# Beyond the Deal Newsletter

*Mergers and Acquisitions that*
*Achieve Breakthrough Gains*

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**March 2012**

Dear Jay,

## Quote of the Month

### "What would I do if I had only six months to live? I'd type faster."

***Isaac Asimov***

## In the March Newsletter:

A record breaking combination is underway with the joining together of the UK based Glencore International Plc with the Swiss based XStrata Plc corporation. This $90 billion fusion brings together the largest publicly traded commodities supplier with one of the world's most sizable mining trading companies. There are concerns about whether this ratcheting up in size brings with it greater ability and effectiveness or will the acquisition result in a bloated, more sluggish and less focused organization. The question is whether this massive transaction will actually create value that its backers have promised. In the March issue we look at questions that need to be successfully answered for significant value creation to take place.

Mark your calendar for a talk on *Leveraging Intellectual Capital in Post-Acquisition Integrations* by Jay Chatzkel, editor of the Beyond the Deal Newsletter at the **March 13 Intellectual Capital Practitioners Program** (http://www.icknowledgecenter.com/events/ic-practitioners-series-ic-in-m-a-and-protecting-the-crown-jewels). This talk will focus on how to capture and leverage intangible assets from the beginning through the end of the acquisition process.

- **The Glencore-XStrata Combination: Is It a Value Creating Proposition?**
- **Presentation on "Leveraging Intellectual Capital in Post Acquisition Integrations"**

# The Glencore-XStrata M&A: Is This a Value Creating Combination?

## A $90 Billion Masterstroke or a Bloated Behemoth?

Glencore International Plc  (GLEN-UK), the world's largest publicly traded commodities supplier, agreed to buy XStrata Plc (XTA), one of world's largest mining firms, for about $41 billion in shares in the biggest mining takeover to date. The transaction would create a business with $209 billion in sales, bringing together Glencore's global trading network for energy, metals and farming products with XStrata's coal, copper and zinc mines.

Mick Davis, the current CEO of XStrata (who will also become the CEO of the combined group), laid out the promise of the proposed combination. Davis expects that "synergies from the transaction will deliver annual gains of $500 to $600 million" which will mainly come from putting XStrata production into Glencore's marketing and trading system. "This would create such a different animal in the space with huge flexibility and optionality to get value from exploration to delivery of product "...and he continued, "No company has that capability."

However, there are also significant questions about that assessment. One doubter is Liam Denning of the Wall Street Journal's Markets Hub. Denning commented that "investors need to ask themselves if consolidation makes economic sense." He added that "from the perspective of shareholder value creation, there is little evidence to support the idea that a $90 billion company will be better at creating value than a $60 billion company" (referring to the value of the combined company versus XStrata's value before the deal). As Denning sees it, "Mega acquisitions destroy value for the acquirer because they tend to overpay. It's a classic 'winner's curse'. He cites that XStrata shares were valued at a 15% premium over the February 1 closing price.

That the valuation is a controversial one is attested to by at least two major shareholders of XStrata opposing the deal on the grounds that that "the proposed exchange ratio clearly understates XStrata's assets and future earnings."

## The Valuation Question: Are Both Cost Savings <u>and</u> Growth Synergies Appropriately Appreciated?

The first question: How did Glencore valuate XStrata?

Most acquisition valuations focus on cost cutting synergies and target tangible assets involving financial assets, property, equipment, inventory and staff head count. It is important to know is whether Glencore also identified and inventoried the key intangible assets in both firms' assets during its due diligence and follow-up negotiations as well since these intangibles are essential for "growth synergies" or generating growth in the new organization. Intangibles range from the more obvious patents and trademarks, to data, to the less obvious embedded knowledge that would be required to develop and sustain R&D as well as other organizational processes, the skill sets of key staff, relationships with customers, regulators, key vendors etc. and ultimately the core capabilities required to achieve optimal value creation outcomes arising from the combination.

While both of the companies involved deal with physical resources, either through trading or extraction, a lack of understanding of their intangibles will erode the new entity's ability to achieve the greatest outcome in the post acquisition period. Just consider one important example that the new combination has to pass muster by a number of anti-trust panels around the world. The members of these panels are all customers of these companies. Being able to successfully gain approvals from these panels will determine whether the new combination can go forward. Think about the failure of the GE-Honeywell planned acquisition to gain approval from the European Commission panel and the subsequent collapse of that deal. Glencore and XStrata will face much the same challenges. A well grounded understanding of the approval process and its stakeholders, both intangibles, is essential here.

## The Question of Readiness

A second question is to examine is whether Glencore has developed the level of readiness that will allow it to shape its integration plan to cull and recombine any core embedded capabilities from both companies. The degree that Glencore is ready to create a new significantly more powerful set of capabilities will become the basis for the newly emerging company's success. Capabilities are often both embedded and unique. They are not low hanging fruit that are harvested with little thought and preparedness. Glencore and XStrata need to be have the specific action plans and trained participants that can bring into play the processes, people and knowledge that will be core to building on their existing capabilities and take them to new and considerably higher levels. The new Glencore needs to be prepared to meet the following challenges:

- Will the senior leadership, business unit managers and sub managers of both companies develop lists of the top 3-5 core organizational capabilities that will enable the new company to meet its strategic goals and differentiate itself from its competitors?
- Will it then be ready to chart and carry out the projects it needs to mobilize these new capabilities for specific outcomes?
- Will it have the sufficient levels of trust in which the flow of open communications can happen?
- Finally, are those involved prepared to honestly evaluate costs and gains from the work of leveraging these outcomes?

## Fulfilling the Promise

If Glencore and XStrata are developing real answers to these questions they can then demonstrably justify the acquisition price for XStrata shares and while at the same time give investors a roadmap for how the integrated company will achieve outstanding value creation that is claimed by its leadership. Until then the question of the worth of the acquisition value can only be debated and then resolved, if at all, after several years of operation.

## Join the Presentation on "Leveraging Intellectual Capital in Post-Acquisition Integrations"

You are invited to join Jay Chatzkel, editor of the Beyond the Deal Newsletter, for a March 13 presentation on "leveraging intellectual capital in post-acquisition integrations". To access this talk visit the IC Knowledge Center's Practitioner's Series link to sign up for this event. You can also contact Jay Chatzkel directly for an invitation at jaychatzkel@progressivepractices.com.

This program is for both intellectual capital practitioners as well as anyone else who would like to learn more about how to discover and enhance the role of intangible assets in their organizations.

The talk will examine the significance of intangibles and capabilities in achieving success in acquisitions and how to mobilize your organization to go about achieving quantum leap value creation gains.

## Subscribe to the Beyond the Deal Blog

Link to the Beyond the Deal Blog, with continuing updates on the changing world of Integration 2.0, with additional articles and commentary. You can subscribe to it at: www.beyondthedeal.net/blog/.

## Using Social Media to Speed Up and Improve Performance and Outcomes of Your Integration Processes

Is social media a fad or is it a viable set of tools for advantage in an integration? Social media is now mature enough to be a major accelerator of speed and quality in integration outcomes. Click on this link to the Social Media Strategy to Transform Integrations PowerPoint presentation to see how you can start developing this capability in your organization now. See how you can develop and implement an effective social media strategy in your firm. Contact Jay Chatzkel or Euan Semple to make arrangements and for further information.

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In addition to having the Newsletter sent to you directly, you can access the Newsletter and article library at: http://www.beyondthedeal.net/Newsletter.html
Please send in your comments, contributions and suggestions to Jay Chatzkel, editor. They are important to making the newsletter as relevant to you as possible.
You are welcome to forward this newsletter on to a colleague or friend.

All the best,

Jay Chatzkel
Progressive Practices

**Jay L. Chatzkel** is coauthor of the *Beyond the Deal*, and editor of the Newsletter. He is Principal of Progressive Practices where he assists organizations in transforming themselves into knowledge-based, intelligent enterprises. This includes working with organizations to develop skills and practices in the areas of merger and acquisition integration, intellectual capital, knowledge management, leadership and collaboration, business process management and performance measurement.

He is also author of *Knowledge Capital: How Knowledge-Based Enterprises Really Get Built* (Oxford University Press, 2003) and *Intellectual Capital* (John Wiley & Sons, 2002).