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**The Blenheim Report**  
**CONFIDENTIAL INTELLIGENCE REPORT**  
**IRON ORE PRODUCERS**

**JUNE 2013**



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### INTRODUCTION

#### Iron ore production overview

Australia is one of the world's major iron ore producers. During 2011, China was the world's largest producer of iron ore with 43%, or 1200 million tonnes (Mt) followed by Australia with 17% or 488Mt and Brazil with around 14% or 390Mt of world production<sup>1</sup>. The Hamersley Range in the Pilbara region of northwest Australia is host to 98% of Australia's iron ore mines, with minor production from Tasmania, New South Wales, Queensland and South Australia. Hematite ores dominate the world production of iron ores and are sourced mainly in Australia and Brazil. Magnetite is increasing its presence in world production and this trend is likely to increase when large Australian magnetite projects such as the Karara Iron, Southdown magnetite and more than \$6 billion Sino Iron projects are operational.

The Bureau of Resources and Energy Economics (BREE) has forecast an increase in iron ore exports of at least 12% or 493Mt in 2012 and around 6% or 525Mt in 2013, however, current business conditions are causing many significant projects to be postponed. Continuing strong demand for iron ore saw the quantity sold in 2012 increase by 12%; however this was not enough to offset lower prices and a high Australian dollar which saw total sales fall by 19%.

Rio Tinto is Australia's biggest iron ore producer followed by BHP Billiton and Fortescue Metals Group.

<sup>1</sup> Source: [http://www.australianminesatlas.gov.au/aimr/commodity/iron\\_ore.html](http://www.australianminesatlas.gov.au/aimr/commodity/iron_ore.html)

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## FORTESCUE METALS GROUP LTD

**Market cap:** \$10.7b (6/6/13) | **Revenue:** \$6.62b (FY12) | **Employees:** around 7,000 | **Operations:** Western Australia | **Head office:** Perth

Fortescue Metals Group Limited (Fortescue) is an iron ore producer and explorer. Fortescue mines iron ore from its Cloudbreak, Christmas Creek and Solomon mine sites. In addition the Company is involved in operating an integrated mine, rail and port supply chain and the expansion of iron ore operations. Fortescue is also engaged in an exploration and metallurgical program which is progressively developing tenement areas outside of the current mine sites.

During the fiscal year ended June 30, 2012, Fortescue produced 64.6 millions of tons of iron ore. Ore processed was 56.9 millions of tons and ore shipped including third party was 57.5 millions of tons. The company's subsidiaries include FMG Pilbara Pty Limited, Chichester Metals Pty Limited, FMG Resources (August 2006) Pty Limited, FMG Resources Pty Limited, International Bulk Ports Pty Limited, The Pilbara Infrastructure Pty Limited and FMG Solomon Pty Limited, among others. The 2013 production capacity is estimated to be approximately 115Mtpa.

### MINING OPERATIONS

Mine	Owner	Operator	Capacity FY10	Production (Mtpa) FY12	Opening year	Location	State
Christmas Creek*	Fortescue	Macmahon	16.0	60.0	2009	Nullagine, Pilbara	WA
Cloudbreak**	Fortescue	NRW and other contractors	28.0	40.0	2008	Nullagine, Pilbara	WA
Firetail / Solomon	Fortescue	Leighton Contractors	20.0 (FY13 estimate)	n/a	2012	Solomon, Pilbara	WA

\* Christmas Creek mine is now the largest material movement mine in Australia, with more than 3,500 employees, 350 mobile assets, moving 320Mtpa total material.

\*\* The mine employs approximately 3,500 people

### EXECUTIVE LEADERSHIP TEAM

Name	Title	Background	Location	Comments
		Profiles available upon request		

### OTHER KEY EXECUTIVES

Name	Title	Background	Location	Comments
		Profiles available upon request		

### BOARD MEMBERS

Name	Title	Background	Location	Comments
		Profiles available upon request		

### STRATEGY

In November 2010, Fortescue announced a major expansion program to increase its production capacity from 55 million tonnes per annum (mtpa) to 155mtpa. As Fortescue is now nearing completion of the expansion program, it is beginning to realise the benefits of its significant investment in the integrated mine and infrastructure projects through increased production output, operating efficiencies, enhanced processing capacity and the integration of low cost Solomon mines.

Fortescue is currently operating three mine sites and is continuing the development of the Kings mine at Solomon. With the Christmas Creek operation fully ramped up during 2013, Fortescue's Chichester Hub is now operating at full capacity.

This, together with the Firetail commissioning in May 2013, allowed Fortescue to achieve an annualised run rate of 120mtpa in the month of June 2013, 5mtpa ahead of target. Fortescue's integrated rail and port infrastructure is considered the real strategic value in the company by many analysts. Amongst other things the analysts highlight that there is plenty of magnetite iron ore for sale in Western Australia, but this is the only one getting the deal because of the available infrastructure. Fortescue's deal with Taiwan's conglomerate Formosa Plastics in August 2013 worth USD 1.15 billion to develop the Iron Bridge magnetite joint venture underscore the strategic importance of infrastructure. Fortescue was looking to sell part of its infrastructure earlier in 2013 in order to start paying off its substantial debt of over \$ 12 billion, but with rising iron ore prices, operational efficiencies, increased shipping capacity and now the Formosa deal, this infrastructure sale is no longer on the table.

The integrated rail and port operations continued to exceed expectations with 81.6mt of ore delivered to the port during the year, an increase of 42 per cent compared to the prior year. Loading capacity at the port increased during June 2013 to 120mtpa from three berths and two ship loaders and increased to 155mtpa when the fourth berth (AP4) and third ship loader were completed in August 2013.

During 2013 there has been a range of different statements regarding the company's strategic direction. These have included potential diversification into the energy sector, shale gas in particular, evaluation of low capital intensive growth opportunities in iron ore and ongoing adjustments of the tenement portfolio through both sales and acquisitions of tenements for ongoing exploration.

Reading through the latest annual report 2013 from September 2013 there are several areas of strategic focus for Fortescue. One is the diversification of its customer base into other regions other than China. The first step was taken with the deal with Formosa Plastics. Operational efficiencies remain a high priority and holding on to 100% of the rail and port infrastructure is also strategically important.

Reduction of the company's significant debt of over \$12 billion is the highest strategic priority for the company going forward, and associated with this is the focus on increasing the free cash flow for the company through operational efficiencies and other cash generating initiatives such as customer prepayments and asset sales.

### 21 June 2013

The Sydney Morning Herald

#### **BHP sells iron ore mine stake to Japanese**

Mining giant BHP Billiton has sold a 15 per cent stake in a West Australian iron ore mine to two Japanese conglomerates for \$US1.5 billion (\$A1.64 billion). ITOCHU Corporation is investing \$US800 million (\$A872.51 million) while Mitsui is stumping up \$US700 million (\$A763.44 million) in shares and loans in BHP's Jumblebar mine in the Pilbara region. ITOCHU will hold an eight per cent stake in the project while Mitsui will have a 7% interest.

BHP Billiton's iron ore president Jimmy Wilson said the deal would improve simplicity and flexibility. "We are pleased to extend our successful, long-standing joint venture relationship with ITOCHU and Mitsui," he said in a statement. The Foreign Investment Review Board has to approve to the transaction for the mine, rail and port infrastructure project, which is expected to be signed off during the September quarter. The Jumblebar mine will have initial production capacity of 35 million tonnes per annum, which will take BHP's West Australian iron ore supply chain capacity to 220 million tonnes per annum once it becomes fully operational.

Article: <http://news.smh.com.au/breaking-news-business/bhp-sells-iron-ore-mine-stake-to-japanese-20130621-2omll.html>

### 15 June 2013

The Australian

#### **\$6bn iron-ore project collapses**

The end of the nation's decade-long mining investment boom was underlined yesterday by the collapse of the \$6 billion Oakajee mine, port and rail network, a project aimed at opening up a huge new iron ore export province in Western Australia. Japanese giant Mitsubishi blamed weaker commodity prices for the collapse, which came after repeated attempts to entice China to invest billions of dollars to save the development. WA Premier Colin Barnett, who has described Oakajee as the most important project in his state's economic development for the next 50 years, last night insisted Oakajee might eventually proceed. "I will persist and I'm still confident Oakajee will proceed, I can't put a date on it but I won't give up on it," he said. The collapse comes as a bitter blow to Mr Barnett who has also had to contend with Woodside Petroleum's decision to walk away from plans to build a \$45bn gas plant at James Price Point on the Kimberley coast. Oakajee and Browse were Mr Barnett's pet projects, but both are now effectively dead. Mr Barnett said last night he knew the project had been shelved before he visited Beijing and Tokyo last week. He returned from the trip at the weekend claiming the project could still proceed. He also hailed what he described as a new plan for China and Japan to work together on the project after he acted as a "middle man" in easing tensions between the two nations. The end of the mining investment boom in WA has been marked by companies sacking workers and deferrals or axing of projects amid a weaker commodity price outlook. This week, Mr Barnett announced the state government would axe up to 1200 public servants in a bid to keep the state budget in surplus.

Opposition Leader Mark McGowan said the loss of Oakajee and Browse reflected badly on Mr Barnett's ability to deliver projects. Oakajee Port & Rail, which is owned by Mitsubishi, said the Japanese company had suspended all work on the infrastructure project in WA's Mid-West region and put its Jack Hills mine on ice. OPR chief executive John Langoulant, who will leave the company at the end of the month, told The Weekend Australian a key reason for the decision was the failure to find an equity partner.

## MARKET INTELLIGENCE

The problems had been exacerbated by the slowdown in the Chinese economy and weaker iron ore demand, and complicated by a diplomatic dispute between Japan and China over islands in the South China Sea. "The biggest issue is the fact the project is too big for one entity like Mitsubishi to do alone," he said.

The project was dealt a blow in 2011 when Chinese steel giant Sinosteel said it was shelving its \$2bn Weld Range mine in response to cost blowouts and long delays in developing Oakajee. OPR then slowed spending on the rail and port network but denied the project had been shelved. A spokesman for Gindalbie Metals, one of the Mid-West iron ore miners, said the company could continue to use the port at Geraldton. It is understood some miners will work on a plan B for a scaled-down Oakajee.

Article: <http://www.theaustralian.com.au/national-affairs/bn-iron-ore-project-collapses/story-fn59niix-1226664137596>

**22 May 2013**

Perth Now

### **Rio Tinto cuts iron ore senior managers**

Rio Tinto's cost cutting measures have continued with its iron ore business getting a major restructure with president Greg Lilleyman taking on a new role. An internal memo, issued to WA staff, said Mr Lilleyman was off to Wharton Business School at the University of Pennsylvania with news of his new role to come later. Rio Tinto iron ore chief executive Andrew Harding, who replaced Sam Walsh earlier this year, said the new structure minimised the "layers" within the organisation. "The senior management layer of chief operating and chief development officers has been removed, which reinstates the managing director/general manager interfaces through the business," he said. Though unclear on where the executives would go, Mr Harding thanked former executives Denis Goldsworthy, Dale Harris, Andrew Kite and Tom Palmer for their contribution. "I will provide further advice when it is appropriate to do so," he said. Mr Harding added Michael Gollschewski, Managing Director Pilbara Mines, and Clayton Walker, Pilbara Supply Chain managing director, to his executive team.

Article: <http://www.perthnow.com.au/business/rio-tinto-cuts-iron-ore-senior-managers/story-fnhocr4x-1226648580432>

**May 6 2013**

ABC News

### **Fortescue Metals Group has officially opened its third mine in Western Australia's Pilbara.**

The Firetail deposit, which is part of the company's \$3.2 billion Solomon project, started operations late last year. Firetail will ramp up to become a 20 million tonne a year operation and increase to 60 million tonnes a year once the Kings deposit in the Solomon hub comes online. The two projects are a key part of the company's plan to meet an export target of 155 million tonnes a year by the end of 2013. Fortescue Metals Group chairman Andrew Forrest says Firetail is a low cost mine which is critical to the company's competitive edge. "It now makes us more competitive delivered to Asia in terms of costs than the world's biggest producer in Brazil, that's a great win for Australia," he said.

Mr Forrest says it marks the opening of the company's third mine in five years. "This achievement consolidates our position as one of the world's leading producers of iron ore and a vital supplier for our Asian customers," he said. He is confident Asia's hunger for iron ore is still strong. "I kind of liken Asia as watching this large horse getting up back onto its feet, shaking itself off and starting to move forward," he said. "When you spend time in China you can see their capital investment plans, the aspirations the government has for



their people." Ore from the mine will be blended with other ores from its Chichester hub to produce an enhanced product called the Fortescue blend. The Solomon deposit was discovered in 2005.

Article: <http://www.abc.net.au/news/2013-05-06/fmg-officially-opens-its-third-pilbara-mine/4672206>

### April 17 2013

ABC News

#### **BHP maintains production despite falling prices**

BHP Billiton has maintained its full-year production forecasts, despite volatility and falls in the prices of some of its key commodities. The world's biggest miner says it achieved record iron ore output from its Western Australian iron ore operations for the first nine months of the financial year, with March quarter production up 6 per cent on the same period last year. BHP says it expects to produce 183 million tonnes of iron ore this financial year, despite some seasonal cyclone-related shut downs over summer. By March next year, BHP expects to have an iron ore production and shipping capacity of 220 million tonnes per annum in WA.

Article: <http://www.abc.net.au/news/2013-04-17/bhp-maintains-production-despite-falling-prices/4634240>

### 6 April 2013

Perth Now

#### **Iron ore miners face glut, warns Morgan Stanley**

Australia's major iron ore producers will soon come under intense pressure as supply overtakes demand, driving prices down, experts warn. A supply surplus looms for the first time in at least a decade, weighing on the value of the nation's biggest export, according to investment banking giant Morgan Stanley. Producers, including Fortescue Metals and Rio Tinto, are among a string of miners ramping up production, fuelling the likely surplus, while demand from China is slowing. The price of iron ore has tumbled 14 per cent to less than \$136 a tonne since February. Concerns about the outlook have weighed heavily on mining stocks. Shares in Rio, which generates about 75 per cent of its earnings from the key steel-making ingredient, and iron ore pure-play Fortescue slumped to a six-month low this week. BHP Billiton's share price hit a seven-month low. Rio and BHP have both launched cost-cutting drives. Rio has put gold, copper and coal mines up for sale, as well as its Canadian iron ore operations. It also continues to review its diamonds division and Pacific Aluminium unit.

Morgan Stanley is tipping global iron ore exports to hit 1.17 billion tonnes this year - still short of forecast global demand of 1.26 billion tonnes. But a surplus will emerge in 2014 as supply outstrips global demand by 3.3 million tonnes, the bank says. It estimates the surplus will blow out to 291 million tonnes by 2018. The surplus is being underpinned by a substantial rise in production, mostly from Australian mines. Fortescue will increase its annual iron ore output from about 100 million tonnes to 155 million tonnes by the end of the year. Rio Tinto this week finished installing a new ship loader at its Cape Lambert wharf in the Pilbara, boosting its annual loading capacity by 55 million tonnes.

Article: <http://www.perthnow.com.au/business/iron-ore-miners-face-glut-warns-morgan-stanley/story-fnhocr4x-1226614054253>

### MOVEMENTS

There have been a number of movements in the Iron Ore sector this year, some include:

- **Andrew MacKenzie** – Appointed Chief Executive Officer, BHP Billiton Ltd, May 2013
- **Andrew Harding** – Appointed Chief Executive Iron Ore, Rio Tinto Plc, Feb 2013
- **Christopher Lynch** – Appointed Chief Financial Officer, Rio Tinto Plc, Apr 2013
- **Clayton Walker** – Appointed Managing Director, Pilbara Supply Chain, Rio Tinto, Plc, May 2013
- **David Joyce** – Appointed Managing Director, Projects and Development, Rio Tinto Plc, May 2013
- **David Woodall** – Appointed Director, Operations, Fortescue Metals Group Ltd, Jan 2013
- **Debra Valentine** – Appointed Group Executive, Legal External and Regulatory Affairs, Rio Tinto Plc, Feb 2013
- **Elizabeth Gaines** - Appointed Non-Executive Director, Fortescue Metals Group Ltd, Feb 2013
- **Isak Buitenday** – Appointed Director, External Affairs, Fortescue Metals Group Ltd, Jan 2013
- **Johnny Velloza** – Appointed General Manager, Area C, BHP Billiton Ltd, Jan 2013
- **Michael Gollschewski** – Appointed Managing Director, Pilbara Mines, Rio Tinto Plc, May 2013
- **Mike Fraser** – Appointed President, Human Resources, Group, BHP Billiton Ltd, Aug 2013
- **Morgan Ball** – Appointed Chief Executive Officer, BC Iron Ltd, May 2013
- **Peter Thomas** – Appointed Director, Shared Services, Fortescue Metals Group Ltd, Jan 2013
- **Sam Walsh** – Appointed Chief Executive Officer, Rio Tinto Plc, Jan 2013
- **Sharon Warbuton** – Appointed Non-Executive Director, Fortescue Metals Group Ltd, commencing Nov 2013
- **Wayne Bould** – Appointed Chief Executive Officer, Grange Resources Ltd, Jun 2013

### CONCLUSION: THEMES

*“The industry needs to think, it needs to sharpen its focus. We have had a very good run and now the time is dawning to step up our efficiency. China will not continue in double digit growth. China has internal issues and yet we will have an oversupply produced next year. We will have a drop in price as a result, and the need for restructure. It is time to be more efficient to avoid the restructure, or at least dampen its effects.”*

Senior Operations Executive, Iron Ore Division

*“The major miners have been lazy in their approach to delivering efficiency from the mine to the Chief Executive. The ego’s of the major miners had an extraordinary effect on the price of labour with no regard for productivity. We hear about taxes, but we are severely missing the point. Labour is our out of control cost. The lack of internal control and understanding of optimisation are hard facts which get lost in bureaucracy.”*

Senior Executive, Iron Ore Division

*“Growth in China is no longer double digit. Seven percent looks about right. Caution prevails with the mega projects and it is expected that price will drop to \$115-120 per tonne. The effect is global; the major minors have had a change in leadership and obvious change in strategy. We have seen restructure in the mining and associated industries, we feel there is some way to go, it has become obvious that we had it easy.”*

Senior Executive, Operations, Iron Ore Company

*“Mining is going through a cycle, and a rethink. There are lessons to be learned. The dynamics are changing, governments are not necessarily supporting the infrastructure program. They want a faster and more competitive playing field. Our approach is to examine our process and drive efficiency from the asset through the total production. We need to tackle industrial relations collectively and this may require more involvement by mineral councils and necessary organisations. Government stability and decisiveness has been lacking.”*

Senior Executive, Iron Ore Company



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