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

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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.

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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 companySyncrude 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 Yong-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.

10 Sep 2014 22:44 ET China's Global Mining Play Is Failing to Pan Out -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.

Corrections & Amplifications

This item was corrected Sept. 15, 2014 1058 GMT because it misspelled the name of BNP Paribas analyst Por Yong-liang as Por Yiang-liang in the 21st paragraph.

15 Sep 2014 06:11 ET Correction to China Mining Story on Sept. 11

"China's Global Mining Play Is Failing to Pan Out," published at 0230 GMT on Sept. 11, misspelled the name of BNP Paribas analyst Por Yong-liang as Por Yiang-liang in the 21st paragraph.

(END) Dow Jones Newswires

September 15, 2014 06:11 ET (10:11 GMT)

CO cnooc : CNOOC Ltd | chno : China National Offshore Oil Corporation

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 | ibasicm : Basic Materials/Resources | iconst : Construction | icre : Real Estate/Construction | iexplo : Natural Gas/Oil Exploration | ifinal : Financial Services

NS c12 : Corporate Crime/Legal Action | ccat : Corporate/Industrial News | mirono : Iron Ore Markets | ncmac : Commodities Asset Class News | ncrx : Corrected Items | nenac : Energy Asset Class News | neqac : Equities Asset Class News | nfiac : Fixed Income Asset Class News | m14 : Commodity Markets | m142 : Metals Markets | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : FC&E Exclusion Filter | nfcpex : FC&E Executive News Filter | nfcpin : FC&E Industry News Filter

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