Australian-British mining merger will lead to a new round of cost-cutting

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Australian minerals and steel corporation BHP announced last month a $A58 billion merger with the London-based mining company Billiton, creating the world's largest mining and exploration group and the second biggest diversified resources company—just behind US-owned giant Alcoa. The merged entity will have annual revenue of $32.8 billion and earnings of $5.9 billion before tax and interest.

The deal, the largest ever merger involving an Australian company, will establish an enterprise with major mining operations in Australia, the Pacific, South America, southern Africa and Europe. BHP will control 58 percent of the new company, which will be a dual-listed structure trading on both the Australian and London stock exchanges.

BHP controls a raft of mineral resources including iron ore, lead, zinc, copper, gold and coking coal as well as owning valuable assets in gas and petroleum. Billiton is a major world producer of aluminum, alumina, nickel, titanium minerals and thermal coal.

Within hours of the announcement, a jubilant Prime Minister John Howard proclaimed that the merger was evidence that Australia's economic prospects remained sound. With mounting signs of recession and the fall of the Australian dollar to record lows, the federal government has faced criticism from sections of big business over its failure to press ahead with economic restructuring.

Howard declared that the BHP-Billiton deal disproved complaints in investment circles that Australian companies were becoming targets for foreign takeover because of the falling dollar and that the country, like New Zealand, was in danger of becoming a “branch office” for overseas corporations. He proudly pointed to assurances that the new corporation's head office would be located in Melbourne.

For about 24 hours, it appeared that Howard's comments might have been justified. The initial reception in the press was favourable and BHP's shares shot up by 44 cents to a record $22.05. But the optimism was short-lived. The following day BHP's share price fell back to $20.38 reflecting a growing concern among local investors that BHP had paid far too much to cement the deal—an estimated 20 percent premium on Billiton's assets.

Moreover, while BHP will have a 58 percent controlling interest in the new corporation, it will contribute 60 percent of the assets. The obvious advantage to Billiton in the deal was recognised by investors in London who pushed the company's shares up by 4 pence to five pounds.

In a bid to placate shareholders, BHP's chief executive Paul Anderson declared that the premium on Billiton's assets was necessary to clinch the deal and the headquarters would be in Melbourne. Despite BHP's assurances, it is unlikely that the corporation will continue to be based in Australia. In 18 months, Billiton's executive chairman Brian Gilbertson will take over from Anderson as the chief executive of the combined operation and a number of other top positions will go to Billiton personnel, including the posts of chief of minerals and chief development officer.

Merrill Lynch's UK resource analyst Russell Skirrow commented that the merger had more the character of a take-over by a “smaller but hungrier suitor” and that Billiton would eventually dominate the new corporation. “If we look at the management structure, it could be viewed as a reverse takeover, because Brian Gilbertson will run the merged vehicle by the end of 2002,” he said.

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The price of BHP shares has since slumped by $1.40. BHP and Billiton have been compelled to launch an international publicity campaign in attempt to stem further damage. The two companies plan to fly a group of financial analysts to South Africa and Mozambique to inspect key Billiton assets and Billiton's chief financial officer Mick Davis has been in Australia this week, seeking to reassure critics.

Global consolidation

Concerned about falling share prices, BHP has, over the last two years under Anderson, been carrying out a major restructuring of its operations, focusing on mineral production and shedding its steel plants. But as Anderson noted, BHP had “reached a crossroads” and was in danger of being left behind as its rivals in the global resources industry consolidated their position through mergers and takeovers. “Given the industry dynamics, given the weakness of the Australian dollar, if BHP is not pro-active, it will be a victim of that consolidation,” he said.

BHP chairman Don Argus said it was necessary to get sufficient size to continue to appeal to global fund managers for investment for further expansion. “Three years ago they [the fund managers] were looking for companies of around $30 billion. Now you are only going to get on the radar screen if you have got around the $60 billion mark. With the projects we have got, it's going to require capital, and we need to have access to those capital markets if we are going to have that flexibility.”

There has been a flurry of merger activity among mineral corporations over the last two years, involving, among others, Glenmore, Billiton, Anglo-American, Shell, Gold Fields and the giant Brazilian iron ore producer CVRD. Anglo-American acquired control of the diamond group DeBeers and Billiton purchased a controlling stake in the Worsley Alumina refinery in Western Australia.

In Australia, Rio Tinto, one of BHP's major competitors in iron ore, went on a $14 billion spending spree in 2000 to acquire key assets: Aston Mining for $1.3 billion, North Ltd for $7 billion and Comalco for $3 billion as well as Peabody Resources and the Lemington coal mine for $480 million.

As with other mergers, the BHP-Billiton deal will lead to further restructuring and job losses. It has already been announced that annual cost savings of $546 million will be achieved by 2003 and more than $800 million by 2005.

Billiton's chairman Gilbertson has a history of drastic cost-cutting. After a career that began in weapons development for the Institute of Defence Research in South Africa and then working for Anglo-American, he became executive chairman of Gencore in 1994.

Gilbertson slashed Gencore's head office staff from 1,100 to 550, reduced the company's size by one third by offloading its papermaking and industrial divisions, and then bought Billiton, Shell's metal and minerals business. In 1997 Gencore listed Billiton on the London Stock exchange to aggressively position the company for international expansion.

Gilbertson, who says he favours “a lean head office,” is tipped to drastically reduce the 800-strong BHP headquarters staff. As part of the agreement with Billiton, BHP will end its 86-year involvement in steel making and ditch its remaining steel assets in Australia and the Pacific, employing around 12,000. According to the *Australian Financial Review*, Billiton “pushed heavily” for BHP to quit steel-making immediately.

The result will be a further assault on the jobs and conditions in BHP's operations, particularly its remaining steelworks. The corporation has already shut its Australian plant at Newcastle with the loss of 3,000 jobs and is preparing to cut another 900 jobs at its Port Kembla plant by outsourcing maintenance, security and ambulance services. Other steelworks and mills in Australia, as well as in New Zealand and South East Asia, will also confront job cuts as the company prepares them for sale or to operate as separate entities.

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