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Xstrata-Glencore Deal a Possible Game Changer

By **David Ebner** Monday, Feb. 06, 2012

Vancouver - The merger of **Glencore International PLC** and **Xstrata PLC** has the potential to spark a new wave of deals in the mining industry, particularly among copper producers, some analysts say.

The two companies are expected to announce an $88-billion (U.S.) deal Tuesday that will unite one of the world's biggest traders of commodities with one of the largest miners of base metals. The new company will be a massive player in resources such as zinc, thermal coal, nickel and copper.

And even though their union has been anticipated for months, even years, the reality of a merged Xstrata-Glencore might be enough to jar others to action.

"There's a big difference between almost pregnant and pregnant," said Michael Locker of consulting firm Locker Associates in New York.

He pointed to the vast concentration in market for iron ore – a key steel-making ingredient – shipped by sea. BHP Billiton, Rio Tinto and Vale control almost three-quarters of it. Mr. Locker predicts the same will eventually happen to metals such as copper, the production of which is more fragmented today. Copper was Xstrata's most-profitable line of business in the first half of 2011.

"Midsize players will be gobbled up," said Mr. Locker "They don't have access to the capital. It's going to be very hard for medium-sized companies to compete."

However, other industry experts believe a flurry of deals is unlikely to be launched by the deal, given that it was well-telegraphed. Xstrata and Glencore, both with headquarters in Switzerland, have been close business partners, Glencore already owns about one-third of Xstrata, and the two companies were long presumed headed toward the altar.

"The analogy is they've been dating for several years and now they've announced their engagement," said analyst John Hughes of Desjardins Securities. "It doesn't mean everyone else is going to get married."

To Mr. Hughes, the driver of any additional consolidation will be confidence in commodity prices rising farther, and general confidence in equity markets.

This theme has played out over the past decade. Ernst & Young research indicates there were 1,008 mining deals in 2011, more than double the amount in 2005, when there were 564 deals, and in 2000, which saw 392 transactions.

On Monday, debt-rater Moody's Investors Service said the proposed merger of Xstrata with Glencore would be "credit positive" for both sides. Glencore would gain by combining with the more profitable business of Xstrata and Xstrata would gain because it would directly connect with Glencore's strengths, trading commodities and the logistics for such work, like ports, ships and warehouses.

One Canadian name talked about in merger speculation is First Quantum Minerals Ltd., based in London and listed in Toronto. TD Securities noted it is well known that there is "substantial overlap" in the operations of First Quantum and a combined Xstrata-Glencore.

First Quantum, TD added, is already "one of the top mining acquisition targets globally" and concluded that "kick-starting another round of large-scale consolidation" is good news for First Quantum investors.

Xstrata-Glencore's coming together doesn't change the dynamics of mining in a way that other blockbuster deals would, said Lee Hodgkinson, national industry leader for mining at KPMG in Toronto.

"I don't know if it's a real game changer of a deal, such as if BHP bought Rio, or if BHP had bought Potash," he said. "I'm not sure if this pressures BHP, or a Rio, or a Vale, into suddenly doing something."

For Canada-based operators, Mr. Hodgkinson said smaller firms with intriguing assets would have already been on the radar screen of the biggest players in the industry, adding that Xstrata had already been large enough to pursue such names before the proposed Glencore deal.