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By Charles Mead

Feb. 7 (Bloomberg) -- For all the acquisitions being struck in the mining industry, no company in North America is a cheaper takeover candidate than Cliffs Natural Resources Inc.

The biggest North American iron-ore producer sells for 6.4 times its cash from operations, after deducting capital expenses, according to data compiled by Bloomberg. That's less than every other metals or mining company in the U.S. or Canada exceeding $5 billion in market value, and a 70 percent discount to the median. Cleveland-based Cliffs, which analysts say will generate record sales in 2012, is also the least expensive relative to its estimated net income this year and next, the data show.

Mining takeovers accelerated to a four-year high in 2011 as companies sought to replace deposits and industrial growth in China and the developing world fueled demand for raw materials. With Glencore International Plc and Xstrata Plc pursuing a merger to create an $89 billion global mining company, Cliffs may attract interest from BHP Billiton Ltd. or Rio Tinto Group, Lutetia Capital said. An acquirer could pay a 30 percent premium and still get Cliffs for less than any comparable publicly traded mining company versus its free cash flow, the data show.

"There could be more vertical integration" after Glencore and Xstrata, Mark Keller, chief executive officer of Confluence Investment Management in St. Louis, which manages $1 billion including shares of Cliffs, said in a telephone interview. As a result, "the first-rate mid-sized companies like Cliffs I think potentially become takeover targets," he said.

Steve Baisden, a spokesman for Cliffs, declined to comment on whether the company has been approached about an acquisition or is considering putting itself up for sale.

## Cars, Skyscrapers

Ruban Yogarajah, a spokesman for Melbourne-based BHP, declined to comment on whether the company is considering buying Cliffs. Illtud Harri, a spokesman for London-based Rio Tinto, didn't respond to a telephone message seeking comment.

Founded in 1847, when investors from Ohio pooled resources to explore for minerals in Michigan, Cleveland-Cliffs Inc. renamed itself Cliffs Natural Resources after it agreed to buy Alpha Natural Resources Inc. in July 2008. While the deal was scrapped four months later in the midst of the biggest financial crisis since the Great Depression, Cliffs kept its current name.

The company now produces the most iron-ore pellets in North America. It also exports the raw material, used to make steel found in everything from automobiles to skyscrapers, to China and other Asian markets from its mines in eastern Canada and Australia, according to its regulatory filings.

## Relative Value

Since reaching an almost three-year high on July 19, shares of Cliffs have retreated 26 percent, the largest drop after Alcoa Inc. among 30 companies in the Standard & Poor's 500 Materials Index, data compiled by Bloomberg show.

In September, Cliffs posted its biggest two-day slump in more than two years amid concern the U.S. economy would fall back into a recession, curbing iron-ore demand. The company said last month that 2011 sales volume for eastern Canada would reach 7.4 million tons, short of its forecast of 8 million as Cliffs suffered crusher, dryer and other equipment outages.

Shares of Cliffs ended at $74.99 yesterday, leaving the company valued at $10.7 billion. That's 6.4 times its free cash flow in the past year, data compiled by Bloomberg show. In North America, the median multiple for the 20 metals and mining companies with more than $5 billion in value was 23.5 times.

Cliffs also traded at 7.3 times analysts' per-share estimates for 2012 profit and 6.3 times their projections for 2013. That's at least 40 percent less than the industry's median ratio in each of those years, the data show.

## Chinese Demand

BHP and Rio Tinto, which both get more than a quarter of their revenue from China, may now want Cliffs' iron-ore business to increase exports to the world's fastest-growing major economy, according to Confluence's Keller and Jean-Francois Comte, co-founder of Paris-based Lutetia.

China, which used more iron ore than all other countries combined last year, relied on imports to meet almost 70 percent of its demand, data compiled by Bloomberg show. It imported 687 million metric tons of iron ore in 2011, more than double the amount it bought from overseas suppliers five years ago.

Buying Cliffs, which produced about 40 million metric tons of iron ore in the past 12 months, could boost BHP's total output by almost 30 percent and Rio Tinto's by about 20 percent, the data show. BHP and Rio Tinto, the world's largest and third-largest mining companies by market value, compete with Rio de Janeiro-based Vale SA in the global iron-ore market.

Iron ore is "where most of the shortage in China is," Lutetia's Comte, who oversees a $100 million event-driven fund, said in a telephone interview. "Cliffs is, on a fundamental basis, we believe undervalued. They're extremely well positioned to be an acquisition target."

## Glencore-Xstrata

Anglo American Plc, less than half the size of BHP and Rio Tinto, may look to acquire Cliffs as the Glencore-Xstrata merger increases pressure on smaller mining companies to combine or risk being taken over, Confluence's Keller said.

Baar, Switzerland-based Glencore, the world's biggest commodities trader, and Xstrata of Zug, Switzerland, together would become the world's biggest producer of zinc, lead and thermal coal and one of the five largest suppliers of copper and nickel, according to UBS AG.

Cliffs may also entice ArcelorMittal, the world's biggest steelmaker, with the possibility of securing more supplies of the material it needs to make the alloy, said Timothy Hayes, a Richmond, Virginia-based analyst at Davenport & Co.

ArcelorMittal earned less than 5 cents operating income for every dollar of revenue in 2010, about three-quarters less than in 2005, data compiled by Bloomberg show.

## Slipping Away

"Cliffs is going to be a very attractive stock in the long term and from the M&A side," Anthony Young, an analyst at Dahlman Rose & Co. in New York, said in a telephone interview.
"If you were to have another miner come in and make an offer for Cliffs, then all of a sudden you could have a steel guy who says, 'Oh man, I can't let these assets slip away.'"

"You could very well have multiple entities that would be interested," he said.

Emily Blyth, a spokeswoman for London-based Anglo, and Giles Read of Luxembourg-based ArcelorMittal, declined to comment on whether the companies are considering buying Cliffs.

A slowdown in China, the world's largest user of industrial metals, may reduce earnings for raw materials suppliers and deter the pace of dealmaking, according to Kuni Chen, an analyst at CRT Capital Group LLC in Stamford, Connecticut.

The International Monetary Fund cut its 2012 growth forecast for China to 8.2 percent from 9 percent last month, after the nation expanded in the last three months of the year at the slowest rate in 10 quarters.

## Takeover Deterrent

China's growth would be cut almost in half if Europe's debt crisis worsens, the Washington-based IMF said yesterday.

If Chinese demand "falls short then you have downside to the iron ore price," Chen said in a telephone interview. "From the standpoint of a potential bidder here, they would certainly be concerned over where supply is heading over the next couple of years, so I think that may be a deterrent."

Economists surveyed by Bloomberg still estimate that China will grow 8.5 percent this year. Even at the 8.2 percent rate that they are projecting for 2013, Chinese demand for iron ore will probably keep prices from falling because the country uses more than 40 percent of the world's steel, Dahlman's Young said.

"Sure it's slowing, but it's already gotten to a point of such size that it's going to continue to draw in a massive amount of raw materials," he said.

Cliffs could command a takeover premium of at least 30 percent, or about $97.50 a share, according to Lutetia's Comte.

Bullish Options

At $110 a share, the price Confluence's Keller says Cliffs could get in an acquisition, it would still be cheaper than any other mining company in North America relative to free cash flow, data compiled by Bloomberg show.

Options traders are betting that the value of Cliffs will also increase. The ratio of calls to buy Cliffs shares versus puts to sell reached 1.28-to-1 on Jan. 25, the highest level since January 2010, data compiled by Bloomberg show.

"If I have to put my money somewhere on what could be a target, what's exciting as an acquisition, I'd rather put my money on a company like Cliffs," said Lutetia's Comte.

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