

Corporate Finance: Mergers and Takeovers

Strap your seatbelts on, keep your hands inside the vehicle and hold on for dear life. The merger mania roller coaster that has been so prevalent in today's market is going for another ride. Just hours after a three-way \$17.6 billion mega-merger was announced between Canada's Alcan, Pechiney of France, and Switzerland's Algroup, U.S. based Alcoa, the world leader in the aluminium industry, announced plans to buy Reynolds Metal for \$5.6 billion. If the merger between Alcoa and Reynolds, the third largest aluminium firm, were to happen it would make the resulting Alcoa by far the market dominator.

There are two things standing in the way of the Alcoa-Reynolds merger. Since the union of the two giants would result in a market leader akin to Microsoft in the computer industry, and because competition would be drastically reduced, there are several regulatory anti-trust concerns. The second potential hold up involves the degree of willingness on the part of Reynolds' management to be purchased by Alcoa. Since mergers also mean layoffs, managers are always cautious about merger deals.

But mergers also mean large stock price increases for the firms who are the target of merger and takeover attempts. Therefore, most stockholders prefer their company to be the topic of bidding speculation. In fact, Highfields Capital Management LP, Reynolds' single largest stockholder, has taken the initiative to foster further merger consideration. They are pressuring Reynolds' management to arrange an auction to the highest bidder.

Highfields Capital's managing director, Richard Grubman, wrote a letter to Reynolds' CEO, Jeremiah Sheehan stating, "Your shareholders deserve nothing less and will hold you accountable if you fail to take this action now." Fearing derivative shareholder action and accepting what seems to be the inevitable, Reynolds appears to be open to listen to deals from anyone and everyone.

So where do the smaller firms in the aluminium industry fit into all this? Industry analysts report that these firms are scrambling in an attempt to be a part of deals while the market is in a state of frenzy. The fear of being left out could be a rational one as many feel bidding wars result in over paying for firms.

Just when things could not be more unpredictable, an outside player has announced intentions to challenge the bid of Alcoa for Reynolds Metal. Michigan Avenue Partners (MAP), a firm who got their start in commercial real estate, has come out of the woodwork to announce interest in Reynolds. MAP is not exactly a stranger to the aluminium industry, however. A few years ago they bought Reynolds' McCook division and are now the second largest producer of aluminium plating (behind Alcoa). They also own Metro Metals which is a steel processing firm. Still, analysts did not even see MAP on the bidding radar screen.

The next few months will prove telling for this capricious environment. Said John Martin, aluminium industry analyst at the CRU consultancy in London, "Nothing would surprise me."

Questions

1. Why is it that firms like Alcoa desire to merger or buy other large firms in the same industry like Reynolds?
2. Why might regulators have a problem with firms like Alcoa buying firms like Reynolds?
3. What are the general reasons why firms merge?
4. What can firms do to prevent a takeover attempt from an unwanted suitor?
5. How are funds raised to complete a merger between two such large firms?
6. In the case it stated that several of the smaller firms in the industry wanted to be considered as bidding candidates because bidders tend to pay over fair market value for the smaller firm's shares. Why does this happen?