VALUE ADDING THROUGH CORPORATE DIVESTITURE: CASE STUDY FROM THE STEEL INDUSTRY

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ABSTRACT
The objective of this research is to analyze a case study of divestiture from the steelmaking field, as corporations go through difficult management decisions during divestiture. In order to understand and identify value-adding opportunities for the companies, the investigation of a divestiture within a major international steel group brings up new developments in the management field. The divestment package includes the most important Romanian steel mill, which was privatized 17 years ago to the Indian buyer. Founded in 1960, ArcelorMittal Galaţi is part of the world's leading steel group and a "veteran" of the Romanian economy, having a very rich history and a very important role to play in the future economic set up. Important management actions are to be taken by the newly appointed Romanian general director.
The intended contribution of the research is to find how divestiture decisions can be used as a strategy to create value.
The most important results refer to the inevitable business transformations and of the managerial talent to make the best of the heritage of the number one global steel group. The conclusions refer to the company's essential goal of maximizing their value, else they are doomed to failure (bankruptcy, restructuring, etc.).

KEYWORDS: *divestiture, enterprise value, growth, management, restructuring.*

1. INTRODUCTION

1.1 The objectives of the work

This case study focuses on the managerial challenges of a company undergoing through divestment by studying the transformation of the world's leading steel and mining company (ArcelorMittal is present in 60 countries, with an industrial footprint in 18 countries). ArcelorMittal Galaţi (AMG) founded in 1960, is a "veteran" of the Romanian economy, having a very rich history (Ion, 2018). The importance and role of this company, which is part of the critical mass of firms that influence the future of the Romanian economy, lies in the fact that AMG had, has and will have a major role, both in the region of Galaţi and in the Romanian economy. In this context, the result of the divestiture process that AMG will go through and the future success of the company are essential for the Romanian economy and the city of Galați, requiring excellent managerial skills.
The investigation of the divestiture decision-making, with a focus on the value of the enterprise aims at describing the accompanying challenges and new developments in management field, in the digital era.

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2. PROBLEM STATEMENT

The problem is how divestiture can be used to increase the enterprise value. The discussion question is: What would be the next step/decisions for the new general director of AMG, after the divestiture, while the company is for sale?
I have used the valuation approach based on enterprise value (EV)-to-Earnings before interest, taxes, depreciation and amortization (EBITDA) and the public data available, in order to understand the group situation before the divestment inherited by AMG.
The tools used: statistical indicators such as the median, etc., for calculating multipliers.
According to (Sewing, 2010), the developments in the international mergers and acquisitions (M&A) market, increased dynamics in industry markets, capital market pressure, and the emergence of strong new types of investors lead to divestitures.
Mergers and acquisitions (M&A) include consolidation of companies and assets, as we can see in figure 1.

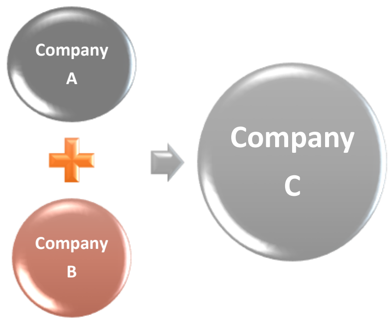

Figure 1. Definition of a merger with consolidation
Source: (CFA Institute, 2013)

The parties in the acquisitions are the target company (or target) - the company being acquired - and the acquiring company (or acquirer).
M&A also encompass divestitures - also called spin-off or demerger, i.e. ceasing to operate business units, or in its simplest form, the sale; often, divestitures and mergers are the different sides of the same transaction (Joy, 2018).
Disinvestment operations consist of two stages:
• A division of enterprise' secondary activities by outsourcing them (as independent enterprises);
• In the second stage, the offer of these unincorporated enterprises for sale and the recovery of their capital in order to develop the main activities (Toma, 2011).
Corporations encounter their toughest business problems during a divestiture (or a merger) and the optimal execution of divestitures can create high value for both parties, as they are strategies to maximize shareholder value (Joy, 2018). Similarly, Gell/Ross (2008), Dranikoff/Koller/Schneider 2002, Müller-Stewens/Schafer/Szelles (2001) considered that corporate divestiture - disposal of significant shares of operational business units - can be a potentially value-adding strategic option for corporation (Sewing, 2010).
The reasons behind the decisions of mergers and acquisitions are presented in figure 2:
(1) undervalued firms by financial markets, relative to their true value; (2) diversification with the intent of stabilizing earnings and reducing risk; (3) the potential additional value from combining firms (Operating Synergy can come from higher growth or lower costs, or Financial Synergy that can come from tax savings, increased debt capacity or cash slack.); (4) Poorly managed firms –as it was the case of the steel producer Sidex Galați - are taken over and restructured by the new owners; (5) Managerial self-interest. (Damodaran, 2018)

Figure 2. Motives for merger
Source: (CFA Institute, 2013)

A systematic analysis of the British privatizations was the first comprehensive treatment of the overall welfare impact of a broad national policy of divestiture, using the tools of social cost-benefit analysis; Florio's findings suggested that the changeover to private ownership per se had little effect on long-term trends in prices and productivity in Britain and contributed to regressive redistribution. Considered a success, the British privatizations greatly influenced the privatization of state industries in the transition economies of Eastern Europe (Florio, 2004).
More recently, the study of Neagu et al. (2017) of the Romanian economy and the "veteran" companies that form the critical mass of firms and influence the future of the Romanian economy (from the point of view of the turnover, added value, number of employees) used a bottom-up analysis, based on the balance sheets and P&L of all companies in Romania, to aggregate at macro level the necessary indicators, which are not available in official statistics. Neagu et al. (2016) used the distribution shape for each indicator because a small minority generates macro developments in Romania and companies form heterogeneous or divergent populations. The findings of the study refer to "veterans in power" that speculate growth opportunities and overwork when problems arise, requiring the implementation of countercyclical policies in a broader manner than recommended by good practices in the field. Otherwise, pro-cyclical policy enforcement may increase the magnitude of phases of the economic cycle (more pronounced growth, followed by a more pronounced decline), against the background of a significant share in the economy of firms doing so.

3. METHOD

3.1 The case: the divestiture of a steel plant

In figure 3, I have presented the evolution of the divestment process in the context of the European Commission decision. The European Commission has approved, under the EU Merger Regulation, the acquisition of Ilva by ArcelorMittal, conditional on the divestiture of an extensive remedy package to preserve effective competition on European steel markets to the benefit of consumers and businesses.
The European steel sector is considered a key industry, from a social point of view (employing about 360 000 people in more than 500 production sites in 23 Member States); also, steel is crucial for many goods and industries dependent on steel employ over 30 million people in Europe. For such reasons, those European industries need access to steel at competitive prices to compete in global markets (Vestager, 2017).

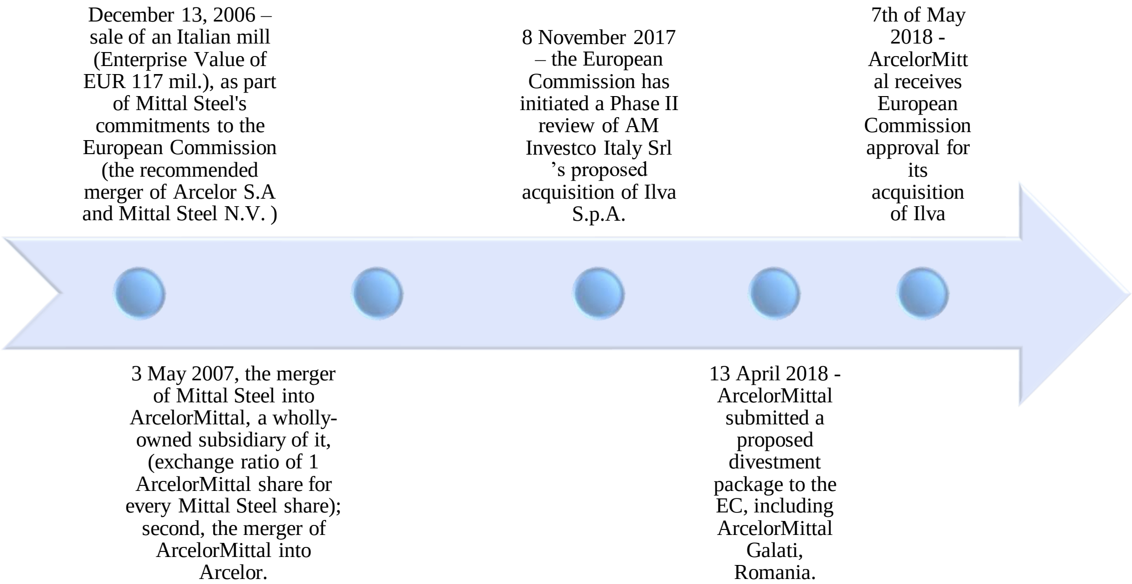

Figure 3. AMG divestiture process' landmarks
Source: (ArcelorMittal, 2018)

The steel plants would be sold to one or more buyers that will continue to operate and develop them to compete effectively with ArcelorMittal (European Commision, 2018).
This deal combines ArcelorMittal-the largest producer of flat carbon steel in Europe and worldwide, with the main assets of Ilva, notably its steel plant in Taranto, Italy, which is Europe's largest single-site integrated flat carbon steel plant, both significant producers in Europe of hot rolled, cold rolled and galvanized flat carbon steel. ArcelorMittal has a wide production network across the European Economic Area (EEA) and Ilva has major production assets in Italy (European Commision, 2018).

3.2 Valuation Approaches

Based on the financial data available, I have used a valuation approach to measure, before the divestiture, the value of the company (which is listed on New York Stock Exchange under MT symbol).

Table 1. Financial highlights on the basis of IFRS

(USDm) unless otherwise shown	1Q 18	4Q 17	3Q 17	2Q 17	1Q 17
Sales	19,186	17,710	17,639	17,244	16,086
Operating income	1,569	1,234	1,234	1,390	1,576
Net income attributable to equity holders of the parent	1,192	1,039	1,205	1,322	1,002
Basic earnings per share (US$)	1.17	1.02	1.18	1.30	0.98
EBITDA	2,512	2,141	1,924	2,112	2,231
EBITDA/ tonne (US$/t)	118	102	89	98	106
Enterprise value (US$ B)	42.8	27.8			

Source: (ArcelorMittal, 2018), (Yahoo Finance & Morningstar, Inc., 2018)

Enterprise Value is the negotiated value between a willing buyer and a willing seller to acquire the business. For the Enterprise Value buyer gets the Operating Balance Sheet including intangible assets. Enterprise value (EV) is often viewed as the cost of a takeover and is calculated as:

EV= market capitalisation + net financial debt + minority interest – investments (1)

or

Enterprise value= MV Equity + MV Debt + MV Preferred Stock- Cash and Investments (2)

Earnings Before interest, Taxes, Depreciation, and Amortization is the "new cash" available for no other purpose than debt-service, taxes and reinvestment and investor return; it is a "more reliable" measure of cash profits and is defined as:

EBITDA = operating income + depreciation, impairment expenses and exceptional items (3)

Multipliers that have the value of an enterprise's value calculator use as denominator elements in the financial statements that do not take into account the company's indebtedness, such as turnover, profit before interest, amortization and profit tax - EBITDA, profit before interest and tax on profit - EBIT, etc.); multipliers that have the amount of equity in the numerator use denominator elements that take into account the enterprise's indebtedness (eg net profit, net book value of equity, etc.);
In figure 4, I have presented drivers of value that the company may consider when establishing their long term strategy. For the company in Galați, the management decisions may include investments, because of the existing old lines of production and identifying the competitive advantage to help it grow.

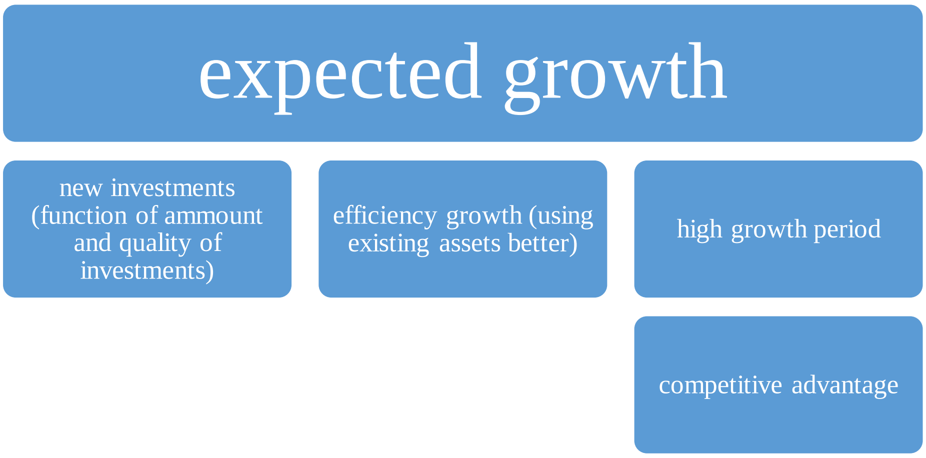

Figure 4. Drivers of value
Source: adapted from (Damodaran)

The world is rapidly becoming digital and companies should adapt to the new environment making full use of the advantages of the global market and the accessibility of market information. With this respect, the company from Galați should improve transparency and investor relations and consider listing on the stock market, as its sister companies from Romania have already done it. For comparison, according to the information made public by the (BSE), in the USA, about 80% of the companies' funding is raised on the capital market and only 20% through bank loans, while in Europe, these numbers are reversed, and in Romania, these numbers are even lower. The financial benefits of going public include business expansion and obtaining the financing necessary for the development and further growth. Using company's own shares is one of fastest and cheapest manners of acquisitions as own stock will always remain the cheapest to obtain currency. Receiving a fair market valuation and liquidity – obtaining a market valuation is of a vital interest to any company and is crucial when looking for a strategic investor. Additionally, in order to be able to apply modern management methods and improve the effectiveness and the value of the business, it is necessary to know its value.

4. CONCLUSIONS

Mergers and acquisitions are very important steps in the life of companies. The failure of such an endeavor puts in danger not only the company itself, its employees, but also the companies that are in business relations with. ArcelorMittal is a company with a long history of successful mergers and acquisitions. Establishing the goal of value maximization will make the difference for AMG between a looser and a successful company.

The new digital era of globalization is still taking shape and organizations have an opportunity to redefine their comparative advantages. Gaining exposure to new audiences through listing on the stock exchange, the company gets on the radar of institutional investors, private equity, venture capital, sector specialists, business partners, index providers and international media, covered by financial analysts. Being a listed company solves the question about the market valuation and provides a liquidity as it is easier and faster to invest in a company listed on the stock exchange, and the newly appointed general director may have a chance to make history.

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