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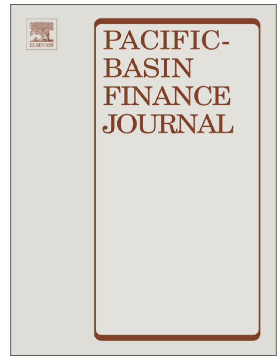


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# A Case Study on Incitec Pivot's Acquisition Strategy of Dyno Nobel

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# A Case Study on Incitec Pivot's Acquisition Strategy of Dyno Nobel

We present a case study on Incitec Pivot Limited's ("IPL") acquisition strategy during a major stock market swing to demonstrate how valuation aberrations can be leveraged to create long term value for shareholders. We discuss the management strategies, structures, and ideology of IPL and critically analyze its acquisition of Dyno Nobel Limited ("Dyno"). Furthermore, we highlight how IPL's acquisition of Dyno transformed its business from an Australian based fertilizer company into the world's 2nd largest explosives company - with operations in 13 countries, 21 major chemical facilities and around 5,000 employees.

**JEL Classifications**: G10; G30; G34

**Key words**: Merger; Acquisition; Strategy, Case Study.

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## 1. Introduction

The main driver for corporate acquisitions is to create value from the synergy in combining the physical operations of the two merging firms (see, for example Bradley et al., 1988). However, several studies in the US find that shareholders of bidding firms do not benefit from mergers and acquisitions (hereafter, M&A) and are associated with negative abnormal returns (Ruback and Jensen, 1983, Andrade et al., 2001, Moeller et al., 2005).[1]

Australian studies on M&A provide mixed results (Casey et al. (1987), Shekhar and Torbey (2005), Bugeja and Walter (1995), Diepold et al. (2008), Akthar (2017) and Krishnamurti et al. (2019). Casey et al. (1987) document an abnormal return of − 1.71% for a two-day event window, whereas Shekhar and Torbey (2005) report positive and significant abnormal returns of 1.02% for bidding firms over a three-day event window. However, Bugeja and Walter (1995) and da Silva Rosa et al. (2004) report statistically insignificant abnormal/excess returns for event windows of three to five days. Further, Diepold et al. (2008) show that bidders earn significant positive abnormal returns of 2.23% on the announcement date when there is no Australian Competition and Consumer Commission (ACCC) involvement but earn significantly negative abnormal

[1] A number of explanations have been offered for this outcome including agency conflicts (Jensen and Meckling, 1976), irrational overbidding due to managerial hubris (Roll, 1986) and managerial overconfidence (Malmendier and Tate, 2005, Masulis and Mobbs, 2014, Aktas et al., 2016). Studies have also examined certain firm characteristics such as poor governance (Masulis et al., 2007), compensation policies (Datta et al., 2001), or excessive free cash flows (Jensen, 1986, Harford, 1999), which allow managers to pursue value-destructive acquisitions.

returns of − 2.47% when there is ACCC involvement. Akthar (2017) show that bidding firms do not earn any significant CARs around the bid announcement period when sample selection bias is accounted for. Krishnamurti et al. (2019) find that the announcement period abnormal return is positive and significant when CSR-oriented bidding firms announce an acquisition decision in the market. To better understand why some acquisitions, create value to bidders while others do not, this study critically analyses the acquisition strategy of Incitec Pivot Limited (IPL) during a major stock market swing, to demonstrate how valuation aberrations can be leveraged to create long term value for shareholders.

An ASX 100 Company, IPL has its origins in Europe and North America in the 19th century in explosives business and in Australia in early 20th century in fertilizers business. It is now a global leader in supplying inputs into the resources and agriculture industries. IPL is an exemplary Australian company that has grown from a small Australian owned farmer co-operative into a global diversified industrial chemicals business. With a diverse leadership, IPL adds value for their customers through manufacturing excellence, leading technology solutions, innovation and world class services focused on customers. IPL is the world's second largest explosives company and Australia's largest manufacturer and supplier of fertilizers.

IPL's management actively pursued a acquisition strategy to rapidly grow the firm's scope and scale to create shareholder value. The company listed on the Australian Stock Exchange in 2003 through a merger between Pivot Limited and Incitec Limited, substantially expanded with the acquisition of Southern Cross Fertilizers in 2006 followed by Dyno Nobel Limited ("Dyno") in 2008 - taking the business from a fertilizer co-operative with an enterprise value of ~$400m to a global diversified chemical company with an enterprise value of ~$8 billion.[2] The largest and most complex acquisition pursued by IPL was Dyno. IPL completed the acquisition of Dyno's global explosives business for $3.9 billion on 16 June 2008.[3] The acquisition transformed IPL from an east coast Australia fertilizer manufacture and distributor to the world's 2nd largest explosives company - with operations in 13 countries, 21 major chemical facilities and around 5,000 employees. Through the acquisition of Dyno, IPL supplies explosives and detonators to the worlds mining, quarrying and construction industries and through its fertilizer business supplies nutrients to Australian and US farmers.

The main objective of this paper is to explain the rationale behind IPL's acquisition strategy to understand how IPL transformed its business under the leadership of its Chief Executive Officer Julian Segal (June 2005 – April 2009), and Chief Financial Officer/ Chief Executive Officer James Fazzino (CFO 2003 -2009, CEO from June 2009 – November 2017).[4] This case study conducts an academic enquiry through the eyes of a management to highlight three important issues on how IPL transformed their business into its current state:

1. How did IPL management craft their M&A strategy to deliver on growth targets set by the IPL Board?

[2] Based on the closing share price on 14 November 2017 multiplied by number of shares on issue on 14 November 2017 plus Incitec Pivot net debt as reported in 2017 annual reported.
[3] Value of equity and cash at closure of scheme of arrangement on 16 June 2008.
[4] Julian Segal holds an MBA from Macquarie University and undergraduate degree from Technion-Israel Institute of Technology. James Fazzino holds an undergraduate Economics (Honours) degree from La Trobe University and he is a Fellow of CPA Australia and is a Vice-Chancellor's Fellow at La Trobe University.

2. How did IPL explore new market opportunities through acquisition?
3. How did IPL fund its acquisition to create long-term value for shareholders?

The rest of the paper is organized as follows. In section 2, we present a brief discussion of the inception of IPL. Section 3 describes IPL's Fertilzer-related Acquisition Strategies. Section 4 discusses acquisition of Dyno. Section 5 provides a conclusion.

## 2. Inception of Incitec Pivot Limited (IPL)

Pivot Limited's history can be traced back to 1919 in Australia when farmers in Eastern Australia formed a co-operative (the Phosphate Co-operative Company of Australia Limited) to source phosphate fertilizer for growing pasture. The company was subsequently corporatized and renamed Pivot Limited and grew to have a leading market share in fertilizers in Victoria, South Australia and Tasmania.[5]

Australian Co-operative Fertilizers Ltd was established in 1915 in Queensland to supply fertilizers primarily to sugar farmers. It was subsequently merged with Shirleys Limited and then NSW based fertilizer company Eastern Nitrogen to form Incitec Limited. Incitec Limited had a leading market share in fertilizers in Queensland and NSW.

Pivot Limited merged with Incitec Fertilizers Limited on 1st of June 2003 to form Incitec Pivot Limited. IPL listed on the Australian Stock Exchange (ASX) on 28th July 2003 with an enterprise value of about $1 billion, and subsequently became Australia's leading agri-business – Australia's largest manufacturer and distributor of fertilizers with

[5] See: https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Events-affecting-shareholders/Specific-events---previous-years/Pivot-merger-with-Incitec---CGT-on-sale-of-pre-CGT-shares/

a market share of about 70%, 3 major chemical plants located close to major markets and a network of distribution centers stretching from Wallaroo in South Australia to Cairns in North Queensland. Post-merger, the company made several follow-on acquisitions to strengthen its market position, broaden its manufacturing base and expand its business into Asia. In the next two sections, this study highlights and comprehensively reviews IPL's key acquisition strategies.

## 3. IPL's Fertilzer-related Acquisition Strategies

Fowler and Schmidt (1988) argue that a firm makes an acquisition decision only when the expected synergies from acquisition tend to improve organizational performance. According to the authors, the firm's acquisition strategies have two-fold objectives: (i) to build shareholder wealth through some form of financial economy; and (ii) to increase the size of the firm so as to control a large empire, and/or to enjoy higher compensatory benefits. The key strategies of IPL are discussed below.

### *3.1 IPL Strategy to Deliver Competitive Shareholder Returns*

The strategic intent of a listed company is to generate competitive shareholder returns either organically – i.e. improving the business that you already own, or inorganically – i.e. expanding the scale and scope of the business through either reinvestment or acquisitions. Former IPL CEO James Fazzino noted that "importantly, shareholder value is only created where investments generate returns above the cost of capital; the market doesn't reward companies for simply "getting bigger", in-fact growth for growth sake often destroys companies.

In the period immediately following the merger with Incitec in 2003, IPL focused on organic growth – cutting costs, rationalizing assets and improving the productivity of operations. By 2005 management believed that it was close to having optimized the existing business and turned to inorganic growth through acquisitions.

### *a. IPL Remuneration Framework*

As is commonplace, the remuneration philosophy and framework for IPL executives is set by the Board. Executive remuneration should create an alignment with shareholder interest through incentive structures that are based on the successful creation of shareholder value. The IPL Board aims to set Executive remuneration at levels to appropriately reflect the duties and responsibilities of the executives, comprising a fixed component and an "at risk" component. The latter piece is intended to remunerate executives for increasing shareholder value, achieving financial targets and successfully implementing business strategies (Merhebi et al. 2006).

The remuneration of the CEO and CFO of IPL during the time of this study consisted of three elements: (a) 33% fixed remuneration; (b) 33% based on annual performance at an individual and Company level (short term incentive); and (c) 34% based on sustained creation of shareholder value over a performance period, typically three years (long term incentive). The long-term incentive (LTI) performance measure during the period of this study was based on a combination of earnings per share (EPS) growth and TSR – total shareholder return - equal to the percentage increase in the Company's share price over the three-year performance period, combined with the after tax value of dividends paid.

### *3.3 Acquisition of Southern Cross Fertilizers (SCF)*

IPL runs an annual two-day Board strategy workshop where the Board works with management to test and challenge IPL's strategic plans for the next five years. The session starts by confirming IPL's strategic intent – which during the time of this case study was to deliver top quartile shareholder returns over the performance period (TSR). Management then develops a range of possible strategies for the business to deliver on the targets and requests the Board's support for its preferred strategy.

Fazzino suggests that management started by first peer-reviewing the existing businesses of IPL to identify plausible options to grow the business by focusing on industry attractiveness of the fertilizer industry, both in Australia and around the world. IPL initially focused on strengthening its Australian business through organic growth and then followed by the acquisition of Southern Cross Fertilizers (SCF) for $165M on 9th May 2006.[6]

The acquisition was "a company maker" and the first step towards becoming a globally diversified industrial chemicals company. The then CEO of IPL, Julian Segal stated (in 2005) that: *"...the complementary nature of the two business makes Incitec Pivot and Southern Cross logical partners"* - *Southern Cross was Australia's sole producer of ammonium phosphate fertilizers and IPL was Australia's largest distributor of phosphates and Australia largest fertilizer manufacturer. The Phosphate Hill plant had a reputation in the global fertilizer industry as an [unreliable] "tarnished asset" – hence the $840m discount on acquisition.* Fazzino was IPL's CFO at that time and described the acquisition *"as being at an auction where IPL was the only bidder".*

[6] See background information on Southern Cross Fertilizers (SCF) in Appendix.

IPL purchased the plant after the completion of a 40-day major maintenance "turnaround" which largely addressed chronic reliability issues in the phosphoric acid and ammonia plants. IPL drew on ammonia plant and phosphate plant expertise from its other plants to put in place an operations regime that ensured the plant could be run reliability. Somewhat fortuitously, the plant was restarted and stabilized in time for the great phosphate boom of 2007/2008.

Between 2005 and the summer of 2008, the price of wheat and corn tripled, and the price of rice climbed fivefold, spurring food riots in nearly two dozen countries and pushing 75 million more people into poverty and the world saw global carryover stocks fall to 61 days of global consumption in 2007 (Bourne, 2009). China had been rapidly growing since the late 1980s bringing millions of people out of poverty – raising incomes from US$200 pa to $2,000 pa; with a significant portion of the increase spent on more and better food (primarily protein)[7] IPL, along with other CEO's from the global fertilizer sector talked of "four Fs" driving a sustained step change in global fertilizer use to a "new normal":[8]

- Food – population growth of 200,000 people per day;
- Feed – the rising middle class in China switching consumption to meat which, in turn, requires a step change in the production of feed (wheat and corn);
- Fibre – cotton and wool for clothing and wood for housing;
- Fuel – bio-fuel mandates in petrol, particularly in the US driving corn production.

[7] The Mosaic company 2008 annual report – page 6.
[8] Refer to Incitec Pivot March 2007 Credit Suisse Asian roadshow presentation (available on the IPL website).

The acquisition of Southern Cross Fertilizers in 2006 drove a step change in financial returns. The key financial outcomes for the 2007/2008 financial year were as follows:

- Sales increased by 113% to $2.9 billion;
- EBIT increased by 210% to $969 million;
- Ammonium Phosphate prices rose from US$254/t in December 2006 to US$1,200/t in April 2007;[9]
- IPL share price rose to $5.07 at year end of 2008, > 400% increase compared to $0.95 at year end 2004 (source: IPL 2008 Annual Report).

During the 2007/08 financial year, IPL paid for Southern Cross using just one month's sales revenue – e.g. every ship of fertilizer sold netting about $50M.

### *4. IPL Moves into Explosives*

After the successful integration of Southern Cross Fertilizers (SCF) and record earnings during the phosphate boom, IPL searched for their next acquisition target. The 2007 Board strategy review focused on "what's next?". Superficially, the logical step was to continue with the successful formula of growing the fertilizer business. Evidence of success is as follows:

- the commentary in the market was the spike in fertilizers was the "new normal" and consequently, profitability in the fertilizer industry had been transformed;
- IPL had a track record of successful M&A in fertilizers;
- IPL operated the most attractive agri-business in Australia and arguably the best in the world and had an outstanding platform for growth.

[9] Source: Historic DAP price series Bloomberg.

The "go global in fertilizers" strategy was compared against the alternate strategy of moving into an adjacent industry. Management raised the following questions to develop strategy to grow and increase shareholder wealth:

- How attractive will the fertilizer industry be in the future?
- What do we need to do "to win" in the industry?
- Can IPL make attractive returns through follow-on fertilizer acquisitions?
- Does IPL have a distinctive set of core competencies that would allow it to step out globally?

Fazzino recalls that he concluded that "doubling down on fertilizers" was unlikely to be successful due to the following reasons:

(1) While it was possible for IPL to make attractive returns in Australia, the global industry was far less attractive with emerging overcapacity (commodity markets respond to price booms by adding capacity) and significant government intervention (including government participating in production).

(2) While IPL was the largest fertilizer manufacturer in Australia, it was around one tenth of the size of the world's largest players.

(3) IPL's returns in Australia were driven by privileged assets positions that were impossible to replicate globally — the opportunistic acquisition of Southern Cross was a "once in a lifetime" acquisition and unlikely to be successfully repeated.

(4) The markets view of a "new normal" in fertilizers was unlikely to eventuate.

Relevant to the last point, Fazzino had a career in commodity chemicals. In his experience, there is no 'new normal' and returns always move back to the cost of capital.

He had observed that the industry always responds when returns are above the cost of capital by constructing new plants. Indeed, the industry did respond by building new plants and prices were pushed down as can be seen in Figure 2, which graphs DAP prices over the long term (also refer to Figure 3 – IPL share price). Prices peaked at US$1200 in April 2008 and have returned to their long-term average of mid to high US$300/ton, growing at global CPI less 1% over the cycle.

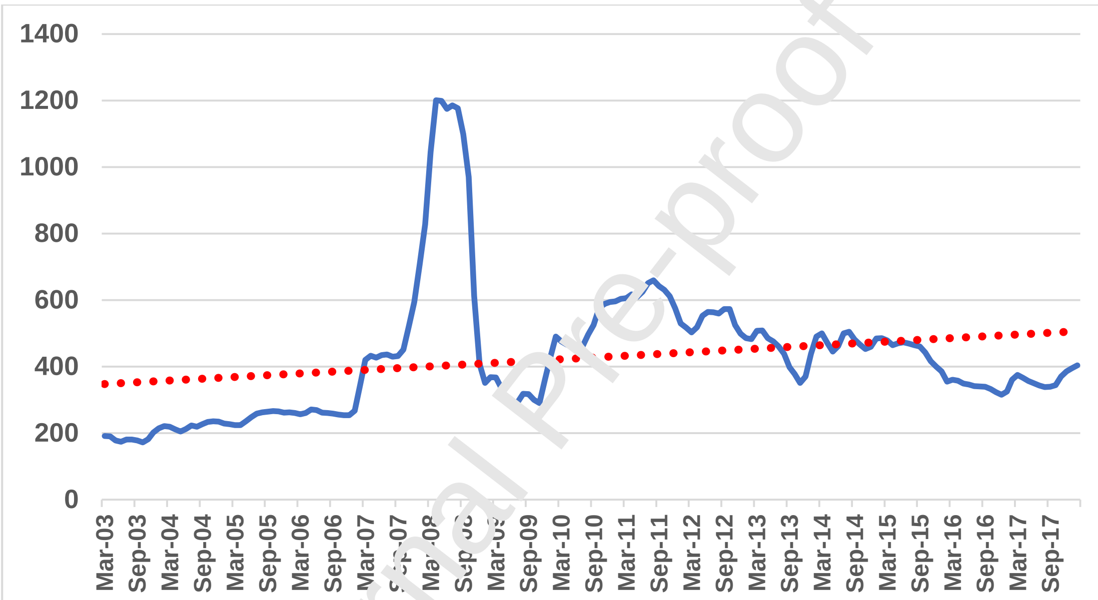


Figure 2: Di-ammonium phosphate (DAP) prices

### *4.1 Alternatives Options*

IPL looked at adjacent industries where it could deploy its distinctive core competencies in chemical manufacturing on a global scale to deliver returns above the cost of capital. IPL initially took an end market view of its business and considered adjacencies in agricultural inputs. The strategy was to think of the business in the context of a "broader chemistry set", linked by commonality of end customers (farmers) and channels (rural merchandisers). Moving into crop protection chemicals (herbicides, fungicides and insecticides) was also considered. Detailed analysis led to this alternative being rejected for the following reasons:

- Manufacturing scale and the supply chain to customers was completely different in both businesses – e.g. fertilizer measured in hundreds of thousands of tons, while crop protection measured in liters.
- The most attractive part of the crop protection value chain was in product development rather than R&D in manufacturing.

IPL turned its attention to adjacent industries which leveraged “a common manufacturing core” into different end markets. IPL evaluated the methanol industry but concluded that the industry structure was not attractive, as it had no prior business experience in that industry.

The standout choice was explosives for the following reasons:

- The distinctive core competency of IPL was nitrogen chemical manufacturing.
- Modern bulk explosives are nitrogen based – with ammonium nitrate (AN) both an explosive and a cold-climate fertilizer.
- The most attractive part of the explosives value chain was in the production of ammonium nitrate.
- Fertilizer and explosives supply chains are similar, involving the transport of hundreds of thousands of tons of bulk commodities.
- Diversification into explosives was relatively low risk being only “one step” from IPL’s core; that is a common nitrogen manufacturing core and a common bulk supply chain leveraged into a new end market.

- IPL had developed a distinctive competency in process safety management and transport, which was directly applicable in the explosives industry – both in transport and in manufacturing of initiating systems (detonators). [10]
- Explosives were an attractive global industry with 2 global majors and no more than 4 competitors in core markets; and high barriers to entry due to the inherent nature of the product – most players outside the industry would find safety concerns a show stopper.
- Segal had prior experience in the explosive industry as he worked as a senior management in Orica (the world number 1 in explosives) from 1999 to 2004. Fazzino (CFO) also had experience in the explosive industry at Orica. Therefore, IPL management had the advantage of a deep understanding of the explosives industry.

Taking all these factors together, IPL management concluded that diversifying its business into the explosives industry via acquisition was an attractive option. Fazzino notes that it was very unlikely that a company would be able to drive returns above its cost of capital if it starts from a point of overpaying regardless of synergies. Fazzino, who was CFO at that time, recognized that a key near-term strength of IPL was its' elevated share price that had risen with fertilizer prices – the market was pricing into a "new normal". There was a great opportunity to leverage the share price as consideration in a merger transaction to avoid paying "too much".

[10] IPL produced and distributed Ammonia to the Australian cotton industry.

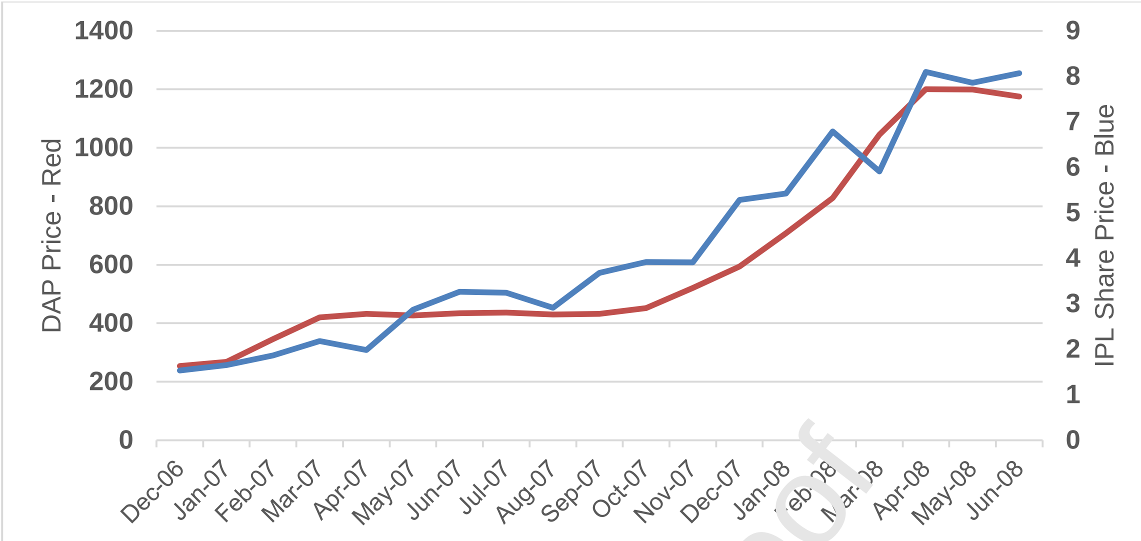


Figure 4: IPL was among the hottest stocks on the ASX peaking at a market capitalization of over $12 Billion (blue line) at the top of the fertilizer cycle (red line)

***4.2 The acquisition of Dyno Nobel***

IPL hired investment-banking firm O'Sullivan Pullini to identify targets in the explosives industry. Dyno was one of three possible targets identified by management. Dyno was the worlds' second largest global player with head office in Australia and listed on the Australian Securities Exchange (ASX). It had operations in Australia, PNG, Indonesia, China, Turkey, South Africa, Zimbabwe, Chile, USA, Canada and Mexico. IPL management concluded that Dyno was a particularly good fit with IPL as:

- It would give IPL instant global scale and a leadership position in the explosives industry.
- While Dyno operated in 13 countries, the bulk of its business was focused on Australia and North America which were the world's most attractive explosives markets.

- The core of Dyno's competitive advantage lay in a network of four US nitrogen plants and seven high explosives assets.
- Dyno had leading blasting technology that gives a technology edge over smaller industry players.
- IPL was able to use its elevated share price as consideration for the acquisition of Dyno Nobel.

### *4.3 Role of IPL Board of Directors*

A better board governance structure can provide more effective managerial oversight. As acquisition decisions can potentially alter the direction of the firm's operations, the Board of Directors have incentives to carefully review the acquisition decisions proposed by the management of the firm (Chan and Emanuel, 2011). The IPL Board recognized that their overarching role in the acquisition was that of their fiduciary duty to ensure that any acquisition was in the long-term interests of its shareholders. The Board played three key roles with respect to the Dyno acquisition:

- **Strategic**: The Board approved the acquisition strategy after testing the value creation thesis and ensuring alternative options have been adequately explored.[11]
- **Monitoring**: The Board supervised the acquisition process, providing guidance to management during the bid.

[11] The Board considers the risks associated with the business case. Moreover, the board checks whether the business case aligns with board risk appetite and leverages the Board's executive experience to test the logic of whether the investment thesis is plausible and compelling. Additionally, the Board seeks confidential third-party views.

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- **Governance**: The Board approved acquisition valuation ranges, ensured long-term funding was put in place to complete the acquisition, ensured adequate due diligence is undertaken by the bid team (through the Board's due diligence committee), ensured risks were identified and appropriate mitigations are put in place and synergies were delivered. The Board also ensured that the market is informed during the process (when it becomes a disclosable event). Specific activities included reviewing and approving bid documents (eg scheme of arrangements), paying attention to "forward looking statements" to ensure that they are reasonable, not misleading and defendable if challenged.

Management presented the strategic case and investment thesis for the acquisition of Dyno to the Board in May 2007 and achieved Board support for the acquisition to complete the acquisition within a valuation range. The 2007-08 annual report of IPL, recorded 21 board meetings during the acquisition year which clearly indicates increased monitoring and scrutiny of the deal and structure by Board members in that period which is an essential part of a successful acquisition outcome.[12],[13]

Post-acquisition, it is not unusual for a few members of the target board to join the acquiring board - providing continuity of business knowledge or "corporate memory". However, in Dyno's case this did not occur as management had considerable experience in the explosives industry.

[12] See page 8 of IPL's Annual report for 2008.
[13] The IPL Board at the time comprised seven members, five independent (John Watson, Chairman; Brian Healey, Deputy Chairman; Allan McCallum, Chairman of Governance Committee and Health, Safety, Environment and Community Committee; Anthony Larkin, Chairman of Audit and Risk Management Committee; and John Marlay) and two non-independent members (Managing Director & CEO Segal and Finance Director & CFO Fazzino) [source: IPL's Annual report for 2007].

### *4.4 Role of Investment Bank*

To assist in identifying an acquisition target and provide advice to management and the Board to execute the acquisition, IPL appointed a boutique investment advisory firm O'Sullivan Pullini (hearafter, OP) as M&A advisor in 2006. The co-founder Tony O'Sullivan had MBA degree from Harvard Business School with expertise in acquisition strategies. OP was chosen by the Board on the advice of management as they were independent – they would not be involved in any equity raising or provide any finance to IPL.

OP worked with management searching for potential acquisition opportunities. Key players in the global explosives industry were identified as potential targets (an African explosive company, a privately-owned US based explosive business and Dyno). Dyno was chosen for the reasons identified earlier in the paper, with a trigger for engagement being when the company disclosed its disappointing interim results (see detail discussion below in Section 4.5).

### *4.5 Dyno's Moranbah Project*

Dyno's Moranbah project involved the construction of a world scale Ammonium Nitrate Explosives plant located in Queensland. Dyno announced that it would proceed with Moranbah in early February 2007 at an estimated cost of AUD$520 million. The project was expected to be completed in the first half of 2009. In August 2007 Dyno announced to the ASX that the plant would cost significantly more than the original estimate $520 million and that production would begin later than expected. Dynos shares hit a record low of $1.89 on the day of the announcement.

Dyno continued to incur massive overruns on the Moranbah project - both in terms of cost and time. On 11 December 2007, it announced that it had “indefinitely suspended” the project because it “no longer met the group's financial criteria having spent AUD$280 million. In addition, IPL calculated that the liability for supplying customer contracts without the plant was about AUD$300 million.

### *4.6 Financing Strategy for Dyno Nobel Acquisition*

Fazzino commented that “IPL had the ‘currency” of fully priced shares due to the phosphate boom; the question was how to leverage this position to lock in acquisition metrics?” Analysts and the share market certainly believed that what they were seeing was indeed a “new normal” and capitalized a step change in global fertilizer prices into IPL’s share price with shares moving from $1.60 in Dec 2006 to an intra-day high of $9.99 in June 2008.[14]

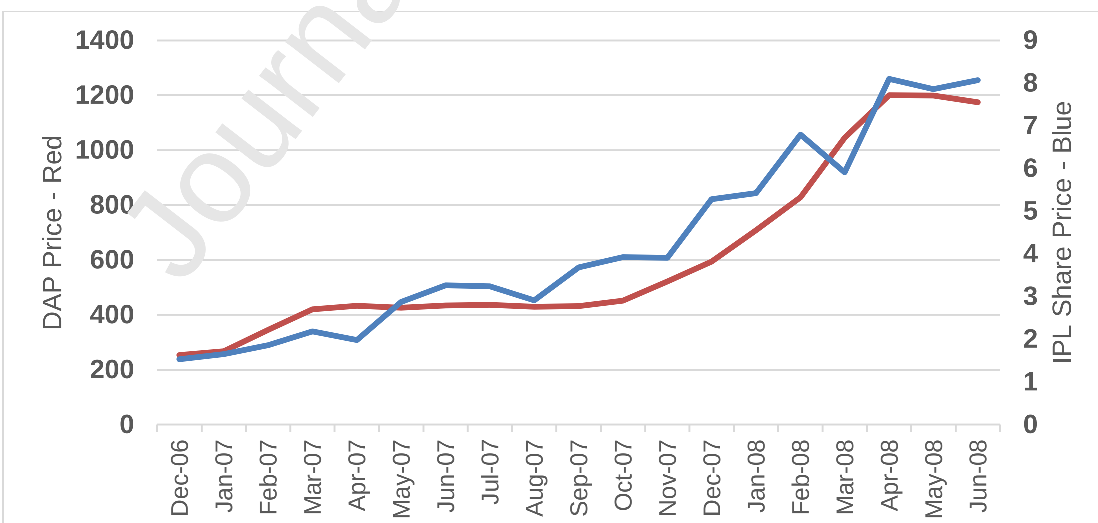


Figure 3: IPL was among the hottest stocks on the ASX peaking at a market capitalization of over $12B

[14] The IPL share price shown in Figure 3 is after a 20 for 1 share split.

Fazzino, insisted that the transaction would be largely equity financed. The proposed takeover value of Dyno Nobel was A$3.3 billion based on the implied offer price of A$2.80 per share. Dyno shareholders received $2.10 in IPL share and 0.70 cents in cash for each share they held - subject to changes in the IPL share price within a band. Importantly, this locked in the acquisition metrics for IPL shareholders as it effectively capitalised peak fertilizer prices into the acquisition metrics. When we asked about acquisition premium, Fazzino replied that '….as a rule of thumb, you can buy any businesses in the world by offering a 30% premium". Generally, businesses are fairly valued in the market – the market is efficient over the long run - and therefore, it is difficult to turn down a proposal as a target Board if a 30% premium is offered. IPL's offer for Dyno was priced at about a 25% premium.[15] The acquisition triggered all of Dyno Nobel existing credit facilities and therefore, IPL put in place a $2.4 billion financing arrangement with CBA, NAB, ANZ and Westpac post acquisition.

### *4.7 Deal Structure*

In this section, this paper highlights how IPL structure the deal initiation stage.

#### *4.7.1 "Bear Hug"*

IPL's first move was to buy 13.2% of Dyno Nobel in an off-market raid on 29 August 2007. The raid is part of what is known in the market as a "bear hug" strategy in that:

(1) IPL had a blocking stake in Dyno – any alternative acquirer of Dyno had to deal with IPL if it wanted to acquire Dyno Nobel.

[15] Source: Dyno Nobel Limited 2008 Scheme Booklet page 4 – Chairman's letter.

(2) At an ownership of 13.2%, IPL was the largest shareholder opening dialogue with the Dyno Nobel Board.

(3) IPL could continue to build its stake in Dyno on market up to a maximum of 20% - providing an ideal base for acquisition.

#### *4.7.2 Register Rotation*

Once an industry player becomes a major shareholder in a target, the company is almost always guaranteed to be taken over. Dyno saw a significant rotation of their register as "long only" shareholders began to sell down to "event driven" hedge funds – with around 20% of Dyno's shares being acquired by these funds. Hedge funds will pressure the target Board to deal with the raider, offer due diligence and management access, in order to bid for the whole company.

IPL never believed that Dyno had the technical capability to build the Moranbah plant, and that the project cost was more likely $1billion rather than the $500 million claimed by Dyno (in-fact IPL ended up building the plant for $1 billion). Accordingly, having put Dyno on top of its M&A list, IPL watched the project closely and through contacts in the Australian engineering industry gained an informed view of issues with Dyno's project execution. In addition, by virtue of having a very similar share register to Dyno, IPL had an insight into what Dyno's shareholders concerns were – and the general feeling was that they also saw it as high risk and outside of Dyno management's competency. On 29 August – shortly after the first delay announcement, IPL reached out to Dyno's major shareholders (which were coincidently were many of IPL's shareholders)[16] expressing an interest in buying Dyno. IPL management's pitch to Dyno's major shareholders are:

- While the business had what should be great US nitrogen assets, they were poorly run – something IPL thought it could quickly fix.
- Dyno had got itself into significant financial difficulty which presented an opportunity to buy Dyno at a reasonable price.
- Fundamentally, Dyno was a good business.
- Notwithstanding the attractiveness of the business, IPL management concluded that there was significant scope for improvement in the business - particularly the operation of the North American plants.
- IPL could fix the Moranbah project.

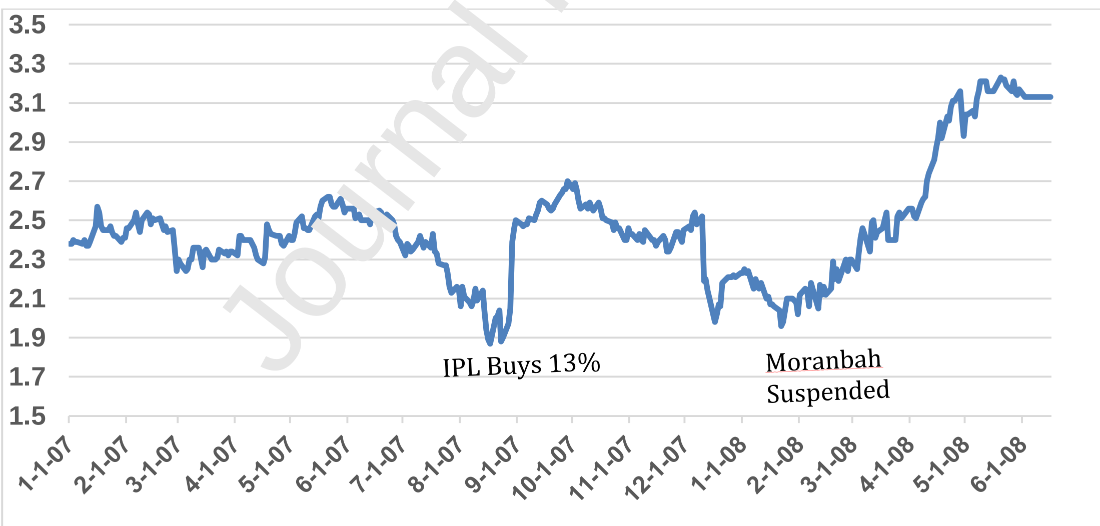


Figure 4: Share price of Dyno Nobel

[16] Appropriate confidentiality agreements and "stand still" agreements were put in place before speaking to shareholders.

#### 4.7.3 Scheme of Arrangement

The Dyno Board's position was significantly weakened following the suspension of Moranbah. IPL was offered due diligence and agreed acquisition metrics with Dyno management. IPL announced the Scheme of Arrangement on Tuesday 11 March 2008 to acquire shares in Dyno Nobel which IPL does not already own. Scheme booklets sent out to shareholders and option holders on Tuesday 22 April 2008 to vote in favour of the Schemes[17] and entered into a scheme of arrangement to buy the business which was completed in June 2008. The post-acquisition ownership stake in the merged entity: (i) Former IPL shareholders owned 70% of the combined group; and (ii) Former Dyno shareholders owned 30% of the combined group.

### *4.8 Post-acquisition Integration and Performance*

When asked about the key post-integration challenges, Fazzino mentioned that "the biggest challenge was that it took IPL from being an Australian company to a global company through this acquisition. Another key challenge was moving into a new industry and creating "one business and one culture". Fazzino spent much of his initial term as CEO addressing these issues.

IPL experienced significant growth and success in the post-acquisition period. Explosives became IPL's growth platform and the relatively more stable earnings from the explosives business provided a balance to the fertilizer business. IPL successfully completed the construction of Moranbah at a cost of around $1 billion – as IPL had predicted when completing Dyno due diligence. Today Moranbah is at the core of IPL's

[17] Details about the scheme booklet is available https://investors.incitecpivot.com.au/static-files/3f4707b6-dd20-4a19-8a68-a760d0fefa6a

Australian explosives business, generating returns significantly above its cost of capital. After Moranbah, IPLs next investment was US850m to construct a world scale Ammonia plant in Louisiana to complement Dyno's other US explosives assets (Ammonia is a feedstock for Ammonium Nitrate Explosives).

Fertiliser prices returned to their long-term trend as Fazzino predicted. The strategy of using the aberration in IPL's share price to transform the business was successful. Pre the acquisition of Dyno, IPL was 100% a fertilisers business. Nine years later in 2017, IPL's earnings were dominated by explosives, which contributed 66% of earnings, with fertilisers contributing just 15% - the remaining 19% of earnings came from a new business called Industrial Chemicals.[18]

## 5. Conclusion

The purpose of this case study is to examine the IPL acquisition strategy and its effectiveness through the lens of shareholder wealth creation and management remuneration. The study systematically explains how IPL conducted its target search and engaged in acquisition activity to maintain sustained growth to improve its shareholders wealth. A critical analysis of the IPL top management role reveals that management aimed to expand the business to improve the shareholder wealth mainly driven through M&A decisions. The case study illustrates that management's experience on mergers and acquisitions combined with good timing, appointment of boutique advisory firms and employing appropriate payment methods can improve M&A outcomes. The key lesson from the Acquisition Strategy of IPL: *while the market gets it right in the long term, there will be short-term valuation aberrations – this creates opportunities.*

[18] Source: Incitec Pivot Limited 2017 Profit report – page 1

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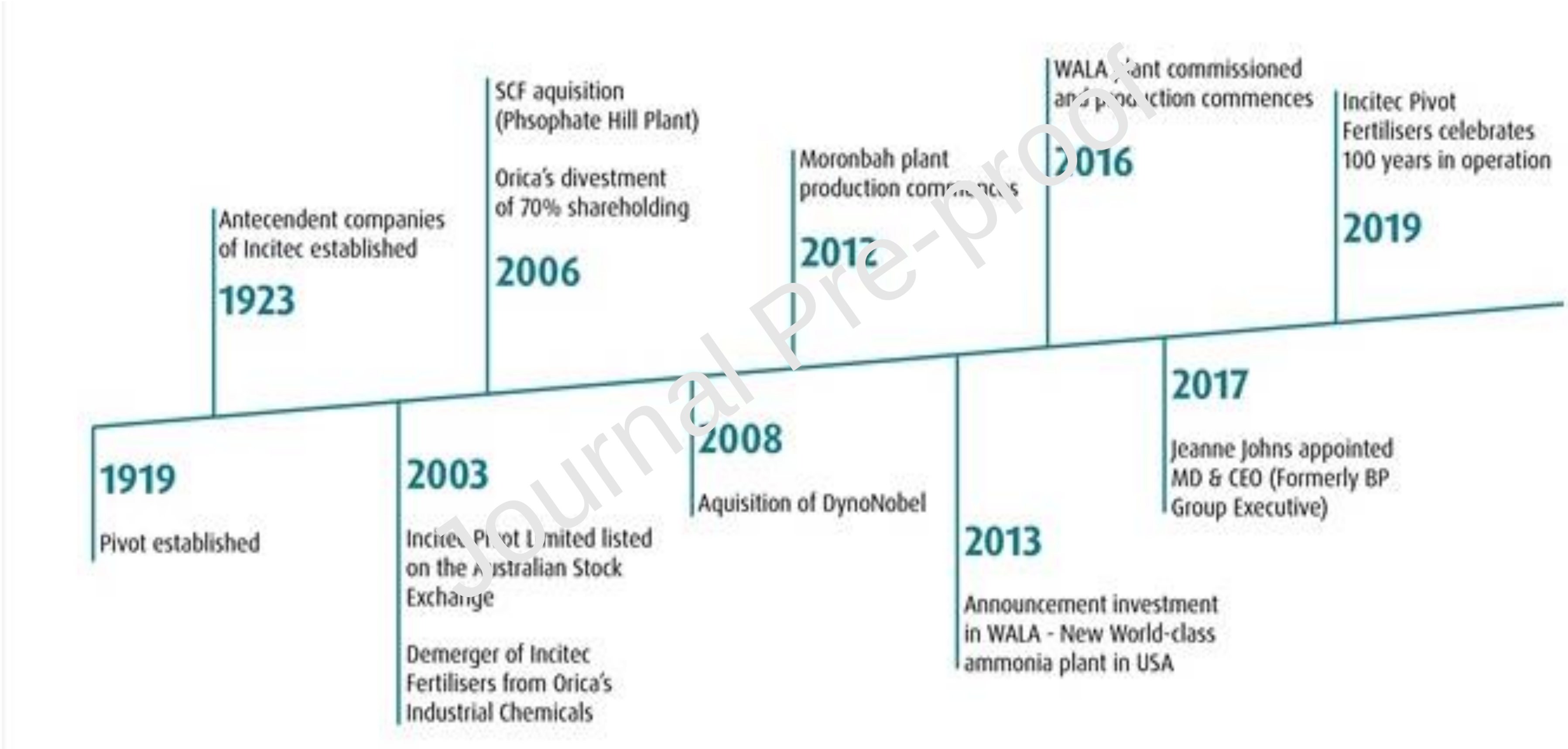


Figure 1: IPL acquisition growth (Source: https://www.incitecpivot.com.au/about-us/about-incitec-pivot-limited/history)

**Appendix - The acquisition of Southern Cross Fertilizers (SCF)**

Southern Cross Fertilizers owned a world-scale Ammonium Phosphate fertilizer plant known as Phosphate Hill. Southern Cross produces Mono-ammonium Phosphate and Di-ammonium Phosphate. These are "pre-plant fertilizers" primarily used in broadacre farming in Australia – wheat, barley, canola. The plant was built by Western Mining Corporation (WMC) at a cost of around $1 billion in the late 1990s.[19] It comprised the world's largest "single train" sulphuric acid plant at Mt Isa producing 1.2 million tons per annum and at Phosphate Hill a large chemical complex comprising: (i) a phosphate mine – which has a reserve of approximately 1 billion tons of phosphate; (ii) a phosphoric acid plant; (iii) an ammonia plant; and (iv) a 1 million-ton granulation plant. It was rumored to be the most remote chemical plant in the world – around 1,000 km from Townsville and 150km North of Mt Isa - and is staffed on a fly-in fly-out basis with a permanent/contractor workforce of about 400 people, which swells to 1,000 during 4 year turn-arounds. It also includes a 1,000-person camp and an airport. BHP took over WMC in 2005 and identified SCF as a non–core asset. The book value of assets of SCF was $550 million at the time of the takeover by BHP Billiton from WMC Resources Limited in 2005. They conducted a global trade sale for this asset. Incitec management acquired Southern Cross Fertilizers (SCF) for $165M on 9th May 2006.

[19] WMC never disclosed the final cost. This is an estimate from the Southern Cross team in 2006.

Highlights

- This study discusses the strategies, structures, and ideology of IPL and analyze its acquisition of Dyno Nobel Limited.
- We demonstrate how valuation aberrations can be leveraged to create long term value for shareholders.
- We highlight how IPL's acquisition of Dyno transformed its business form an Australian based fertilizer company into the world's 2nd largest explosives company.