HD **Rio hoses down Glencore deal**

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ANALYSTS say any deal is unlikely despite the lure of $US2 **billion** cost savings.

The potential for a deal was widely downplayed by Rio, analysts and investors but the prospect of $US2bn ($2.27bn) of annual savings and a re-rating of Rio's relatively underperforming stock saw Rio's shares log their biggest one-day percentage gain in more than a year.

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Yesterday's gain came after a Bloomberg report said Glencore had recently held talks with Rio's biggest shareholder, **China**'s state-owned **Chinalco**, about a deal, prompting Rio to reveal it had in August knocked back a merger proposal.

It is understood Mr Glasenberg, the South African chief executive and second-biggest shareholder of British-listed Glencore, made a direct approach to his compatriot, Rio chairman Jan du Plessis, in London.

GRAPHIC: How a merger would shape up

Protocol in merger approaches is normally chairman-to-chairman, but Mr Glasenberg's direct approach is reflective of the influence he exerts on the board with his 8.3 per cent **stake**.

The Bloomberg report said Glencore was targeting what it hoped was **Chinalco** dissatisfaction at both a failure to gain a Rio board seat with its 9 per cent **stake** in the **company** and delays to the $US20bn Simandou **iron ore** project in Guinea, where **Chinalco** is a partner but where progress has slowed.

The hurdles to a potential deal include Glencore's $US49bn debt load, potential regulatory blocks, including from the Foreign Investment Review Board and **China**, culture clashes, potential dividends and buybacks coming Rio shareholders' way and the fact Glencore would be unlikely to offer a significant premium.

"When it comes to Glencore, you can never say never, but the reality is I don't see the attraction from a Rio point of view," Arnhem Investment Management managing partner Neil Boyd-Clark said.

"Glencore shareholders might like the idea because you're upgrading asset quality, taking advantage of higher-priced scrip and improving your balance sheet ... but the only reason for this to happen from a Rio Tinto perspective would be an outrageous premium, which I don't think Glencore is in a position to offer."

Rio's statement on Mr Glasenberg's approach indicated a premium may not even be enough to get the offer across the line, unless Glencore's publicising of the deal is successful in pressuring the board.

Unlike most deal knock-backs, Rio's statement made no mention of the approach being undervalued, saying only that it was not a good idea.

"The Rio Tinto board, after consultation with its financial and legal advisers, concluded unanimously that a combination was not in the best interests of Rio Tinto's shareholders," Rio said.

The lack of any mention of value contrasts with Rio's rejection of BHP Billiton's proposed takeover in 2007, where Rio said the board had concluded the bid "significantly undervalues Rio Tinto".

And again in March, when Rio chief Sam Walsh hosed down comments from Mr Glasenberg revealing Glencore wanted to **merge** Hunter Valley **coal** assets with those of Rio, value was the only problem.

“If somebody is interested in putting a worthwhile proposal to us, well that’s exactly what they should do,’’ Mr Walsh said at the time.

There was speculation that Glencore’s goal in talking up a merger was to put more focus on a potential Hunter Valley tie-up, a proposition Glencore promoted to analysts in a site tour last week.

“It (the merger proposal) may pressure Rio ... to come to the table with Glencore on a potential Australia thermal **coal** joint venture,” Credit Suisse analyst Liam Fitzpatrick said.

In what should further placate shareholders yesterday, Rio indicated a recent slump in the **iron ore** price would not dampen capital return plans flagged in August.

“The board believes that the continued successful execution of Rio Tinto’s strategy will allow Rio Tinto to increase free cash flow significantly in the near term and materially increase returns to shareholders,” Rio said.

The dividend statement may have contributed to the biggest one-day price rise in Rio’s shares in more than a year, Rio’s Australian-listed shares rose $2.48, or 4.3 per cent, to $60.07, more than doubling the 1.7 per cent gain in BHP.

Analysts at Credit Suisse and UBS estimated annual savings of $US2bn a year could be achieved through the merger of Rio and Glencore.

One local fund manager said Rio’s recent history of overpaying for acquisitions, including Alcan and Riversdale **Mining**, could support an argument for bringing in Glencore’s management but that the big Glencore debt could be a worry.

Another said a deal was not out of the question because combined potential involvement of **Chinalco** and any London funds that had big cross-shareholdings could provide unexpected outcomes.

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