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China Inc.'s Top Deal Maker Provokes a Backlash Abroad

By SHAI OSTER and RICK CAREW

BEIJING -- China's biggest corporate deal maker is now a rising star in government -- a fact that could trip up one of the nation's biggest-ever foreign investments.

Just days after the head of state-owned [Aluminum Corp. of China](#) signed a landmark \$19.5 billion deal for part of Anglo-Australian miner [Rio Tinto](#), he left his post to join China's cabinet.

The move by aluminum czar Xiao Yaqing into politics in February raised a critical question about China's state-owned corporate giants as they step onto the global stage: Are they driven by profits, or **are they pursuing a nationalist agenda for the Chinese government?** A close look at the Rio Tinto deal suggests that the answer is both, as business and politics intertwine for a new breed of globally savvy Chinese executives.

On Wednesday, the deal with the Chinese aluminum company, also known as Chinalco, was the focus of shareholder scrutiny at Rio Tinto's annual meeting. Chief Executive Tom Albanese defended it. "We remain committed to delivering the Chinalco transaction, and our focus is on successfully navigating the regulatory process before putting it to a shareholder vote," he said.

But nailing down regulatory approval could be complicated by the political battle now brewing in Australia over the country's ties to China. In the latest twist, opposition politicians have accused Prime Minister Kevin Rudd, a Mandarin-speaking former diplomat in China, of being a "roving ambassador for Beijing." They also have attacked the defense minister for not disclosing that a **Chinese-Australian property developer paid for two trips he made to China** when he was an opposition lawmaker. Both men have defended their ties to China.

China Inc. is drawing increased attention as Chinese companies snap up mining and energy assets around the world. China announced foreign acquisitions totaling \$52 billion last year, two-thirds in natural resources, according to Dealogic. This year, there have already been 65 deals totaling \$23.2 billion, nearly all in natural resources, Dealogic says.

Bankers, lawyers and diplomats contend that Chinese leaders have sent out word that China should secure natural resources. "There is a **clear policy of getting resources,**" says one Western diplomat.

Australian regulators are expected to rule on the deal by mid-June. The regulators are looking closely at the relationship between Beijing and Chinalco. The complex deal would give Chinalco an 18% stake in Rio Tinto, the world's third-largest miner, which owns valuable iron-ore and copper mines in Australia and around the world.

Four years ago, concerns by U.S. lawmakers about ties between China's government and business helped kill a bid for

Unocal Corp. by Chinese oil company Cnooc Ltd.

Australia has benefited as foreign investors such as the Japanese and Chinese poured money into developing its rich natural resources for export. But a recent stampede of Chinese money into Australia has stirred an anti-China backlash, which could make it tougher for the government to let the Chinalco deal go through, people in the industry say.

In late March, Australia blocked an offer by China Minmetals Corp. to buy all of OZ Minerals Ltd. for 2.6 billion Australian dollars (\$1.9 billion), citing the proximity of one of the target company's mines to a sensitive military zone. Minmetals has submitted a revised bid for a substantial portion of Oz Minerals' assets, not the whole company. The bid excludes the mine at issue.

Chinalco's state connections are a rallying cry for Australian critics of the Rio Tinto bid, which would give Chinalco minority stakes in some of Rio's mines.

"The Australian government would never be allowed to buy a mine in China," Sen. Barnaby Joyce declares in television ads attacking Chinese investments now on the table. "So why would we allow the Chinese government to buy and control a key strategic asset in our country?"

Rio Tinto has said the deal wouldn't compromise Australia's national interests. For the debt-laden company, the deal offers a big advantage at a time when credit has dried up. Rio Tinto would gain access to a multibillion-dollar credit line from Chinese banks.

China's National Development and Reform Commission has wide-ranging power over China's overseas investments. If more than one state-owned enterprise is interested in the same overseas asset, they must first compete in a kind of beauty pageant judged by the NDRC. Usually, only one winner gets to represent China.

Chinalco's Mr. Xiao, 49 years old, was especially ambitious in that regard, and attuned to the government's goal of turning Chinalco into a global metals-mining group. He was born in Beijing and grew up amid the political chaos of Communist China's early decades. When colleges reopened after the Cultural Revolution, he qualified, graduating with a degree in engineering in 1982, just as China was starting to experiment with capitalism.

China's State Council, the nation's cabinet, turned down several requests for an interview with Mr. Xiao.

Over the next decade, Mr. Xiao rose from a government-assigned teaching job at an aluminum plant near the Russian border to factory manager. In 1998, the government dispatched him to turn around a money-losing state-owned factory in southwest China. High-profile visitors lauded his success, including then Premier Zhu Rongji and President Jiang Zemin. In 2002, the factory was absorbed by Chinalco. Within two years, he was appointed president and Communist Party secretary of Chinalco.

Mr. Xiao pushed to diversify, according to Chinalco executives and bankers. In 2004, the company outbid 10 others for an Australian mine producing bauxite, the raw material for aluminum. The A\$3 billion investment was China's biggest in Australia. Rio Tinto, which owned an adjacent bauxite mine, held talks with Chinalco about sharing infrastructure.

In May 2007, Chinalco agreed to invest in a Saudi joint-venture smelter, and that June, it spent \$860 million to buy Canada's [Peru Copper Inc.](#)

Unlike most of the technocrats running China's big state-owned enterprises, Mr. Xiao cultivated a high public profile. His political fortunes rose. After the Peru Copper deal, he was named an alternative delegate of the powerful Central Committee of the Communist Party.

In November 2007, [BHP Billiton Ltd.](#), the world's largest miner, made a hostile bid for Rio Tinto. The deal would have

combined the world's second- and third-largest producers of iron ore, the key ingredient for the steel that China needs for factories, cars and skyscrapers.

Concerned about the potential pricing power of a combined company, China's government hastily called meetings with several big state-owned enterprises, say people familiar with the events. NDRC officials led the meetings, and they wanted ideas for blocking the BHP bid. Among the attendees, these people say, were Chinalco; Baosteel Group Corp. Ltd., a steelmaker; Shenhua Group Corp., China's biggest coal miner; and China Development Bank.

Rio Tinto was looking for a white knight, according to a banker who worked on the matter. Mr. Xiao had held earlier discussions with Rio Tinto about the Australian bauxite mine. He decided to try to accumulate a large block of Rio Tinto shares, say people familiar with the matter. Such an investment had the potential to fulfill the government's objective of blocking the BHP deal, and to further Chinalco's efforts to diversify outside China and beyond aluminum.

Mr. Xiao turned to Chinese banks for support, including China Development Bank, run by the son of a onetime deputy of former Chinese leader Deng Xiaoping, and China International Capital Corp., run by the son of former Premier Zhu. He also hired Lehman Brothers Holdings Inc., and together they hatched a plan to build a stake in Rio Tinto.

Baosteel and others also were angling for the deal, bankers say. Chinalco pitched its idea at a meeting where NDRC officials heard competing proposals. According to Chinalco, government regulators had only two questions for the company: Could it afford the deal? And could it limit the risks?

NDRC chose Chinalco's plan, and the company teamed up with U.S. aluminum maker Alcoa Inc. Their plan was to buy enough shares to have influence over the BHP deal, with Alcoa taking a small slice of the stake, according to a banker familiar with the matter. Chinalco has said the intent of the two companies was not to block BHP.

After markets closed on Jan. 31, 2008, Lehman traders in London worked through the night to snap up Rio Tinto shares. Mr. Xiao sat by the trading desk, too anxious to eat, he told Chinese reporters. All told, they spent \$14 billion to buy 9% of Rio Tinto's total shares, becoming Rio's biggest shareholder. It was the biggest overseas equity investment to date by a Chinese company.

Chinalco's stake was too small to block BHP. Still, as a major Rio Tinto shareholder, Chinalco didn't want to be viewed in Australia as a threat. It hired lobbying firm Hawker Britton to reach out to Prime Minister Rudd.

Then, last November, BHP dropped its bid for Rio Tinto. That was a relief for China. But the subsequent slump in Rio Tinto's share price left Mr. Xiao sitting on a paper loss that at one point reached roughly \$10 billion.

Bankers, including J.P. Morgan Chase & Co., argued Chinalco should "double-down" on its original investment, bankers familiar with the matter say. By investing more in Rio Tinto, they said, Chinalco could average down the cost of its entire investment.

By December, Rio Tinto's managing director for strategy, Douglas Ritchie, was in talks with Wang Wenfu, the head of Chinalco's Australian subsidiary. The two men lived near each other in Brisbane. Rio Tinto was growing concerned about \$38 billion of debt it had taken on when it bought Alcan, Canada's largest aluminum company, in July 2007. In October 2009, \$8.9 billion of debt was coming due.

Mr. Wang told Mr. Ritchie that Chinalco was interested in long-term cooperation. Mr. Ritchie said Rio Tinto wanted access to credit from Chinese banks, according to a person familiar with the discussions.

Their companies struck a tentative deal: Chinalco would buy \$7.2 billion of bonds that would convert into Rio Tinto shares, and an additional \$12.3 billion of Rio assets, including stakes in giant iron and copper mines.

Chinese bureaucrats were wary. "The NDRC was nervous about the second investment," Lu Youqing, Chinalco's vice

president, said in an interview. "We needed to prove to them that it could be profitable."

With the debt coming due in October, Rio Tinto debated whether to sell new shares or go with the Chinalco deal. The board endorsed the Chinalco option. In February, Chinalco and Rio announced the \$19.5 billion investment, which would raise Chinalco's stake in Rio to 18%.

Diplomats say Chinese government officials erred by never consulting with their counterparts in Australia beforehand about that planned Rio Tinto deal. Doing so might have helped reduce the resulting political tempest.

Should the deal go through, Rio Tinto officials don't discount the idea that Chinalco's involvement could grow. Asked if Chinalco plans to some day buy all of Rio Tinto, Mr. Lu burst out laughing.

"We could never do that," he said, adding: "Who knows what will happen in 10 years?"

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