



## Biggest Junk Bond From Miner in 5 Months Shows Optimism: Australia Credit

By Elisabeth Behrmann and Sarah McDonald - Oct 27, 2011

Confidence in [China](#)'s ability to weather global economic and financial turmoil is bolstering parts of Australia's credit market, allowing [Fortescue Metals Group Ltd. \(FMG\)](#) to sell the most junk bonds by a miner in five months.

Australia's third-biggest [iron ore](#) producer issued \$1.5 billion of 8.25 percent notes on Oct. 25 in the largest non-investment grade offering by a miner worldwide since Vedanta Resources Plc's \$1.65 billion sale on May 26, according to data compiled by Bloomberg. Junk-rated mining bonds returned 6.4 percent this month, compared with 4.8 percent for other high-yield debt, Bank of America Merrill Lynch indexes show.

Debt investors are showing optimism China's economy will strengthen after a slowdown helped push iron ore prices this week to the lowest in more than a year. The nation is the world's biggest metals consumer and its demand for resources underpins economists' forecasts of 4.3 percent growth in [Australia](#) next year, the fastest pace among Group of 10 nations.

Fortescue's deal shows investors "have long-term confidence in iron ore and China's industrialization," Chris Viol, a credit analyst at UBS AG in Sydney, said by phone. "Iron ore prices have fallen but profit margins for Fortescue are still historically strong."

### Relative Yields

Yields on Perth-based Fortescue's November 2019 notes, which the company can buy back after four years, fell to within 637 basis points of government bonds of similar maturity on Oct. 26 from 648 at the sale, according to Trace, the bond price reporting system of the Financial Industry Regulatory Authority. The company paid a 420 basis-point spread when it issued \$900 million of securities in December that mature in February 2018.

The average yield premium on dollar-denominated speculative-grade mining bonds has climbed 161 basis points since June to 641 basis points, as [Europe](#)'s sovereign debt crisis threatens to damp global growth, Bank of America Merrill Lynch's U.S. High Yield, Metals/Mining Index shows.

Spreads on bonds sold by investment-grade borrowers widened 86 to 267 in the same period. Investment-grade bonds are rated BBB- and above at S&P, and Baa3 and higher at Moody's.

Australian mining firms have issued \$6.6 billion of bonds in the U.S. this year, up from \$5.5 billion in 2010, data compiled by Bloomberg show. Mitsubishi Development Pty., a unit of Mitsubishi Corp., sold A\$150 million (\$158 million) of three-year notes in August 2004 in the most recent sale by a mining company in the Australian debt markets, Bloomberg data show.

## Growth Slowdown

[China's economy](#) grew 9.1 percent in the third quarter, the least since 2009, the statistics bureau said Oct. 18. Growth will slow to about 7 percent in the next 12 months as a stagnate global economy damps exports while new political leaders focus on boosting domestic demand, [Isaac Meng](#), a senior vice president at Pacific Investment Management Co., said Oct. 24.

Of the three biggest exporters of iron ore to China --Australia, Brazil and [India](#) -- the South Pacific nation has the "most advantageous position" in a slowdown due to lower mining costs per ton and less political and regulatory interference, money managers at Pimco wrote in a report on the firm's website yesterday. Newport Beach, California-based Pimco runs the world's biggest bond fund, the \$242.2 billion Total Return Fund.

Australia is forecast to grow 4.3 percent in 2012, compared with 0.8 percent in Europe and 2 percent in the U.S., according to separate surveys of economists by Bloomberg.

## Rising Yields

Australia's benchmark 10-year bond yield rose 12 basis points to 4.49 percent in Sydney yesterday, or 224 basis points more than similar-maturity Treasuries. Australia's dollar, the world's fifth-most traded currency, rose to \$1.0527 at 4:43 p.m.

The gap between yields on Australian [government bonds](#) and inflation-indexed notes shows investors estimate consumer prices will rise an average of 2.46 percent for the next five years, down from 2011's peak of 3.14 percent on May 6.

Futures show an 86 percent chance that RBA Governor [Glenn Stevens](#) will cut the benchmark [interest rate](#) on Nov. 1 to 4.5 percent from 4.75 percent, the developed world's highest.

The average of two core measures of consumer prices closely watched by the RBA gained 0.3 percent in the three months through September from the previous quarter, an Oct. 26 report from the statistics bureau showed. That was half the pace predicted by economists.

The Markit iTraxx Australia index of credit-default swaps that gauges perceptions of corporate bond risk declined 13 basis points to 172 basis points at 4:45 p.m., according to Credit Agricole SA.

## Trade Partners

China, the world's biggest producer of crude steel, became Australia's largest economic partner as bilateral trade quadrupled over the past seven years to A\$97.6 billion in 2010, government data show.

Iron ore for delivery to the port of Tianjin fell 7.2 percent to \$131.70 a ton on Oct. 25, according to The Steel Index Ltd. That's the biggest slump since Aug. 20, 2009, and the lowest since July 2010. Prices may decline to \$120 a ton if steelmaking demand and China's economy weakens more than expected, Bank of America Corp. said the same day.

Rio Tinto Group Chief Executive Officer Tom Albanese said Oct. 24 in a presentation to analysts that there's "weakness" in the market for iron ore, while Alex Passmore, head of metals and mining at Patersons Securities Ltd. in Perth said in a phone interview that "there's pushback on the iron ore price" by Chinese steel mills facing declining profitability.

## Fortescue's Outlook

Prices won't fall much further from a 15-month low, Fortescue Chairman [Andrew Forrest](#), Australia's third-richest person as measured by BRW magazine, said in an interview with Bloomberg Television on Oct. 26.

Fortescue's production costs are about \$53 a ton, [Standard & Poor's](#) said in an Oct. 26 statement. It rates the company at B+, four levels below investment grade. Moody's Investors Service has Fortescue at an equivalent B1 while [Fitch Ratings](#) gives the miner a BB+ grade, three rungs higher, Bloomberg data show.

Fortescue plans to use the money raised from its latest bond sale for an \$8.4 billion expansion of operations in the Pilbara region in [Western Australia](#) to almost triple its iron ore output.

"The company is well positioned to fund" its capital expenditure needs for this year, Pradeep Mohinani, a credit analyst at Nomura Holdings Inc., wrote in an Oct. 26 note to clients. "We remain of the view that Fortescue is a solid credit."

## Rising Profit

Fortescue's profit increased 31 percent in the six months to June 30 after boosting production and increasing shipments. The company scrapped plans in May to borrow \$1 billion through an unsecured [term loan](#) from U.S. investors, saying lender offers didn't meet expectations. It has sold \$5.04 billion of [junk bonds](#) since the start of 2010, Bloomberg data show.

The company gets all its revenue from iron ore, according to Bloomberg data. The steelmaking material provided 43 percent of Rio Tinto's revenue and 29 percent of BHP Billiton Ltd.'s in the six months ended June 30, the data show.

Fortescue has "the inherent risk of being tied solely to iron ore," said Andrew Gordon, director of fixed-income research at FIIG Securities Ltd. in Sydney, and a former director of high-yield [capital markets](#) at Bank of America in [New York](#). Still, "U.S. accounts view Fortescue as a direct play on the China growth story and are obviously optimistic on the prospects."

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