Why M&A arb funds are sitting out 'trade of year'; Due Diligence

Australian Financial Review
July 29, 2024 Monday
Print & First Editions

Section: COMPANIES AND MARKETS; Pg. 15

Length: 1021 words

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Body

One investor describes it as the M&A arbitrage trade of the year, except for the fact hedge funds are noticeably absent.

Sierra Rutile, spun out of ***Iluka*** ***Resources*** in 2022, has attracted three takeover bids from three wildly different suitors in the past five months.

In March, commercial construction company PRM Services lobbed a 9.5¢ a share offer (and was swiftly rejected).

Now, the board has recommended an 18¢ a share offer from Sierra Leone-controlled oil company Leonoil Group, which outbid London-based emerging markets fund Gemcorp within weeks. A bidders' statement from Leonoil, which supplies fuel to Sierra Rutile, is due this week.

It's a return of more than three times since January if the bid goes through, but most of the well-known investors on the register, including Samuel Terry, Regal and Perpetual, are long gone.

In a market where contested M&A remains thin on the ground, three bidders - even for a $76 million company - is notable. All the more so as this company's performance has underwhelmed, and its cash position looks strained.

Adding further intrigue are the different bidders tussling for control. They range from a Sierra Leone-backed energy group, a global metals trader, through to a London investor that the Financial Times has described as among the "most daring emerging markets funds" in an article documenting its historical links to Russian money.

Sierra Rutile, which mines rutile, the natural form of titanium dioxide used in paint and tiles, in West Africa, has been better known as another cautionary tale of large Australian companies investing offshore.

Iluka spun out the business within five years of buying it for $375 million. Within three years of the purchase, ***Iluka*** impaired the carrying value by $US290 million and wrote down associated tax assets by $US115 million.

On deciding to divest in 2022, Greg Martin, now Sierra Rutile's chairman, said ***Iluka*** had to report corrupt behaviour by previous management, and the introduction of new mining technologies proved operationally difficult. At the start of this year, the company's register was still dotted with institutional investors that simply inherited the stock as part of their ***Iluka*** holdings.

But they were beginning to get antsy. Shares in the company that estimates it controls 20 per cent of the world's rutile had fallen to 5.8¢ ahead of the PRM bid, from as high as 43¢ at the time of spinout.

One tension point was whether it made sense to keep developing its Sembehun project, or focus on returning capital to investors. The issue looked set to curdle further as Sierra Rutile found itself in a dispute with the Sierra Leone government, essentially over the split the West African nation's government should receive.

But then the rush of bidders arrived.

Since July 22, the board has recommended investors back Leonoil's 18¢ a share bid, which has no minimum acceptance conditions. It's an impressive turnaround from January levels, but still a long way from a demerger success story for ***Iluka***.

It's unclear which parties are siding with which strategic investors, and whether it is a done deal. Gemcorp, for one, still holds 19.9 per cent of the company and has an offer that remains live, even if it is subject to a minimum 51 per cent acceptance.

This is far from the only question around this evolving situation. (A Takeovers Panel application by PRM Services arguing some parties were acting together was dismissed. On Friday, the panel released the reasons for doing so, which disclosed that Sierra Rutile held talks with Gemcorp before it bought its shareholding.)

Among the many questions are how any bidders can appropriately value the mine based on available information about Sierra Leone's taxes and fees.

Much of the intrigue is around the bidders themselves, which make up three of the group's four largest investors and account for almost 65 per cent of the company between them.

Focus on trumped suitor Gemcorp, which swooped in late April as local fund Samuel Terry sold its 19.9 per cent holding, has increased after the FT article. It outlined how Gemcorp turned its focus to Africa at the same time Vladimir Putin drove Russian diplomatic and commercial investment to minimise the impact of Western sanctions. And it detailed how it had hired a long list of well-connected UK government ministers and advisers.

Gemcorp told the FT that neither it nor its founder had ever acted in support of the Russian state nor broken sanctions.

Even so, Gemcorp has been outbid by Leonoil. Leonoil Group popped its head above the substantial line on April 29 and has since upped its stake to 7.5 per cent. The company provides fuel to Sierra Rutile and exports oil from the largest terminal in the country, as well as owning and managing 24 petrol stations. Traditionally, sources say, the company has been more aligned to the Sierra Leone opposition party than the government.

(That compares to the only major investor that is yet to make an offer: contractor Mano Mining & Logistics, which owns 13.3 per cent of the company and is regarded as more aligned to the ruling government. Mano had been one of the contractors operating at the company's Area 1 until the suspension of mining, announced on March 11.)

And there is still lots of noise around the first bidder to show up at Sierra Rutile, PRM Services, which maintains an 11.46 per cent shareholding. Initially, PRM, which had its offer swiftly rejected, had sought to remove four non-executive directors and replace them with its own candidates.

The Puerto Rico-registered group's majority shareholder and chairman is Craig Dean, who runs the London-headquartered Gerald Group. Gerald Group is an employee-owned metals trading company that already has a presence in Sierra Leone through its Marampa iron ore mine.

As the bid was lobbed, photos surfaced of Sierra Leone president Julius Maada Bio disembarking a plane registered at the same address as the Gerald Group office in Connecticut. A spokeswoman for Gerald Group did not confirm or deny if the jet belonged to the company, instead providing The West Australian with a statement on broader "market rumours".

Load-Date: July 31, 2024