Andrew Forrest's 'lesson in humility'

Australian Financial Review
December 13, 2024 Friday
Print & First Editions

Section: NEWS; Pg. 3

Length: 2253 words

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Body

It was a meeting whispered about as ***Fortescue***'s version of the "red wedding" scene from Game of Thrones, in which a slew of characters were killed off in one sitting. ***Fortescue***'s executive chairman, Andrew Forrest, refers to it as "judgment day", which in the Bible is God's final sorting of people into the saved and the damned.

Appropriately, it took place in the "red cafe" at the company's Perth headquarters, so named for its colour scheme. And it was a bloodbath. One person who was there says ***Fortescue***'s chief executive at the time, Elizabeth Gaines, was in tears, and the rest of the company's C-suite was rattled and emotional.

The catalyst for the meeting was the troubled Iron Bridge magnetite mine. A joint venture between ***Fortescue*** and Taiwan's Formosa Steel, the mine is about 145 kilometres south of Port Hedland in the Pilbara. In early 2021, it was behind schedule and over budget. Forrest was furious.

Gaines and other executives, including former chief financial officer Ian Wells, were forced to apologise and take responsibility for the situation. Greg Lilleyman, a well-respected mining executive who was then chief operating officer, announced he was leaving the company. Project director Don Hyma and Iron Bridge project director Manie McDonald would also depart, the company confirmed later on February 16, and Gaines and Wells would forgo their bonuses.

"It was like a public shaming," says one person who was at the meeting. The executives were forced to make "a confession, saying they had betrayed the ***Fortescue*** values".

These values are clearly laid out on the company's website and referred to repeatedly by management. They include family, empowerment, frugality, enthusiasm and "stretch targets". ***Fortescue*** sets deliberately ambitious goals to ensure employees strive to do tasks faster and with fewer dollars.

But that cost-saving ambition has been put under a spotlight at Iron Bridge. The project has so far increased its expected capital expenditure at least five times and has suffered from persistent leaks in the pipelines that deliver water to the site and then slurry the ore product to Port Hedland. What's more, dust issues have put the company in regulators' sights.

"It's been a lesson in humility," says Forrest, in an interview with The Australian Financial Review during a visit to the mine site. Labelling the project "the company's most difficult" mining venture, he lays the blame for the expensive leaks on pipeline contractors.

The company has previously said cost blowouts and delays at Iron Bridge were due to cultural problems and that negative news had not reached executives and directors fast enough. But interviews with at least a dozen ***Fortescue*** insiders reveal Iron Bridge was hamstrung from the start by tough cost-saving targets and because planners failed to anticipate the difficulties of piping large amounts of water in high-pressure pipelines across tough terrain.

Iron Bridge was much more than just another mine for Forrest. Unlike the more common hematite iron ore mines, it is a magnetite mine - which involves turning low-grade ore into a much higher 68 per cent grade ore through energy-intensive processing. Its success is key to transforming ***Fortescue*** from a low-cost, lower-quality iron ore operation to one of the largest iron ore producers in the world. It allows the company to take the fight more directly to rivals BHP and Rio Tinto, as mining companies bet air pollution-conscious countries such as China will favour higher-grade ore because it produces fewer fumes.

Central to the development of Iron Bridge was one of Forrest's oldest friends, former ***Fortescue*** executive Michael Masterman. The pair go way back. Masterman was finance director for Forrest's first disastrous business venture, Anaconda Nickel, before following him to ***Fortescue*** as one of the company's executives. They are also family friends; Forrest is the godfather to one of his children. But they have since fallen out. Masterman left ***Fortescue*** last year to set up a green metal company, Element Zero, triggering a messy legal dispute. ***Fortescue*** is now suing the firm and Masterman over alleged intellectual property theft.

But in 2013, Masterman was a senior executive at ***Fortescue*** and crucial to arranging the finance for Iron Bridge. That year, as he jetted between Shanghai and Perth, he organised for Taiwan's Formosa Plastics Group, one of the North Asian nation's biggest conglomerates, to invest $1.15 billion for a 31 per cent equity stake. ***Fortescue*** had already secured an investment from Baosteel, the world's largest steel producer, with the Chinese conglomerate throwing in a stake it already had in a magnetite mining lease. And so ***Fortescue*** set up FMG Iron Bridge, with the aim of developing the Glacier Valley and North Star deposits where the mine now sits.

It is a huge project. Alongside an airstrip, accommodation camp and an ore-processing facility which aims to churn out 22 million tonnes of concentrate a year, Iron Bridge also has hundreds of kilometres of pipeline. One, which runs for more than 200 km from borefields in the Canning Basin to the mine, has been the most susceptible to leaks. "That water pipeline failure, so that was a shock to the organisation," Forrest says. Another 135-km pipeline pumps magnetite slurry to Port Hedland and a third returns water to the mine.

"It was absolutely the contractor who gave us the guarantee this solution would work," Forrest says when asked who he blames for the pipeline issues. "But going after them is a puerile practice as they are too small. Sending people broke is not our speed." He later adds that the company was working with the contractor and manufacturer on the issue. The prime pipeline contractor on the project, MPC Kinetic, declined to comment.

The company said at the start of the year that it would need to set aside $US100 million to replace 65 kilometres of the pipeline that feeds raw water from the Canning Basin to the plant. But more recently, the on-site project team, led by operations director Graham Howard, has been able to sufficiently stem the leaks, and the company has put the more expensive fix on the back-burner.

If all goes well this year, Howard, a ***Fortescue*** veteran, is confident Iron Bridge will meet its target to produce between 5 million and 9 million tonnes of product by the end of the financial year. But that is still less than half the mine's ultimate target of 22 million tonnes a year.

It's been a journey. He jokes to the Financial Review on the same visit last week to Iron Bridge that the amount of hair on his balding head tells the tale.

But as always with Forrest, there are even more demands. As the bus rolls into the mine site, Forrest asks why the plant's lights aren't sensor activated to save energy and instead stay on during the day. Executives have been under relentless pressure, with much of it related to cost control - ***Fortescue*** is renowned for its focus on costs. When Iron Bridge was first proposed, the company estimated capital expenditure would be $US2.6 billion.

On a site visit after the announcement, Forrest warned a crowd of workers including senior engineers that they may as well resign if they were not committed to building the mine within budget, people with direct knowledge of the event said.

Iron Bridge had been planned for some time and the company had conducted thorough cost estimates for smaller mines, including 11 million-tonne and 16 million-tonne versions, bringing in outside consultants and planners to put together the expected capex. But in the lead-up to the project getting the green light in 2019, the decision was made to expand it to a 22 million-tonne mine.

Instead of getting a new capex estimate, the company "factored" up those previous cost estimates, people with knowledge of the process said. Though it did take outside advice, it was not a calculation from scratch, which those with knowledge of mine planning said would have been more in line with the industry norm.

The only way the company's internal planners could get closer to the $US2.6 billion figure authorised by the board was by not including as much "contingency", an amount typically set aside by miners for additional, unforeseen costs, and by including a large cost-reduction target.

Forrest does not deny the project was subject to cost saving targets. "We deliver operations at the lowest cost in the world. And it's who we are. We don't pretend to be like others." But he rejects any notion that the company underplayed the costs. "We all thought we'd get change out of $US2.6 billion as we have in our other projects, so we didn't see this as different," he says.

"That's not how we roll. The board approves projects on exactly the information it has, and it got to $US3.2 billion well after it had been approved and it was being built. And that's when you have the come-to-judgment day," he says.

Fortescue's upward capex revisions may have cost the company investors. Chinese steel giant Baosteel, formerly a shareholder, quit the project in 2021, selling its stake in the holding company for the mine. Though the motivations behind the decision are unknown, the company has since participated in other Pilbara mining projects, including Mineral Resources' Onslow Iron project and Rio Tinto's new Western Range mine.

Sources say planners underestimated the price of laying the long pipelines needed by the mine, which cost hundreds of millions of dollars.

This pressure on costs filtered down to ***Fortescue***'s contractors, who were constantly forced to revise plans after the company demanded more savings.

In the end, the capital expenditure estimate was revised up five times. In August last year, more than two years after the infamous "red wedding" meeting, the company announced the mine's capex at $US4 billion, more than a third higher than the initial estimate. Jon Mills, an equity analyst at Morningstar who covers ***Fortescue***, says rising inflation hasn't helped and could not have been anticipated.

Fortescue's tight focus on costs has attracted support and has been central to the company's success. "They are much leaner, much more focused on lower unit cost of iron ore than their rivals and that makes their business more sustainable," says one person intimate with the project's operations.

Delays in the ramp-up have been costly. On May 1 last year, Forrest declared that the mine had produced its first ore. But when the mine got going in August that year, it reported a $US726 million pre-tax impairment charge - effectively devaluing the mine - because of delays in the project's ramp-up.

After the company announced its latest production report in September, it fielded questions about why it wasn't getting premium prices considering the higher grade of iron ore that the mine promised.

"At the moment, they aren't seeing as high a premium as they had hoped," says Morningstar's Mills.

In September, ***Fortescue*** Metals chief Dino Otranto blamed the lower prices on "low steel volumes, depressed margins" and a "slight oversupply" of the concentrate market in China.

"So long story short, capex has been higher," says Mills. "It's taken longer to ramp up, costs are going up as well for similar reasons. And then, you know, on the revenue side, they're not getting the premium they hoped for."

Cost blowouts have not been the only problem at Iron Bridge. In September, mine safety officers from WorkSafe WA issued four improvement notices and one prohibition notice "related to dust management".

Workers at the site said they were concerned about their exposure to silica dust, present in the ore mined at the site, which can lead to silicosis, a potentially terminal condition. Magnetite needs to be crushed into such fine particles, finer than talcum powder, that dust is inevitable. Other Pilbara sites have similar issues.

"People were coughing ... it gets under your mask and in your clothes," says one worker who was not authorised to speak publicly. Forrest wore a PAPR dust mask on his visit to the mine last week.

A rope chain separates the area where you are required to wear a dust mask and where you no longer need one, and the area was recently expanded. "There has always been a requirement to wear respiratory protective equipment in the mandated restricted areas of the dry plant, however in September the senior site executive increased the restricted area to include the entirety of the dry plant to ensure compliance," a company spokeswoman said.

Two workers told the Financial Review they were concerned some of the staff facilities and offices were too close to mine infrastructure, so dust filtered into mask-off areas.

"We categorically dispute this," the spokeswoman said. "Our PAPR and P2 requirements are adequate. Outside of the mandatory dry plant area, our sample analysis does not require protection."

One former executive says they decided to leave ***Fortescue*** not long after the "red cafe" meeting in 2021. "The culture had changed and it felt very deliberate," the person says.

But Forrest does not resile from his actions of that day. He had just returned from overseas, and after Gaines alerted him there was an issue he says they decided to change the management team and conduct an audit.

"Here at ***Fortescue***, you get rewarded heavily on doing well, and not if you disappoint. And that was a really deep disappointment. They took the information they received and believed it, but below them there were issues, and unfortunately, like with me, others in leadership, the buck stops with you."

Load-Date: December 24, 2024