UNIVERSITY OF BRADFORD

MERGERS & ACQUISITIONS

MAN4125M

03 July 2013 09:15 – 11:15 hours + 15 minutes reading time

Main

This is an **OPEN BOOK** examination

Duration: 2 hours

Answer **Two** questions

You **must** answer **Question 1 (compulsory)**
and must choose either question 2 **or** 3.
Each question carries the same weight.

You are strongly advised to divide your time for each question roughly in line with the %-weight.

Examination questions (each question 50 %)

The following remarks apply to all three questions:

Higher marks are given for original and critical thinking, good support/illustration of arguments through M&A concepts discussed in class, case study material and references to empirical evidence as well as a logical structure and clear communication.

Please note: Marks **cannot** be earned by simply copying textbook material, slides or case study material.

Question 1 is mandatory for all students.

SECTION A: This question is compulsory for all students.

Question 1

At the beginning of February 2012 Glencore announced merger talks with Xstrata (see attachment). The EU approved the merger on December 22, 2012. Critically assess the value creation potential of this merger and develop your own perspective.

(50%)

SECTION B: Please choose ONE of the following two questions:

Question 2

Which way is best? Critically assess different growth methods as well as different growth strategies. Use academic evidence and case studies presented and discussed in class to support your answer.

(50 %)

Question 3

Critically review the effectiveness of acquisition audits and related learning on acquisition performance. Refer to case examples to support your answer.

(50 %)

Glencore and Xstrata

Merger of Equals

In mining circles it has been widely assumed that the age of mega-mergers that built mining titans such as BHP Billiton and Rio Tinto is over. Except of course, as everyone agreed, the inevitable big deal between Glencore and Xstrata. Ivan Glasenberg, Glencore's prickly boss, has long talked about Xstrata as if the tie-up had already taken place. On February 2nd it seemed that he was close to getting what he wanted. Xstrata admitted that it was in talks with Glencore about an all-share merger of equals.

It should succeed. Mining is a business that spawned plenty of talk of huge deals before the financial crisis as Chinese demand for commodities boomed and cash was easy to borrow. Xstrata itself was linked with Brazil's Vale and even attempted its own nil-premium takeover of Anglo American. Now the assumption is that financing a huge takeover would be near impossible, with banks unwilling to lend. The mining giants have instead concentrated on organic growth and smaller bolt-on acquisitions rather than transformational deals.

Xstrata and Glencore are different because they are so similar. Xstrata was born over a decade ago when Glencore, a commodity trader with mines of its own, spun off its coal assets. Glencore still has a 34% stake in Xstrata, which has rapidly grown through the dealmaking prowess of its boss, Mick Davis, to become one of the world's biggest mining companies. Both firms are listed in London but are based a few miles apart in low-tax Switzerland. Both bosses are shrewd South Africans and fiercely competitive.

And both firms are worth similar sums. Glencore is valued at nearly $45 billion, Xstrata at about $50 billion. Glencore went public last year, raising $11 billion with an IPO. Most observers interpreted the flotation as both the savvy Mr Glasenberg cashing out at the top of the commodity market and a way to put a market price on Glencore - a condition for the deal with Xstrata. Glencore's shares have sagged as investors try to figure out a company that is part miner (with some ropy assets in risky parts of the world) and part successful commodity trader (it makes pots of cash delivering metal, oil and agricultural products from the ground to customers around the globe). The company also prides itself on its huge network of traders with their ears to the ground all over the world to be the first to hear about opportunities to make money. And Glencore already markets much of Xstrata's minerals.

A deal would forge the world's fourth-largest miner with revenues of some $200 billion. For Glencore, which is so dominant in trading a range of commodities that it is unclear where it might grow in that business, the merger brings the opportunity for fast expansion in mining (despite signs of a Chinese slowdown commodity prices will remain high for years to come). As for Xstrata, its skill as a mining company is to take underperforming assets and restructure them operationally and financially. Glencore has plenty of these.

Still, for Xstrata the attraction of the deal is less obvious. The company already has impressive plans for organic growth, although some analysts interpreted these as a negotiating chip to boost the company's value before Glencore came knocking. And it has a unique structure among the big miners in that it is hugely decentralised, with most operational decisions taken by the people on the ground (Xstrata's head office contains a handful of people rather than many hundreds like its competitors). This may not fit well with Glencore's more top-heavy management structure. But with an approach by Glencore hanging over Mr Davis, some say, he could not effectively pursue his own strategy for Xstrata so decided to get on with a tie-up.

The biggest impediment to a deal had seemed to be the differences—or similarities, depending on how one looks at it—between Mr Glasenberg and Mr Davis. They are said to concur about many things, but they rarely agree about the value of each other's assets. They appear to have come to an understanding that will forge a predatory new mining giant that may once again revive the days of the mega merger.

Source: The Economist, February 2, 2012

Glencore, Xstrata merger to rival BHP

Glencore International, the world's largest publicly traded commodities supplier, is in talks with Xstrata to merge in a deal that would create an $US82 billion ($US77 billion) rival to BHP Billiton. Glencore, which already holds 34 per cent of the Switzerland-based mining company, made an approach regarding an all-share "merger of equals," Xstrata said yesterday in a statement. Glencore said there's no certainty of an offer.

The transaction, driven by Glencore Chief Executive Officer Ivan Glasenberg, would be the industry's largest. The approach drove up mining shares from Sydney to London as investors anticipated a round of consolidation. Rising commodity demand from developing nations and the deteriorating quality of mineral reserves is spurring producers to combine and boost efficiency.

The combined company may be valued at about 52 billion pounds ($77 billion) after excluding Glencore's 11 billion-pound stake in Xstrata. "Glencore being such a dominant trader and marketer of commodities, and Xstrata being such a strong operator of difficult assets, I think it creates enormous value," Prasad Patkar, a portfolio manager at Platypus Asset Management Ltd. in Sydney, said before the statement. "On one end you have great mining expertise; on the other you've got great marketing expertise. Two and two together should make five."

Shares rise

Xstrata climbed 9.9 per cent in London trading to close at 1,230.5 pence, a six-month high, and Glencore gained 6.9 per cent to 461.7 pence. The commodities trader also rose in Hong Kong before the shares were suspended after Bloomberg reported the potential deal. Bloomberg's Europe 500 Metals and Mining Index increased 3.3 per cent to the highest since July, led by Xstrata, Glencore, Vedanta Resources and Anglo American. Anglo, the London-based mining company targeted by Xstrata in a failed approach in 2009, may again be vulnerable to a bid should Xstrata join forces with Glencore.

Together, Glencore and Xstrata would have the flexibility and financial firepower to make large acquisitions, according to people familiar with the matter. They may consider an offer for Anglo, though any such move would be unlikely to happen before they complete their merger, the people said. That process may take as long as six to eight months, one person said, adding that any offer for Anglo could be preempted by rival bids from competitors such as Rio Tinto Group.

Anglo rose 3.6 per cent to 2,830.5 pence in London, a six- month high, valuing the company at 37.5 billion pounds.

Anglo as target

“What is affecting sentiment the most is the speculation about Xstrata and Glencore,” Doug Blatch, head of equity trading at Investec Asset Management, said from Cape Town. “We know that Anglo has potentially been a target before. What would be the next move for a combined Xstrata-Glencore?”

A merger would give Glencore coal, copper and nickel mines from Africa to Asia. For Xstrata, the deal would be its biggest deal after dropping a 29.2 billion-pound offer for Anglo in October 2009. Glencore, located two miles away from Xstrata in Baar, is required to announce a firm intention to make an offer by 5 p.m. on March 1 under U.K. takeover rules, Xstrata said.

The combination would bring together two groups that separated a decade ago when Xstrata bought Glencore’s Australian and South African coal mines for $US2.5 billion and went public in London. It would also reunite Xstrata CEO Mick Davis, 53, with Glasenberg, 55, a former coal trader who led Glencore to a $US10 billion initial public offering in May.

Share synergies

“This may be the rare case where a nil-premium merger of equals in which shareholders of both companies share the synergies is possible, and maybe even sensible and likely,” Christopher LaFemina, an analyst at Jefferies Group Inc., said today in a note. “A deal like this would never be easy, but now is as good a time as any for it to happen.”

A transaction may bring savings of as much as $US704 million, Credit Suisse Group AG said in a report in October. BHP, the largest miner, withdrew from what would have been the world’s biggest mining deal, a $US66 billion offer for Rio, in 2008. BHP has a market value of 126.9 billion pounds. Rio is valued at 77.6 billion pounds and Xstrata at about 36.5 billion pounds.

Glencore is working with Citigroup Inc. and Morgan Stanley as financial advisers, while Xstrata has tapped Goldman Sachs Group Inc., JPMorgan Chase & Co., Deutsche Bank AG and Nomura Bank International Plc.

Glencore M&A

Glasenberg said in August that Glencore is “aggressively” seeking mergers and acquisitions as market valuations slide. He said in an April interview there was “good value” in a combination with Xstrata. He declined to comment today.

A South African native and Australian citizen, Glasenberg is the second-richest person in Australia with an estimated net worth of $US7.2 billion, Forbes Magazine said today. Gina Rinehart, the Australian mining heiress and media investor, is the richest person, valued at $US18 billion.

Mining takeovers are accelerating as companies struggle to replace depleting deposits and China’s industrial growth stokes metals demand for construction, cars and appliances. Global mining deals swelled to $US98 billion last year, the highest level since 2007, from

$US76 billion in 2010, according to data compiled by Bloomberg. The average premium for takeovers last year was 23 per cent, according to the data.

'Massive cash'

"There's really nothing technically that should be preventing large-scale M&A activity," Daniel Rohr, an analyst at Morningstar Investment Services Inc. in Chicago, said by telephone yesterday. "Balance sheets across the industry are in rather rude health and large miners have massive cash balances that seem to grow larger with each passing quarter."

Mining companies may spend $US134 billion developing assets this year, up 23 per cent from 2010, according to a report last month by Citigroup. Glencore had $US18.3 billion in long-term borrowings as of Dec. 31 and Xstrata had borrowings of $US7.2 billion, according to data compiled by Bloomberg. Both have a Baa2 rating from Moody's Investors Service, the second-lowest investment grade.

Combined, Xstrata and Glencore would report net income of about $US11.2 billion in 2012 and Glencore would control about 65 per cent of a merged company, assuming a takeover with no premium attached, Credit Suisse said in October.

Glencore, which owns mines, plants and warehouses, had a first-half profit of $US2.5 billion, up 68 per cent on a year earlier. It may post adjusted net income of $US4.4 billion for 2011, according to the average estimate of 15 analysts surveyed by Bloomberg. It's due to report earnings on March 5.

Increased Competition

Joji Okada, chief financial officer of Mitsui, Japan's second-largest trading house, said a merger would create a "major" competitor. "I'm concerned that the competition for developing resources will really intensify," he told reporters in Tokyo today. "We feel that there's a threat of a major competitor emerging."

Xstrata's Davis, a South African, built the group through more than $US30 billion of deals since its purchase of Glencore's coal mines and its London IPO in 2002, adding copper, nickel and zinc. His largest deal was the $US18.1 billion acquisition of Canadian nickel producer Falconbridge Ltd. in 2006.

He abandoned a hostile bid for platinum producer Lonmin Plc in October 2008 after metal prices plunged, and withdrew from bidding for Australia's WMC Resources Ltd. in 2005 after being trumped by BHP. Xstrata produced 85.3 million metric tons of coal last year.

Source: The Sydney Morning Herald, February 3, 2012