The Ebola health crisis is shaking up the iron ore sector

Since last July, there have been rumors of a merger between the Australian mining group Rio Tinto and the Swiss metal trading giant Glencore, which has long wanted to secure a major position in the iron ore market. Glencore’s iron ore quest might well be linked to its attempts to increase business with China. Rio Tinto has rejected Glencore’s advances; however, the ‘market’ seems fascinated by the prospects of a Glencore-Rio Tinto union while the Ebola crisis in West Africa has weakened Rio Tinto’s iron ore position. Glencore’s iron ore business is marginal compared to that of Rio Tinto but together they would form the second largest iron ore producer in the world, second only to Brazil’s Vale SA. Ivan Glasenberg, Glencore’s CEO is determined to find a willing iron ore target, one of the few commodity sectors in which its activity is marginal. A Glencore-Rio Tinto union would also become the largest mining company in the world; iron ore would contribute to improving the profitability of its traditional commodity trading activities. In fact, the iron ore is a highly profitable commodity for mining companies such as Rio Tinto, which try to expand iron production of in the expectation of increasing profits through increased efficiencies and economies of scale even as prices have dropped by more than 40% year to date. Nevertheless, Rio Tinto may not be able to ward off Glencore for much longer.

The ever worsening Ebola outbreak in West Africa has left hundreds of dead among the local population and it has affected the world economy. The iron ore sector has been one of the hardest hit even as its price has dropped from USD$ 190/ton in 2013 to the current USD$ 80/ton. Such a price makes it very difficult for mining and commodity giants, even on the scale of Rio Tinto or Vale, to sustain their activities in Africa, which happens to be one of the important ingredients in the economies of scale that makes iron ore profitable. The Ebola virus, however, has even more subtle effects. According to reports, in fact, even the fear of contagion is playing an important part in the economic crisis in the area, fueling instability in the mining industry. Many new and existing contracts are at risk of being cancelled and ArcelorMittal, another iron and steel giant, has already started to pull away from the region.

Others may soon follow, including Rio Tinto. Ironically, Glencore's CEO has criticized the aggressive expansion strategies of iron ore companies, having negative effects on prices and especially, because of excessive projects investments in Africa. Nevertheless, the closure of projects and termination of new contracts in Africa may help prompt iron ore prices to increase in the medium term. The largest mining companies are also starting to rationalize operations. Rather than expanding into new ventures – as has been the case in recent years – BHP Billiton, the first mining company in the world by market capitalization, has decided to dispose of non-core activities such as mining of nickel and aluminum smelters to focus on four key market segments including iron ore and oil resources. Rio Tinto's Chairman Jan du Plessis has defended Rio Tinto's rejection of suitors claiming that the Company has made significant progress in repositioning and strengthening its activities while Rio Tinto shareholders "would benefit from the considerable value that will be generated", but he did not take Ebola into consideration when proffered those words in July. Nevertheless, Glencore will likely continue to court Rio Tinto and iron ore.

Vale SA and BHP Billiton either do not fit into its model: Vale has a different geographic focus and too many overlapping activities while BHP is simply too large a morsel for any one Company to chew. Rio Tinto is also a big and expensive 'bite' and there are several obstacles in the way of an acquisition from Glencore, but Ebola has turned some of the obstacles into opportunities. The dropping prices of iron ore, for example, would make the acquisition less expensive now. Meanwhile, once in charge, Glencore would benefit from Rio Tinto's efficiencies and low operating costs, capable of generating profits even in these times of reduced commodity values. China's Chinalco owns 10% of Rio Tinto and Glencore sees that as an opportunity to expand into China. Even then, Glencore would have to deal with the American, European, Australian and Chinese anti-trust authorities. The good news there is that the lackluster performance in the extractive sector, worldwide, may prompt industry regulators and regulators to send a jolt and stimulate the mining sector as a whole. Glencore will make its move quickly while iron ore prices are low, planning to use the resulting market share and higher efficiency to challenge and defeat less efficient producers.

The Ebola health emergency and the already low iron ore prices are making the mining sector more vulnerable to the whims of giants like Glencore. Smaller players – some of them like London Minerals, having exclusive operations in Sierra Leone, one of the most affected countries by Ebola – have been confronted by severe financing problems. Rather than shut down completely, they rely on larger players, which like sharks, are hunting for easy prey. Iron ore profits rely on high output and efficiency of scale. The Ebola crisis has made already struggling firms unable to operate.