

HD Cover Story: Australia report 2014 - Rinehart's ore-some ambition

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At Roy Hill in Australia's vast northwest Gina Rinehart is on the cusp of fulfilling a 20-year dream of owning and operating an iron ore mine

Most of the passengers on the pre-dawn charter flight from Perth to Australia's remote Pilbara region are fly-in fly-out construction workers dressed in high-visibility shirts. They doze behind dark sunglasses, savouring memories of home leave and preparing for 14 straight days of 12-hour shifts.

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In the front row sits Barry Fitzgerald, chief executive of Roy Hill Holdings and the man in charge of the only major greenfield iron ore mine under development in Australia.

Around him are a couple of Roy Hill employees, three conservative senators, bankers from BNP Paribas and National Australia Bank, a South Korean lawyer, a handful of journalists from Asian media outlets, and two well-dressed women who even in this offbeat group seem a little out of place. They are later introduced as the long-serving personal assistants of Gina Rinehart - chairperson of Hancock Prospecting and Australia's richest person with a fortune of Adollars 20 billion (dollars 18.5 billion).

It is late-July 2014 and we have been invited on a tour of Roy Hill's Adollars 10 billion mine, the biggest construction project underway in the country. Rinehart owns 70% of Roy Hill and our tour has been timed to celebrate an important milestone - the first blast in a pit called Delta 2 where Rinehart will cut her first iron ore and thus fulfil a 20-year dream of being an owner-operator.

Rinehart has been working towards this day since 1992 when she took over Hancock Prospecting from her late father Lang Hancock and pegged out the Pilbara leases. The early years were spent channelling her energies towards another tenement at Hope Downs but after several unsuccessful attempts at finding a minority partner, Rinehart reluctantly signed a deal with Rio Tinto, giving Rio 50% of the asset and operational control.

Royalties flowing from Hope Downs have funded Rinehart's pursuit of Roy Hill and in 2009 she hired South Korean steelmaker Posco and fellow Korean investors STX Corp to conduct a Adollars 330 million feasibility study on the deposit. In 2012 - just after the global iron ore price peaked at dollars 181 a tonne - she sold 30% of the project to equity investors Marubeni Corp of Japan (which owns 15%), Posco (12.5%) and China Steel Corp of Taiwan (2.5%). The trio paid Adollars 3.2 billion for the stake and secured rights to 28.75 million tonnes of annual iron ore offtake.

Finally, in March this year Rinehart closed a dollars 7.2 billion loan facility backed by five export credit agencies and a consortium of 19 commercial banks from Australia, Japan, Europe, China, Korea and Singapore.

'This is emotional. (My father) dedicated much of his adult life to what I've also been trying to do,' Rinehart says, addressing members of our tour at a celebration dinner in the mine's camp later that day. 'You have to take some giant risks when you do a project like this and this is a project Australia can be proud of.'

Vast resources

The Pilbara is a sparse, prehistoric plain covering 400,000 square kilometres in the middle of Western Australia, about 1,200km northeast of Perth. With an average yearly rainfall of just 250mm the red earth is quickly whipped up by the **wind**, covering everything in a fine film of crimson dust. Venomous snakes bake in the searing sun, easily outnumbering the kangaroos and wild horses that forage in the brittle spinifex.

Roy Hill sits on an **ore** body 34km long and 7km wide, or about twice the size of **Hong Kong Island**. At the northern end of the tenement, at the **site** of Rinehart's new Delta pit, the **ore** body rises to the surface and is visible underfoot. It then slopes away underground, below the water table. The deposit contains an estimated 1 **billion** tonnes of high-grade material and 1.3 **billion** tonnes of low-grade material, giving the mine a total lifespan of 20 years. At peak production it will produce 55 **million** tonnes of **iron ore** a year, most of it is destined for Asia's steel mills.

'We will be shipping lump and fines product,' explains Fitzgerald as he marks out the boundaries of the lease on a map. 'To prove the size and quality of the deposit we have completed 960,000 meters of core drilling which is far beyond a project of comparable size.' The extensive drilling programme was needed to convince financiers to back the venture.

A typical Pilbara blend is 62% grade, said Fitzgerald. 'Our product grades are around 61%, making us a direct replacement for the major Pilbara producers such as Rio or BHP, and considerably above the grades of other producers.'

Fitzgerald knows the numbers well having spent more than 30 years in the industry, including stints at BHP and Citic Pacific's Sino **iron** project near Karratha, elsewhere in the Pilbara. He has an easy-going manner with his staff, talking amiably while kicking the dirt and welcoming feedback on his initiatives.

To prepare its **ore** for shipment, Roy Hill is building two enormous crushers, a water processing plant, a power station, a heavy vehicle maintenance workshop, a giant tailings dam, and a train loader, all at various stages of completion. The **ore** will be hauled from the pits to the crushers by a fleet of 80 giant **mining** trucks, each worth Adollars 4 **million** and each fitted with six tyres at Adollars 40,000 apiece. The fly-in fly-out miners will sleep in air-conditioned metal huts arranged in a ring-shaped camp on the edges of the lease. The camp accommodates 2,000 people.

To get its **ore** to market, Roy Hill is building a 344km railway track to Port Hedland in the north. At peak production, five trains a day will ply the route, each 2.5km long with capacity for 32,000 tonnes spread across 234 wagons. At Port Hedland, work is underway on a huge stockyard, a railcar dumper and a 14km conveyer belt that will carry the **ore** to ships berthed at two purpose-built jetties. So far a total of 5.6 **million** cubic metres of mud has been dredged from the harbour floor to make it deep enough for the tankers to manoeuvre.

Iron lady

It is easy to get carried away by the immense scale of the Roy Hill project and the sheer determination of its mastermind, Gina Rinehart.

Rinehart lives and breathes **mining** and clearly has a nose for the business. It could be said she eats risk for breakfast - making daily decisions that would leave the average person nauseous with anxiety.

Rinehart is an intensely private person and it is rare for journalists to be invited into her realm. We are told she won't answer direct questions, nor will she discuss the ongoing court case with two of her four children over control of the family trust.

Known as a tough negotiator, Rinehart isn't afraid to use her considerable wealth to exert political influence. She has strong views about Australia's **mining** industry and believes it is critical for creating jobs and generating income to pay back the country's debt. She is a staunch opponent of a government tax on excess **mining** profits and has written columns and made online videos criticising the lazy attitude of average Australians and promoting her idea of creating a dedicated economic zone in the north where there would be fewer regulations and taxes.

Maybe it is Rinehart's brash style and her ability to play in a mainly male industry that has brought her to the point where she can finally call herself an owner-miner. After all, it is one thing to inherit **mining** leases with the promise of great wealth, and another thing to realise that wealth by staying the course and convincing others to come along for the ride.

The road has had its bumps. Before Roy Hill secured its **equity** partners, the port authority at Port Hedland handed two of Rinehart's four proposed berths to Fortescue and ordered her to begin dredging works on the harbour or risk losing the berths altogether. There were also protracted negotiations over

access to existing rail facilities owned by BHP, until the discussions failed and Rinehart was forced to borrow more debt to cover the cost of building a separate rail link.

On our visit to the mine she travels with a bodyguard and a small entourage of trusted advisors. One of those is Tad Watroba, a **mining** engineer hired by Hancock more than 25 years ago and now an executive director of the **company** and Rinehart's right-hand man. Another is Sydney-based Jason Morrison, a former radio shock-jock who is said to be working with Rinehart on her recent attempts to gain control of Fairfax Media, a publisher of influential newspapers in Australia. Hancock Prospecting currently owns just under 15% of Fairfax.

Morrison is a fairly recent recruit and thinks Rinehart is fundamentally a nationalist, deeply committed to developing Australia's resources and promoting ties with Asia. She has a particular interest in the country's far north and in July this year **purchased** a Adollars 40 **million stake** in two vast cattle stations in the Kimberley that sell processed beef and live cattle to overseas markets.

In her dinner speech Rinehart calls on the government to make Australia a more competitive place to do business, starting with the repeal of the **mining** profits tax. 'It's not about making Gina richer, or anything short-sighted like that. It's about making our country sustainable in world markets,' she says.

Rinehart tells us she is particularly delighted to have her daughter Ginia on the trip. The 27-year-old is tipped as Rinehart's most likely successor and is being schooled in the business of **mining**. 'I'm thrilled to bits Ginia is here,' she says. 'It's lovely because one, she's my daughter and two, the next generation. These are the types of projects the next generation needs and this project, so long as we keep costs down and get our act together, will be around for decades.'

Ginia films the speech on her iPhone and as her mother sits down, the pair exchange kisses.

Bank support

The five export credit agencies and 19 **commercial** banks behind Roy Hill's financing package committed to the loan back in December 2013 but took another four months to **iron** out the detail. While they share Rinehart's vision, they are also hedging their bets by setting construction targets and imposing strict funding management controls.

The export credit agencies from Korea, Japan and the US have also insisted Roy Hill **buy** equipment from their various local companies such as Caterpillar trucks, Hitachi excavators, Nippon Steel rail tracks, and Posco-supplied workers' huts.

Early negotiations with lenders also specified a preference for a full-liability end-to-end engineering and construction contract to be awarded a third-party builder. Both Posco E&C and Samsung C&T bid for the Adollars 5.6 **billion** contract and in March last year Samsung won, putting it in charge of delivering the mine as well as the railway and port infrastructure. The fixed-priced nature of the contract means Samsung has to swallow any cost overruns.

The first shipment of **ore** is due to leave Roy Hill in September next year and, after that, the loan calls for a 30-month ramp-up to full production. 'We're hoping we can do it quicker than that,' said Fitzgerald. 'If we are ahead of schedule we get revenue sooner and we reduce our holding and operating costs.'

Beyond construction, Roy Hill's ability to meet interest payments will be determined by the price it receives for its **iron ore** and its efforts to keep a lid on production costs. Sources close to the funding package say there is 'plenty of slack' between current **iron ore** prices at dollars 92 a tonne and Roy Hill's all-in cash costs. While these numbers have been revealed to FinanceAsia, they are not public. Fitzgerald won't be drawn on the topic, confirming only that independent assessments place Roy Hill at the 'lower quartile of production costs'.

A Melbourne-based project finance source said there is a 'sufficient cashflow buffer before the banks start to get nervous', adding the buffer is larger than the one negotiated in Fortescue's loan facility and 'Fortescue is producing a lower-grade product than Roy Hill'.

'The biggest variable in the cost structure is diesel,' said the source. 'Mines use a lot of diesel in their heavy vehicle and rail **operations**.'

The other large variable is labour but here too Roy Hill is benefiting from a sector-wide reduction in pay scales and a series of retrenchments at BHP and Rio. Fitzgerald said when Roy Hill recently advertised for a geologist it received hundreds of applications - a scenario that would have been unheard of three years ago when mine operators were paying twice the average national salary to attract truck drivers.

Still, Roy Hill is by no means a low-risk venture. Commodity markets are fickle and the **iron ore** price is tracking lower. According to a survey of 60 **mining** executives conducted by Newport Consulting in July, sentiment is at a five-year low with 93% of executives indicating they are not optimistic about growth prospects for the next 12 months.

Those hardest hit by the cyclical downturn are the junior miners with lower-grade **ore** deposits and higher shipping costs. Big miners like BHP and Rio have been compensating by cutting costs and driving for higher production volumes. Both have reported double-digit increases in their Western Australian output in the past year.

Fortescue's average price per tonne in the June quarter was dollars 82, a 20% discount on the benchmark price, and there are rumours it is currently negotiating with contractors to rewrite agreements that were made at the top of the cycle.

With new mines starting up in countries from Brazil to the Republic of Congo, Roy Hill will be selling its product into a saturated market. Some commentators predict global **iron ore** demand will be lower than global supply for the next five years. 'There is room in the market for Roy Hill, but only from 2019 onwards,' said Paul Gray, an analyst with consultancy Wood Mackenzie, in an interview with Dow Jones in March.

Low cost producer

Unable to control market forces, Roy Hill is focused on costs and Fitzgerald talks about what is being done to save time and money. The **company** will process its **ore** through a wet plant rather than a less-reliable dry plant, and conveyer belts are being installed to ferry **ore** around the processing yards so fewer trucks are needed. To ensure the consistency of its product, and therefore lift its average **sale** price, Roy Hill will take care when blending its shipments. 'Our port access limits our annual output to 55 **million** tonnes a year so we can spend time blending the **ore** to maximise our price per tonne and extend the life of our reserves,' Fitzgerald said.

To boost worker productivity Rinehart has built her own airport to lessen the time it takes for fly-in workers to be on the job and has introduced a new 14-day roster system in place of the 10-day system used by other operators. There are also reports workers have been offered a 'no strike' bonus to discourage industrial action.

If Rinehart's careful planning pays off, the revenue from Roy Hill will flow thick and fast, adding to her already enormous wealth.

As we prepare to leave the mine, a worker serving coffee at the airport wants to know if one day he will be able to **buy** shares in the business. He is taken by the scale of the project and believes in 'getting in at the ground floor' on opportunities like these.

I put this question about a possible initial public offering to one of Rinehart's entourage. 'I can't see it happening,' he says. 'Not while Gina is still alive, and probably not under Gina's reign either.'

- Five trains a day will leave the mine, each 2.5km long with capacity for 32,000 tonnes spread across 234 wagons

Dollars 92 - Current per tonne price of **iron ore** versus peak of dollars 181

20 Years - Roy Hill has 2.3 **billion** tonnes of **ore** and a lifespan of 20 years

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