NIKKEI

HD **Citic Pacific 's pit of despair**

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MICHAEL SAINSBURY, Contributing writer

BANGKOK -- Once-mighty Citic Pacific was almost destroyed in a 2008 currency-hedging scandal. It survived that but is again caught up in crisis as it pours cash into the much-delayed Sino Iron mining project in Western Australia. The project has proved a black hole, swallowing up some $10 billion to date.

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The iron ore mine in the Pilbara region is one of the biggest single Chinese investments in Australia. It is expected to be the world's largest source of magnetite, a lower-grade iron ore.

The project was beset by problems from the moment Citic Pacific , majority-owned by state-run Citic Group , paid an initial $415 million for the mining rights in 2006. It was the first in a string of problematic investments in Australia by the Chinese that were designed to reduce the Asian nation's reliance on the "big three" of the iron ore trade: BHP Billiton and Rio Tinto , the two Anglo-Australian giants, and Brazil's Vale.

There have been instances when Chinese companies overpaid, such as Sinosteel's 2008 purchase of Midwest Corp . There have also been failed deals, such as Aluminum Corp. of China 's $19.5 billion bid to double its stake in Rio Tinto .

But the Sino Iron project is by far the costliest.

Citic Pacific announced Feb. 20 that losses at Sino Iron, which operates one of the company's three core business lines, doubled in 2013 to 1.6 billion Hong Kong dollars ($206 million). The Australian mine on Dec. 2 made its first shipment, more than four years behind schedule.

Mining newbie

The Hong Kong-listed company had never mined iron ore before and ran into unforeseen cultural issues with Australian management and regulatory hurdles, including stringent labor laws. The main contractor, China Metallurgical Group, also had no Australian experience, and was surprised to find out it could not bring over thousands of Chinese laborers to work on the project.

Citic Pacific also has a long-running legal dispute with the Australian billionaire lawmaker Clive Palmer over royalty payments, as well as asbestos detected at the Pilbara site.

"The ironic fact is that in meeting the major milestone of the first export shipment, our company's financial results will suffer in the short term," Chang Zhenming , Citic Pacific 's chairman, said in February. "I want to prepare you for these realities."

The mine may never be economically viable. The spot price of iron ore has dropped almost 20% since the start of the year -- it peaked at about $190 per ton in February 2011 -- and declined to $104.70 on March 10.

Citigroup analysts said in a Feb. 20 note that it might settle at $90 within two years. Hundreds of millions of tons of new production is coming on line just as Chinese growth is slowing and overcapacity in its steel industry is being tackled. It is exactly the wrong time to be ramping up production on a high-cost mine for low-grade iron ore.

Tim Murray, managing partner at Beijing-based research firm J Capital Research, calculates that Sino Iron can only cover its interest bills even if the price of iron ore recovers to $120 per ton. "We do not see any scenario where the iron ore division can make a profit, let alone repay debt," he said.

Citic Pacific 's only forecast on cost is that it will remain "high" until the mine is in full production, at least three years hence.

The scale of Citic Pacific 's cost and schedule overrun has shocked Beijing officials. Instead of leading the way for a new generation of Chinese producers in the region, Sino Iron is among the disastrous deals that have made the government cautious about state-owned companies investing abroad.

The State-owned Assets Supervision and Administration Commission of the State Council last year started a much stricter vetting process for these investments.

The failure of China to establish any substantial iron ore mining presence in Australia has seen Beijing refocus on its domestic mines. It has encouraged large steel mills to take over highly fragmented domestic iron ore mines to cut costs and raise efficiency.

"This marks a strategy for our country to break our reliance on imported ore, and to support the transformation of our steel industry for international competitiveness," the Metallurgical Mines Association of China said in a statement.

CO citic : CITIC Group Corporation

IN i211 : Metal Ore Mining | i2111 : Iron Ore Mining | imet : Mining/Quarrying | ibasicm : Basic Materials/Resources | i81502 : Trusts/Funds/Financial Vehicles | ifinal : Financial Services | iinv : Investing/Securities

NS reqrmm : Suggested Reading Metals/Mining | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE austr : Australia | china : China | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRICS Countries | chinaz : Greater China | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | easiaz : Eastern Asia

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