

Massive Bids on Table as Giants Fight for Dofasco

Scarcity and an iron ore mine drive the battle between Arcelor and ThyssenKrupp for the Canadian steel-maker, says Peter Marsh.

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The global steel industry has been through a transformation as spectacular as any to have affected the business world in the past few years.

That is confirmed in the bidding battle between Arcelor and ThyssenKrupp, two giants of the European steel industry, for Dofasco, a mid-sized Canadian steelmaker that both companies are valuing at more than USDollars 4bn.

Luxembourg-based Arcelor is considering whether to make a fresh bid for the Ontario company higher than that tabled by its German rival - and other companies could still enter the fray. Just before Christmas, Lakshmi Mittal, chairman and majority owner of Mittal Steel, the world's biggest steelmaker, indicated he had not ruled out making an offer for Dofasco, even though such a move is considered unlikely. Mr Mittal has been a prime initiator of steel industry mergers since 2000 that have increased the size of the main players in the sector and put them in a much stronger position to dictate terms to customers. At the same time, steel prices have rocketed due to rapacious demand from China as its economy has expanded to suck in about 30 per cent of world steel output.

As a consequence, share prices of quoted steel companies in recent years have been among the best performers on global stock markets, despite a downturn in recent months. Thyssen's most recent January 3 offer of CDollars 63 a share values Dofasco at CDollars 4.9bn (USDollars 4.2bn). It was pitched at the same level as a rival bid by Arcelor - which started the effort to acquire Dofasco through a CDollars 56-a-share bid in November. But the Canadians regard Arcelor as a predator and the Dofasco board is backing the Germans, at least in part because if it sells to another suitor, Dofasco would have to hand Thyssen a CDollars 100m break-up fee.

Mike Locker, of Locker Associates, a US steel consultancy, says the magnitude of both bids is "eye-popping", given that Dofasco is a relatively small player with production last year estimated at about 5m tonnes. In the first nine months of 2005, Dofasco turned in net income of CDollars 142.6m on sales of CDollars 2.69bn, with the earnings figure well down on the CDollars 280.1m net income recorded in the

first nine months of 2004, a result of tougher conditions generally in the steel industry in the early part of last year.

But in spite of the earnings drop, **Mr. Locker still thinks the high price of the offers can be justified**, given Dofasco's strong position in higher-value segments of the steel industry -- particularly in flat galvanized sheet used for car bodies. About 75m tonnes of this material -- which has to be made using special processes so it especially shiny and resistant to corrosion -- is made each year, with Arcelor being the world leader with about 10m tonnes.

While Thyssen is well behind with 5m tonnes, both are keen to expand in this field in North America - where Dofasco is the fourth biggest producer with output estimated at about 1m tonnes a year. Mittal Steel and US Steel are the two largest producers of automotive sheet steel in the region - with global output of 6m tonnes and 5m tonnes respectively, most of this coming from their US plants.

The third player in North America, with 2m tonnes, is AK Steel -- which has been in financial difficulties and is burdened by healthcare and pensions liabilities estimated at Dollars 3.5bn. "Since neither Mittal nor US Steel is available, and AK is probably ruled out, there is a scarcity value about Dofasco (in automotive steel) which inevitably increases its price," **says Mr Locker.**

Another attraction of the Canadian company is its ownership of QCM, an iron ore mine in Quebec. This raw material has been in short supply in the past two years, with a consequent big increase in price.

Michelle Applebaum, of Michelle Applebaum Research, an Illinois-based consultancy, says "roughly a third" of the money Arcelor and Thyssen are prepared to pay for Dofasco could be linked to ownership of the mine -- which produces about 16m tonnes of ore a year, most for sale to other steelmakers.