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Fortescue Returns Crushing Rio Tinto Where China Finds Its Ore

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By William Mellor



March 26 (Bloomberg) -- Zeljko Zaic, a leathery-skinned surveyor at a Chinese-backed mining company, stands atop a sun-scorched ridge in the Australian Outback and kicks a lump of red **iron ore** lying on the trail.

"One day soon this will be part of someone's house in China," he says.

In only five months, this 1,900-square-kilometer (734-square-mile) stretch of semidesert and salt lakes in the midwestern region of Western Australia has been transformed from a desolate habitat for kangaroos and bush flies into a base for the next wave of the nation's mining boom, Bloomberg Markets reports in its May issue. Below the 80-meter-high (260-foot-high) ridge, Australia's **Gindalbie Metals Ltd.** has joined with China's **Anshan Iron & Steel Group** to build a A\$1.8 billion (\$1.65 billion) iron ore mine. The project includes a nine-story processing plant, a township of air-conditioned homes and a pub, restaurant and cricket pitch for 1,500 workers.

Fueled by China's **appetite** for minerals, about 50 publicly traded **mining companies**, many with market caps of less than A\$2 billion, are spreading out mostly in Western Australia, a region four times the size of Texas with a population of just 2.2 million. Chinese investors, mainly state-owned steelmakers, have funded at least 20 of these outfits as part of Beijing's move to reduce its dependence on **Melbourne-based BHP Billiton Ltd.**, the world's biggest miner, and **Rio Tinto Group**, the No. 2 iron ore exporter.

15-Fold Jump

The **shares** of eight Chinese-backed iron ore companies skyrocketed as much as 15-fold from 2005 to 2010, turning a handful of entrepreneurs into actual or aspiring billionaires.

"It's been life changing for some of these people," says **Tim Schroeders**, who helps manage \$1 billion, including mining shares, at Pengana Capital Ltd. in Melbourne. "It would have been a pipe dream 10 years ago to think you could compete with the world's biggest mining companies."

The global financial crisis put a momentary damper on the five-year Australian mining frenzy. Three months after the spot **price** of iron ore plunged by more than 60 percent to \$59 a ton in March 2009, relations between Australia and China also took a nose dive. In June, London-based Rio Tinto rejected an investment from **Aluminum Corp. of China**, known as Chinalco.

Soon after, Chinese authorities arrested and indicted four Rio Tinto executives on charges of stealing commercial secrets and bribery. At the time, Australian politicians in Canberra decried the arrests as an act of retaliation and Rio Tinto said the allegations were without foundation.

Guilty Pleas

During a three-day trial which finished on Wednesday, all four employees, including Australian citizen **Stern Hu**, admitted to accepting bribes, according to lawyers present. Hu denied stealing commercial secrets, Australia's The Age newspaper reported, as did two other defendants, according to their lawyers. The court, which barred foreign media from covering the proceedings, will deliver its verdict on Monday, Rio Tinto said in a statement.

As China's **economy** speeds up again, spurring record iron ore imports, political tensions are fading. The government of Prime Minister **Kevin Rudd**, a Chinese speaker and former diplomat in Beijing, said in March that the arrests were separate from Australia's productive relationship with China.

Rio Tinto, which sells 70 percent of its iron ore to China, is also trying to rebuild its relationship with Beijing. Three days before the trial of its employees began, the company announced it plans to take Chinalco as a partner to develop an iron ore mine in the African state of Guinea. Rio Tinto's Chief Executive Officer **Tom Albanese** spoke at a conference in Beijing on Monday, saying he hoped Chinalco's agreement to invest \$1.35 billion in the Guinea joint venture would be a model for other Chinese partnerships.

'Ride of Our Lives'

Thanks to its A\$22 billion in iron ore exports to China, Australia was one of the few major economies to escape a recession during the credit crackup.

"China is giving us the ride of our lives," says **Colin Barnett**, premier of Western Australia. "There are risks and uncertainties, but it's a ride we have got to take."

The Foreign Investment Review Board has approved the vast majority of the Chinese deals for small Australian mining outfits. The government is more likely to challenge Chinese attempts to buy more than 15 percent of major resource companies and 50 percent of new outfits, says Patrick Colmer, a member of the review board.

Andrew Forrest

"The Chinese government asks its companies to acquire strategic natural resources," says **Deng Qilin**, general manager of **Wuhan Iron & Steel Group** Corp., which invested in two small Australian mining companies in 2008. "We are not saying we must take a controlling stake. We like any form of investment so long as we get the resources."

Last year, state-owned **Hunan Valin Iron & Steel Group** paid A\$1.3 billion for a 17.3 percent stake in **Fortescue Metals Group Ltd.** The company was founded in 2003 by **Andrew "Twiggy" Forrest**, 48, who grew up on an Outback cattle ranch as the great-grandnephew of a 19th-century Western Australian explorer and state premier. Perth-based Fortescue, which makes almost all of its revenue from exports to China, earned A\$508 million in the year ended in June 2009.

Forrest's worth grew to at least **A\$4.7 billion** as his company's shares soared 1,200 percent in the five years from March 2005, giving it a market cap of A\$14.8 billion.

Shares of Fortescue have increased **almost 10 times faster** than Rio Tinto's and eight times more than BHP's in that five-year span. BHP shares have also pleased investors, hitting a record high close of 2,248.5 pence in **London** on March 25. Rio Tinto's London-listed **shares** hit 3,882 pence, the highest since Sept. 2, 2008.

Leucadia National

Western investors have made many millions on the Chinese-backed companies. In 2006, **New York-based Leucadia National Corp.** paid \$452 million for a stake of about 10 percent in Fortescue and the rights to 4 percent of revenues from two mines until 2019. Although this year Leucadia reduced its stake to 8 percent to take some profit, the value of its investment more than doubled to A\$1.19 billion as of March 25.

Paul Kopejtka has both battled and collaborated with Chinese investors. A coal miner's son from Western Australia, Kopejtka, 42, earned a chemical engineering degree from Perth's Curtin University before founding **Murchison Metals Ltd.** in 2004 and selling shares a year later. In 2009, **Sinosteel Corp.**, China's biggest iron ore trader, outflanked Murchison in its bid to buy **Midwest Corp.** Sinosteel paid A\$1.4 billion in a hostile takeover of Midwest.

Sinosteel has also taken a 5.5 percent stake in Murchison and will use rails and a port that the Australian company is building to ship iron ore to China.

China's Top Supplier

"It's like a big chessboard, and everyone is jockeying for position," says Kopejtka, who aspires to become a billionaire. Shares of Perth-based Murchison have **soared** 12-fold to A\$2.65 since March 2005, making Kopejtka worth A\$60 million.

Australia is China's top **supplier** of iron ore, providing it with 43 percent of its imports, according to data compiled by Bloomberg. BHP and Rio Tinto control more than 80 percent of the Australia-China iron ore trade.

In 2007, BHP launched a takeover bid for Rio Tinto and abandoned the deal a year later as commodity prices began their plunge. Beijing officials denounced the planned takeover in state-controlled media as an attempt to create a price-fixing monopoly -- an accusation that China has repeated several times.

Iron ore spot prices more than doubled to \$147.50 a metric ton on March 25 from a year earlier, according to the Steel Index.

BHP and Rio Tinto, which have publicly denied they are trying to inflate prices, declined to comment for this article.

Concentrate Power

Beijing intensified its own dealmaking for Australian companies in 2008 when state-controlled Chinalco and Alcoa Inc. agreed to pay \$14.5 billion for a 9 percent stake in Rio Tinto. The company accepted and then last June said no to an additional \$19.5 billion investment from Chinalco following protests from shareholders and politicians. The politicians claimed that Chinalco wouldn't be an asset to the mining industry because it would act in the interests of Beijing's communist rulers.

Instead, Rio returned to its former suitor, BHP, to form an iron ore joint venture. By combining mines, rails, ports and workforces in Western Australia's Pilbara region, the two companies say they will save \$10 billion.

Executives Arrested

The agreement will concentrate power in the iron ore market and result in higher prices for customers, according to Brussels-based steel industry group Eurofer. The European Union announced in January that it's investigating whether the deal curbs competition. BHP and Rio Tinto have said their iron ore will continue to be marketed separately.

In July, four weeks after the deal was announced, Stern Hu, head of Rio Tinto's iron ore operations in China, and three other Rio Tinto employees were arrested in Shanghai.

While China's Foreign Minister **Yang Jiechi** said in July that the arrests weren't related to Rio Tinto's rejection of the Chinalco investment, some Australians aren't so sure.

"I don't think it's coincidental," says **Geoffrey Garrett**, professor of political science at the University of Sydney.

As the Rio Tinto executives await sentencing after pleading guilty to bribery in the People's Court, Chinese-backed companies in Western Australia are ramping up operations. In Fortescue's 2009 annual report to shareholders, Forrest, the founder, wrote that his company was battling against BHP and Rio Tinto on their home mining turf of the Pilbara, a northern region possessing the nation's richest iron ore deposits.

Shattered Duopoly

"Your company has shattered the iron ore duopoly which existed in the Pilbara for many decades and firmly established itself as a vital alternative supplier of iron ore," wrote Forrest.

Forrest told Bloomberg Television on March 19 that he was studying plans to raise as much as \$8.9 billion to help lift annual production to an eventual 260 million tons from the present 40 million. Four days later, Forrest told a conference in Perth that Fortescue was prepared to sell stakes of more than 50 percent in some of its lower grade iron ore projects in Western Australia to overseas steel mills. These projects include a joint venture with **Baosteel Group Corp.**, China's second-largest steelmaker, that the company said is about to begin.

While Fortescue posted **sales** of A\$1.83 billion in the year ended in June 2009 -- its first full year of mining -- smaller companies face huge hurdles in competing against the mining giants. BHP and Rio Tinto, who trace their history back more than 100 years, occupy the best mining leases in the Pilbara.

Port and Rail

The hematite ore they mine needs only to be crushed before being loaded onto trains and ships. When the ore gets to China, it can often be fed directly into steelmaking furnaces without processing.

Smaller companies are at a disadvantage because many of the remaining mining leases are for lower-grade ore, including magnetite. It contains less iron than hematite and needs more costly processing.

Citic Pacific Ltd., the Hong Kong unit of China's biggest state-owned investment company, paid \$200 million to Australian entrepreneur **Clive Palmer** for the rights to mine 1 billion metric tons of magnetite. Citic is now spending a total of \$4 billion on several projects, including a 450-megawatt power station to process 28 million tons of the iron ore annually. The company also has to construct a 51-gigaliter (13.5 billion-gallon) desalination plant and a 25-kilometer (15.5-mile) slurry pipeline to transport the processed ore from the mills to a custom-built port.

Mining Frontier

BHP and Rio Tinto have another advantage: In the Outback, where there are few roads and train tracks, the mining giants built their own railway and port for their exclusive use. Their iron ore is loaded onto separate 2.5-kilometer-long trains and freighted 300 kilometers to the coast.

In 2008, Fortescue became the first of the smaller iron ore mining companies to construct its own rails and port after spending five years and part of A\$2.8 billion on the project.

"It may have been one of the most challenging projects in mining," says **Philip Falcone**, founder of New York hedge fund firm Harbinger Capital Partners, which has a 5.9 percent stake in Fortescue and owns 18 percent of Murchison, according to Bloomberg data. "There were very few that were capable of executing it like Andrew Forrest."

Japan's Mitsubishi

Six Chinese companies and their Australian partners are also setting up operations in the midwestern region, a new, mostly magnetite-mining frontier in Western Australia 1,000 kilometers south of the Pilbara. In the midwest, Karara Mining Ltd., the joint venture between Perth-based Gindalbie Metals and Anshan Iron & Steel, aims to start mining hematite and magnetite beginning next year. Unskilled workers can earn with overtime as much as A\$140,000 a year. Foremen can make A\$200,000.

"Thank God for China," says Dionne Drew, 43, a Karara safety officer. "Where would we be without them?"

Mining outfits in the midwest won't export large quantities of iron ore until the completion of the Oakajee Port and Rail project in 2013. The Western Australian government in 2008 awarded a A\$4 billion contract to a joint venture between Murchison Metals and Japan's **Mitsubishi Corp.** to build a deep-water port and 560-kilometer railway line. Murchison says the midwest may eventually produce as much as 100 million metric tons of iron ore a year -- about one-third of the Pilbara's output today.

Riding the Dragon

"There's a lot of talking and development, but apart from Fortescue, very few of them are shipping yet," says **Richard Elman**, founder of **Noble Group Ltd.**, a Hong Kong-based commodities supplier and owner of mines in Australia. "The infrastructure is very expensive and takes a long time to build."

Dennison Hambling, chief investment officer of Melbourne-based First Samuel Ltd., is splitting his bets between the big and small companies. He says First Samuel holds shares in Rio Tinto because, along with BHP, it will be dominating iron ore exports to China for years to come. The firm is also investing in the rise of Perth-based **Feraus Ltd.**, an iron ore company backed by two Chinese state-owned companies that operates in the Pilbara.

"China is positioning itself to play a major role in the next generation of iron ore miners," says Hambling, who helps manage \$300 million. "In 5 or 10 years, I don't think Rio Tinto or BHP will be in as commanding a position as they are in now. There will be a fourth and fifth force in mining."

Investors will soon have another chance to cash in. Clive Palmer, 56, a law school dropout, became a billionaire investing in real estate and mining. This year, he plans to sell shares in his Brisbane, Queensland-based Resourcehouse Ltd., a company with iron ore and coal reserves. Palmer hopes to raise \$3 billion -- highlighting how the rewards of doing business with China have so far exceeded the risks entailed in riding the dragon.

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Fortescue Metal's Forrest Interview

March 19 (Bloomberg) -- Andrew Forrest, chief executive officer of Fortescue Metals Group Ltd., Australia's third-biggest producer of iron ore, talks with Bloomberg's Susan Li and Heidi Couch about the company's performance and expansion strategy. Forrest, who is Australia's richest person, also discusses China's criminal trial next week of Rio Tinto Group Ltd. executives accused of taking bribes and infringing company secrets.



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Former Fortescue Executive Moves From Iron Ore to Movies

March 18 (Bloomberg) -- Bloomberg's Heidi Couch reports on former Fortescue Metals Group Ltd. Executive Director Graeme Rowley's move from mining to movie-making. Rowley co-founded Fortescue, Australia's third-biggest iron ore producer, with Andrew Forrest, the nation's richest person. Rowley resigned from his role with the company on March 2.

Australian Mining Boom Helps Blue-Collars Create Wealth

March 19 (Bloomberg) -- Bloomberg's Heidi



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Couch reports on how Australia's mining boom creates demand for blue-collar workers, helping mechanics earn more than doctors.



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[Australia's Crean Interview on Rio Trial, Yuan](#)

March 25 (Bloomberg) -- Australian Trade Minister Simon Crean talks with Bloomberg's Heidi Couch and Susan Li about the impact of China's trial of Rio Tinto Group executives, including Australian citizen Stern Hu, on the trade relationship between the two countries. Crean, speaking from Canberra, also discusses U.S. calls for China to allow its currency to appreciate, and China's demand for Australian resources.



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