

BHP Billiton MarketBuster

Summary

In March 2001, BHP and Billiton announced their intention to form a Dual Listed Company (DLC) in which both companies would maintain their primary listings (London and Australia) while merging the board of directors and home office. The MarketBusting strategy employed by both BHP and Billiton was that of exploiting the industry's structure for the next stage of the life cycle. In looking at competitors, both BHP and Billiton realized that the industry was in flux and that in the next stage of the life cycle the industry would be highly consolidated and more vertically integrated, especially backward into the mining process. The merger was successful and brought the company from a market capitalization of \$28b in 2001 to one of \$42b in 2003. In addition, the cost savings that resulted from the synergies of the merger amounted to \$285m, exceeding the \$270m target.¹

The Story

In the mid-to-late-1990s, there was a movement of consolidation among the mineral mining companies. Companies such as Glenmore, Billiton, Anglo-American, Shell, Gold Fields, and CVRD participated in such activities throughout the early decade. Anglo-American acquired the diamond mining company, DeBeers, while Billiton acquired a controlling interest in the Worsley Alumina refinery in Western Australia.² International boundaries were becoming irrelevant, as companies looked to expand wherever possible.

At that time, BHP, an Australian minerals mining company, was beginning to feel constricted in its ability to expand as a company, particularly with one of its principal competitors in iron ore, Rio Tinto, buying up key assets throughout the continent. In 2000, Rio Tinto spent \$14 billion to acquire mining assets, including Aston Mining, North Ltd, and Comalco. In doing so, Rio contributed to BHP's desire to move more of its operations abroad.³

BHP was incorporated in 1885 as the Broken Hill Proprietary Company. The company had three major operations prior to the merger, namely minerals, petroleum, and steel. In addition, the company offered a host of complementary businesses, including transport and logistics, corporate services, and internal groups for finance, strategy, and legal. In its minerals and petroleum operations, the company was involved in the discovery, development, production, and marketing of iron ore, coal, copper, oil and gas, diamonds, silver, lead, and zinc, as well as a number of other natural resources. The company was also among the market leaders in value-added flat steel products. Before the merger, the company was headquartered in Melbourne, Australia and employed about 30,000 individuals.⁴

Before the merger with Billiton, BHP was undertaking in a range of acquisitions and expansions. The company acquired several other companies, opened new mines, began new petroleum production, and expanded its steel operations. It opened two new mines in Queensland, the Cannington silver, lead, and zinc mine and the Crinum coal mine, and opened a new mine in Canada, the Ekati Diamond Mine.⁵

Billiton was incorporated in 1860 in the Netherlands and was named after the tin-rich island in Indonesia (now Belitung) that it began mining. It became a part of the Royal Dutch/Shell group in 1970 and became a member of the FTSE 100 index in 1997. Before the merger, the

¹ 'Annual Report 2003', 2003.

² Cook, 2005.

³ Ibid.

⁴ 'BHP History', 2005.

⁵ Ibid.

company was a global leader in mining and metals and a major producer of aluminum and alumina, chrome and manganese ores and alloys, steaming coal, nickel, and titanium minerals, as well as a growing copper portfolio.

Billiton, like BHP, was also undergoing expansion at the time of the merger, having recently purchased Rio Algom, a Canadian based base metal and metal distribution business for \$1.75 billion, a 56% stake in Worsley, a Western Australia alumina refinery for \$1.49 billion, CdelC and CZN, two Columbian coal companies, for \$291 million, and a 2.3% indirect interest in CVRD, the Brazilian mineral company, for \$327 million.⁶

According to the CEO of BHP before the merger, Paul Anderson, some of the major market conditions before the merger were⁷:

- Global capital markets becoming increasingly selective, as national and trading exchange limitations become less relevant, shareholders demand enhanced returns
- Customers consolidating and have become much more efficient themselves
- Employees learning that increasingly a "suite" of skills is necessary for promotion and job security
- Uncertain economic environment with most of the major economies of the world facing a period of slow, or no, growth

In essence, Anderson felt that the market leader in this industry would have to have free access to global capital markets, offer consolidated, global minerals solutions to customers, provide employees with a variety of opportunities for career development, operate with high regard for the environment and society, and hedge against potential economic, and hence, commodity price downturns.

MarketBusting Moves

#27: Exploit your industry's structure for the next life cycle stage

BHP was undergoing a period of strong growth and recognized the need for foreign investors. They had already become large for Australia and wanted the opportunity to expand further and this merger was an ideal method for them to list on a more active and more highly capitalized exchange. On the other end, Billiton's debt was not rated at the time, and the merger with BHP would bring BHP's investment-grade debt to the combined enterprise, bringing more money into the combined company on the part of Billiton than Billiton could have raised on its own.⁸

With this new merger, BHP Billiton could now offer integrated, global, industrial minerals solutions to customers as it could now operate two major centers as well as provide an extensive array of services.⁹ BHP Billiton would become the world's third largest producer of copper, the Western world's third largest producer of aluminum, the world's largest integrated producer of manganese/chrome/ferro alloys, the world's third largest iron ore producer, and the world's largest producer of export steaming coal and hard coking coal. The combined firm would also have significant oil, gas, and liquid natural gas holdings as well as significant titanium holdings.¹⁰ Billiton also brought to the table expertise in biotech processes for minerals processing with its BioCop technology, a technology that could more efficiently process copper than the existing smelting process. Billiton was also working on Project Falcon, an airborne gravity exploration tool.¹¹

The internationalization and diversification of the firm would also have important implications for employee relations. Now, employees that survived the massive restructuring with the merger would have the opportunity to work in locations around the globe, as well as the potential to acquire experience in multiple materials processing functions.

⁶ Hollins, 2001.

⁷ Anderson, 2001.

⁸ Tomlinson, 2001.

⁹ Anderson, 2001.

¹⁰ Bennett, 2001.

¹¹ Tomlinson, 2001.

One of the biggest benefits of this diversification of the merged company's portfolio would be the reduced reliance on exchange-traded commodities (such as aluminum and copper) and on oil prices. For example, Billiton's pre-merger share price was extremely dependent on the aluminum spot price on the London exchange and derived over 42% of its EBITDA from aluminum.¹² After the merger, the company's dependence on aluminum would be greatly reduced, with only 18% of the estimated 2003 operating profit coming from aluminum.¹³ In fact, by 2003, the largest estimated segment would be the petroleum segment brought to the combined firm by BHP with 19%, a far cry from the 42% dependence on aluminum from which Billiton suffered.

A further benefit in this merger, as is the benefit in many industry roll-ups, is the inherent cost savings and enhanced revenue generation achieved through synergies. Such synergies include enhanced purchasing power and hence procurement savings, reduction of corporate offices by the combining of the two head offices, and the less tangible items such as joint marketing and common customers. Altogether, these synergies were expected to produce somewhere in the range of \$250-400 million per year.¹⁴

One final strategic decision made by the merged company was the demerger of BHP Steel. The rationale for this move was that with the merger of BHP and Billiton, the company's assets would be heavily favored toward minerals and petroleum. This move was positive for the merged company as it would allow them to divest of all non core assets¹⁵

Key Lessons

According to the 2003 Annual Report of BHP Billiton Plc, the problem of foreign investment seemed to disappear overnight. The market capitalization at the time of the merger was \$28 billion; by the time the AR was released, this number had reached a level of \$42 billion. From the time of the merger to the 2003 Annual Report, BHP Billiton Limited had outperformed the ASX 200 by 2.3% and the S&P 500 by 9.4%, and BHP Billiton Plc had outperformed the FTSE 100 by 24.4% and the S&P 500 by 16.25%.¹⁶

In addition, the company was well on its way to generating the cost savings promised by synergies created by the merger, having achieved \$285 million in merger benefits by December 31, 2002, well ahead of the target of \$270 million by June 30, 2003, with another \$310 million in cost savings that would be achieved by the end of June 2003. The company was well on its way to obtaining overall efficiency gains in excess of \$770 million by 2005.¹⁷

Currently, the company is experiencing a great amount of financial growth, having grown net income from \$0.9 billion at the end of June 2001 to \$3.4 billion as of the end of June 2004. The company currently boasts a 21.4% return on capital, up from 10.9% in 2002. The company is also no longer as exposed to economic disturbances and falling commodity prices, as through the 9/11 terrorist attacks, the Enron bankruptcy, the falling dollar, and the Iraq war, the company consistently saw increases in EBITDA.¹⁸

As a result of the BHP Billiton merger, the company has successfully beat out its competitors by capitalizing on the shift toward a new stage of the industry life cycle. By forming a large conglomerate of minerals and petroleum divisions, the company now has a worldwide distribution network, as well as a portfolio that is no longer as exposed to the ups and downs of the commodities markets and foreign exchange markets. BHP Billiton continues to expand into new markets, increasing the extent to which it sells to Asia by finding new customers, especially in the burgeoning Chinese economy, and diversifying the minerals and products it sells there.

¹² Olsher, 2001.

¹³ Tomlinson, 2001.

¹⁴ Tomlinson, 2001.

¹⁵ 'BHP Steel Demerger Meeting', 2002.

¹⁶ 'Annual Report 2003', 2003.

¹⁷ 'Annual Report 2003', 2003.

¹⁸ Goodyear, 2004.

DRAT Table, BHP Billiton**SOURCE**

External

Powerful Incumbents	Large, established competitors: Alcoa, Rio Tinto, Anglo-American also acquiring many global minerals assets
Opposition from advocacy groups	Drilling in many areas can leach harmful chemicals into environment
Risk to key external Stakeholders	Australian government afraid of losing more investment abroad
Inertia	Great growth occurred from 1998 for BHP with small acquisitions, large merger may not be desirable
Disruption of customer's system or process	NA
Changes in standards or regulations required	Formation of DLC structure necessary, approval of shareholders for merger and for steel demerger

Internal

Internal political maneuvering	Thousands of jobs would be cut, top management positions consolidated, internal competition to remain with company, steel division divested
Reluctance or resistance by those needed for active implementation	Individuals in each company would be needed for successful consolidation, many jobs lost after consolidation, vested interest to prevent consolidation
Resource Constraints	None, large external investments expected following merger, divestment of steel assets

Platform changes required

Human resource and skills platform	Allow internal mobility, track skills acquired by employees to allow relocation/reassignment, find optimal assignments
Logistics platforms	Coordination of strategic activities in nearly 100 global locations, ~40,000 employees
Distributor platforms	Two separate distribution networks must be consolidated to form one coherent network
IT and database platforms	Systems to consolidate global data
Technology platforms	New surveying, mining tools necessary to achieve cost savings
Assets, operations, and systems platforms	Divest of underperforming assets/operations, find systems that work and replicate in other sites, find strengths of each former company's systems

Marketbusting Kite

Element	Needed to Support the Marketbusting System
Agenda The key things that the critical people spend time on	<ol style="list-style-type: none"> 1. Optimize operational performance/efficiency 2. Maintain world-class petroleum/minerals assets 3. Implement leading edge-technology 4. Focus on customer needs 5. Opportunistic acquisitions 6. Deep inventory of growth projects
Norms What principles and behaviors are valued?	<ol style="list-style-type: none"> 1. Safety standards 2. Environmental responsibility 3. Individual responsibility and teamwork 4. Forthright communication and integrity 5. Developing win-win relationships
News What information and measures are paramount?	<ol style="list-style-type: none"> 1. Return on capital 2. Commodity price exposure 3. Employee injuries/fatalities 4. Cash flow stability/growth
Allocations What gets resourced and how are people rewarded?	<p>Resources go to</p> <ol style="list-style-type: none"> 1. Building technological assets 2. Developing resource assets 3. Resource exploration 4. Developing safety systems <p>Rewards and recognition for successes go to</p> <ol style="list-style-type: none"> 1. Maintaining safety standards 2. Achieving asset returns 3. Increasing efficiency
Structure Power, authority, responsibility structure	<ol style="list-style-type: none"> 1. Each resource is individually managed 2. Each resource divided into regional management 3. Different set of activities depending on resource
History Key routines that have developed and drive activities	<ol style="list-style-type: none"> 1. Global mineral/petroleum asset base 2. Global distribution network 3. Attention to high performing/high yield assets 4. Desire to be complete customer solution
Symbols Meaningful actions, ceremonies, icons	<ol style="list-style-type: none"> 1. Charter 2. HSEC Policy 3. Zero Harm

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