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.

The ebola virus – a catalyst

for a hotbed of change in Africa

There is yet no licensed vaccine to confront the Ebola virus outbreak. Several vaccines are being tested, but none have yet reached the clinical use stage. The World Health Organization (WHO) has tracked Ebola contagion cases in Guinea, Liberia, Nigeria, Senegal and Sierra Leone from 30 December 2013 to 21 September 2014, noting that there have been at least related 6,263 and 2,917 suspected deaths attributed to the Ebola virus. The WHO and various international organizations have encouraged the African Union with regard to adopt a comprehensive action plan, as the African situation continues to deteriorate rapidly and has already had significant negative effects on the economy and public order in a large area of the continent. The Ebola crisis has already become very complex, having implications ranging from political security to economic and social conditions that will continue to affect the region well beyond the current emergency care.

The Ebola outbreak that has affected the countries of West Africa has hurt the population and the regional economy. The iron mining and production industry is the sector that has suffered the most from the health emergency. The price of iron itself has dropped from an average USD$ 190/ton in 2013 to about USD$ 100/ton today. This price is too low to make iron mining economically sustainable in Africa, which has generated considerable difficulties for such mining giants as Vale.SA, Rio Tinto and BHP Billiton. The Ebola virus, however, has even more subtle effects. It seems that the very fear of contagion is playing an important part in the economic crisis in the area as several contracts have been interrupted or canceled outright, including one that involved ArcelorMittal, one of the world’s largest steel and iron ore suppliers.

The latest news coming from the African continent says that the contagion could cause another social/civil war in Liberia, the country most affected by the epidemic. Liberia suffered an internal conflict (1989-2003) that claimed the lives of about 250 thousand people. Should the Ebola epidemic continue to spread in the three most affected countries, Guinea, Liberia and Sierra Leone, the economic impact will be felt throughout the region, which had been experiencing unprecedented resource driven growth in the past few years. From an operational point of view, the Ebola epidemic has put the pharmaceutical sector in the spotlight. Whereas, resources and mining might suffer from the epidemic in West Africa, in the long run the pharmaceutical sector can expect significant growth in the region, given the increased household wealth that many African states have witnessed recently. The pharmaceutical and rising family income correlation will affect all types of medicines and ailments – not just Ebola – as the recent epidemic and its widespread media coverage (combined with higher internet and TV penetration rates in Africa than ever before) crisis has served to alert the more affluent population of the importance of preventative healthcare.

The ‘big Pharma’ players with a firm presence in emerging markets such as Bayer – which generates some 30% of its earnings in developing countries – will benefit most. Sanofi also has a good track record, having set up a massive presence in China and in Russia. Smaller pharma companies, heretofore involved in research, have a chance to make their mark through Ebola. Zmapp – the experimental anti-Ebola drug, for which there is no more availability – could be produced in large quantities quickly and cheaply, using genetically modified (GM) tobacco plants. Zmapp’s producer, Mapp Biophamaceutical in San Diego, has partnered with several pharmaceutical companies specializing in the production of drugs from GM tobacco plants such and Caliber Biotherapeutics which holds the largest GM facility in the world (acres and acres of greenhouses for seedlings of tobacco) to produce medicines from this plant. It is a very short stretch to suggest that the legalization of marijuana might itself lead to the development of specialized GM varieties that could be used to target various ailments and perhaps generate a few vaccines of its own.

This means that Africa will become a hot market for established and emerging pharmaceutical and infrastructure improvement companies, especially those working around hygiene issues. Ebola does not spread through water but its effects and dangers have also instigated interest and concern over all kinds of diseases and illnesses that continue to spread in Africa from basic dysentery to cholera. This is because the Ebola epidemic has uncovered the many years of neglected health services that have plagued Sub-Saharan African countries for decades and the fact that increased personal mobility, mobility and even economic growth – as well as refugee and migration crises – have made epidemics more frequent and faster spreading in the 21^{s} century. Indeed, not all economic news from Africa is bad and renowned international financial institutions are on the hunt for African opportunities even as Ebola reports keep increasing.

No less than the London Stock Exchange (LSE) has been trying to woo African companies to list in London to take advantage of the recent period of strong economic growth in the Continent, which has attracted the interest of many institutional investors. There’s a strong push toward Africa and especially a strong interest in creating alliances with local stock exchanges. The London Stock Exchange, which has already successfully launched IPOs in conjunction with the Exchanges in Casablanca (Morocco), Lagos (Nigeria), Nairobi (Kenya) and Cairo (Egypt), intends to continue this strategy making additional agreements in the aforementioned countries as well as others. More importantly, the LSE intends to go beyond the field of energy, raw materials and mines, which account for the majority of African companies listed in

London, in an attempt to add companies involved in finance, technology and manufacturing.

The LSE aims to compete with Dubai, Singapore and Johannesburg, which have been trying to attract the many African companies seeking capital to finance their expansion. Over the past five years, 55 African companies have launched IPO’s in London – about 40% more than the previous five years. Meanwhile, Nigeria has surpassed South Africa to become the continent’s largest economy.