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# Ivanhoe plunges after Rio shows little interest in full takeover

Peter Koven Dec 13, 2011 – 7:40 AM ET | Last Updated: Dec 13, 2011 6:53 PM ET



Mongolian workers are seen at 551 meters below the surface of the earth while sinking an exploration shaft at the Oyu Tolgoi copper-gold project

REUTERS/Luke Distelhorst

Rio Tinto Ltd. faces a bill that is likely in the billions of dollars if it wants to take control of Ivanhoe Mines Ltd., even after it won a key arbitration ruling.

Ivanhoe shares fell 22% Tuesday after the long-running arbitration case was settled in Rio's favour. The ruling prevents Rio's 49% stake in Ivanhoe from being diluted if Ivanhoe receives a takeover bid and its shareholder rights plan is triggered.

After the ruling, Rio hinted it may buy enough Ivanhoe shares to get more than 50% without bidding for the whole company, a scenario that spooked investors. Rio will have the opportunity to do so once a standstill agreement between the two firms expires Jan. 18.

However, it would not come cheap.

While the arbitration ruling protects Rio Tinto's anti-dilution rights for its 49% stake, it does not strike down Ivanhoe's shareholder rights plan. If Rio Tinto buys more Ivanhoe shares, the plan would be triggered and new shares would be issued. Ivanhoe shareholders would have the right to buy 10 shares for every one they own at half price. Rio Tinto would then have to buy enough of the issue to get a majority stake in Ivanhoe.

Depending on how many investors bought stock under the rights plan, the bill for Rio Tinto could be extremely high. Sources close to both companies said it would likely amount to billions of dollars. "It would be an expensive exercise," one source said.

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Rio still seems to prefer that option to an outright takeover. On Tuesday, the company said it “currently has no intention” of bidding for all of Ivanhoe, though it left the option open for the future. In the meantime, Rio’s advisors will be working hard to determine how much it would cost the company to boost its Ivanhoe stake over 50%.

With no guarantee that the price will be worth the investment, it is possible that the dysfunctional relationship between Ivanhoe and Rio could continue for some time. The Ivanhoe shareholder rights plan is not set to expire until April 2013, and it could be renewed.

Despite the ongoing tension around Rio’s 49% stake in Ivanhoe, the two companies continue to work together to develop the massive Oyu Tolgoi copper-gold mine in Mongolia. After many setbacks and delays, the mine is expected to enter commercial production in 2013.

Under the current ownership structure, Ivanhoe owns 66% of Oyu Tolgoi and Rio Tinto owns 49% of Ivanhoe. However, Rio has made no secret of the fact that it wants a direct ownership stake in the project.

Ivanhoe stock has always traded at a high valuation, as investors trusted chief executive Robert Friedland to fetch a huge takeover premium for Oyu Tolgoi (as he has done with other assets). After the arbitration ruling, investors are much less confident it will happen. “It totally removes the takeover premium,” said John Stephenson, senior vice-president and portfolio manager at First Asset Investment Management.

Investors also have little confidence that an outside company will make a bid for Ivanhoe, since Rio’s stake is a natural deterrent. Rio also has a right of first offer that is in effect until October of next year.

Posted in: Investing, Mining Tags: Ivanhoe Australia Ltd., Ivanhoe Mines Ltd., Mongolia, Oyu Tolgoi, Rio Tinto Plc



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