Investors Squawk at Xstrata's Big Deal

Long-Awaited Deal Would Create Commodities Giant, but Some Mining-Firm Shareholders Balk at Premium

By DANA CIMILLUCA, JOHN W. MILLER and RHIANNON HOYLE

Large shareholders of Xstrata PLC came out against the company's plan to merge with Glencore International AG, highlighting what could be a difficult task selling the giant deal to shareholders and regulators.

The companies announced Tuesday they will combine in a swap of Xstrata shares for Glencore stock that would give Glencore 55% of the new company, to be called Glencore Xstrata International PLC. In a sign that investor approval of the deal isn't a given, Xstrata shares fell 4.9% to 1,200 pence ($18.99) in London; Glencore slipped 3.8% to 443.25 pence.

As Glencore and Xstrata unveil terms for a major merger, the deal may not pan out in favor of current Xstrata shareholders, Liam Denning argues on Markets Hub. (Photo: REUTERS/Romina Amato)

Underscoring the perils for the deal's principal architects—Xstrata Chief Executive Mick Davis and his Glencore counterpart, Ivan Glasenberg—two of Xstrata's top shareholders, Standard Life Investments Ltd. and Schroder Investment Management Ltd., came out against the deal, saying Glencore needs to pay more.

Together, they own more than 3% of Xstrata. Because of the way the deal is structured, it would take "no" votes from less than 17% of Xstrata shares to scuttle it.

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Crucial to the deal's success are the views of Xstrata's other top shareholders, mainly BlackRock Investment Management, the biggest outside holders with a 5.8% stake. A number of Xstrata's top investors said Tuesday that they hadn't made up their minds yet on how to vote. A spokeswoman for BlackRock declined to comment.

Messrs. Davis and Glasenberg plan to spend the coming weeks in an effort to convince shareholders of the merits of the deal, which would give Glencore's formidable commodities-marketing arm increased access to Xstrata's vast output of products including coal, copper and zinc.

Glencore's army of traders around the world gives the company access to vast market intelligence that the new company could harness to more effectively fill supply gaps and also source acquisitions.

Messrs. Davis and Glasenberg expressed confidence that the deal, which would create a company with a market value of $90 billion, will ultimately win approval.

"As shareholders begin to go through the deal, I have no doubt this is a deal they will be willing to support," Mr. Davis said in a joint interview with Mr. Glasenberg. "There is an enormous amount of value that can be created, and this is the clear, logical next step for these companies."

Glencore and Xstrata billed the deal as a merger of equals, even though Xstrata investors are to receive 2.8 Glencore shares for every share they own, reflecting a premium of 8% over Xstrata's share price before the potential agreement surfaced last week and about 11% taking into account a small rise in Glencore shares since then. Those levels are short of the typical 20%-plus takeover premium.

In a possible effort to diffuse criticism of the deal, Mr. Davis, who is to be CEO of the new firm, said he would forgo a payment he would have been entitled to in the event of a change in control of Xstrata that, based on company disclosures, could have reached £9 million ($14.2 million). He still stands to collect upon the closure of the deal £6 million in long-term incentive pay for 2010 and 2011. He otherwise would have gotten most of that noncash compensation in 2013 and 2014.

The combined group, which would be listed on the London and Hong Kong stock exchanges with headquarters in Switzerland, would generate more than $200 billion in annual sales from operations in five continents. It would be the world's fourth-largest miner.

Getting the proposed merger approved by antitrust regulators is going to be almost as complicated as securing permits to dig a mine, say antitrust lawyers. The world's top economies are all commodities buyers and have antitrust regulators with the power to block such deals.

The entire process is expected to take around six months and cost over $10 million in legal fees.

The new company would have operations in over 100 countries and significant market shares in several commodities, most notably coal used for energy, where it would produce one-third of global output.

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On Tuesday, Japanese Economy Minister Tadahiro Matsushita said he had "some concerns that increasing the concentration of market power of mining companies could give them more leverage," with regard to resource-constrained countries such as his.

But given that Glencore is essentially a trader, and Anglo-Swiss Xstrata is a miner, potential problems would more likely come from the new company's influence over the entire length of the supply chain, say lawyers.

“There could be issues with Xstrata’s competitors being able to adequately access the market without going through Glencore,” said Matthew Wall, a Brussels-based lawyer with McGuireWoods LLP. However, traders like Trafigura Beheer NV are already big enough to offer competition, he said.

Glencore, based in Switzerland and listed in London, has at least one trump card to play in an important and tough antitrust jurisdiction, one which could help set a precedent to secure approval elsewhere.

In 2006, Xstrata bought Falconbridge, a Canadian miner, for $16.2 billion. In approving the deal, the European Union determined that Glencore, with its 34% stake in Xstrата, had “decisive influence,” meaning that it effectively viewed Glencore and Xstrata as one company.

The EU is currently leaning toward applying the 2006 ruling and not reviewing the deal, said an EU official. A spokesman for EU declined to comment on the case.

And at least one figure in the metals-and-mining sector gave his blessing Tuesday. “Consolidation is always good,” Lakshmi Mittal, CEO of ArcelorMittal, the world’s biggest steel company, said in an interview. “We have been expecting this for many years, it’s good news for the industry, and we have been doing a lot of business with them.”

—Frances Robinson and Alex MacDonald contributed to this article.

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