

HD **China's Global Mining Play Is Failing to Pan Out -6-**

BY By Wayne Arnold

WC 2,361 words

PD 11 September 2014

ET 16:11

SN Dow Jones Newswires Chinese (English)

SC RTNW

LA English

CY Copyright © 2014, Dow Jones & Company, Inc.

LP

CAPE PRESTON, Australia--A \$10 **billion iron-ore** mine that has taken more than eight years to develop near this remote Australian port is a glaring example of how much has gone wrong with **China's** decadelong push to **buy** up raw materials around the world.

Citic Pacific's Sino **Iron** mine cost roughly four times its initial budget, and analysts who track the project say it likely will lose hundreds of **millions** of dollars in 2014, its first full year of production. Citic Pacific, a **Hong Kong**-listed subsidiary of **Chinese** state-owned behemoth Citic **Group**, and its contractors made a series of blunders, from thinking they could import workers at **Chinese** pay levels to a botched bet on currencies that forced the **company** to seek a \$1.5 **billion** bailout from its parent.

TD

And while Sino **Iron** is at last shipping **ore**, it remains locked in a legal battle with its local partner, Clive Palmer, a **property** mogul turned politician who has accused Citic Pacific of taking Australian resources without fully paying for them.

"It was a painful learning process," said Zhang Jijing, who spent 16 years running Citic **Group's** Australian business before being appointed in late 2009 president and executive director of subsidiary Citic Pacific, which recently changed its name to Citic Ltd. "Today I look back and I did not realize it would be so difficult."

Over the past decade, **China** rushed to **buy** up global commodities as its economy boomed--both to feed its factories and to ensure it wasn't reliant on Western powers for raw materials. **China's** overseas investments in resources soared to \$53.3 **billion** last year, from \$8.2 **billion** in 2005, according to an investment database compiled by the American Enterprise Institute and the Heritage Foundation.

Now it is becoming clear that **China's** shopping spree yielded numerous bad investments. Many big-ticket deals are losing money, running into unexpected costs or generating significantly less output than expected. Some **Chinese** investors are moving away from resources--a shift that could mean less **Chinese** money for countries in places like Africa, Latin America and the Middle East.

The reasons for **China's** struggles vary. **China** came late to the global resources boom and often overpaid for assets Western companies had passed over or wanted to sell. **China** typically paid one-fifth more for **oil**-and-gas assets than the industry average, estimates Scott Darling, Asian regional head of **oil**-and-gas research at J.P. Morgan Chase & Co.

China Petroleum & Chemical Corp., also known as Sinopec, paid \$4.65 **billion** in 2010 for ConocoPhillips's **stake** in Canadian **oil**-sands **company** Syncrude Canada Ltd. The price was a 10% premium to the asset's market value at the time, gauged by the market valuation of its largest shareholder, Canadian **Oil** Sands Ltd. The project subsequently was dogged by rising costs and falling production, according to financial disclosures by Canadian **Oil** Sands.

Sinopec said the Syncrude project was the only **oil**-sands project of its scale available at the time and that the price was reasonable. Syncrude's production and profitability were stable until recently, Sinopec said, and Sinopec expects the project to produce for 60 years. "So the project could still be considered as a qualified profitable one in the long term," it said.

Cnooc Ltd. paid \$15.1 **billion** in 2012 for Canadian **energy** producer Nexen Inc., whose net profits are now less than one-fifth what they were in 2010. The **company** has suffered from lower natural-gas prices, declining output from some key fields and other problems.

Cnooc said that Nexen's performance since the merger was in line with its expectations and its assets were operating smoothly.

In April, Iran canceled a \$2.5 **billion** deal with **China** National Petroleum Corp. to develop an onshore **oil** field called South Azadegan after Iranian officials alleged **China** was overcharging for drilling equipment and services and causing projects to be delayed. A month earlier, Iran's deputy petroleum minister, Mansour Moazzami, said CNPC was at risk of losing its \$4.7 **billion** contract to develop the giant South Pars gas field because it had failed to make sufficient progress. CNPC didn't respond to requests for comment.

Mining and **energy** projects are difficult by nature, and Western resource companies often run into troubles of their own. Some analysts say **China** is simply waking up to the hard realities that Western companies have long confronted in such projects.

"The world is littered with projects that have had massive cost overruns," said Megan Anwyl, executive director of the Magnetite Network, a **mining**-industry lobbying **group** in Perth.

Some of **China's** bad deals could still pay off if global commodity supplies become tight and prices rise. A few of **China's** major deals, including Sinopec's \$3.5 **billion purchase** of **oil** assets from Russia's OAO Rosneft in 2006, appear to be either profitable or close to breaking even, according to **company** disclosures and news reports.

Big new **Chinese** deals are still being done. In April, a unit of **China** Minmetals Corp. led a consortium to **purchase** a Peruvian **copper** mine from Glencore Xstrata PLC for \$5.85 **billion**.

But **Chinese** officials acknowledge difficulties. Last year, the head of **China's mining** association estimated that 80% of all overseas **mining** deals had failed, though he didn't elaborate, according to state media.

China's National Audit Office in June blamed mismanagement for losses on at least 10 foreign investments by **China** Investment Corp., the \$600 **billion** sovereign-wealth fund that bought tens of **billions** of dollars in resource-related holdings between 2009 and 2012. The office didn't specify which deals.

CIC has begun shifting away from **energy** investments and into other sectors, according to people familiar with the fund. **Energy** and metals deals fell to two-thirds of **China's** offshore investments in 2013, from 80% in 2005, according to the American Enterprise Institute and Heritage Foundation data, and **China's** \$53.3 **billion** in resource investments last year was below the record \$57.5 **billion** in 2011.

China's Ministry of Commerce said it had stepped up efforts to vet overseas investments and make companies more aware of the risks and responsibilities they face abroad.

"The government said from now on this 'buy any resource at any price' is finished," said Por Yiang-liang, an analyst at BNP Paribas in **Hong Kong**. "It's a complete reversal of the past decade."

Citic Pacific's misadventures in northwestern Australia suggest why **China** is changing course.

Citic Pacific signed its deal with Mr. Palmer, a **property** tycoon who owned rights to mine **iron ore** around Cape Preston, in March 2006. Citic Pacific wanted to feed three steel mills it operates in **China**.

Iron-ore prices were soaring at the time, and Beijing was eager to break the dominance of BHP Billiton Ltd., Rio Tinto PLC and Vale SA of Brazil, which together controlled more than 70% of the world's seaborne **iron-ore** trade.

Citic Pacific paid Mr. Palmer's **company**, Mineralogy Pty. Ltd., an initial \$415 **million** and agreed to invest \$2.5 **billion** to build the project and a port, with production slated to begin by 2009. It also agreed to pay Mineralogy royalties on every ton of **ore** it produced, and a penalty if by 2013 it wasn't producing at least 6 **million** tons a year.

Miners in the area had long focused on **iron-ore** deposits called hematite that could be shipped without processing. Cape Preston's **ore** is poorer-quality magnetite, which must be concentrated before it is **sold**. Citic Pacific would have to build six processing plants, which also would require a power plant and desalination facility for water needed to run the operation.

Within six months of winning Australian government approval for its investment, Citic Pacific gave a \$1.75 **billion** contract to build the project to Metallurgical Corp. of **China**, or MCC.

"I don't know why everything was pushed in such a hurry in the beginning," said Mr. Zhang, the Citic executive. Preparing such a big project, he said, would normally take two years.

Australian consultants had said a project half the size would take \$5 **billion** and five years to complete. **China's** MCC said it could do it for \$2.5 **billion** in just three.

Officials at MCC didn't respond to requests for comment. In its 2012 annual report, the **company** said that "preparatory works from both sides were insufficient" and that the "project was commenced hastily without full understanding of the Australia laws," among other issues.

Sino **Iron** was bigger than anything MCC had built in **China**, Mr. Zhang said. The mine uses seven-story crushers in the pit and a mile-long conveyor belt to carry rock to processing lines.

The area's magnetite turned out to be much harder than magnetite in **China** and wore out equipment. The **ore** also is riddled with asbestos, according to Citic Pacific financial disclosures, so the **company** had to invest in airtight vehicles to prevent workers from breathing the carcinogenic fibers.

Officials at MCC wanted to import inexpensive **Chinese** workers but faced obstacles, Mr. Zhang said.

Australia only gives workers visas if they speak English and pass Australian qualification exams. Those that pass have to be paid no less than an equally qualified Australian, with standard benefits such as a week off for every three on **site** and flights to and from Perth.

In the end, MCC was only able to bring in a few hundred **Chinese**. Each of the 1,000 miners working at Sino **Iron**, Mr. Zhang said, costs the **company** more than \$200,000 a year, including benefits and other expenses.

Complying with Australia's environmental and cultural regulations was another headache. Sino **Iron**, for example, worked with Aboriginal communities to protect or move sacred sites.

China's Global **Mining** Play Is Failing to Pan Out -6- -2-

The costs were in Australian dollars, which strengthened against the U.S. dollar between 2007 and the time construction started in August 2008. To protect itself from currency losses, Citic Pacific bought currency-related derivatives that backfired when the global financial crisis struck.

In October 2008, facing more than \$2 **billion** in potential losses, Citic Pacific took a \$1.5 **billion** bailout from its parent, Citic **Group**.

Citic Pacific enlisted Mr. Zhang, who wasn't involved in the project until then, to become its executive director. Mr. Zhang agreed to increase Citic Pacific's payments to MCC, which eventually paid MCC a total of \$3.4 **billion**.

Sino **Iron** also was clashing with Mr. Palmer, who after striking his deal with Citic Pacific had invested in a soccer team, a nickel refinery and a golf resort that he turned into a dinosaur theme **park**. In 2012, he announced plans to build a replica of the Titanic. Last year he established his own political party, the Palmer United Party, and won a seat in Parliament.

Analysts estimated Sino **Iron's** delays were costing Mr. Palmer hundreds of **millions** of dollars a year in royalties.

In October 2012, Mineralogy issued a notice terminating Citic Pacific's **mining** rights, alleging that it had not been paying royalties due. Citic Pacific acknowledges it wasn't paying royalties but argued it didn't need to because it wasn't yet shipping any processed **ore**.

A court eventually ruled Citic Pacific would have to start paying those royalties. But when Citic Pacific's additional penalty for not producing 6 **million** tons a year--equivalent to about 10% of the expected **sale** value of processed **ore**--came due last year, the **company** said it wouldn't pay until the two sides could agree to a pricing formula. They are in mediation.

"We're confident before the courts," said Andrew Crook, a spokesman for Mr. Palmer. "We'll let them sort it out." Mr. Palmer declined to comment.

In July, Citic Pacific sued Mr. Palmer for fraud, alleging he siphoned \$11.2 **million** from an account for operating the port, part of which allegedly was used to pay for his party's political campaign last year. Mr. Palmer has denied wrongdoing, but created a diplomatic stir in August. When asked about the

accusations on Australia's ABC television, he accused **China** of wanting to bring in workers to Australia, among other things. "I don't mind standing up against the **Chinese** bastards and stopping them from doing it," he said, referring to Citic Pacific as "mongrels." He continued: "I'm saying that because they're communist, because they shoot their own people, they haven't got a justice system and they want to take over this country."

Citic Pacific declined to comment on Mr. Palmer's remarks, for which he subsequently apologized. Mr. Palmer said his comments "were not directed at the **Chinese** community or the **Chinese** government."

Last December, Citic Pacific fired MCC, taking over the construction of the mine's last four production lines. It held a simple ceremony to mark its first shipment of **iron ore** from Cape Preston to **China**.

In February, Citic Pacific disclosed its latest tally for the project: \$9.9 **billion** in investment and \$3.6 **billion** in debt to build an asset the **company** values at less than \$7 **billion**.

Its **iron-ore** division, which only includes the Australia mine, lost more than \$208 **million** last year, according to its annual report, in which its chairman said it may lose more as expenses mount.

Mr. Zhang said costs would come down once the remaining four lines are completed. He said it would take a couple of years more before the mine is running at full capacity. But the worst of the mine's troubles, he predicted, are behind it.

Chester Dawson, Benoît Faucon, Ned Levin, Drew Hinshaw, Joy Ma, Wayne Ma, Brian Spegele, Lingling Wei and Kersten Zhang contributed to this article.

Subscribe to WSJ: <http://online.wsj.com?mod=djnwires>

(MORE TO FOLLOW) Dow Jones Newswires

11-09-14 0611GMT

CO bkhlp : BHP Billiton Ltd | craaus : Rio Tinto Ltd | cvrd : Vale S.A. | athoil : Canadian Oil Sands Limited | cpetc : China Petroleum and Chemical Corp (Sinopec Corp) | mcochn : Metallurgical Corporation of China Limited | bltpc : BHP Billiton PLC | rtz : Rio Tinto PLC | skfdev : CITIC Limited | cnooc : CNOOC Ltd | philp : ConocoPhillips | chinvm : China Investment Corp. Ltd. | cnpngc : China National Petroleum Corp | syncan : Syncrude Canada Ltd | chmeco : China Metallurgical Group Corporation | chno : China National Offshore Oil Corporation | chpc : China Petrochemical Corp | citic : CITIC Group

IN i1 : Energy | i13 : Crude Oil/Natural Gas | i1300002 : Oil Exploration | i1300005 : Support Activities for Oil/Gas | i211 : Metal Ore Mining | i221 : Iron/Steel/Ferroalloys | i502 : Heavy Construction | ibcs : Business/Consumer Services | iindstrls : Industrial Goods | iinv : Investing/Securities | imet : Mining/Quarrying | i22 : Primary Metals | ibascm : Basic Materials/Resources | iconst : Construction | icre : Real Estate/Construction | iexplo : Natural Gas/Oil Exploration | ifinal : Financial Services | i1300003 : Crude Petroleum Extraction | i2111 : Iron Ore Mining | i81502 : Trusts/Funds/Financial Vehicles | i8396 : Diversified Holding Companies | iextra : Natural Gas/Oil Extraction | isover : Sovereign Wealth Fund

NS ccat : Corporate/Industrial News | ncmac : Commodities Asset Class News | nenac : Energy Asset Class News | neqac : Equities Asset Class News | nfiac : Fixed Income Asset Class News | ncat : Content Types | nfact : Factiva Filters

RE china : China | austr : Australia | braz : Brazil | caab : Alberta | cana : Canada | eurz : Europe | hkong : Hong Kong | usa : United States | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRIC Countries | chinaz : Greater China | devgoz : Emerging Market Countries | dvpcoz : Developing Economies | easiaz : Eastern Asia | lamz : Latin America | namz : North America | samz : South America

PUB Dow Jones & Company, Inc.

AN Document RTNW000020140911ea9b0005g