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Innovative Financing Pattern in Tata-Corus Deal: Rise of India's First Fortune 500

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Abstract: Investment decisions, Dividend decisions and Liquidity decisions are crucial to successfully manage firm's finances; to implement corporate policies and to achieve organization's goals. First in line to these three is- Financing Decision.

Tata Groups endeavour to acquire Corus Group Plc was a mammoth task; a task never been attempted by Indian corporation, a venture that has given shape to rise of India's first Fortune 500 company. Financing pattern and design of capital structure in case of Tata- Corus deal was also first of its kind. It has uniqueness; a carefully crafted subsidiaries-holding companies network.

This work is an attempt to have a deep insight in the financing structure adopted in case of Tata – Corus deal. The work also discusses the adverse quid-quo- pro of macro scenario on the deal in balance to the financing structure chosen by the management.

Keywords: Financial Management, Dividend decisions, Tata, Corus, Investment finance and Corporate finance.

I. INTRODUCTION

The steel industry all over the world, owing to industralization, flourished immensely but was largely fragmented with top three ore companies of world controlling 75% of the world's supply and top 10 auto companies of world controlling 95% of world demand. Consolidation remained only option for steel makers to adjust supply-demand issues.

Economic growth in US and Europe, during 1945-1975, accounted for growth in steel industry by 6-7% annually. The average growth in 1975-2000 remained just 1 percent that further reduced to 0.4% annually post 1990s.

II. HISTORY OF COMPANIES INVOLVED IN TATA-COURSE DEAL

Asia's first and India's largest steel maker, Tata Steel, was established in 1907. Among all steel makers of the world, Tata Steel with its positve EVA is also ranked among the lowest cost steel producer in the world. Tata has state of art plant at Jamshedpur in Jharkhand, India that produces 5 MTPA (million tonnes per annum). Tata Steel manufacturing network in eight markets in Pacific Rim countries and South Asia includes Nat Steel Asia (with 92 MTPA) and Tata Steel Thailand (previously Millennium Steel). With rich iron ore, manganese, chromium and dolomite minning and related assets, Tata Steel excels in valued based vertical integration and enjoys the status of world's most profitable steel maker.

Corus was formed in the year 1999 on 6th of October as a result of combination of British Steel and the Dutch Koninklige Hoogovens and emerged as Europe's largest. Corus is listed on London, Amsterdam and New York stock exchanges. Poor intergration of the two resulted in an operating loss of $1.152 billion. CEO of Corus, Phillipe Varin planned cost saving to the tune of 680 million pounds in next three and a half year and launched a 'Restore Success' programme soon after taking charge in

2003. Efforts by management bear fruits and Corus margins increased owing to cost saving and operational efficiencies. The sale of aluminium business for $570 million to Aleris, US in 2006 helped Corus to reduce its debt substantially. With a work force of nearly 47,000 people and business across 50 countries, Corus is UK's largest steel company with production facilities in UK and Netherlands. It mainly caters to package, engineering, construction and automobile sectors. Corus gets raw material mainly from Canada, US, South Africa and Australia. Due to economic slowdown in Europe and other part of the world, Corus, with its declining sale volumes slipped into the grip of financial problem and was facing the mammoth task of restoring the company's competitive strength. With Corus acquisition, Tata Steel would be able to reach out to markets in Europe that were previously unaccessable to it.

III. Tata Steal Bid for Corus-Tata-Steal Corus War: The Battle Begins

Corus was four times the size of Tata Steel when Tatas entered in a bid war for Corus against resource rich Brazilian company CSN (Companhia Siderurgica Nacional) in 2005 and finally acquired it for 608 pence a share totalling $12.19Bn for 1.01 billion outstanding shares. Tata started the bid with 455 pence-all in cash per share on October 20, 2006 valuing Corus at 4.3 billion pound. Brazilian company, CSN made the counter offer of 475 pence per share on 17 November, 2006. Bid war between the two intensified when Tata upped the offer and valued Corus at 4.7 billion pound on December 11, 2006. CSN quickly responded and raised their offer to Corus. They offered 515 pence a share. On 31 January, 2007 Tatas sealed the deal with their final offer of 608 pence per share against CSN's 603 pence bid (a 33.6% higer than their first offer) and India's first Fortune 500 Multinational came into existence. Final official announcement of acquisition came on 2 April, 2007. Tatas maintaining a low profile, during whole process, worked in their favour in closing the deal with Corus.

The combined entity became Europe's second and world's fifth largest steel producer. After this acquistion, Tata steel international business rose to $6.7Bn in 2006 up from $2.5Bn in 2003. Tatas chose Special Purpose Vehicle (SPV), Tata Steel UK, for Corus's acquisition. The deal involved debt equity ratio of 60:40. Out of required funding of $12.1 Bn, $4.1Bn was arranged by Group holding as equity into the SPV and remaining $8Bn as debt from banks like ABN Amro, Duetsche bank through junk bonds and senior term loans that would expected to generate $640 million as annual interest charges (approx 8%).

Post acquistion, Tata steel formed a 7 member's integration committee, headed by Chairman Ratan Tata, for smooth integration of two entities.

IV. Market Reaction to the Deal

Analysts opined Tata Steel purchase of Corus as a costly affair and market reacted sharply after closing of the deal. Tata Steel share fell nearly 12% from previous day's close of Rs.519 to Rs. 461 within a minute of the opening session on the day deal was struck. Interestingly, CSN's market value rose to nearly $1.6billion after losing the deal. The enterprise value to earning before interest, tax, depreciation and amortization (EV/EBITDA) multiple of 9 for Corus and 4.6 for Tata Steel made the deal unattractive for market participants.

V. Financing Options Available for Capital Investment Decisions: Choice Made by Tatas

The expansion of a business through merger or acquisition involves experience. The ability to envision how two or more combined companies can equal far more than the sum of their parts involved. The art of M&A financing envisages how to obtain and repay that money, taking the complex, technical aspects of M&A finance. It involves tapping key financial sources and instruments in apt of kind of deal; selection of the most appropriate type of financing-debt, equity, or a combination of the two; financing via debt, loans, bonds, and leases and the virtually infinite ways to borrow or lend. Determining the need for refinancing is also crucial and acquirer must plan for it as a probability. Achieving a proper blend of innovative sources of financing like mezzanine financing, private equity, seller take back financing along with traditional sources like debt, equity is a formidable task and if conducted suitably, helps the management to stay on the profitable side of the M&A success ledger. Moreover, volatile global events affect economic systems and in turn influences financing and refinancing for M&A. So they must be taken into consideration by the management while zeroing sources to finance the deal. Source among which some can be tapped for M&A can be categorized as either Internal or External sources. They are

Internal Source of Finances	Benefits
• *Cash* • *Working Capital* • *Existing Debt Facilities* • *Right Issues*	❖ *Move quickly* ❖ *Stronger Bid can be made* ❖ *Less disclosure is required*
External Source of Finances	**Benefits**
• *Senior bank Debt* • *Mezzanine Debt* • *Capital Notes* • *IPO* • *Private Equity* • *Vendor Finance*	❖ *Larger Transaction* ❖ *More options* ❖ *External expertise* ❖ *Competitive Process*

Table 1: Form of Finances

Following are some of the basic alternatives among infinite range transaction structures:

- Financed from firm's own cash resource- All cash deal
- Financed from firm's own cash resource- by issuance of stock
- Through exchange of stock- all stock deal
- Combination of cash & stock- mixed deals
- Financed through issue of debt- leveraging
- Leveraged cash transaction, financed through debt issue
- Majority of equity replaced by debt- leveraged buyout
- Offering debt to selling company shareholders- debt transaction
- Mixed deal involving cash/debt
- Issuance of preferred stock

Evaluating & re-evaluating each and every source of finance with its counterpart alternative sources embarks open opportunities before acquiring company to secure an optimum blend of those options available for finance and pave the way for combined firm to have minimum cost of capital so procured and that too with calculated risk and return.

VI. How the Tata-Corus Deal was Financed

A bridge finance scheme was created to buy out Corus's shareholders and debtors via a special- purpose vehicle that would take over Corus's assets, financed by fresh equity and new non-recourse debt, raised against Corus's cash flows (**Davies, Leahy and Tett**).

Despite of very weak debt market, the company got success in securing $6.2 billion of debt financing in a volatile market. The average life of debt was 5 years. In place of securing the non-recourse debt on Tata Steel, the Company raised the financing based on servicing capability of Corus cash flows. On the equity side, $2.27 billion (Rs. 9,120 crores) of equity and convertible preference shares on a rights basis have been raised by Tata Steel. The Company further raised around USD 875 million in Convertible Alternate Reference Securities (CARS) which is a 5 years convertible instrument with a coupon of 1% and a conversion premium of 35% to the prevailing market price in August 2007. As a result of the above, your Company rose around USD 10 billion during the year and completed the long term financing for the Corus acquisition (Tata Steel Annual Report 2008).

VII. Holding-Subsidiaries Network Pattern in the Deal

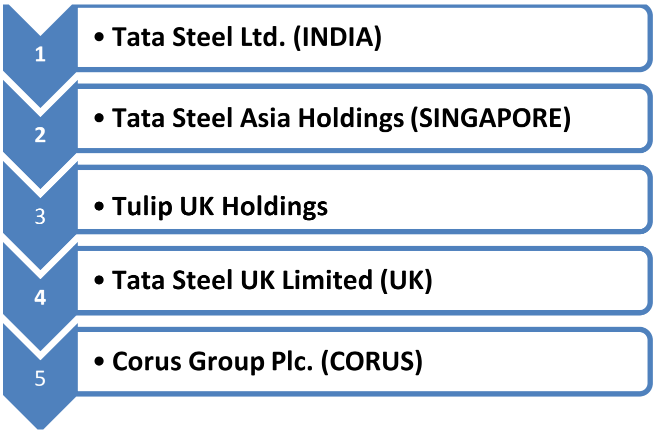

Figure 1

- All Cash–Leveraged Buyout is proposed to be made by Tata Steel U.K., a wholly-owned indirect subsidiary of Tata Steel, recently incorporated in the United Kingdom for the purpose of completing the Acquisition. The said Acquisition is proposed to be effected by means of a scheme of arrangement under Section 425 of the (English) Companies Act 1985; subject to High Court of Justice in England and Wales and Corus' shareholders approvals being obtained.
- Acquisition is proposed to be funded through its own cash resources and loans raised by Tata Steel and its subsidiary companies formed for the purpose of this acquisition.
- The long term financing pattern for the net acquisition consideration of Corus would be USD 12.9 billion and Tata Steel UK would be funded in the long term from the following sources:

✓ Equity Capital from Tata Steel Ltd - USD 4.10 billion.

✓ Long-term debt from consortium of banks - USD 6.14 billion.

✓ Quasi - Equity funding at Tata Steel Asia Singapore - USD 1.25 billion.

✓ Long term Capital funding at Tata Steel Asia Singapore - USD 1.41 billion

Total USD Investment of 12.90 billion

Sources of funding for Tata Steel's investment of USD 4.1 billion (about Rs.17,750 crores) in its wholly-owned subsidiary Tata Steel Asia Holdings (Singapore) Ltd. which would in turn invest the same in Tata Steel UK which has acquired Corus Plc. U.K.

- Internal Generation - Rs.3,000 crores (USD 700 million).
- External Commercial Borrowings - Rs.2,170 crores (USD 500 million).
- Funds from the Preferential Issues of equity shares to Tata Sons Ltd. of Rs.2,770 crores (USD 640 million)
- Rights Issue of equity shares to the shareholders in the ratio 1:5 at a price of Rs.300 per share involving issue of equity shares of Rs.3655 crores (USD 862 million).

- Un-linked Rights Issue of Convertible Preference Shares in the ratio of 1:7 having a coupon rate of 2% with conversion into equity shares after two years at a price in the range of Rs.500 to Rs.600 per share as may be determined at the time of the issue. This issue would provide a total amount of about Rs.4,350 crores (about USD 1000 million).
- A foreign issue of an equity-related instrument upto an amount of upto USD 500 million in such form as may be considered appropriate. This issue would be made on an ex-Right basis and on terms as may be determined at the time of the issue subject to approval of the shareholders.
- **The post-tax cost of this total financing package on completion is expected to be around only 4.3% per annum**

VIII. Why all Cash Deal Option was Opted for the Deal

When an acquirer sees confidence in its investment; cash mode of payment is chosen. Such act of acquirer; as most often seen; is rewarded by the upturn in the stock prices after the announcement of the deal. Tata Steel management knew that bid war with Brazil CSN for Corus have added premium to the value of Corus and thus have opted for all cash deal. Stock prices would have surely see a downturn; if market participant see the deal a costly affair to the acquirer. Historically, this has happened and seen in more than 75% of the deal in which stocks of acquirer has seen a dip soon after the closure of the deal. As mentioned earlier, Tata Steel fell nearly 12 percent after the announcement of the deal considering Corus a costly buy.

Two other obivious versions for adoption of all cash deal for Tatas are requirement of immediate takeover of Corus for reaping advantage of economies of scale; to cater surge in demand back in India and worldwide. Tatas were planning to acquire Jaquar Land Rover from Ford Motors during the same period. Steel from Corus plant would serve as raw material for JLR manufacturing. The other reason was that Corus and its employees battling downsize in economy would have find all share deal unattractive. Moreover, cost of debt (around 8 percent) would be less costly than cost of equity which would be around 15 percent. Curtailment of fullfilment of regulatory requirement in case of all share deal; as a case of FDI; might have prevented Tatas to adopted all share swap while acquiring Corus. Though Tata Steel share seen a dip immediately after announcement of the deal, Standard & Poor's Rating Services cuts its rating from BBB to BB and removed them from negative watch list soon after Tata Group announced the financial structure for the aquisition of Corus. Thus the rating was seen as a positive outlook for the stock of Tata Steel.

Ratan Tata, emeritus Chairman of Tata Group in an interview to Business Week special correspondent *Nandini Lakshman* said

"It would have taken us several years to build a steelmaker with 19 million-ton production capacity from scratch, leave alone establishing it in Europe with a brand name. We feel confident the synergies of the two companies will be quite substantial, and we have satisfied ourselves that the company has in no way jeopardized the interests of the shareholders in this acquisition. I believe that over the next few years, we will all come to think that this was a visionary move."

\- **Ratan Tata, Chairman of Tata Group**

IX. Tata's Steal-Solid Decision for Acquiring Corus

The main strategy of Tata Steel behind acquisition of Corus is adopting philosophy of disintegrated production by making semi finished steel in India at cheaper cost due to their proximity to iron ore and value add in Europe. Ratan Tata, Chairman of Tata group and his team members involved in the deal were convinced that economies in manufacturing, access to untapped market and combined R&D would generate value in the long run. Cost saving to the tune of $350 million per year was also expected by exporting cheaper inputs (steel slabs) from India that would be processed in Corus plant in UK. The management convincingly see the combined entity emerging as the second most diversified steel maker company in the world. Only time will tell whether Tata will be able to reap benefits out of the acquisition of corus to the fullest.

In first quarter of 2016, there were reports of Tata Steel Board contemplating on exploring all options, even disinvestment of Tata Steel Europe (formely Corus Group Plc), to steer the firm's embattled operations in UK that resulted in asset impairment to Tata Group of more than 2billion pound in past 5 years. Till mid of May 2016, seven probable contenders have shown interest in acquiring Tata Steel Europe operations from Tata Group. UK government has also comes to rescue and agreed to pick up 25 percent stake in Tata Steel Europe to save thousands from getting jobless in event of complete shutdown of operation.

Situations seen a turnaround after 23rd of June 2016, after Britains voted for exit from European Union. Though the process of divorce from EU would be a long cumbersome process for both EU and Britain, Tata Group management see a silver lining after the dark decade of incurred losses and started looking for a prospective joint venture in its UK operations instead of opting for an outright sale of UK plant.

X. Conclusion

Global slowdown and slump in demand in the infrastructure sector in developed countries like US and European countries, post deal, proved acquisition of Corus to Tatas a costly affair. Till 2016, when Tata Sons zeroed in strategy to either sell off UK plant completely or find joint venturer to support operations, the company's UK operations was reaping negative operating performance & loosing market to cheap steel from China. In 2016, company reported 1million pound of loss per day to the Tata Group. After Brexit (*Britain's decision to exit from European Union*) in March 2016 Tata sought UK government intervention and support to run the plant at Port Talbot.

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