

Forging ahead

Fourth-quarter 2011 global metals industry mergers and acquisitions analysis

Special report:

*Using divestitures and
spin-offs to position an
organization for growth*



Robert McCutcheon

To our metals industry readers:

Welcome to the latest edition of *Forging ahead*, PwC’s analysis of mergers and acquisitions in the global metals industry. In this report, you’ll find an overview of M&A in the sector during the fourth quarter of 2011, plus expectations for deal activity in the near future. We also include a special section on the impact of divestitures and spin-offs, increasingly viewed as essential strategies for helping companies to better position themselves for growth opportunities.

PwC analysts point to several trends affecting the values and locations of deals in the metals sector:

- **In deals valued at \$50 million or more**, the average value increased by more than 20% over the third quarter, stemming from increased mega-deal activity (deals valued at \$1 billion or more). Overall deal volume and value increased as well. For 2011, however, average deal value declined compared with 2010; the high average of 2010 largely stemmed from the BHP-Billiton deal during the second quarter that was later withdrawn.
- **Cash balances have increased** over the last two years, while debt to capital ratios have declined, suggesting that acquirers are becoming better capitalized over the long term. Stock-swap deals have increased, pointing to the potential for equity-funded expansion, but leveraged buyouts have declined, indicating that financial investors may be reluctant to engage in deals.
- **Three mega-deals were announced in 4Q11:** the proposed acquisitions of China’s Hebei Shougang Qian’an Iron & Steel, Brazil’s Usina Siderurgicas de Minas Gerais, and the US-based Commercial Metals. The deals, worth \$7.36 billion, comprised more than half of the total for deals valued at \$50 million or more.
- **Asia and Oceania drove overall regional deal value in 2011.** And a repeat is likely in 2012. China continues to consolidate its domestic metals industry as part of its Twelfth Five Year Plan.



Jim Forbes

While steel prices seem to have stabilized, expectations are that 2012 will bring a slowdown in the steel industry, given weakening global demand and tighter control of the Chinese real estate market. Consequently, metals deals will grow only moderately, with robust increases in M&A unlikely until metal prices and other fundamentals improve.

We’re pleased to present the fourth-quarter 2011 edition of *Forging ahead* as a part of our ongoing commitment to providing a better understanding of M&A trends and prospects in the industry.

Robert McCutcheon
U S Metals Leader

Jim Forbes
Global Metals Leader

Special report:

Using divestitures and spin-offs to position an organization for growth

Global merger and acquisition activity has risen significantly in recent years, increasing to \$2.54 trillion in 2011, a 7.6% jump over 2010.¹ US M&A activity is expected to continue at the current pace through 2012 and could accelerate if there is increased access to capital.² M&A activity has shown a rise in the number and value of divestitures and spin-offs. US divestiture deal volume as a percentage of total M&A volume increased to 36% in 2011 from 35% in 2010, according to PwC.³

Although divestiture activity has increased, the transactions have taken longer to close than in previous years. Some companies have been forced to go to market several times before successfully striking deals with buyers. Also slowing such deals are the following:

- Tighter lending standards for a smaller pool of buyers
- Investors made skittish by volatile stock markets
- Sovereign debt crises in Europe and the United States
- An uncertain economic forecast
- Shrinking government spending

Third-party lenders and other constituents are requiring more diligence, and, even when they don't, buyers are being more cautious. In the mid-size market, corporate buyers have been prepared to pay stronger multiples for the highest-quality industrial products businesses. Processes are also being structured to better benefit trade buyers, as vendors are able to provide them with more access to management and more time, although they expect to be paid for their synergies.

Buyers also are often more aggressive in seeking a price below the value sought by sellers. But many companies continue to view divestitures and spin-offs as effective strategies for shedding noncore businesses, rightsizing their organizations, and providing a platform for growth.

Spin-offs were on the rise in 2011 as an attractive way for companies to separate their high-growth or low-growth components from more traditional pieces of the business. Such was the case with several high-profile transactions, including ITT's split into three publicly traded companies, Motorola's spin-off of its mobile phone division, McGraw-Hill's spin-off of its educational unit, L-3's announced spin-off of several government services businesses, and Sara Lee's spin-off of its international beverage business.

The metals sector has seen M&A activity increase, too. The 122 deals with a disclosed value greater than \$50 million and a total deal value of \$55.2 billion during 2011 compares with 106 deals and \$92.6 billion in deal value in 2010. Divestitures and spin-offs accounted for 38.5% of deal activity in the sector during 2011.

Among the drivers of spin-offs and divestitures in the metals sector:

- Shifts in the value chain, with upward pricing pressure in raw materials and commodities creating challenges for converters compared with the companies that are vertically integrated. Going forward, what will the profit margins look like if the industry shifts toward commodity producers?
- Portfolio rationalization, with companies making decisions hinging on which businesses they believe will be profitable in the future and which will not.
- Concerns regarding geographic footprints in markets. Certain countries or regions may not be as profitable as in previous year; it may be risky to divest of assets in those markets.
- A refocusing on core competencies and shedding of noncore businesses.
- Pressures from distressed markets, particularly in Europe.
- Interest from strategic buyers with more integrated operations or from financial buyers seeking to make their businesses more attractive to future strategic buyers.

¹ "On Wall Street, Renewed Optimism for Deal-Making," by Evelyn M. Rusli, *The New York Times*, Jan. 2, 2012.

² "Hunt for Growth to drive 2012 US Mergers & Acquisitions," says PwC US," PwC, 2012.

³ *ibid.*

Driving spin-offs and divestitures

Spin-offs are often the way to dispose of a business while preserving shareholder value. For businesses with significant appreciated value, they are a sound strategy instead of a sale, which may trigger a large taxable gain. A spin-off is a tax-free transaction that allows shareholders to maintain their appreciated value without triggering a gain. This characteristic allows shareholders to preserve capital gains treatment and control the timing of the realization of the gain. Following the repeal of the General Utilities Doctrine, a tax-free Section 355 spin-off may be the only remaining means by which a corporation may extract appreciated assets without paying corporate-level tax.

Selling a long-standing unit of a company can be a difficult, and often controversial, decision for an organization, particularly if members of the management team have ties to the unit being divested. But by selling a business unit that is no longer part of the core strategy because it may be poorly performing, in a contracting market, or simply no longer a priority, a company may raise capital to invest in its strategic priorities and allow the business unit to do the same, possibly enhancing overall shareholder value.

By taking such an approach, an organization may gain the financial resources to inject additional funding into its core business. It may refocus on essential aspects of the business that help define the organization and launch key projects that may have been delayed. These initiatives may allow the company to improve its overall performance. The infusion of cash may also help a company shed its debt.

Additionally, certain sellers are interested in acquiring capital as companies look to restructure their balance sheets by building up cash reserves or paying down debt. Selling a high-performing or high-value business unit at a desirable price may go a long way toward helping a company achieve such a goal.

Navigating a challenging process

Corporate sellers often delay making divestiture decisions thanks to the financial and logistical challenges of timing, valuation, and potential pushback from management teams running targeted business units. Participants in a PwC roundtable on divestiture strategies and solutions noted that failing to adequately consider these factors may contribute to a portfolio review that is poorly planned, in turn driving unhealthy or conflicting incentives across an organization. Such a dynamic may lead to institutional resistance to identifying divestiture candidates and can ultimately hamper or derail divestiture efforts. Timing, price, and ease are priorities to balance when evaluating candidates for divestiture. Once moving forward with a divestiture, leadership and investors may focus on the future of the core business and expediting the divestiture to limit executive and investor distractions.⁴

The road to closing also may be long and complex, with global economic uncertainty increasingly leading buyers to expect and demand more detailed data about a target company. More intensive and extensive due diligence is extending the divestiture process.

Companies in recent years have become aware of gaps in their approach to divestitures: Nearly half of the C-suite executives and corporate development directors responding to a PwC survey reported their acquisition process was better defined than their divestiture process. More than half of respondents in the same survey said that recent divestitures had taken at least 20% longer to complete than in previous years.⁵

⁴ "Divestiture strategies and solutions," PwC, 2009.

⁵ "Divestitures in difficult times," PwC, 2009.

For a corporate entity, divestitures typically are far less common than acquisitions. Consequently, there are great challenges when it comes to effectively managing the process and drawing on their team's experiences. Any company planning an acquisition may obtain significant value and meet its business case by choosing the appropriate target, achieving planned synergies, and effectively integrating the target. A management team accustomed to serial acquisitions may conduct these activities as core capabilities. However, the skills are not as relevant for a divestiture.

Over the years, a company refines the list of targets it would seek to acquire at the appropriate time and price, and management pays close attention to the targets, some of which may be competitors. Identifying a thorough list of buyers may be more challenging to management teams — for example, when suitable buyers may not work directly in the same industry but instead may be seeking to enter it.

Consequently, sellers are paying closer attention to how they manage the divestiture process, from start to finish. They frequently assemble a team dedicated to managing and executing the deal and the operational separation simultaneously.

To close deals and increase the value of their assets, sellers are striving to gain a better, more detailed understanding of the complexities of the divestiture market. They are gauging the wide scope of buyer concerns and responding to the global economic crises that have changed the rules of the game, requiring a tweak in strategies.

The overriding goal is to evaluate the business from a buyer's perspective and better position it for sale. Reducing or avoiding delays altogether may be essential to maintaining the desired value of the sale because the longer a transaction takes, the more opportunity there is for value erosion.

Also helpful is to prepare for separating the operations of the unit from the parent company as early as possible when deal preparations begin. Looking out for the unexpected, including dual-track transactions (sale or spin-off), also may help make deals successful..

Asking relevant questions upfront

When planning a divestiture, an organization may enhance its chance of a successful transaction by asking and answering questions in specific areas:

- Who is the anticipated buyer? Public or private? Corporate? Domestic or foreign? Management? A financial buyer?
- How will the transaction team managing the divestiture be motivated or rewarded, along with the executives who will be leaving the parent company to start working for the acquirer?
- How complex is the anticipated divestiture and the attendant separation of financial systems, people, and operations?
- What will a buyer request in regard to data and additional information?
- What are the risks, and has a plan been developed to reduce risks and surprises?
- What are the anticipated buyer's audit and financial reporting requirements?
- How will the process be managed, and what is the timeline for the transaction?
- Who will manage the process, and does the company have adequate internal resources/knowledge?
- What ongoing transactions with the divested operations are to be expected, and how will those be handled?⁶
- What are the tax or other regulatory requirements that could result in potential additional costs or restrictions on how the divestiture is completed?

Carve-outs frequent among metals companies

When it comes to divestitures in the metals sector, carve-outs are frequent, particularly in North America and Western Europe. The focus is often on product segment spin-offs.

There are three levels of carve-outs most frequent in divestitures of metals companies, and each requires

⁶ "Generating Value from Corporate Divestitures in 2011," PwC, 2011.

involvement with different deal dynamics and multiple complexities.

With a **corporate-level carve-out**, operations typically handled at the corporate level are not included in the divestiture. So negotiations focus on such areas as the legal, accounting/finance, taxation, treasury, IT, supply chain, and insurance departments. Typically, a transition services agreement (TSA) will cover six to 12 months (or longer), until the new leadership of the unit being divested can develop or integrate the corporate services.

In the case of a **plant-level carve-out**, which is common in the metals industry, every divestiture may result in the division of a plant. The seller typically will keep the half of the plant viewed as core to its mission, with the other half of the plant transferred to the unit being divested.

As a result, a series of complex ownership issues arise for resolution. For example, will the plant maintenance group, essential to ongoing profitable operations, be split, or will one party in the transaction own the group and rent maintenance services to the other party?

Other plant issues also have the potential for significant operational and cost consequences, including questions regarding ownership and control of:

- Steam supply
- Co-generation plants
- Meters
- Suppliers
- Rail lines
- Pumps and other equipment

Delineating ownership issues typically requires an extensive walk-through and inspection of the plant site. Often the result is permanent service agreements robust enough to weather plant expansion, inflation, and other ongoing concerns and outcomes that cannot be entirely predicted before completion of the deal.

With **supply chain carve-outs**, deal negotiations may center on everything outside the plant that remains operational—including, for example, a common supply contract for a particular raw material. While the buyer of the divested unit may require that raw material, its needs may not be substantial enough to trigger the volume discounts enjoyed by the selling company. As a result, deal valuation may be affected.

There are also concerns around shared distributors. For example, if a metals company ships products to Asia, the organization's Asian distributor may be handling multiple products sold by the target company's parent or subsidiaries that are not included in the transaction. When a unit is divested, the buyer may want to establish a new, separate relationship with the distributor. Alternatively, the seller and buyer may create a TSA or continue to both use the distributor until each engages its own distributor.

A seller looking for success in any given divestiture or spin-off will prepare on a number of fronts:

Repositioning to seize opportunities

By employing a well-defined and regular portfolio process, a company may achieve better opportunities from its business and product portfolio. Forward-thinking companies identify appropriate divestiture candidates based on financial, operating, and commercial parameters. Such factors include a business maturing or becoming ripe for sale because of restructuring or market factors; an acquiring business requiring a capital infusion or specialized knowledge that resides in the portfolio company or company's management; or a business being part of a larger acquisition and not fitting with the overall strategic plan of the acquiring company or its portfolio businesses.

After settling on a business to exit, the company begins the process in earnest by validating the case for separation. The process may encompass resolving such issues as:

- What type of exit suits my investors? Is it realistic?
- Which buyers in which markets are more likely to be willing and able to pay full price?

- Would a strategic partner add value? If so, which candidates are suitable for the business we will divest?
- What scope of diligence on prospective buyers or partners is appropriate from the financial and commercial perspectives?
- Which deal structures strike a balance between the buyer's and seller's needs?

Evaluating operations for possible correction

In today's environment, concerns that buyers might have overlooked in previous years may damage or even derail a deal. To prepare for a divestiture, sellers conduct an assessment of operations and identify and correct significant issues, such as unusually high back-office costs and plant inefficiency, and restructure their options before going to market. Even if sellers cannot correct issues prior to closing, buyers are keen to gain an understanding of the target's costs and benefits.

Walking in the buyer's shoes

Adopt a buyer's perspective by performing due diligence of the business before involving potential buyers. A thorough review of the unit slated for sale may be essential when the seller's and buyer's pricing expectations vary significantly. Advance diligence may also help the seller identify and promote the unit's strengths and evaluate alternative transactions and structures from an informed perspective.

Buyers often are suspicious that executing a divestiture is merely a strategy for a company to rid itself of a problem asset. To defuse that issue, sellers should be equipped to answer critical questions:

- Why is the asset for sale?
- Why has it been underperforming?

- Why is it expected to do well outside the company?
- How will the forecast be prepared?

Determining separation issues early during the process

Human resources, intellectual property, information technology systems, employee benefit plans, and other systems and processes that took years to create may be disentangled during a divestiture. The process includes the development of TSAs, which provide for services between the seller and the buyer after closing. Buyers will want not only to outline the issues and timelines involved, but also to incorporate TSA and post-TSA costs into their initial valuations.

Presenting the business in a more favorable light

Historical financial results often may be revised to accurately reflect the unit as a stand-alone operation and exclusive of nonrecurring items. A business plan may clearly and convincingly describe the results to link the forecasts and actions and drive profits.

For the most challenging divestitures to be successful, the vendor may develop a detailed business plan to present to prospective purchasers. The plan could include a detailed analysis of the recurring historical figures and move to describe the forecasts and actions to consider for implementation. A vendor may make a divestiture more attractive to potential purchasers by using strategies such as providing them with contracts for a predetermined time. Such incentives could be considered when preparing the business plan.

Sellers also could consider the various tax and accounting structures available to them and choose the one that works from a deal perspective.

Moving quickly to reduce value deterioration

Divestiture transactions, as with acquisitions, may involve lengthy processes. Depending on whether a carve-out audit was required and other buyer financing and regulatory requirements, a divestiture typically may take six months to a year, according to a group of corporate development executives surveyed by PwC. The long transaction period may be driven by the complexities of developing an accurate financial understanding of the business unit or carve-out and disentangling its employees and operations from the larger corporate parent. The latter process may last an additional six months and tie up resources long after the transaction closes.

A long, cautious preparation period may be critical to a successful sell transaction. The journey to getting the asset marketed and ultimately off the company's balance sheet begins once a business unit is chosen for divestiture. Even though planning may extend the time spent on a divestiture, it may save time and costs overall because the process is likely to be more efficient once the seller goes to market.

Avoiding pitfalls

Business development executives recently surveyed by PwC agreed on nine common pitfalls in a divestiture. Among the areas that may damage or derail a deal:

- Failing to understand your anticipated buyer profile
- Failing to address critical pension issues

- Failing to address critical financial reporting issues
- Lack of detailed, credible support for the business plan
- Data reconciliation issues while going to market before vetting the numbers, requiring significant bridging from the confidential information memorandum, or CIM, to the data room information
- Stranded cost identification
- Lack of risk identification and response
- Lack of a clear transition services plan as well as a vision for post-TSA period
- Lengthy divestiture process resulting from lack of structure or data preparedness⁸

The critical factor shared by companies that achieve their goals for successful divestitures and spin-offs: extensive preparation. Unpreparedness may be costly. Sellers in some industries that were startled by the speed and scope of the economic crisis discovered they had little bargaining power against buyers that could cherry-pick attractive assets and operations.

In many cases, negotiations moved too quickly to let sellers effectively argue the value of their assets, and having prepared too late, they had no alternative except to take what they were offered or scramble to survive during an extended process. Preparing early and effectively prepares sellers to act when necessary and retain negotiating power, so they may realize more value from their divestiture.

⁸ *ibid.*

Key tax considerations

Tax consequences in every applicable country should be explored for a divestiture. These considerations vary and may be reviewed. The specific discussion of taxes in this report relates to the United States only.

There are numerous ways to structure a proposed divestiture, but considering tax efficiencies in advance may help increase shareholder value. For example, if a divestiture is treated as a dividend to the shareholders, the result could be taxable income to the individual shareholders. Similarly, the sale of a business to a third party may result in capital gain to the seller. However, the US Internal Revenue Code provides several mechanisms that let taxpayers structure certain corporate divestitures as tax-free reorganizations and/or distributions. In particular, the use of spin-offs, split-offs, and split-ups may allow for the distribution of stock of one or more corporations to shareholders or other security holders without the recognition of gain or loss. The rules governing these types of transactions are highly technical, and to qualify, a taxpayer faces certain requirements. Some of these include:

- **Active trade or business**—Either the distributed corporation or the distributing corporation (or, in some cases, an affiliate) must have conducted this active trade or business for five years prior to the distribution. Furthermore, both the distributing and distributed corporations must be engaged in the active conduct of a trade or business immediately after the distribution. This also means that both businesses must be able to demonstrate that they are viable stand-alone businesses post-split.
- **Business purpose**—The transaction is required to be carried out for one or more corporate business purposes. The principal business purpose cannot be to provide nonrecognition treatment of any gains or losses on the transaction. Depending on the facts and circumstances, acceptable business purposes may include providing an equity interest to certain employees, facilitating financing transactions (stock offering or debt borrowing), saving costs, resolving competition problems with customers or suppliers, or applying “fit and focus” (resolving management or other issues resulting from operating multiple businesses in one corporation/group of corporations).
- **Distribution of control**—When the distribution is made, the distributing corporation must distribute “control” (usually defined as 80% of the voting power and shares).
- **Device test**—Similar to the business purpose analysis above, the transaction cannot be used principally as a “device” to distribute the earnings and profits of a corporation so as not to garner dividend treatment. The US tax authorities consider the facts and circumstances surrounding the transaction to determine whether this test is met, but a strong, nontax corporate business purpose without a prearranged plan or intention by the distributees to sell to stock post-spin generally is a favorable factor in this analysis.

Many additional federal, state, and foreign regulatory and tax requirements apply and could be analyzed prior to undertaking a corporate spin-off. Nonetheless, any corporation planning to dispose of a business line could consider whether a tax-free alternative is available.

Perspective:

Thoughts on metals deal activity in the fourth quarter of 2011

In the fourth quarter, we saw an increase in both deal volume and value over the third quarter. Average deal value increased as well. On an annual basis, however, average deal value declined. The BHP-Billiton deal of the second quarter of 2010 skewed annual figures; absent this withdrawn deal, both total value and volume would have increased in 2011, although average deal value would still have been down slightly.

Like the improvement in total deal value, the increase of average deal value in the fourth quarter reflects increased mega-deal activity (deals valued at \$1 billion or more). Overall, fourth-quarter average value increased by more than 20% over the third quarter for deals valued at \$50 million or more.

During the past two years, we have seen an increase in cash balances, while debt to capital levels have declined, indicating that potential acquirers are becoming better capitalized over the long term. At the same time, while the proportion of deals involving stock swaps has increased, indicating the ability to finance expansion with equity, leveraged buyouts have declined, as financial investors show some reluctance to engage in deals.

As in the third quarter, three mega-deals were announced in the fourth quarter: the proposed acquisitions of China-based Hebei Shougang Qian'an Iron & Steel, Brazil-based Usinas Siderurgicas de Minas Gerais, and US-based Commercial Metals. Valued at \$7.36 billion, these three deals were a key driver of deal value this quarter, comprising more than half of the total for announced deals in our report.

On a regional basis, Asia and Oceania drove overall deal value for 2011. The majority of the local deals (those within

national borders) were also led by Asia and Oceania. We expect that this region will continue to drive local deal activity in 2012, as China makes progress in consolidating its domestic metals industry, a goal of its most recent Five Year Plan.

Despite the gains in the deal environment this quarter, the outlook for the near term is uncertain. The collapse of aluminum prices has impacted the bottom lines of large producers, reducing the capital available for acquisitions. Exacerbating the issue, accumulating stock levels and soft economic conditions have further affected pricing: Prices had fallen by 23% in December from an April high. Some companies may profit from mergers as prices are declining (reflecting overcapacity in the sector) by increasing their competitiveness through inorganic growth.

There is a potential of a slowdown in the steel industry given weakening global demand and the tighter control of the Chinese real estate market. At the same time, steel prices appear to have stabilized, at least for now; the AME Steel Index increased approximately 5% in 2011.

Despite steel price stability, though, there is still cause for concern. The weak construction end market is contributing to soft earnings, given that it accounts for approximately half of worldwide steel demand. However, this could be offset by greater demand from the energy sector—through an increase in activity related to oil and gas drilling, for instance.

Overall, given the current economic environment, PwC expects moderate deal growth in 2012. It is doubtful that we will see robust growth, however, until metal prices and other fundamentals including margins improve.

Commentary

Quarterly metals deal activity

Measured by number and value of deals worth \$50 million or more

	2009				2010				2011			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Number of deals	18	17	24	38	25	23	33	25	28	41	25	28
Total deal value (US\$ bil)	11.8	63.1	7.5	10.6	8.1	17.5	53.4	13.7	23.9	8.5	9.7	13.1
Average deal value (US\$ bil)	0.7	3.7	0.3	0.3	0.3	0.8	1.6	0.5	0.9	0.2	0.4	0.5

Note: Sum of quarterly deal values may not match total deal value chart below because of rounding.

Deal values continue to increase in fourth quarter

Both the number of deals in the metals industry and their value increased in the fourth quarter. With 28 deals valued at \$50 million or more, total value increased to \$13.1 billion. This is an increase from the 25 deals valued at \$9.7 billion in the third quarter.

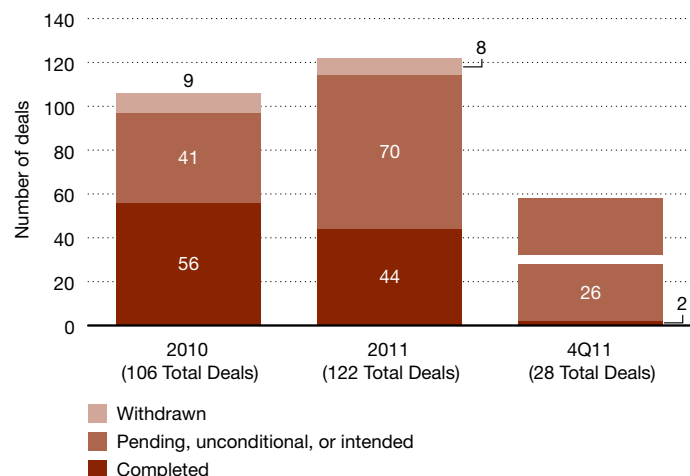
Along with increase in the total deal value, average value also grew for the quarter from \$388 million to \$468 million.

In a year-over-year comparison, there was a slight increase from 4Q10 to 4Q11 in deal volume, from 25 to 28. But the total value of these deals declined from \$13.7 billion to \$13.1 billion.

Sixteen more deals were made in 2011 than 2010 for M&A valued at \$50 million or greater. But these deals' value represented a substantial decline, from \$92.6 billion to \$55.2 billion. This 40% decline in value drove a steep decrease in average deal value as well, from \$874 million to \$452 million. However, had the withdrawn BHP-Billiton deal (valued at \$39.8 billion) been excluded, 2011 would have exceeded 2010 in both deal value (\$55.2 billion versus \$52.8 billion) and volume. And so 2011 was a robust year for metals M&A activity when removing the impact for this outlier.

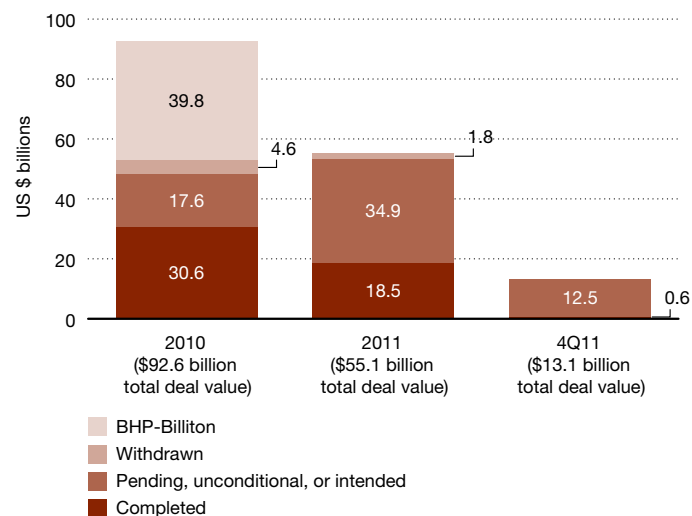
Deal activity by number of deals

Measured by announced deals worth \$50 million or more (2010, 2011, 4Q11)



Deal activity by total deal value*

Measured by value of announced deals worth \$50 million or more (2010, 2011, 4Q11)



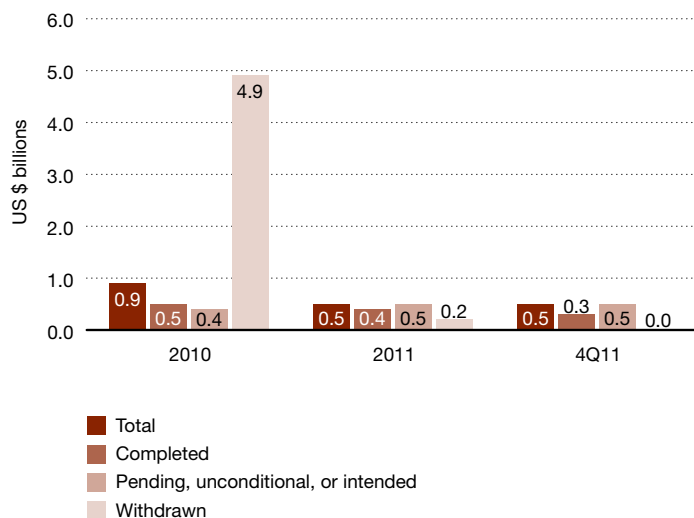
Average deal values increase in 4Q11 driven by larger deals

Similar to the increase in total deal value from the third quarter of 2011 to the fourth quarter, the improvement in average deal value reflects the announcement of three mega-deals. Overall, the average value for deals valued at \$50 million or more increased in the fourth quarter from \$388 million to \$468 million, a quarterly increase of more than 20%.

On an annual basis, average deal value declined from \$873 million to \$452 million. However, absent the withdrawn BHP-Billiton deal, average deal value would have declined by much less, from \$503 million to \$452 million. Based on the results for the year, it appears that while more deals are being transacted, they tend to be smaller.

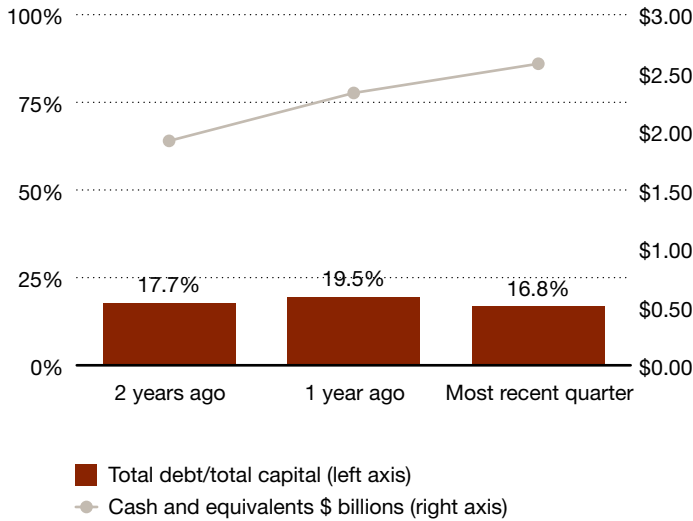
Deal activity by average deal value

Measured by value of announced deals worth \$50 million or more (2010, 2011, 4Q11)



Financial leverage

Measured by average of top 50 global public competitors (Y-2, Y-1, MRQ)



Source: Company

Acquirers are relying on equity to advance deals

A review of the top 50 publicly traded global competitors reveals that these companies have increased their cash balances over the past two years. Cash grew to \$2.58 billion in 2011, compared with \$2.33 billion in 2010 and \$1.93 billion for 2009.

Over the same period, debt to capital declined, indicating that potential acquirers among metals companies are becoming better capitalized over the long term.

This quarter saw an increase in stock swaps. Stock swaps occur when a company exchanges equity in itself for equity in the target. The acquirer is acquiring at least 50% of the target's equity or the remaining interest up to 100% of the target's equity, and at least 50% of the consideration offered is in the form of equity.

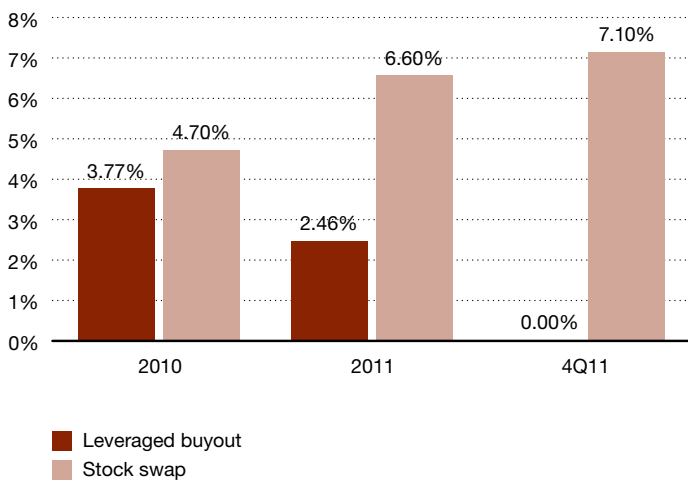
Since companies are using more equity, they may have a greater flexibility to engage in larger deals in the future. At the same time, leveraged buyouts are declining, which is indicative of the recent decrease in the proportion of deals we have seen by financial investors.

Thus, while financial investment has decreased, strategic investments appear to be strong. Current trends indicate that we may see an increase in the size and/or volume of deals as producers seek additional growth through acquisitions.

In the long term, we expect financial investors will return to the deal environment. But they are likely to focus on downstream targets. Upstream assets will likely remain in the purview of strategic acquirers. The reasons for this include the inherent volatility, political risk, and potentially longer holding period required for upstream acquisitions.

Acquisition characteristics

Measured by percentage of deals worth \$50 million or more (2010, 2011, 4Q11)



Mega-deals in 2010 (value of \$1 billion or more)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US\$ bil.	Category
Aug	Potash Corp of Saskatchewan Inc	Canada	BHP Billiton Ltd	United Kingdom	Withdrawn	39.76	Other
May	Vale SA-Aluminum Operations	Brazil	Norsk Hydro ASA	Norway	Completed	4.95	Other
Jul	Arcelor Mittal NV-Stainless Division	Luxembourg	Shareholders	Luxembourg	Completed	3.18	Other
Oct	CommScope Inc	United States	The Carlyle Group LLC	United States	Completed	3.02	Other
Apr	BSG Resources Guinea Ltd	Guernsey	Vale SA	Brazil	Completed	2.50	Steel
Jun	Hangang Hanbao Iron & Steel Co Ltd	China	Hebei Iron & Steel Co Ltd	China	Pending	2.35	Steel
Jun	Mineracao Usiminas SA	Brazil	Sumitomo Corp	Japan	Completed	1.93	Iron ore
Dec	Anshan Iron&Steel Group Corp- Assets	China	Pangang Group Steel Vanadium & Titanium Co Ltd	China	Pending	1.73	Steel
Feb	Lai Wu Steel Corp	China	Jinan Iron & Steel Co Ltd	China	Pending	1.73	Steel
Jun	Gerdau Ameristeel Corp	Canada	Gerdau Steel North America Inc	Canada	Completed	1.61	Steel
Nov	Draka Holding NV	Netherlands	Tianjin Xinmao Science & Technology Co Ltd	China	Withdrawn	1.37	Other
Mar	Rio Tinto PLC-Simandou Iron Ore Project	Guinea	Aluminum Corp of China {Chinalco}	China	Pending	1.35	Iron ore
Aug	ArcelorMittal South Africa Operations(Pty) Ltd	South Africa	Lexshell 771 Investments(Pty) Ltd	South Africa	Pending	1.26	Steel
Nov	Draka Holding NV	Netherlands	Prysmian SpA	Italy	Completed	1.26	Other
Mar	Itaminas Comercio de Minerios SA	Brazil	East China Mineral Exploration & Development Bureau	China	Pending	1.22	Other
Jul	Paranapanema SA	Brazil	Vale SA	Brazil	Withdrawn	1.14	Other
Jul	JSW Steel Ltd	India	JFE Steel Corp	Japan	Completed	1.03	Steel
Oct	Draka Holding NV	Netherlands	Nexans SA	France	Withdrawn	1.02	Other

Mega-deals in 2011 (value of \$1 billion or more)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US\$ bil.	Category
Feb	Sumitomo Metal Industries Ltd	Japan	Nippon Steel Corp	Japan	Pending	9.43	Steel
Jan	Consolidated Thompson Iron Mines Ltd	Canada	Cliffs Natural Resources Inc	United States	Completed	4.36	Iron ore
Nov	Hebei Shougang Qian'an Iron&Steel Co Ltd	China	Beijing Shougang Co Ltd	China	Pending	2.92	Steel
Nov	Usinas Siderurgicas de Minas Gerais SA{Usiminas}	Brazil	Investor Group	Argentina	Pending	2.88	Steel
Jan	Elkem AS	Norway	China National Bluestar(Group) Co Ltd	China	Completed	2.18	Aluminum
Mar	Cia Brasileira de Metalurgia e Mineracao{CBMM}	Brazil	Investor Group	Japan	Pending	1.95	Other
Sep	Cia Brasileira de Metalurgia e Mineracao{CBMM}	Brazil	China Niobium Investment Holding Co	China	Completed	1.95	Other
Nov	Commercial Metals Co	United States	Icahn Enterprises LP	United States	Pending	1.56	Steel
Jul	Sundance Resources Ltd	Australia	Hanlong Mining Investment Pty Ltd	Australia	Pending	1.27	Iron ore
Mar	Severstal North America Warren Wheeling Ops	United States	The Renco Group Inc	United States	Completed	1.19	Steel

Mega-deals in 4Q11 (value of \$1 billion or more)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US\$ bil.	Category
Nov	Hebei Shougang Qian'an Iron&Steel Co Ltd	China	Beijing Shougang Co Ltd	China	Pending	2.92	Steel
Nov	Usinas Siderurgicas de Minas Gerais SA{Usiminas}	Brazil	Investor Group	Argentina	Pending	2.88	Steel
Nov	Commercial Metals Co	United States	Icahn Enterprises LP	United States	Pending	1.56	Steel

Three mega-deals drive fourth-quarter growth

Following on the three mega-deals (deals valued at \$1 billion or more) announced in the third quarter, three more mega-deals were announced in the fourth quarter, all in November. With a value of almost \$7.4 billion, these three deals comprised more than half of total value for deals valued at \$50 million or more.

The largest deal, valued at \$2.92 billion, is the planned takeover of Hebei Shougang Qian'an Iron & Steel, a China-based manufacturer of steel and iron products, by Beijing Shougang, a majority-owned unit of Chinese state-owned Shougang Corporation, in a reverse takeover transaction. This Chinese within-border transaction is indicative of expected future deals in China, given the November announcement by the Chinese government of its Twelfth Five Year Plan for the steel industry. The plan includes speeding up the mergers and acquisitions in several industries, including steel. After the steel industry was ranked second in importance among the eight key industries defined in July, it was ranked first in importance at a working meeting held in December. It is believed by

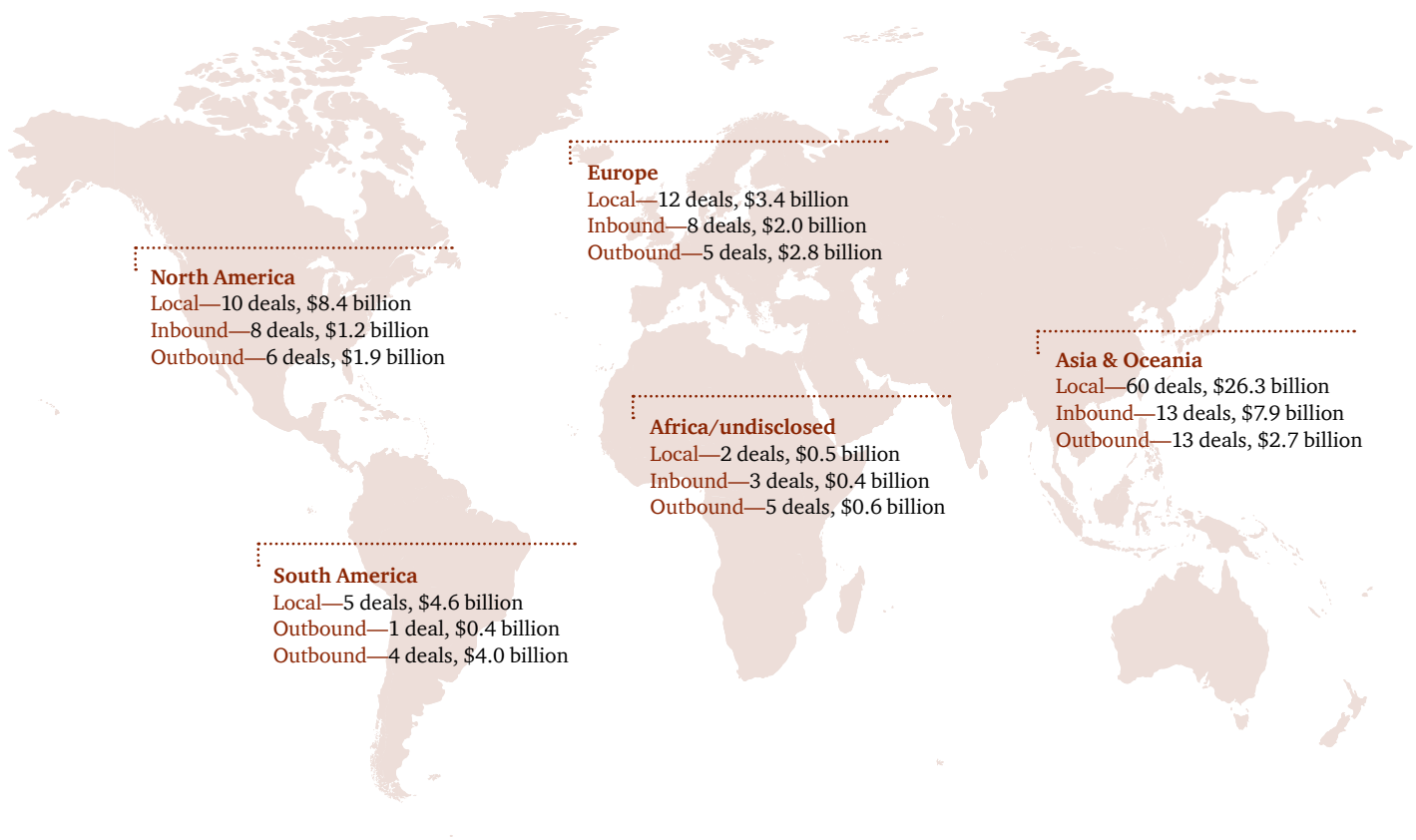
observers the higher ranking is closely linked to poor performance within China's steel industry.

The second-largest deal was the \$2.88 billion acquisition of a 13.78% stake in Brazil-based flat steel producer Usinas Siderurgicas de Minas Gerais SA (Usiminas) by an investor group comprising Ternium SA of Argentina, Siderar of Argentina, Prosid Investments SCA of Uruguay, and Brazil-based Confab Industrial SA. This is also one of several mega-deals involving Brazilian targets in 2011, including the \$2.5 billion acquisition of Vale S.A. in April and Sumitomo Corp.'s June acquisition of Minercao Usiminas for \$1.92 billion.

Finally, billionaire Carl Icahn, through Icahn Enterprises, launched a \$1.56 billion hostile tender offer to acquire the remaining 90.03%, which he did not already own, in Commercial Metals Co., a California-based manufacturer and wholesaler of steel and metal products. Commercial Metals' board of directors has recommended that stockholders reject the offer, and Icahn has indicated that he will drop his proxy fight if he is not able to acquire at least the additional 40.1% of shares needed to gain control.

Global metals M&A activity

Measured by number and value of deals worth \$50 million or more (2011)



Asia and Oceania deals drive local deal volume

The Asia and Oceania region saw the highest overall deal value in 2011, with 86 inbound, outbound, and local deals valued at a combined \$36.9 billion. Among local deals, Asia and Oceania companies lead the way, striking 60 deals with a combined value of \$26.3 billion of the worldwide total of \$51.5 billion. Asia and Oceania is expected to continue to drive local deal value through 2012.

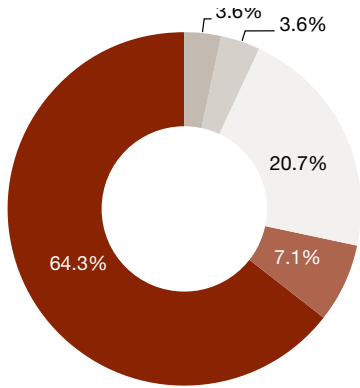
It is not a surprise that China-based deals were the primary driver of activity in Asia and Oceania (29 deals in 2011) given the emphasis that the Chinese government has put on steel company consolidation in its most recent Five Year Plan. Australia also saw high activity in 2011 (18 deals), which indicates that country's importance to the metals sector. Asian emerging markets are relatively fragmented, which may contribute to deal flow from this region.

Asia and Oceania also dominated inbound deals, with \$7.9 billion of the \$11.9 billion total. Similar to the local deal interest, we expect that Asia and Oceania will see large inbound activity as companies in other regions seek a foothold in emerging nations such as India and China.

Europe, on the other hand, was the primary driver for outbound deals in 2011, with five deals valued at \$2.8 billion. One driver of this activity might be that European investors seek higher growth rates than may be available from domestic economies. In addition, concerns remain about local economic conditions such as sovereign debt risk, credit rating downgrades, and the possibility of a future recession.

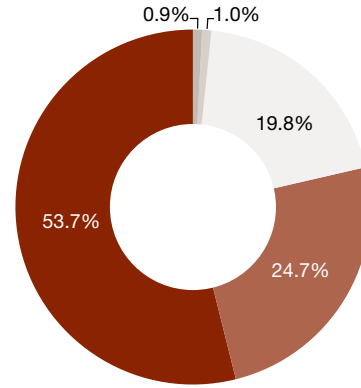
Regional distribution of deals by target region*

Measured by number of deals worth \$50 million or more (4Q11)



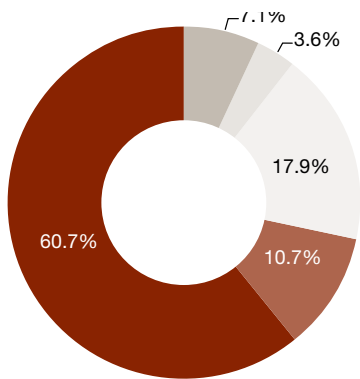
Regional distribution of deals by target region*

Measured by value of deals worth \$50 million or more (4Q11)



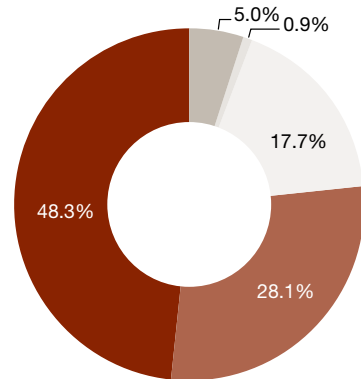
Regional distribution of deals by acquirer region

Measured by number of deals worth \$50 million or more (4Q11)



Regional distribution of deals by acquirer region

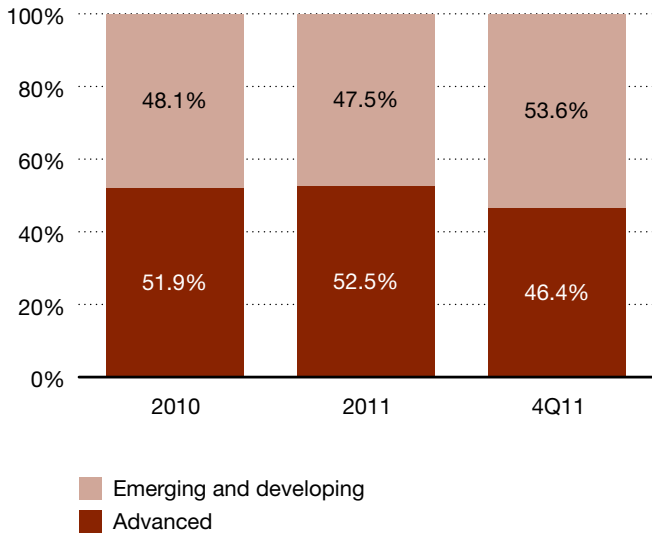
Measured by value of deals worth \$50 million or more (4Q11)



Europe ex-UK & Eurozone
 Africa/Undisclosed
 UK & Eurozone
 North America
 South America
 Asia & Oceania

Acquirers from advanced versus emerging and developing economies

Measured by value of deals worth \$50 million or more



Acquirers from emerging economies create greatest percentage of fourth-quarter activity

In the fourth quarter, acquirers from emerging and developing economies once again drove the majority of deals valued at \$50 million or more, with 53.6%. This follows similar results in the third quarter, when emerging and developing nations were responsible for 52.2% of deals.

However, on an annual basis, emerging and developing economies decreased their proportion of deals slightly, from 48.1% in 2010 to 47.5% in 2011.

Steel continues to drive value of metals M&A

PwC segments the metals sector into four categories by comparing standard industrial classification (SIC) codes to our internal classification system. Based on this process, we group deals (measured by number) into four product segments:

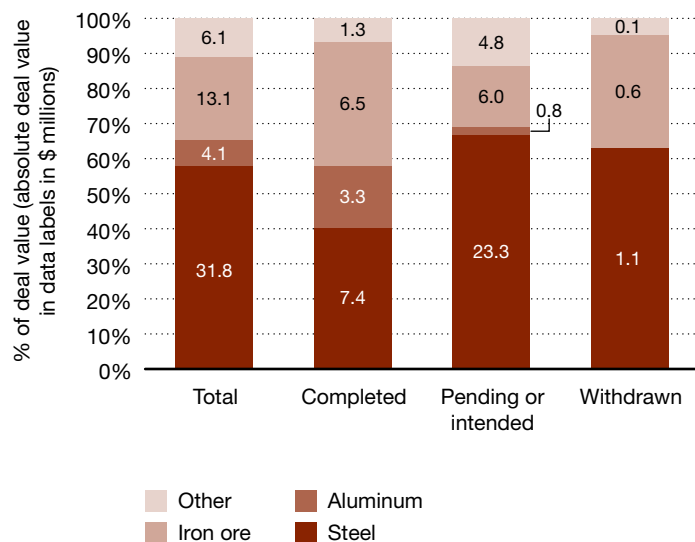
- Steel
- Aluminum
- Iron ore
- Other

Based on this methodology, steel manufacturing targets drove most of the fourth-quarter activity, contributing almost two-thirds of the deal value. For 2011 overall, steel was also the key driver with 57.6% of value.

Steelmakers were responsible for the three mega-deals valued at \$7.36 billion. The emphasis on steel manufacturing makes sense: steel is a more fragmented part of the metals sector and so is likely to see more consolidation, creating economies of scale for market expansion and cost cutting.

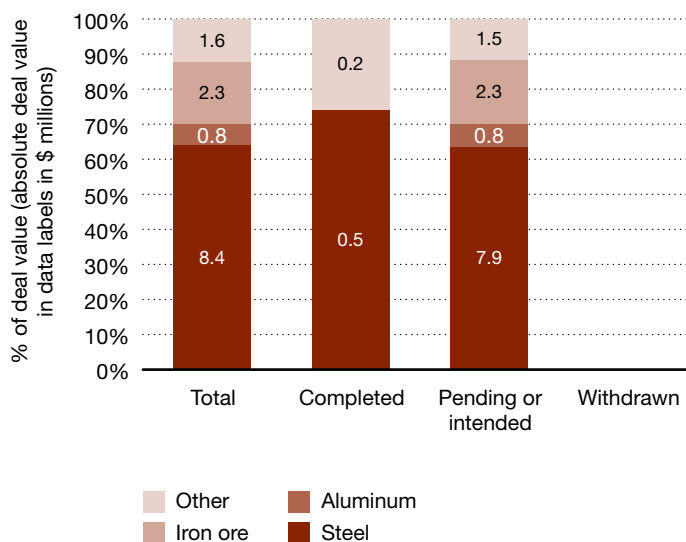
Deals by target metal category—2011

Measured by value of deals worth \$50 million or more



Deals by target metal category—4Q11

Measured by value of deals worth \$50 million or more



PwC spotlight

In an uncertain global economy, liquidity issues and stakeholder pressures for improved performance have turned more attention to divestiture activities in the short term. Divestiture may be inevitable. But a smaller pool of likely buyers and greater scrutiny from banks have resulted in more due diligence among buyers, which often extends the sale process and sometimes erodes sale prices.

For the seller, readying a company for more rigorous buyer due diligence may preserve the value of a divestiture. Also important: preparations for mitigating other areas of frequent value loss, including ineffective terms and pricing of transition services agreements and insufficient infrastructure planning for stranded costs.

How PwC may help

We've seen market conditions fluctuate dramatically in recent years. Still, extracting top value remains the overriding goal of a divestiture. The divestiture professionals with PwC's Transaction Services support clients in accelerating the speed to market/close and help them ready companies for sale to gain the most value of the business in the offering price. Our divestiture professionals, part of a Transaction Services team of about 1,000 deal professionals in 16 cities across the United States, may address carve-out financials, stand-alone audit requirements, identification of potential buyer deal issues, transition service agreements, data room assistance, and structural alternatives

designed to help maintain the value of the divestiture. We offer:

- Divestiture management support—PwC has put together a winning approach to launching and managing divestitures. We bring a time-tested divestiture and separation methodology and an expansive set of processes, tools, templates, and guides to support the overall divestiture.
- Functional divestiture assistance—PwC is equipped with core competencies in the fundamental infrastructure areas that form the building blocks for capturing and preserving value in a divestiture. Our experienced divestiture professionals draw on their subject matter and process knowledge to help clients position a business for sale and optimize overall results from transition to transformation.

PwC helps clients prepare for rigorous buyer due diligence. We may deliver support, methodology, tools, and templates that take you from start to finish of a divestiture and consider:

- Divestiture strategy
- Candidate acquirer screening
- Sell-side commercial due diligence
- Sell-side financial due diligence
- Financial and tax structuring
- Financial statements and reporting
- Carve-out statements and filings for regulatory compliance
- People and HR matters including employee benefits
- Operational carve-out analysis

- Insurance risk
- Contract transition
- Divestiture management and separation

PwC deploys a team tailored to each client's engagement. In addition to supporting a speedy, more efficient go-to-market process and close, rigorous divestiture management and due diligence help clients:

- Execute a smooth transaction, close, and post-close transition
- Reduce risks, avoid costly surprises, and enhance overall control of the process
- Address operation separation issues early, including transition services agreements and potential stranded costs
- Avoid value deterioration throughout the process and after the close
- Reduce disruptions to both the target and remaining businesses
- Mitigate regulatory, financial reporting, and operational risks
- Seek transaction value for the seller

Our tailored approach gives clients the appropriate balance of transaction, functional, and industry experience across the value chain. We start with a client's transaction viewpoint and investment thesis. Then we guide the company through assessments and evaluations of divestiture considerations exclusive or auction situation planned capital structure and financing sources timing and deliverables critical deal and valuation issues and integration challenges and solutions.

Specialty case study: Divestiture and spin-off for global company

Issue	A global metals company sought opportunities to divest several business operations that were not central to its core mission. The company urgently needed cash to pay a lender loan and was required to efficiently conduct a series of divestiture transactions.
Action	PwC performed sell-side due diligence on entities for divestiture, analyzing earnings trends, working capital issues, and potential separation concerns. We helped management gain an accurate view of normalized earnings and working capital and helped prepare the company for buyer diligence by identifying areas of value leakage. PwC also helped the company establish a central divestiture management office and achieve its goals for the separation, including transition service agreements and IT and people approaches.
Impact	<p>PwC's involvement helped the company's management and its bankers prepare for the deal negotiations. With the first few weeks of PwC's field deployment, the company:</p> <ul style="list-style-type: none">• Established its divestiture management office• Developed operational and functional Day One separation plans• Conducted separation activities with transition teams <p>The company successfully closed the transactions by the debt call date, raising enough cash to restructure its debt.</p>

PwC's metals experience

Deep metals experience

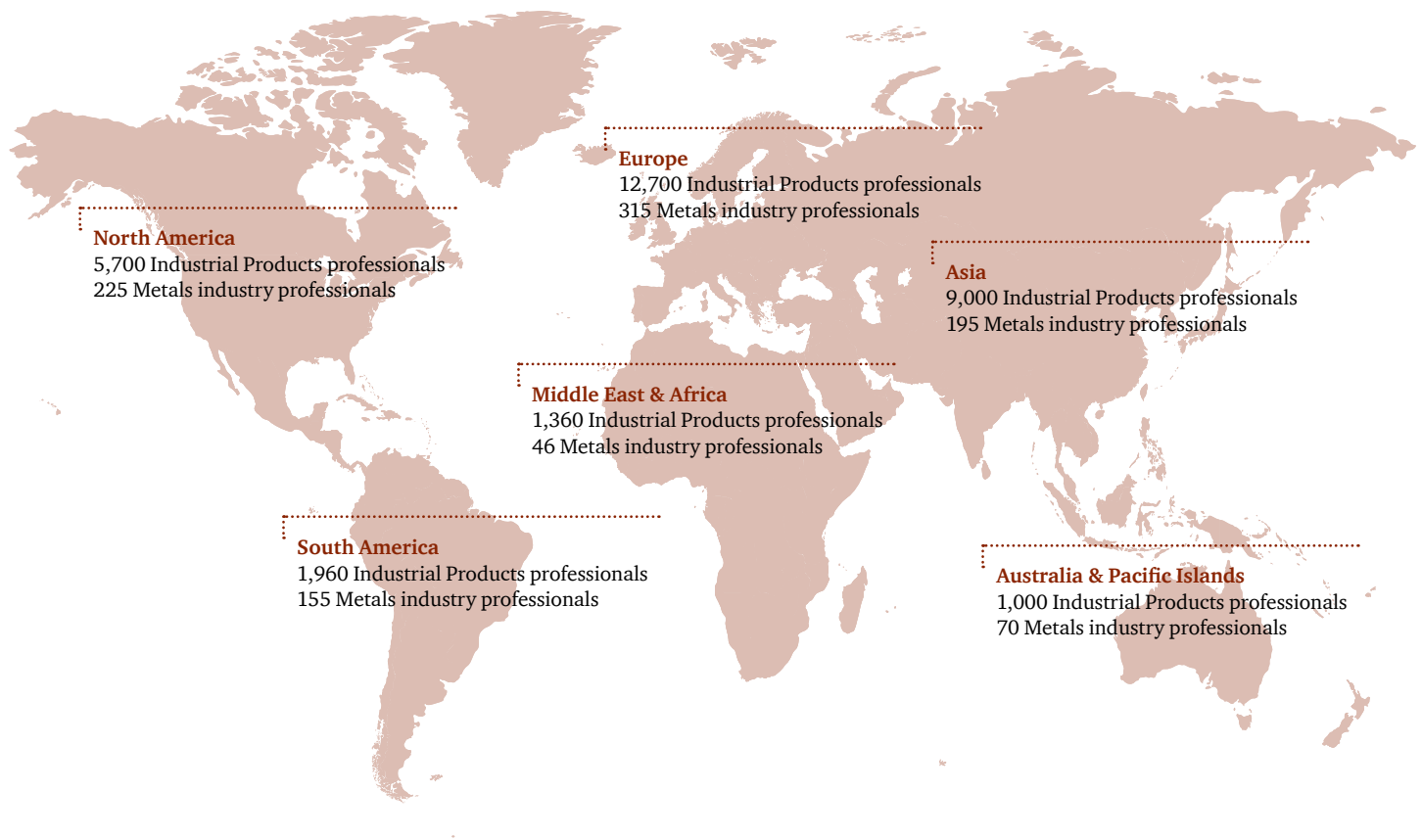
PwC continues to have the leading Fortune Global 500 market share in the metals industry. Our Metals practice serves ferrous and nonferrous primary and secondary metals producers through a network of more than 1,000 professionals strategically located around the world. Central to the successful delivery of our services is an in-depth understanding of today's industry issues, in addition to our wealth of industry resources and "best practices" that help in solving complex business challenges. Our highly skilled team encourages dialogue on trends and issues through participation in industry conferences and associations, such as the American Iron and Steel Institute, as well as through industry-focused publications and Web forums. To address your industry needs wherever they arise, our professionals are concentrated in areas where the metals industry operates today and in the emerging markets where it will operate in the future.

Quality deal professionals

PwC's Transaction Services practice, with more than 6,500 dedicated deal professionals worldwide, has the right industry and functional experience to advise you on various factors that could affect a transaction, including market, financial accounting, tax, human resources, operating, IT, and supply chain considerations. Teamed with our Metals practice, our transaction professionals may bring a unique perspective to your deal, addressing it from a technical aspect as well as from an industry point of view.

Global connection

In addition to the more than 1,000 professionals who serve the metals industry, our team is part of an expansive Industrial Products group that consists of more than 32,000 professionals, including approximately 17,000 providing assurance services, 8,300 providing tax services, and 7,000 providing advisory services. This expands our global footprint and enables us to concentrate efforts in bringing clients a greater depth of talent, resources, and know-how in the most effective and timely way.



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PwC Global Metals practice

PwC's Metals practice provides industry-focused assurance, tax, and advisory services. Through our global network, we may draw upon the in-depth industry experience of professionals in every country in which your company operates. Our people may help you deal with the challenges of today, and they understand the implications for tomorrow.

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PwC's Transaction Services practice offers a full range of tax, financial, business assurance, and advisory capabilities covering acquisitions, disposals, private equity, strategic M&A advice, advice on listed company transactions, financing, and public-private partnerships.

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Methodology

Forging ahead is an analysis of merger and acquisition activity in the global metals industry. Deal information was sourced from Thomson Reuters and includes deals for targets with primary SIC codes that fall into one of the following industry groups: iron ores; ferroalloy ores, except vanadium; steel works, blast furnaces, rolling mills, and finishing mills; iron and steel foundries; primary smelting and refining/nonferrous; secondary smelting and refining/nonferrous; rolling, drawing, and extruding/nonferrous; nonferrous foundries; miscellaneous primary metals products; and metals service centers and offices. Balance sheet data was sourced from public company reports.

This analysis includes all individual mergers and acquisitions for disclosed or undisclosed values, leveraged buyouts, privatizations, minority stake purchases, and acquisitions of remaining interest announced between January 1, 2010, and December 31, 2011, with a status of completed, intended, partially completed, pending, pending regulatory approval, unconditional (i.e. initial conditions set forth by the acquirer have been met but deal has not

been completed), or withdrawn. The term *deal*, when referenced herein, refers to transactions with a disclosed value of at least \$50 million unless otherwise noted.

Regional categories used in this report approximate United Nations (UN) regional groups, as determined by the UN Statistics Division, with the exception of the North America region (includes North America, Latin America, and the Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups), and Europe (divided into United Kingdom and Eurozone and Europe ex-UK and Eurozone regions). International Monetary Fund classifications were used to label economies as advanced or developing and emerging. Overseas territories were included in the region of the parent country. China, when referenced separately, includes Hong Kong.

Competing deals, not just the ultimate successful deal partner, were included in the data set used throughout the document.

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