

# Gimme smelter

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## Are more big deals ahead?

THE notion that aluminium is merely a dull, grey metal has taken something of a hammering lately. A dramatic string of mergers, bids and counterbids has enlivened an industry that is proving to be as malleable as its end product. On July 12th Rio Tinto, one of the world's biggest mining firms, comprehensively trumped Alcoa's hostile \$27 billion offer for Alcan, a Canadian rival, by stumping up \$38.1 billion in cash. The deal will make Rio Tinto the world's top aluminium producer (see chart), ahead of Russia's RUSAL, which was itself involved in a big merger in March. And the flurry of activity in the industry might even result in Alcoa itself being gobbled up. BHP Billiton, an Anglo-Australian mining giant sitting on a pile of money earned from high metal prices, is thought to be mulling a \$40 billion bid for the American aluminium-maker.

What explains all this dealmaking? Tom Albanese, Rio Tinto's boss, is confident that the huge sum he is paying for Alcan is justified, in large part because of the situation in China. It is expected to consume 12.5m tonnes of aluminium this year out of a world total of 40m tonnes. But although Chinese demand has pushed up the aluminium price to twice its level of 18 months ago, the price has hovered around \$2,700 a tonne for some months.

Where it will go next is the subject of much debate. Until a few years ago China was a net importer of aluminium. Since then both production and consumption have exploded to satisfy the demands of the expanding economy. But production outpaced consumption, making China a net exporter. Jim Lennon, an analyst with Macquarie Bank, points out that aluminium plants can be built far more quickly there than anywhere else in the world, and at about a quarter of the cost.

China is home to Chalco, one of the giants of the aluminium business, and to over a third of the world's smelters. But although plants can be built cheaply in China, production costs are among the highest in the world. China relies on expensive imported alumina, the refined version of bauxite, the ore from which aluminium is made. And smelting it uses vast amounts of energy, accounting for one-third of the costs in an average plant. The government has tried to rein in aluminium producers on the ground that they are hogging prized energy resources that it would prefer to divert to other parts of the economy. Last year a tax rebate on the export of aluminium ingots was eliminated, and then an export tax was imposed.

But China's policymakers may fail to stem the power drain. Ingot exports have slowed down in recent months but exports of semi-finished and finished aluminium products, which are much harder to track, may have filled the gap. Demand for aluminium grew by 23% in China in 2006 and is expected to expand by 30% this year. The government may

try to intervene to prevent production from expanding commensurately; but it may not succeed.

Even so, many industry watchers believe that China will once again become a net importer of aluminium. On current trends world demand for the metal will reach 70m tonnes by 2020. But where will the extra supply come from? There are few places with the abundant cheap energy needed to make the stuff. Alcan is probably best placed to take advantage of growing demand, because a deal with Quebec, its home province, provides it with cheap, plentiful hydro-electric power. Hence its appeal to Rio Tinto.

What of BHP Billiton's supposed interest in Alcoa? Unlike Alcan, the American firm does not have access to bargain-priced power supplies. And along with its smelters and bauxite deposits, it has a raft of less tasty downstream assets, such as a packaging business with pitiful margins. But BHP Billiton could team up with a private-equity buyer to offload the less desirable parts of Alcoa, and some analysts reckon that of all the potential suitors it is in the best position to extract savings from a deal. So it might still prove enticing, particularly if BHP Billiton shares Mr Albanese's cheerful forecast of growing demand for aluminium from another source. "Where goes China, India is likely to follow," he says.