CASE STUDY 9.2

Cleveland Cliffs Fails to Complete Its Attempted Takeover of Alpha Natural Resources in a Commodity Play

Key Points

- Financial models enable the assessment of the impact of different offer prices on postacquisition net present value and earnings per share.
- Such assessments enable negotiators to develop offers and counteroffers quickly during the negotiation process.

In an effort to exploit the long-term upward trend in commodity prices, Cleveland Cliffs, an iron ore mining company, failed in its attempt to acquire Alpha Natural Resource, a metallurgical coal mining firm, in late 2008 for a combination of cash and stock. In a joint press release on November 19, 2008, the firms announced that their merger agreement had been terminated due to adverse "macroeconomic conditions" at that time. Nevertheless, the transaction illustrates how a simple simulation model can be used to investigate the impact of alternative offer prices on postacquisition earnings per share.

When first announced in mid-2008, the deal was valued at about $10 billion. Alpha shareholders would receive total consideration of $131.42 per share, an approximate 46% premium over the firm's preannouncement share price. The new firm was to be renamed Cliffs Natural Resources and would have become one of the largest U.S. diversified mining and natural resources firms. The additional scale of operations, purchasing economies, and eliminating redundant overhead were expected to generate about $290 million in cost savings annually. The cash and equity portions of the offer price were 17.4% and 82.6%, respectively. See Table 9.12. The present value of anticipated synergy discounted in perpetuity at Cliffs' estimated cost of capital of 11% was about $2.65 billion. Posttransaction net income projections were derived from Wall Street estimates.

Discussion Questions

1. Purchase price premiums contain a synergy premium and a control premium. The control premium represents the amount an acquirer is willing to pay for the right to direct the operations of the target firm. Assume that Cliffs would not have been justified in paying a control premium for acquiring Alpha. Consequently, the Cliffs' offer price should have reflected only a premium for synergy. According to Table 9.12, did Cliffs overpay for Alpha? Explain your answer.
2. Based on the information in Table 9.12 and the initial offer price of $10 billion, did this transaction implicitly include a control premium? How much? In what way could the implied control premium have simply reflected Cliffs' potentially overpaying for the business? Explain your answer.
3. The difference in postacquisition EPS between an offer price in which Cliffs shared 100% of synergy and one in which it would share only 10% of synergy is about 22 percent (i.e., $3.72 ÷ $3.04 in 2008). To what do you attribute this substantial difference?

Answers to these questions are found in the Online Instructor's Manual available to instructors using this book.

Cleveland Cliffs' Attempted Acquisition of Alpha Natural Resources: Offer Price Simulation Model

Deal Terms and Conditions										
Cash Portion of Offer Price (%)	0.174									
Equity Portion of Offer Price (%)	0.826									
Percent of Anticipated Synergy Shared with Target (%)	1.00									
Specific Firm Data										
Acquirer Share Price ($/Share)	102.50									
Target Share Price ($/Share)	90.27									
Target Shares Outstanding (Millions)	64.40									
Acquirer Shares Outstanding, Preclosing (Millions)	44.60									
PV of Anticipated Net Synergy ($M) (@ 11% WACC)	2,650									
		Alternative Scenarios Based on Different Amounts of Synergy Shared with Target								
						Postacquisition EPS				
		% Shared Synergy	**Offer Price ($M)**	**Offer Price per Share**	**Postacquisition Total Shares**	**2008**	**2009**	**2010**	**2011**	**2012**
Calculated Data		0.1	6,078	94.38	104	3.72	4.09	4.42	4.73	4.96
Minimum Offer Price ($M)	5,813	0.2	6,343	98.50	106	3.63	3.99	4.31	4.61	4.84
Maximum Offer Price ($M)	8,463	0.3	6,608	102.61	109	3.55	3.90	4.21	4.50	4.72
Initial Offer Price ($M)	8,463	0.4	6,873	106.73	112	3.47	3.81	4.11	4.40	4.61
Initial Offer Price Per Share ($)	131.42	0.5	7,138	110.84	114	3.39	3.72	4.02	4.30	4.51

TABLE 9.12 Continued

Deal Terms and Conditions										
Purchase Price Premium per Share (%)	0.46	0.6	7,403	114.96	117	3.31	3.64	3.93	4.20	4.41
Composition of Purchase Price per Target Share:		0.7	7,668	119.07	119	3.24	3.56	3.84	4.11	4.31
Acquirer Equity per Target Share	108.55	0.8	7,933	123.19	122	3.17	3.48	3.76	4.02	4.22
Cash per Target Share ($)	22.87	0.9	8,198	127.30	125	3.11	3.41	3.68	3.94	4.13
Share-Exchange Ratio	1.28	1.0	8,463	131.42	127	3.04	3.34	3.61	3.86	4.05
New Shares Issued by Acquirer	82.57									
Acquirer Shares Outstanding, Postclosing (Millions)	127.17									
Ownership Distribution in New Firm										
Acquirer Shareholders (%)	0.35									
Target Shareholders (%)	0.65									
	Consolidated Acquirer & Target Net Income									
	2009	**2010**	**2011**	**2012**	**2013**					
Postacquisition Consolidated Net Income ($M)	387	425	459	491	515					