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HD **Elephants in the boom contemplate a jumbo merger**
BY BARRY FITZGERALD, MATT CHAMBERS, MERGERS
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Glencore is hoping diversification might tempt its target Rio

APART from the value question, Rio Tinto chief executive Sam Walsh sees a \$190 **billion** merger with Ivan Glasenberg's Glencore as being fraught with difficulties, having compared it with trying to get two elephants into a single bed.

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"How do you actually make that work without one falling out," the urbane grandfather and **milk** jug collector told Bloomberg last December in a London interview.

The trouble is, his adversary Glasenberg, a triathlete and a race-walker of some talent in his younger days and a man who enjoys the thrill of the hunt as all traders do, thinks Rio-the-elephant has a wound that he can exploit.

A South African who carries an Australian passport from his days as a **coal** trader in Sydney, Glasenberg has zeroed in on Rio's heavy reliance on **iron ore** for its earnings as a weakness that a merger with Glencore could fix. After all, Glencore is the most diversified of all of the resource companies thanks to its global trading arm and agricultural commodity interests.

Iron ore has been in free fall this year. That it is down by 40 per cent from last year's annual average of \$US135 a tonne to less than \$US80 a tonne is a key factor in Rio's relative underperformance on the market.

On Barclays' numbers, Rio is trading on a 2015 prospective price/earnings multiple of 8.7 times. That compares with 10.7 times for Glencore, and 10.8 times for BHP Billiton.

In July, Glasenberg — the richest mineral resources **company** executive in the world, courtesy of his \$US6bn (\$8.6bn) **stake** in Glencore — decided the time to act on Rio's vulnerability to **iron ore** price weakness had arrived.

Acting on that vulnerability could deliver Glencore something Glasenberg has long coveted, and something that for all of its diversity, Glencore has no meaningful presence in — **iron ore**. Rio's Pilbara **operations** are best-in-class, a point it felt the need to highlight this week in response to both the Glencore approach, and BHP's warning it was after Rio's lowest-cost producer status.

Glasenberg picked up the phone and called Rio chairman and fellow South African, Jan du Plessis, suggesting a merger between the two companies — one that would also knock BHP off its perch as the world's biggest **mining company**.

Come early August, Rio rebuffed the mega-merger approach, something that both Rio and Glencore were only to confirm on Tuesday after a London report by Bloomberg said Glasenberg had responded to the rejection by "reaching out" to Rio's 9.8 per cent shareholder, **China's** state-owned **Chinalco**.

The **Chinalcostake** is a throwback to early 2008 when Rio was reeling from the GFC. BHP's then chief executive Marius Kloppers was also close to making a hostile \$US150bn scrip bid for the **company**,

one which the young South African said was both compelling and one for all seasons. It wasn't, with BHP walking away in November 2008, blaming the fallout from the GFC.

Chinalco's earlier dawn raid on Rio was seen as a response to Beijing's fears that a BHP-Rio combination would have undue influence over **iron ore** prices.

Beijing — and European antitrust regulators — were equally alarmed when a planned \$US116bn combination of the Pilbara **iron ore operations** of BHP and Rio was proposed in 2009, only to be abandoned in 2010 after it became clear it would not gain clearance from antitrust regulators.

The aborted merger was bitterly disappointing for BHP, whereas Rio had effectively stumbled into preserving its independence, given the **iron ore** merger was unveiled with a \$US15bn rights issue that allowed Rio to call off the garage **sale** of \$US19.5bn in **iron ore** and **copper** interests to **Chinalco** under an earlier recapitalisation proposal. **Chinalco** has been tight-lipped about a Glencore-Rio merger, saying only it would like to protect its **equity** investment in Rio, on which it is down by half.

Because of Glencore's limited **iron ore** interests, **China** will not be alarmed about the potential combination, although the **copper** production and **copper** trading presence of a merged **group** could well prompt it to seek remedies to its satisfaction, as was the case with Glencore's takeover of its 34 per cent-owned Xstrata last year. But commentary about what hurdles there are around a merger proceeding presupposes that there will be one. Rio made clear in this week's belated confirmation that it had rejected Glencore, and that it would be staying the course under Walsh.

Since Walsh was called up by De Plessis to replace Tom Albanese as CEO in January last year he has said time and again that merger and **acquisition** activity is not on the agenda.

While his comments on **M&A** have been taken to mean that Rio was in no hurry to get back on the **M&A** wheel after its disastrous Alcan and Riversdale acquisitions, they can also be viewed against Rio's long understanding that Glasenberg has had the **company** in his sights — as early as 2007 by some accounts.

Comments earlier this year by Glasenberg that the **mining** majors like Rio had killed the super-cycle by massively increasing supply are now seen as part of his strategy to switch investors on to the need for greater diversification at Rio through a merger with Glencore.

But not wanting to detract from Glencore's own exposure to commodities where oversupply has become a problem, Glasenberg said in August that super-cycle was not dead. "It is there, the demand is there; it's a matter of what people are going to do about supply," Glasenberg said. His criticism of the Pilbara expansions, and the role they have played in bringing down **iron ore** prices down, is not shared by investors.

Colonial First State's \$2.2bn global resources fund, which has BHP, Rio, Vale and Glencore in its top 5 holdings, says the expansions are shareholder-friendly. "The price is obviously suffering from the supply growth exceeding demand growth," fund manager Todd Warren said. "But in the medium-term, more supply will be needed and the most profitable tonnes on the planet are mined in the Pilbara region by BHP and Rio Tinto.

Walsh would undoubtedly agree. Glasenberg too. TERRY MCCRANN P32

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