoundland and Labrador/ Quebec, Canada	100.0%	Iron Ore
Bloom Lake	Quebec, Canada	82.8%	Iron Ore
Tilden	Michigan	85.0%	Iron Ore
Empire	Michigan	79.0%	Iron Ore
Koolyanobbing	Western Australia	100.0%	Iron Ore
Pinnacle	West Virginia	100.0%	Coal
Oak Grove	Alabama	100.0%	Coal
CLCC	West Virginia	100.0%	Coal

Intercompany transactions and balances are eliminated upon consolidation.
Also included in our consolidated results are Cliffs Chromite Ontario Inc. and Cliffs Chromite Far North Inc. Cliffs Chromite Ontario Inc. holds a 100 percent interest in each of the Black Label and Black Thor chromite deposits and, together with Cliffs Chromite Far North Inc., a 70 percent interest in the Big Daddy chromite deposit, all located in northern Ontario, Canada.

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Equity Method Investments
Investments in unconsolidated ventures that we have the ability to exercise significant influence over, but not control, are accounted for under the equity method. The following table presents the detail of our investments in unconsolidated ventures and where those investments are classified in the Statements of Unaudited Condensed Consolidated Financial Position as of March 31, 2014 and December 31, 2013. Parentheses indicate a net liability.

				(In Millions)	
Investment	Classification	Accounting Method	Interest Percentage	March 31, 2014	December 31, 2013
Hibbing	Other non-current assets[1]	Equity Method	23	$1.7	$(3.9)
Other	Other non-current assets	Equity Method	Various	34.3	34.7
				$36.0	$30.8

[1] At December 31, 2013, the classification for Hibbing was Other liabilities.

Significant Accounting Policies
A detailed description of our significant accounting policies can be found in the audited financial statements for the fiscal year ended December 31, 2013 included in our Annual Report on Form 10-K filed with the SEC. The significant accounting policies requiring updates have been included within the disclosures below.

Foreign Currency
Our financial statements are prepared with the U.S. dollar as the reporting currency. The functional currency of the Company’s Australian subsidiaries is the Australian dollar. The functional currency of all other international subsidiaries is the U.S. dollar. The financial statements of international subsidiaries are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities and a weighted average exchange rate for each period for revenues, expenses, gains and losses. Where the local currency is the functional currency, translation adjustments are recorded as Accumulated other comprehensive loss. Income taxes generally are not provided for foreign currency translation adjustments. To the extent that monetary assets and liabilities, inclusive of intercompany notes, are recorded in a currency other than the functional currency, these amounts are remeasured each reporting period, with the resulting gain or loss being recorded in the Statements of Unaudited Condensed Consolidated Operations. Transaction gains and losses resulting from remeasurement of short-term intercompany loans are included in Miscellaneous - net in our Statements of Unaudited Condensed Consolidated Operations. For the three months ended March 31, 2014, net losses of $6.5 million related to the impact of transaction gains and losses resulting from remeasurement, of which losses of $8.8 million and losses of $3.1 million, respectively, resulted from remeasurement of short-term intercompany loans and cash and cash equivalents. For the three months ended March 31, 2013, net gains of $3.7 million related to the impact of transaction gains and losses resulting from remeasurement, of which losses of $0.5 million and losses of $0.3 million, respectively, resulted from remeasurement of short-term intercompany loans and cash and cash equivalents.

NOTE 2 - SEGMENT REPORTING
Our Company’s primary operations are organized and managed according to product category and geographic location: U.S. Iron Ore, Eastern Canadian Iron Ore, Asia Pacific Iron Ore, North American Coal, Ferroalloys and our Global Exploration Group. The U.S. Iron Ore segment is comprised of our interests in five U.S. mines that provide iron ore to the integrated steel industry. The Eastern Canadian Iron Ore segment is comprised of two Eastern Canadian mines that primarily provide iron ore to the seaborne market for Asian steel producers. The Asia Pacific Iron Ore segment is located in Western Australia and provides iron ore to the seaborne market for Asian steel producers. The North American Coal segment is comprised of our four metallurgical coal mines and one thermal coal mine that provide metallurgical coal primarily to the integrated steel industry and thermal coal primarily to the energy industry. There were no intersegment revenues in the first quarters of 2014 or 2013.

The Ferroalloys operating segment is comprised of our interests in chromite deposits held in Northern Ontario, Canada and the Global Exploration Group is focused on early involvement in exploration activities to identify new projects for future development or projects that add significant value to existing operations. The Ferroalloys and Global Exploration Group operating segments do not meet reportable segment disclosure requirements and, therefore, are not reported separately.

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We evaluate segment performance based on sales margin, defined as revenues less cost of goods sold, and operating expenses identifiable to each segment. This measure of operating performance is an effective measurement as we focus on reducing production costs throughout the Company.
The following table presents a summary of our reportable segments for the three months ended March 31, 2014 and 2013, including a reconciliation of segment sales margin to Income (Loss) from Continuing Operations Before Income Taxes and Equity Loss from Ventures:

	(In Millions) Three Months Ended March 31,				
	2014			2013		
Revenues from product sales and services:						
U.S. Iron Ore	$361.3	38	%	$410.1	36	%
Eastern Canadian Iron Ore	158.3	17	%	245.3	22	%
Asia Pacific Iron Ore	254.2	27	%	270.8	24	%
North American Coal	166.2	18	%	214.3	18	%
Total revenues from product sales and services	$940.0	100	%	$1,140.5	100	%
Sales margin:						
U.S. Iron Ore	$95.0			$157.3		
Eastern Canadian Iron Ore	(49.7	)		19.4		
Asia Pacific Iron Ore	66.3			61.3		
North American Coal	(48.4	)		1.8		
Other	—			(1.9	)	
Sales margin	63.2			237.9		
Other operating expense	(113.9	)		(69.6	)	
Other expense	(41.5	)		(48.0	)	
Income (loss) from continuing operations before income taxes and equity loss from ventures	$(92.2	)		$120.3		
Depreciation, depletion and amortization:						
U.S. Iron Ore	$28.7			$26.6		
Eastern Canadian Iron Ore	41.2			41.1		
Asia Pacific Iron Ore	39.1			36.4		
North American Coal	29.9			32.5		
Other	2.2			4.0		
Total depreciation, depletion and amortization	$141.1			$140.6		
Capital additions[1]:						
U.S. Iron Ore	$14.9			$11.7		
Eastern Canadian Iron Ore	51.0			167.0		
Asia Pacific Iron Ore	3.2			4.3		
North American Coal	9.2			11.1		
Other	0.9			1.6		
Total capital additions	$79.2			$195.7		

1 Includes capital lease additions and non-cash accruals. Refer to NOTE 19 - CASH FLOW INFORMATION.

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A summary of assets by segment is as follows:

	(In Millions)	
	March 31, 2014	December 31, 2013
Assets:		
U.S. Iron Ore	$ 1,742.9	$ 1,671.6
Eastern Canadian Iron Ore	7,854.2	7,915.5
Asia Pacific Iron Ore	1,074.9	1,078.4
North American Coal	1,784.4	1,841.8
Other	467.5	455.6
Total segment assets	12,923.9	12,962.9
Corporate	278.9	159.0
Total assets	$ 13,202.8	$ 13,121.9

NOTE 3 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The following table presents the fair value of our derivative instruments and the classification of each in the Statements of Unaudited Condensed Consolidated Financial Position as of March 31, 2014 and December 31, 2013:

	(In Millions)							
	Derivative Assets				Derivative Liabilities			
	March 31, 2014		December 31, 2013		March 31, 2014		December 31, 2013	
Derivative Instrument	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under ASC 815:								
Interest Rate Swaps	Other current assets	$ 0.6		$ —	Other current liabilities	$ 0.4	Other current liabilities	$ 2.1
Foreign Exchange Contracts	Other current assets	4.1	Other current assets	0.3	Other current liabilities	15.1	Other current liabilities	25.8
Total derivatives designated as hedging instruments under ASC 815		$ 4.7		$ 0.3		$ 15.5		$ 27.9
Derivatives not designated as hedging instruments under ASC 815:								
Foreign Exchange Contracts		$ —		$ —	Other current liabilities	$ 1.9	Other current liabilities	$ 1.1
Customer Supply Agreement	Other current assets	42.0	Other current assets	55.8		—		—
Provisional Pricing Arrangements	Other current assets	1.3	Other current assets	3.1	Other current liabilities	7.4	Other current liabilities	10.3
Total derivatives not designated as hedging instruments under ASC 815		$ 43.3		$ 58.9		$ 9.3		$ 11.4

Total derivatives	$48.0	$59.2	$24.8	$39.3

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Derivatives Designated as Hedging Instruments

Cash Flow Hedges

Australian and Canadian Dollar Foreign Exchange Contracts

We are subject to changes in foreign currency exchange rates as a result of our operations in Australia and Canada. With respect to Australia, foreign exchange risk arises from our exposure to fluctuations in foreign currency exchange rates because the functional currency of our Asia Pacific operations is the Australian dollar. Our Asia Pacific operations receive funds in U.S. currency for their iron ore sales. The functional currency of our Canadian operations is the U.S. dollar; however, the production costs for these operations primarily are incurred in the Canadian dollar. We use foreign currency exchange contracts to hedge our foreign currency exposure for a portion of our U.S. dollar sales receipts in our Australian functional currency entities and our entities with Canadian dollar operating costs. For our Australian operations, U.S. dollars are converted to Australian dollars at the currency exchange rate in effect during the period the transaction occurred. For our Canadian operations, U.S. dollars are converted to Canadian dollars at the exchange rate in effect for the period the operating costs are incurred. The primary objective for the use of these instruments is to reduce exposure to changes in Australian and U.S. currency exchange rates and U.S. and Canadian currency exchange rates, respectively, and to protect against undue adverse movement in these exchange rates. These instruments qualify for hedge accounting treatment, and are tested for effectiveness at inception and at least once each reporting period. If and when any of our hedge contracts are determined not to be highly effective as hedges, the underlying hedged transaction is no longer likely to occur, or the derivative is terminated, hedge accounting is discontinued.

As of March 31, 2014, we had outstanding Australian and Canadian foreign currency exchange contracts with notional amounts of $315.0 million and $275.7 million, respectively, in the form of forward contracts with varying maturity dates ranging from April 2014 to March 2015. This compares with outstanding Australian and Canadian foreign currency exchange contracts with a notional amount of $323.0 million and $285.9 million, respectively, as of December 31, 2013.

Changes in fair value of highly effective hedges are recorded as a component of Accumulated other comprehensive loss in the Statements of Unaudited Condensed Consolidated Financial Position. Any ineffectiveness is recognized immediately in income and, as of March 31, 2014 and 2013, there was no material ineffectiveness recorded for foreign exchange contracts that were classified as cash flow hedges. However, certain Canadian hedge contracts were deemed ineffective during the fourth quarter of 2013 and no longer qualified for hedge accounting treatment. The de-designated hedges are discussed within the Derivatives Not Designated as Hedging Instruments section of this footnote. Amounts recorded as a component of Accumulated other comprehensive loss are reclassified into earnings in the same period the forecasted transactions affect earnings. Of the amounts remaining in Accumulated other comprehensive loss related to Australian hedge contracts and Canadian hedge contracts, we estimate that losses of $0.7 million and losses of $7.3 million (net of tax), respectively, will be reclassified into earnings within the next 12 months.

The following summarizes the effect of our derivatives designated as cash flow hedging instruments, net of tax in Accumulated other comprehensive loss in the Statements of Unaudited Condensed Consolidated Operations for the three months ended March 31, 2014 and 2013:

	(In Millions)				
Derivatives in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Earnings (Effective Portion)	
	Three Months Ended March 31,			Three Months Ended March 31,	
	2014	2013		2014	2013
Australian Dollar Foreign Exchange Contracts	$5.5	$3.2	Product revenues	$(9.1)	$1.8

(hedge designation)					
Canadian Dollar Foreign Exchange Contracts (hedge designation)	(7.8)	(8.2)	Cost of goods sold and operating expenses	(3.4)	0.2
Canadian Dollar Foreign Exchange Contracts (prior to de-designation)	—	—	Cost of goods sold and operating expenses	(0.3)	—
	$(2.3)	$(5.0)		$(12.8)	$2.0

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Fair Value Hedges
Interest Rate Hedges
Our fixed-to-variable interest rate swap derivative instruments, with a notional amount of $250.0 million, are designated and qualify as fair value hedges as of March 31, 2014. The objective of the hedges is to offset changes in the fair value of our debt instruments associated with fluctuations in the benchmark LIBOR interest rate as part of our risk management strategy.
For derivative instruments that are designated and qualify as fair-value hedges, the gain or loss on the hedge instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in net income. We include the gain or loss on the derivative instrument and the offsetting loss or gain on the hedged item in Other non-operating income. The net gain recognized in Other non-operating income for the three months ended March 31, 2014 was $0.2 million. There were no derivative instruments that were designated as fair-value hedges for the period ended March 31, 2013.
Derivatives Not Designated as Hedging Instruments
Foreign Exchange Contracts
During the fourth quarter of 2013, we discontinued hedge accounting for Canadian foreign currency exchange contracts for all outstanding contracts associated with Wabush and Ferroalloys operations as projected future cash flows were no longer considered probable, but we continue to hold these instruments as economic hedges to manage currency risk. Subsequent to de-designation, no further foreign currency exchange contracts were entered into for Wabush or Ferroalloys operations. As of March 31, 2014, the outstanding de-designated foreign currency exchange rate contracts had a notional amount of $38.6 million in the form of forward contracts with varying maturity dates ranging from April 2014 to June 2014. This compares with outstanding de-designated foreign currency exchange contracts with a notional amount of $74.8 million as of December 31, 2013.
As a result of discontinued hedge accounting, the instruments are prospectively adjusted to fair value each reporting period through Cost of goods sold and operating expenses on the Statements of Unaudited Condensed Consolidated Operations. For the three months ended March 31, 2014, the change in fair value of our de-designated foreign currency exchange contracts resulted in net losses of $0.9 million. The amounts that were previously recorded as a component of Accumulated other comprehensive loss prior to de-designation are reclassified to earnings and a corresponding realized gain or loss will be recognized when the forecasted cash flow occurs. For the three months ended March 31, 2014, we reclassified losses of $0.3 million from Accumulated other comprehensive loss related to contracts that matured during the period, and recorded the amounts as Cost of goods sold and operating expenses on the Statements of Unaudited Condensed Consolidated Operations. As of March 31, 2014, approximately $0.4 million of losses remain in Accumulated other comprehensive loss related to the effective cash flow hedge contracts prior to de-designation. We estimate the remaining $0.4 million of losses will be reclassified to Cost of goods sold and operating expenses in the next three months upon the maturity of the related contracts.
Customer Supply Agreements
Most of our U.S. Iron Ore long-term supply agreements are comprised of a base price with annual price adjustment factors. The base price is the primary component of the purchase price for each contract. The indexed price adjustment factors are integral to the iron ore supply contracts and vary based on the agreement, but typically include adjustments based upon changes in the Platts 62 percent Fe spot rate and/or international pellet prices and changes in specified Producers Price Indices, including those for all commodities, industrial commodities, energy and steel. The pricing adjustments generally operate in the same manner, with each factor typically comprising a portion of the price adjustment, although the weighting of each factor varies based upon the specific terms of each agreement. In most cases, these adjustment factors have not been finalized at the time our product is sold. In these cases, we historically have estimated the adjustment factors at each reporting period based upon the best third-party information available. The estimates are then adjusted to actual when the information has been finalized. The price adjustment factors have been evaluated to determine if they contain embedded derivatives. The price adjustment factors share the same economic characteristics and risks as the host contract and are integral to the host contract as inflation adjustments; accordingly, they have not been separately valued as derivative instruments.
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