Lonmin Seen Tempting Chinese Platinum Bid on Discount: Real M&A

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By Carli Cooke

Aug. 28 (Bloomberg) -- For an acquirer willing to bet platinum prices will rebound, Lonmin Plc has never been valued so cheaply versus its biggest mining competitor.

The third-largest platinum producer has plunged to the lowest share price since 2008 as Lonmin posted an unexpected loss and grappled with higher wage and power costs and an industrywide glut of platinum that's used in jewelry and cars. The stock slump accelerated this month as 44 protesters and police officers were killed at Lonmin's Marikana project, the worst mine violence in South Africa since apartheid ended.

With Lonmin's chief executive officer also out for "some months" because of illness, investors are willing to pay the least on record per dollar of profit to own the London-based company's shares compared with Anglo American Platinum Ltd., according to data compiled by Bloomberg.

After Lonmin said it may need to sell new shares as it faces a likely breach of debt covenants, Stanlib Collective Investments Ltd. and Renaissance Group said a Chinese buyer may see a chance for a takeover if Xstrata Plc will sell its 25 percent stake. Other South African mining companies may also be interested, said Momentum Asset Management.

"These are extreme conditions and that's when extreme things happen," Peter Major, head of mining at Cadiz Corporate Solutions, which advises on mergers and acquisitions, said in a telephone interview from Johannesburg. "Everything's got a price. It's a real asset. It's a platinum company with metal in the ground."

Police Violence

James Clark, an outside spokesman for Lonmin at Cardew Group in London, said the company doesn't comment on speculation. While Lonmin is registered in London, the operational headquarters and some of the management team have moved to Johannesburg.

Lonmin's shares reached their lowest price since December 2008 last week in the wake of a labor uprising at its Marikana mine. On Aug. 16, police killed 34 people at the mine, the deadliest police action since the end of apartheid in 1994. Prior to the shooting, 10 people, including two policemen, died in fighting and protests after an illegal strike that began Aug. 10 at the operation about 100 kilometers (62 miles) west of South Africa's capital, Pretoria.

About 3,000 rock-drill operators had gone on strike this month demanding that Lonmin increase their pay. Lonmin said the protests turned violent because of rivalry between two unions. Marikana accounts for about 96 percent Lonmin's output.

Lonmin fell 2.1 percent to 626.5 pence by 9:12 a.m. in London.

Platinum Prices

Spot prices for platinum have advanced 10 percent since Aug. 15 as violence idled about a fifth of the world's platinum-output capacity. Previously, prices were down 23 percent in a year as demand slowed for the metal. According to Impala Platinum Holdings Ltd., global supply last year exceeded demand.

Platinum is little changed from 2010, when prices averaged $1,613.46 an ounce, while electricity and labor costs increased by amounts exceeding inflation each year in South Africa, the nation with the most known platinum reserves. Lonmin gave workers pay increases of as much as 10 percent last year, and state-owned Eskom Holdings SOC Ltd. raised average electricity prices 26 percent in the country in the year ended March 31.

That led to a net loss in the six months ended in March and sent the stock down 47 percent in a year, giving Lonmin a market value of 1.3 billion pounds ($2 billion). In addition, Lonmin said last week that CEO Ian Farmer won't return to full-time work for "some months" as he is treated for a "serious illness." Chief Financial Officer Simon Scott is acting CEO.

Declining Valuation

Anglo American Platinum, the world's largest producer of the metal, has fallen 21 percent in the past year, less than half of Lonmin's decline, giving the Johannesburg-based company a price-earnings ratio of more than 109. Lonmin traded at 13 times profit on Aug. 24. Anglo American Platinum's multiple was more than eight times higher than Lonmin's last week, the biggest premium on record, according to data compiled by Bloomberg that dates back to 1999.

Last week, Lonmin's price-book ratio was as much as 59 percent less than Johannesburg-based Impala's multiple of 1.64 for the steepest discount since December 2008, data compiled by Bloomberg show. Lonmin was at 0.71 times book value, a measure of its assets minus liabilities, on Aug. 24. Impala, the second-largest platinum producer, is down 20 percent in the past year.

Nationalization Risk

"Long-term it has traded above 2 times book over the last 14 years," Paul Whitburn, a mining analyst at Regarding Capital Management in Cape Town, said of Lonmin. "I wouldn't say it's the best business around, but it's a good business."

The violent Marikana protests highlight structural problems in South Africa, including high unemployment that's associated with "widespread crime, which is regularly cited as one factor deterring foreign investment," Fitch Ratings said Aug. 24.

The now-expelled youth leader of the ruling African National Congress last year called for mines to be nationalized, saying it will create more jobs in a country where about one in every four people are unemployed. Mining accounts for 8.8 percent of the country's gross domestic product and generates jobs for about 1 million of the nation’s 51 million people, according to the South African Chamber of Mines.

“If you look at developments in South Africa -- one, on account of labor unions and, second, talks of mine nationalization -- any foreigner would be very foolhardy to bid for assets at this time,” said Abhishek Shukla, an analyst at Paris-based Societe Generale SA. “While price has certainly come down, the fact remains that you might keep on losing money for several years if platinum prices don’t recover. I just don’t see why someone would be in a great hurry to buy Lonmin.”

Nationalization Risk

Lonmin said on Aug. 21 it will probably breach debt covenants and is studying funding options including issuing shares. It may need to raise $1 billion, Societe Generale estimated Aug. 16.

Xstrata, the owner of 24.6 percent of Lonmin’s shares according to data compiled by Bloomberg, could maintain its holding by purchasing stock should the company offer new equity, or it could opt not to exercise those rights and reduce its stake. A spokesman for Xstrata declined to comment on the company’s plans.

Xstrata raised its ownership in Lonmin in October 2008 after scrapping a bid to acquire the whole company. The following year, Xstrata CEO Mick Davis said the attempt was “one deal too many” and that it was “not so smart” to raise its stake to prevent any other company from buying Lonmin. He paid an average 1,979 pence a share to raise the stake after bidding 3,300 pence a share for Lonmin in August 2008.

Xstrata's Options

Xstrata is being acquired by Glencore International Plc, which hasn't been "too enamored with deep-level mining or platinum," said Whitburn of Regarding Capital, which owned shares of Lonmin as of June 30, data compiled by Bloomberg show.

If Xstrata doesn't want to increase its holdings of Lonmin shares through the rights offering, "then there's a chance that you can see corporate activity on the company," Kobus Nell, a fund manager at Stanlib Collective Investments, said in a phone interview from Johannesburg. "The obvious crowds are the Chinese and Russians."

Stanlib, which manages more than 365 billion rand ($43 billion) according to its website, owned shares of Lonmin as of June 30, data compiled by Bloomberg show.

Companies in China may consider acquiring Lonmin to secure platinum supplies for the automotive industry, said Patrick Mathidi, a fund manager in Johannesburg at Momentum Asset Management, a unit of Momentum Investments which has more than 320 billion rand under management. Platinum is used in pollution-control equipment for cars.

Chinese Buyers

“Longer term, platinum is still a very strategic metal,” Sven Richter, who helps manage $3 billion of assets at Renaissance, said in a phone interview. “There have been issues of oversupply but I don’t perceive that pollution controls are going to go away. So, especially if you’re Chinese and you’re thinking strategically, it must be very attractive.”

Jeffrey Rhodes, global head of precious metals at INTL FCStone Inc., forecasts that platinum may climb to $2,000 an ounce by December, up 31 percent on its spot price of $1,527.25.

Mathidi of Momentum Assets said African Rainbow Minerals Ltd. may also be a potential buyer as it seeks to boost platinum’s contribution to its net income, while Exxaro Resources Ltd. might study a deal to diversify into new metals.

African Rainbow, which owns platinum mines with Russia’s OAO GMK Norilsk Nickel, Anglo and Impala, said in February it appointed banks to advise it on potential platinum deals.

African Rainbow

“In line with ARM’s growth strategy, we continually evaluate new business and acquisition opportunities in all commodities that we see value in,” Johannesburg-based African Rainbow said in an e-mailed response to questions.

Exxaro, based in Pretoria, declined to comment about whether it has any interest in acquiring Lonmin. On Aug. 1, Exxaro, the country’s second-largest supplier of coal, said it was studying gold, platinum and copper acquisitions.

A takeover of Lonmin won’t happen any time soon even though “the potential upside in Lonmin is enormous,” according to Blake Allen, a London-based mining analyst at Anchor Capital. “Although we think the platinum companies are cheap and the metals they produce are fundamentally undervalued, we still think an acquisition of Lonmin won’t happen in the near term.”

While acquirers may remain on the sidelines during the political fallout from the recent violence, buyers, including Chinese companies, could still see an opportunity, said Kurt Benn, head of resources at Cape Town-based Cadiz, which owned shares of Lonmin as of June 30, data compiled by Bloomberg show.

“Anyone who is looking for top-quality assets in the platinum space would definitely be interested” in Lonmin, Benn said in a phone interview. “You’d need deep pockets. The Chinese government wouldn’t have a shareholder to explain things to.”