

Getting back in the water  
Consolidation in the global  
steel industry





# Executive summary

*In 2008 steel industry consolidation—which had accelerated at a blistering pace over the past decade—hit a brick wall. With the advent of the global economic decline and, in particular, the freezing of credit markets, demand plummeted and the availability of financing to support transactions all but disappeared.*

In fact, some companies are facing debt covenant violations, requiring them to consider share issuances and divestitures to maintain financing for their current operations. As a result, the number of completed deals in 2008 fell by 25 percent and deal value dropped by more than half, to US\$31 billion.<sup>1</sup>

Yet, despite the current cool down in consolidation, mergers and acquisitions (M&A) remains a critically important business strategy to achieve synergies, expand the customer base, and enhance competitive position. Even in today's challenging business environment, steel companies need to master the ability to carefully evaluate potential targets and quickly execute acquisitions in order to be as well-placed when the economy regains steam. In a recent study of global steel consolidation, Deloitte Touche Tohmatsu's (Deloitte) Global Manufacturing Industry Group sought out major players in the steel industry to learn more about their overall M&A business strategies, the impact of the credit crisis and economic downturn, and the challenges they face in planning and executing acquisitions. From 15 October 2008 to 6 April 2009, a global online survey and case study interviews were conducted, including 10 of the top 15 largest global steel producers. Sixty-nine percent of the executives who completed the survey were from companies with annual revenues of US\$5 billion or more. Senior executives from ArcelorMittal, POSCO, Severstal, Tata Steel, and U.S. Steel participated in one-on-one interviews to gain further insight on how major players are addressing M&A and the new challenges presented by today's economy. Finally, the report draws on the extensive experience of Deloitte leaders in steel industry M&A.

In general, executives surveyed underscored the importance of developing and executing a successful acquisitions strategy by stating their intent to keep M&A squarely in view. And though most executives did cite the economic

downturn as a significant factor in their short-term decisions regarding M&A activity, companies expected they will be making acquisitions over the next three years. Indeed, 69 percent of the executives surveyed are currently considering an acquisition. They also anticipated the climate for M&A to become increasingly competitive in the coming years.

But while M&A will continue to play a key role in steel companies' strategies going forward, many need to make progress in acquiring the key competencies required to effectively carry out an acquisition. Taking a new view of the overall processes used to evaluate an acquisition should be a top priority. That includes looking beyond financial factors and seeking a more holistic perspective of an acquisition. Focusing heavily on financial issues in due diligence, companies often fail to delve deeply into cultural issues or consider the potential integration challenges in deciding whether to proceed with a deal. Strikingly, less than half of the executives surveyed said their companies conducted a detailed analysis of corporate or cross-border cultural issues when considering an acquisition or that these issues were very important when deciding whether to proceed. This was despite the fact that 64 percent termed cultural issues as extremely or very challenging when managing an acquisition, making it the highest-rated challenge. The survey also found that companies had a high interest in future cross-border transactions—only heightening the importance of cultural considerations to the completion of a successful acquisition.

Beyond integration, companies should have an explicit plan to identify and capture the synergies that provide the rationale for an acquisition—and evaluate the potential non-financial obstacles that must be overcome to be successful. In general, M&A processes need to expand to include more than evaluating the recent financial performance or capacity of the target asset and take a broader view of the full range of challenges—and opportunities.

<sup>1</sup> Mergermarket.com historic deals database, accessed 25 March 2009.

# The M&A imperative

*With the availability of easy credit, a commodities market that was on fire, and an ever-increasing demand for raw materials from emerging markets, the past decade saw the ideal set of circumstances for the rapid consolidation of steel companies.*

To expand market share, build synergies, and extend supply chains, merger and acquisition activity took off from 2000 to 2008.

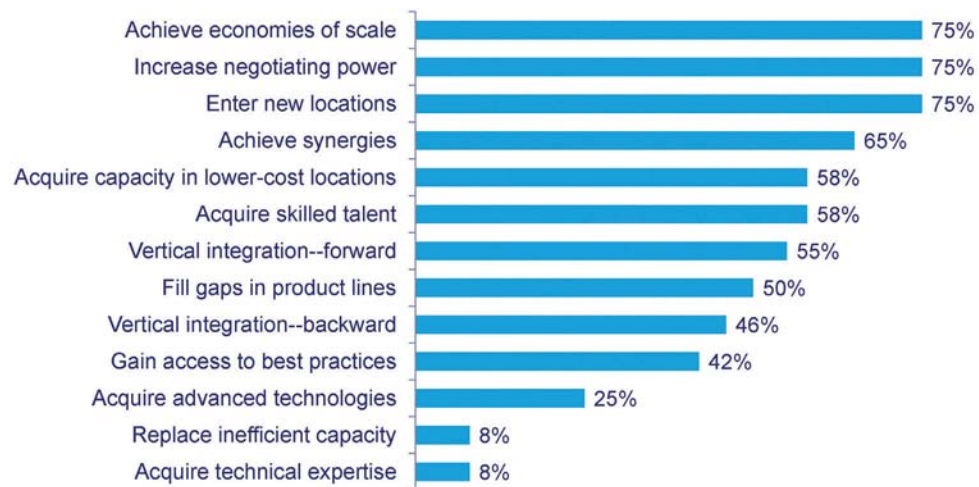
This M&A furor hit a new peak in 2006 with the merger of industry giants Arcelor and Mittal to form the colossus ArcelorMittal—an enterprise with a 2008 steel production of approximately a 103 million tonnes.<sup>2</sup> Another milestone was Tata Steel's 2007 acquisition of Corus Group—itsself the result of a 1999 merger between British Steel and Koninklijke Hoogoven—which contributed to their ranking that year as the sixth-largest steel producer<sup>3</sup> in the world and

their current standing as the eighth largest.<sup>4</sup> Indeed, metals industry M&A reached new heights in 2006 and 2007, both in terms of volume and value, with 200 deals taking place in 2007 at a total amount of US\$73 billion.<sup>5</sup>

But then came the global economic meltdown—and the credit crisis that sent M&A fever into a deep freeze as cash preservation became the industry's business priority. The second half of 2008 saw a significant dip in M&A activity: only 52 deals completed as compared to 107 deals in the first half of 2008.<sup>6</sup> And in the first quarter of 2009, only 14 deals were closed.<sup>7</sup> With continuing tight credit markets

**Figure 1: Importance of objectives when making acquisitions**

Percent of executives responding "extremely" or "very important"



Source: Deloitte's Global Manufacturing Industry Group

<sup>2</sup> ArcelorMittal profile, ArcelorMittal.com, 2008 production volume, accessed 3 April 2009.

<sup>3</sup> "Top steel producers 2007". World Steel Association. www.worldsteel.org., accessed 6 April 2009.

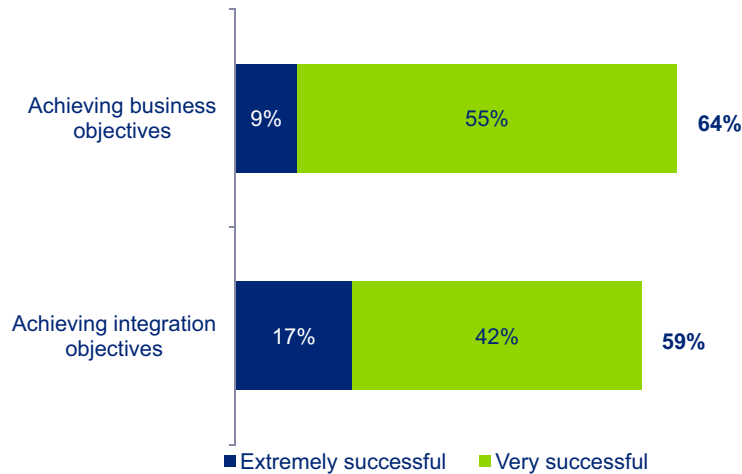
<sup>4</sup> "Global steel slowly consolidating - but still fragmented," Iron and Steel Statistics Bureau, www.issb.co.uk.

<sup>5</sup> Mergermarket.com historic deals database, accessed 25 March 2009.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

**Figure 2: Success of acquisitions over last three years in achieving objectives**



Source: Deloitte's Global Manufacturing Industry Group

and stagnant demand, most industry observers do not foresee a major pick-up in M&A activity until at least late in 2009.

Yet executives are clearly still considering acquisitions a key strategy to achieving business objectives. Two-thirds of the executives surveyed rated M&A as an extremely or very important business strategy, and roughly two-thirds of executives said their companies are currently considering a potential acquisition.

There are a variety of reasons why steel companies pursue acquisitions. According to executives surveyed, achieving economies of scale, increasing negotiating power with customers and vendors, and entering new geographies lead the list, with 75 percent rating these as extremely or very important (see figure 1). Take the leading Korean steel manufacturer POSCO. So far, this company has relied mostly on greenfields investment in the Korean market to expand. With merger frenzy in high gear over the past few years, greenfields construction proved more cost-efficient, costing US\$1,000 per tonne compared to US\$1,500 per tonne for

M&A. However, POSCO has used acquisitions to defray rising raw materials costs, including the purchase of 10 percent of common stock of McArthur Coal Ltd. to ensure a fixed-cost supply of coal.<sup>8</sup>

Yet POSCO sees M&A as a key component to their future growth. Their 10-year plan lays out the goal of increasing annual production from 33 million to above 50 million tonnes. They are also planning to expand non-steel revenues, reconfiguring the balance from steel providing 90 percent of their revenues to a split of 70 percent steel revenues and 30 percent non-steel. This strategy relies heavily on acquisitions—and POSCO, with its strong capital position is now poised to execute.<sup>9</sup> This recognition of the importance of M&A is borne out in practice. Survey results show roughly 60 percent of executives rated their past acquisitions as successful in achieving their business and integration objectives (see figure 2). This level of success in past transactions would seem to provide the confidence to bolster continued M&A activity in the future.

<sup>8</sup> Deloitte interview with Mr. Young-Hoon Lee, Senior Vice President, Finance and formerly Senior Vice President, Corporate Strategic and Planning Development, POSCO, 11 November 2008.

<sup>9</sup> Ibid.



Russian steel manufacturer Severstal is also looking to M&A to help create value. They are seeking to diversify within markets as well as attain more size. This will allow them to increase the efficiency of production and achieve economies of scale. “We are always looking for ways to reinforce and strengthen our position in our current and potentially new markets,” says Nicolas Vallorz, Head of Corporate Development at Severstal.<sup>10</sup>

POSCO’s and Severstal’s M&A business objectives reflect another goal embraced by most acquisition strategies—entering new markets. Of the roughly two-thirds of executives surveyed who expected their companies to make at least one acquisition over the next three years, most stated that these transactions were likely to take place outside their home country. In 2007 and 2008, close to 25 percent of the target companies for M&A were in the United States, compared to approximately 18 percent of bidding companies, indicating a number of non-U.S. companies investing in the country, according to Mergermarket.com. In the BRIC countries (Brazil, Russia, India, and China), 46 acquisitions were made by domestic companies compared to 24 targets in the region. Russia was particularly active in cross-border deals, with 12 companies acquiring compared to one seller from the region in 2008.<sup>11</sup> Severstal made four acquisitions in the United States in 2008—in fact, all their acquisitions last year were outside of Russia.<sup>12</sup>

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<sup>10</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

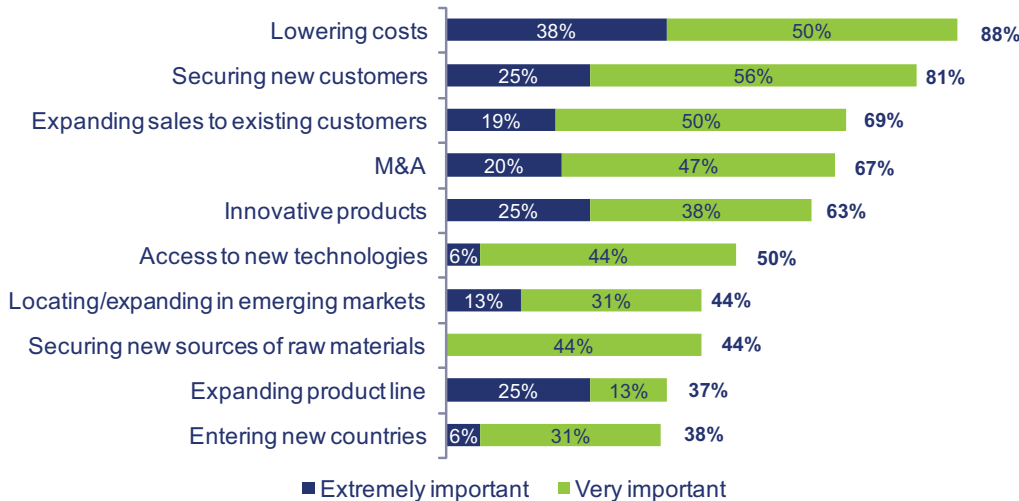
<sup>11</sup> Mergermarket.com historic deals database, accessed 25 March 2009.

<sup>12</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

And with 81 percent of executives surveyed rating securing new customers as an extremely or very important business strategy, this cross-border trend should only increase over the coming years (see figure 3). One of Tata Steel's major business objectives is to expand beyond operations in India—a goal served by its acquisition of UK-based Corus Group in 2007 and before that of NatSteel, Singapore and Millennium Steel Thailand.<sup>13</sup> The Corus acquisition allowed Tata to gain or increase their presence in the 22 countries in which Corus operates—including major production facilities in the United Kingdom and the Netherlands.

However, domestic deals have recently dominated steel sector M&A in terms of volume and value, with approximately 60 percent of deals taking place within borders in 2008 and value close to double that of cross-border deals.<sup>14</sup> This is supported by one of the top business objectives of the executives surveyed in the Deloitte survey—to expand sales to existing customers, rated extremely or very important by 69 percent. In recent years, European companies topped the list of domestic activity, both as targets and buyers. BRIC countries were also active acquirers of domestic steel assets: these four countries accounted for 24 percent (39 deals of 160 domestic deals globally) of total volume as acquirers in 2008. But there is no question that China will soon be the leader in domestic M&A activity, given the Chinese government's recent push for domestic consolidation.<sup>15</sup>

**Figure 3: Importance of strategies in achieving business objectives**



Source: Deloitte's Global Manufacturing Industry Group

<sup>13</sup> Deloitte interview with Mr. N. K. Misra, Vice President and Head of M&A, Tata Steel Group, 23 December 2008.

<sup>14</sup> Mergermarket.com historic deals database, accessed 25 March 2009.

<sup>15</sup> Ibid.

# Weathering the storm

*Although M&A is considered a critical part of overall business strategy, the economic downturn is having a major impact on acquisition plans, in some cases prompting a complete rethinking of short-term tactics to further business strategies.*

In response to the credit crisis, 73 percent of executives surveyed said their companies were likely to assess the implications of decreased liquidity and the higher cost of capital. Sixty-seven percent expected to manage capital to free up cash, and 60 percent said they were setting new priorities for capital investment. This indicates an overall more cautious approach to acquisitions, at least until the credit markets thaw. Severstal, though it has a strong cash position, is, like other companies, now looking to conserve cash. The company will most likely be less active over the next year or so in cash deals.<sup>16</sup>

Conserving cash is clearly becoming a top priority for companies. Eighty-eight percent of executives surveyed stated that lowering costs was an extremely or very important part of their current business strategies. And, according to executives, cash and bank loans were the most common sources of financing for acquisitions. With bank loans nearly non-existent, using precious cash to finance an acquisition is now heavily scrutinized. This is especially true as expectations about the impact of an acquisition on the bottom line are relatively low: half of the executives surveyed expected revenue growth of less than 25 percent as a result of acquisitions over the next three years. Additionally, the volatility and uncertainty of the equity markets have made share-based transactions problematic and made it more difficult to value assets.

And yet, many companies are seeing opportunity in this down market. M&A plans may have slowed in the current crisis—but deals are still happening. Cash-rich companies with low debt will most likely use the current crisis to acquire businesses deemed “non-core” by competitors or smaller companies weakened by the financial turmoil. For the weak companies, an acquisition by a strong competitor may be the only chance for their business to survive. Others will just “stay the course.” Tata Steel still has aspirations to acquire raw material companies and continue its vertical integration process.<sup>17</sup> And while the pace may slow for its acquisition of other steel companies and there will be less reliance on debt acquisitions, the company still believes it can raise debt for an acquisition supported by a strong business case. Tata Steel has also started to use more innovative structures to pursue a deal. For example, with their New Millennium acquisition, it acquired an option to purchase assets after the feasibility study had been completed.<sup>18</sup>

Similarly, POSCO CEO, Chung Joon-yang, says the company plans to forge ahead with their M&A plans—especially now that acquisition costs have dropped to around US\$500 per tonne.<sup>19</sup> “This isn’t a time to remain skittish,” he has pointed out, adding that the company will actively explore merger and acquisition opportunities overseas this year, citing falling asset values as a prime motivation.<sup>20</sup> Even more important, he believes POSCO, with its conservative approach and strong capital position, has the ability to acquire companies at today’s lower prices when it makes sense.<sup>21</sup>

<sup>16</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

<sup>17</sup> Deloitte interview with Mr. N. K. Misra, Vice President and Head of M&A, Tata Steel Group, 23 December 2008.

<sup>18</sup> Ibid.

<sup>19</sup> Deloitte interview with Mr. Young-Hoon Lee, Senior Vice President, Finance and formerly Senior Vice President, Corporate Strategic and Planning Development, POSCO, 11 November 2008.

<sup>20</sup> “POSCO’s new CEO aims at expansion,” *The Korea Times*, 27 February 2009.

<sup>21</sup> Deloitte interview with Mr. Young-Hoon Lee, Senior Vice President, Finance and formerly Senior Vice President, Corporate Strategic and Planning Development, POSCO, 11 November 2008.

The economic downturn hasn't led U.S. Steel to change its M&A strategy either, but they may delay pursuing acquisitions as they keep an eye on the economy and their cash position. And though values have declined—making potential targets more attractive—they are weighing the fact that credit has become less available and more expensive for any acquisition. The current economic uncertainty has also made it especially difficult: "A major challenge is determining the value [of a potential acquisition]," points out James Kutka, Senior Vice President, Strategic Planning and Business Development for U.S. Steel.<sup>22</sup>

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**“The financial crisis has made it more difficult to execute deals since the availability of capital has shrunk and the cost has shot up. Today, only the best companies and transactions can attract capital.”**

Sudhir Maheshwari, member of Group Management Board, responsible for M&A and Business Development, ArcelorMittal

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Apart from the decline in overall activity, the significant difference in most transactions in the near-term will most likely be the size and form of the deal. Almost three-quarters of executives surveyed expected their largest acquisition over the next three years would be valued at less than US\$500 million. This is most likely due in large part to a lack of credit as well as the overall lower valuations of companies. "The financial crisis has made it more difficult to execute deals since the availability of capital has shrunk and the cost has shot up," points out Sudhir Maheshwari, member of ArcelorMittal's Group Management Board, responsible for M&A and Business Development, and previously Managing Director, Business Development and Treasury at Mittal Steel. "Today, only the best companies and transactions can attract capital."<sup>23</sup>



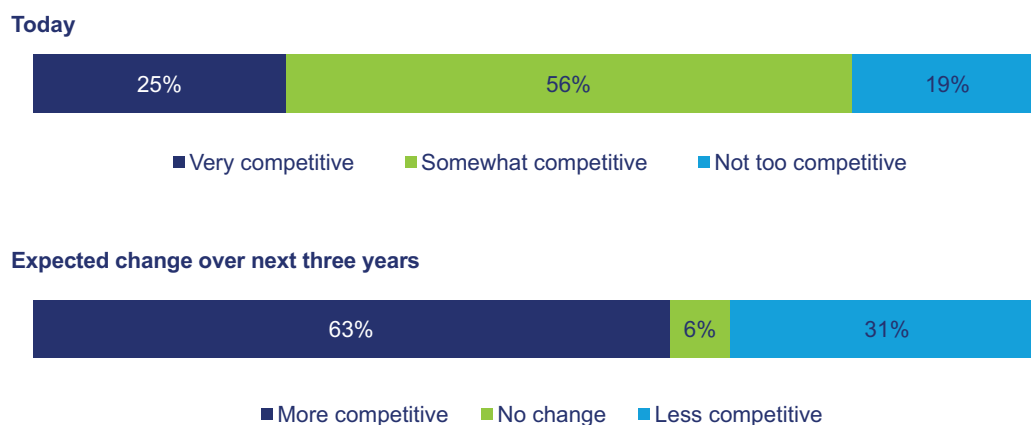
But companies in a strong position right now may do well not to let M&A activity slip too much and seek out opportunities quickly. With many companies in a weak financial position and looking for relief—paired with the difficulty of getting financing—it is a buyer's market. And while only one-quarter of executives surveyed described the current climate for acquisitions as being very competitive, almost two-thirds expect competition to increase over the next three years (see figure 4). The window for easy bargain shopping may slam shut sooner than companies think once credit markets begin to revive and economic volatility lessens. Now may be the time for steel companies to position themselves to lead when the economy and credit markets improve.

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<sup>22</sup> Deloitte interview with Mr. James Kutka, who recently retired and held the role as Senior Vice President, Strategic Planning and Business Development, U.S. Steel Corporation, 12 November 2008.

<sup>23</sup> Deloitte interview with Mr. Sudhir Maheshwari, member of ArcelorMittal's Group Management Board, responsible for M&A and Business Development, and previously Managing Director, Business Development and Treasury at Mittal Steel, 2 April 2009.

**Figure 4: Climate for making acquisitions**



Source: Deloitte's Global Manufacturing Industry Group

In addition to lower valuations, there are distinct advantages to pursuing an M&A strategy in the current economic climate. When the M&A market was white-hot, targets had greater leverage in dealing with potential acquirers and limiting access to their organizations, making due diligence more difficult and often preventing a broader view of their culture and management structure. Now, however, an acquirer is in a position to demand more transparency from its target. This is critical to developing a clear, actionable integration strategy prior to closing an acquisition. And though deals may take longer to complete—as skittish buyers more closely scrutinize the merits of each potential deal and sellers provide more data and access—the chances of identifying problems early on improve, which could cause an increase in uncompleted transactions.

With today's lower valuations, however, also comes more reluctance to sell—especially among those companies with stronger balance sheets whose share prices have been battered by equity market volatility. These targets—who most likely will attract much M&A attention—may be unwilling to see their assets sold for much less than what they perceive as their true worth (unless they view the stock being offered by a prospective buyer as being equally battered by the market). So low stock valuations may prompt another shift in acquisitions strategy, that is, away from direct negotiations. Both of U.S. Steel's recent acquisitions—of Lone Star Technologies and Stelco—were acquired through direct negotiation, right now by far the most common type of acquisition transaction.<sup>24</sup> Survey results support this trend with 77 percent of executives surveyed saying that privately negotiated purchases were used almost always or frequently. Hostile acquisitions, in contrast, accounted for only 7 percent—a number that may increase in response to fewer motivated sellers as well as the overall increased competition for attractive targets.

<sup>24</sup> Deloitte interview with Mr. James Kutka, who recently retired and held the role as Senior Vice President, Strategic Planning and Business Development, U.S. Steel Corporation, 12 November 2008.

# Making the most of M&A

*According to Louis L. Schorsch, Executive Vice President and CEO, Flat Americas, ArcelorMittal, the steel industry continues to be a “fragmented industry—the consolidation wave still has a long way to run.”<sup>25</sup>*

His observation of M&A in the steel industry aligns with the views of most executives surveyed. Interestingly, the top 15 global steel producers hold a market share similar to the cumulative share they held in 2006—about 35 to 38 percent, depending on the source.<sup>26</sup> And with the current climate for acquisitions expected to become increasingly more competitive, mastering the ability to carefully evaluate potential targets and quickly execute acquisitions will be critical for companies to maintain competitive advantage as the economy recovers.

Pursuing an acquisition should enhance a company’s market position, help achieve its business strategy, diversify risks, and support the overall growth of the organization. Yet, while almost 55 percent of executives surveyed considered their past acquisitions to be very successful in achieving business objectives, only 9 percent said they were extremely successful in doing so. Clearly, challenges remain. Steel companies need to improve their key competencies that would yield the most successful M&A transaction—mainly the ability to assess, plan, and integrate an acquisition quickly and effectively.

## Set standard processes

Only slightly more than half of executives surveyed said their companies have standard procedures for acquisitions—with the rest leaving this process to develop on a case-by-case basis. Establishing a comprehensive M&A process for the company that clearly supports its business goals is vital to effectively managing each deal. Developing core criteria by which any potential acquisition can be evaluated will also save time, effort, and money. And while acquisition objectives will vary for each target, the high-level processes

for evaluating and integrating an acquisition should be standardized and performed by team members who are savvy enough to know when to tailor new processes to the situation at hand. For example, by working within a business process with three-year rolling projections, U.S. Steel uses a set base case to assess all potential acquisitions. A dedicated strategic planning and business development group leads all M&A processes.<sup>27</sup> Similarly, Tata Steel has established standard processes and criteria for both identifying and evaluating targets, with all M&A activities overseen by a dedicated M&A group.<sup>28</sup> Severstal M&A goals are set by the executive committee, including the strategy department, which screens targets to see if they offer a strategic fit as well as synergies.<sup>29</sup> And POSCO is in the process of developing its own acquisition processes.<sup>30</sup>

## Take a broad view

When setting evaluation and integration processes, it is important that companies incorporate a wide range of triggers and benchmarks that will yield a broad view of the transaction. For example, with approximately 90 percent of executives surveyed citing financial reasons as the key factors in deciding whether to proceed with an acquisition (see figure 5), a positive assessment of a target’s finances alone can keep a transaction moving forward. While this is obviously important, companies should build into their processes not only financial measures that will indicate if a deal should proceed, but also procedures to identify and address non-financial “deal breakers,” or issues that would cause them to walk away.

<sup>25</sup> “More steel consolidation near: execs say,” *American Metal Market*, 8 October 2008; Euromoney.com, October 2008.

<sup>26</sup> Iron and Steel Statistics Bureau, <http://www.issb.co.uk/>.

<sup>27</sup> Deloitte interview with Mr. James Kutka, who recently retired and held the role as Senior Vice President, Strategic Planning and Business Development, U.S. Steel Corporation, 12 November 2008.

<sup>28</sup> Deloitte interview with Mr. N.K. Misra, Vice President and Head of M&A, Tata Steel Group, 23 December 2008.

<sup>29</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

<sup>30</sup> Deloitte interview with Mr. Young-Hoon Lee, Senior Vice President, Finance and formerly Senior Vice President, Corporate Strategic and Planning Development, POSCO, 11 November 2008.

**Figure 5: Importance of factors in deciding whether to proceed with potential acquisitions**



Source: Deloitte's Global Manufacturing Industry Group

Severstal looks at a variety of financial and nonfinancial factors when reviewing a deal, including quality of management and facilities, whether the target has sufficient capacity, and the nature of their raw materials supply. And they have decided *not* to proceed because they found such problems as poor management or facilities or issues with long-term raw materials contracts. They also look beyond financials by identifying early on key stakeholders and their concerns—and then engaging them with strong communications. When acquiring Esmark in 2008, Severstal was in competition with another company. Yet they were able to acquire the target at the same price, in part because they had obtained the support of the unions, which knew Severstal from their other U.S. companies.<sup>31</sup>

To broaden the view of the transaction, company's acquisition processes should also draw on the expertise of a wide range of business functions. Though many companies have a "single owner" for each transaction, to avoid deal breakers and other critical issues from slipping through the cracks, a "deal team" that comprises internal and external functional experts to provide a comprehensive view of the target often yields the best results. For each potential acquisition, U.S. Steel forms a team with the appropriate executives from across the company to evaluate the target. For example, if the target is a raw materials supplier, then the company's raw materials group will be involved to assess the company's future needs.<sup>32</sup> Assembling teams comprising the core competencies that are required to assess the opportunity is one of the best ways to ensure a holistic view of the target is obtained.

<sup>31</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

<sup>32</sup> Deloitte interview with Mr. James Kutka, who recently retired and held the role as Senior Vice President, Strategic Planning and Business Development, U.S. Steel Corporation, 12 November 2008.

## Develop an integration plan

Taking a broader view of a transaction will also help when planning the integration and synergy capture process once a transaction is concluded. While critical to the success of an acquisition, integration remains problematic for many companies: 50 percent of executives surveyed named integrating acquisitions as one of their top three challenges facing their companies over the next 12 months. And 58 percent of executives cited integrating management processes as extremely or very challenging when conducting acquisitions. Part of the problem may be determining an integration strategy—and then executing on it. Although almost 60 percent of executives surveyed said the goal of their companies was to fully integrate acquisitions, roughly 40 percent said they only somewhat integrated them or left them largely independent.

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“After an acquisition, our goal is to disseminate best practices—both of U.S. Steel and of the acquired firm—across our company.”

James Kutka, who recently retired and held the role as Senior Vice President, Strategic Planning and Business Development, U.S. Steel Corporation

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Though employing markedly different approaches, both U.S. Steel and Tata’s goals in terms of integration are well-defined and supported. For U.S. Steel, it is important to integrate an acquisition quickly. To that end, the company develops a “first-day plan,” laying out precisely what will happen on the day the acquisition is completed. Post-merger integration is led by the heads of the business units with the involvement of functional areas such as human resources and information technology. The team identifies

the synergies to be achieved and creates a business plan to guide the process and track progress. “After an acquisition,” says Kutka, “Our goal is to disseminate best practices—both of U.S. Steel and of the acquired firm—across our company.”<sup>33</sup>

In contrast, Tata Steel chooses not to fully integrate its acquisitions—using what it terms a “one enterprise, two entities” approach. That is, acquisitions continue to operate as separate companies with management left in place to manage day-to-day operations independently but within Tata’s overall financial and business objectives. The company then uses a strategy and integration committee (SIC) to integrate corporate and other functions where appropriate, for example, technology. Tata has registered significant gains by sharing best practices using SIC as a forum. This reflects Tata Steel’s philosophy to seek the good will of the target and the community: “In acquisitions, we follow a collaborative, non-disruptive approach,” says N.K. Misra, Vice President and Head of M&A at Tata Steel.<sup>34</sup>

In ArcelorMittal’s case, companies that are acquired operate fairly autonomously in executing their business plan. Integrating business processes and technology is not an immediate priority, due to the costs and risks. “When it comes to processes and systems it can not be changed overnight just because it is different to what the group is following. If it has been working for a company for years, you have to be very careful about changing it. Overtime, people tend to come together towards developing a common system. it’s an iterative process.” What is a top priority, however, is leadership involvement in the integration—a lesson learned from the original merger of Arcelor and Mittal. “Leadership from the top is the most critical aspect,” says Maheshwari. “After the ArcelorMittal merger, the CEO of Mittal spent hundreds of hours with the top 200 executives at Arcelor to share his vision and learn what they do. Arcelor had many misconceptions about Mittal, but they found there were many similarities between the two companies. The personal involvement of the CEO changed the views of the top executives overnight.”<sup>35</sup>

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<sup>33</sup> Ibid.

<sup>34</sup> Deloitte interview with Mr. N.K. Misra, Vice President and Head of M&A. Tata Steel Group, 23 December 2008.

<sup>35</sup> Deloitte interview with Mr. Sudhir Maheshwari, member of ArcelorMittal’s Group Management Board, responsible for M&A and Business Development, and previously Managing Director, Business Development and Treasury at Mittal Steel, 2 April 2009.



Though Severstal's approach is on a case-by-case basis, they also generally look to keep local management intact. And with their acquisitions all cross-border in 2008, it was even more important to keep management in place, rather than sending executives from their headquarters in Russia. "We may sometimes try to integrate regionally," says Vallorz, "such as in the United States, where to achieve efficiencies we put in place centralized reporting, financial management, and sales forces. But mostly we try to leave companies autonomy in day-to-day operations."<sup>36</sup>

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Nicolas Vallorz, Head of Corporate Development, Severstal

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In terms of synergy capture, a "One Mill" model of decision making is also a reliable approach. This entails considering all the choices a steel company has to make—about products, supply chain, production, and logistics—with a view of the business as if it were a single operation. This holistic view can expose many different types of post-closing synergies and can help further define the integration process.

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<sup>36</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

# The culture disconnect

*One of the most striking findings of the Deloitte survey is the critical role culture plays in acquisitions. Even the most-detailed integration and synergy capture plans will not be effective if companies fail to address culture—both corporate and cross-border.*

Almost two-thirds of executives surveyed agreed in principle, rating managing corporate cultures as an extremely or very challenging issue in acquisitions—the highest-rated issue (see figure 6). Yet, less than half of the executives said their companies conducted a detailed analysis of cultural issues when considering a potential acquisition (see figure 7). And only 42 percent deemed corporate culture as extremely or very important when deciding whether to proceed with an acquisition (see figure 5).

Corporate culture can be understood as the shared beliefs and attitudes that underlie the companies' leadership style, its responses to change, its employees' decision-making approach, its cooperative work ethic, and its beliefs about personal success. Assessing cultural issues can be difficult, especially prior to the deal closing when access to a target may be limited. However, corporate cultures that do not

complement each other, or worse yet, stand at odds with each other, can make it extremely difficult for companies to make decisions quickly and operate effectively at the critical time period just following a merger or acquisition. "Steel has been a fragmented industry, with each company having its own processes and practices," points out Maheshwari. "Not all targets are best-in-class, but it is often hard for employees to change their practices."<sup>37</sup>

To overcome obstacles that differences in these cultural areas can pose, a rigorous program to effectively harness culture and address cultural integration needs to be employed. This can be done by linking merger and acquisition cultural programs to measurable business results. Above all, Maheshwari recommends a collaborative and inclusive approach. "Be transparent and open," he advises. "Don't just tell the acquired company what to do; have them meet

**Figure 6: Challenges in conducting acquisitions**

Percent rating issue "extremely" or "very challenging"

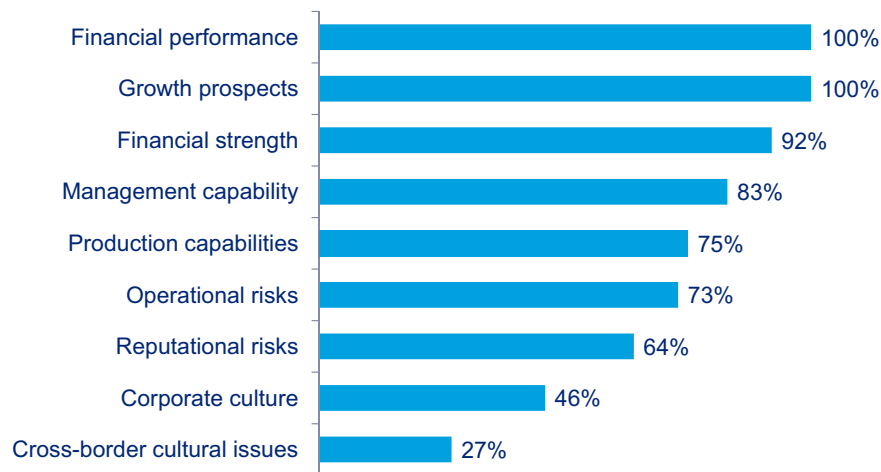


Source: Deloitte's Global Manufacturing Industry Group

<sup>37</sup> Deloitte interview with Mr. Sudhir Maheshwari, member of ArcelorMittal's Group Management Board, responsible for M&A and Business Development, and previously Managing Director, Business Development and Treasury at Mittal Steel, 2 April 2009.

## Figure 7: Level of detail in analysis when investigating potential acquisitions

Percent responding very detailed (4 – 5 on 5-point scale)



Source: Deloitte's Global Manufacturing Industry Group

with other divisions to see how it is done. Use peer learning and understand that every company has something to teach other companies. It's not a one-way street." Executives in the target, he notes, are more receptive to changing practices if their own practices are duly recognized as having merit.<sup>38</sup>

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**“When assessing a potential acquisition, we ask if there is a cultural fit, and only consider targets that are compatible with the Tata culture.”**

N.K. Misra, Vice President and Head of M&A, Tata Steel Group

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Given the challenges of integrating and managing cultures, mechanisms to evaluate cultural compatibility must be built into the due diligence process. In spite of the human impact on achieving success, cultural issues, as demonstrated in the survey, are considered by many the least important aspect to investigate during the diligence process. However, Tata Steel understands the importance of the link between business culture and business success and focuses on culture even before due diligence has begun. “When assessing a potential acquisition,” says Misra, “we ask if there is a cultural fit, and only consider targets that are compatible with the Tata culture.”<sup>39</sup>

And both U.S. Steel and POSCO consider recognizing and managing cultural differences a key challenge, but critical to executing an effective merger. “You have to realize there are cultural differences when integrating two established organizations,” says Kutka, “and also that there is value to each culture.”<sup>40</sup>

<sup>38</sup> Ibid.

<sup>39</sup> Deloitte interview with Mr. N.K. Misra, Vice President and Head of M&A, Tata Steel Group, 23 December 2008.

<sup>40</sup> Deloitte interview with Mr. James Kutka, who recently retired and held the role as Senior Vice President, Strategic Planning and Business Development, U.S. Steel Corporation, 12 November 2008, and Deloitte interview with Mr. Young-Hoon Lee, Senior Vice President, Finance and formerly Senior Vice President, Corporate Strategic and Planning Development, POSCO, 11 November 2008.

## Figure 8: Expected locations of future acquisitions

Based on executives at companies somewhat or very or extremely likely to make an acquisition over the next three years

China	60%	CIS	20%
United States	30%	Canada	20%
India	30%	Africa	10%
Brazil	20%	France	10%
Australia/New Zealand	20%	Argentina	10%
Central/Eastern Europe	20%	Middle East	10%
Mexico	20%	Russia	10%

Note: Percentages total to more than 100 percent because respondents could make multiple selections.

Source: Deloitte's Global Manufacturing Industry Group

This challenge to link culture to business value will only intensify as steel companies increasingly expand across borders. Fifty-seven percent of executives surveyed that are expecting to make an acquisition in the next three years believed it will take place outside their home country. Considering both domestic and foreign expected acquisitions, the most frequently named market was China, at 60 percent—nearly double the next most-named location, the United States (see figure 8). Language, management philosophy, and a business environment heavily influenced by the state are just some of the potential challenges of entering the Chinese market. And yet only a mere 27 percent of executives surveyed undertook detailed analyses of cross-border cultural issues as part of their due diligence.

Addressing cultural issues will have to take on greater consideration as M&A increasingly goes global. Take Severstal and their expanding non-domestic portfolio. They use their presence in a market to help inform their handling of cultural issues with other acquisitions. For instance, as they already own several U.S. companies, they leverage their experience with other targets in the country.<sup>41</sup>

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“One of our biggest challenges is gaining the ability to manage the cultural aspects of acquisitions outside Korea.”

Young-Hoon Lee, Senior Vice President, Corporate Strategic and Planning Development, POSCO

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Those companies that are successful in cross-border acquisitions—which could be, by default, those that are successful at all going forward—are those who incorporate cultural reviews into their overall M&A strategy and processes. This is readily acknowledged by POSCO: “One of our biggest challenges is gaining the ability to manage the culture aspects of acquisitions outside Korea,” remarks Young-Hoon Lee, Senior Vice President, Corporate Strategic Planning Development at POSCO.<sup>42</sup>

<sup>41</sup> Deloitte interview with Mr. Nicolas Vallorz, Head of Corporate Development, Severstal, 6 April 2009.

<sup>42</sup> Deloitte interview with Mr. Young-Hoon Lee, Senior Vice President, Finance and formerly Senior Vice President, Corporate Strategic and Planning Development, POSCO, 11 November 2008.



# Bouncing back

*While the feverish pace of acquisitions seen over the last decade may not be seen again for many years to come, consolidation is expected to continue within the steel industry. But what will be the indicators that will let players know it is safe to get back in the water?*

Most industry observers agree that it will be a loosening of the credit markets and the recovery of the economy—with the short-term outlook not encouraging.

Yet the economic downturn presents enormous opportunities for the steel industry. Many industry observers believe that the consolidation that the industry has experienced over the past decade has improved the ability to manage or idle excess capacity until steel markets rebound. The ability to extend up and down the supply chain by picking up bargain assets or to “fix” the cost of raw materials may allow many companies to emerge from this crisis in a stronger position than ever. Regionally, the playing field seems to be shifting as well. BRIC market players are increasingly targeting companies in the developed markets, with distressed U.S. producers at the top of the list.

But even when credit markets rebound and equities calm down, there remains the question of global demand. This economic crisis may yield permanent changes in the pattern of consumer consumption—particularly for the products and services that use steel. While problematic for the overall steel industry, the changes could make the case for consolidation even more compelling.

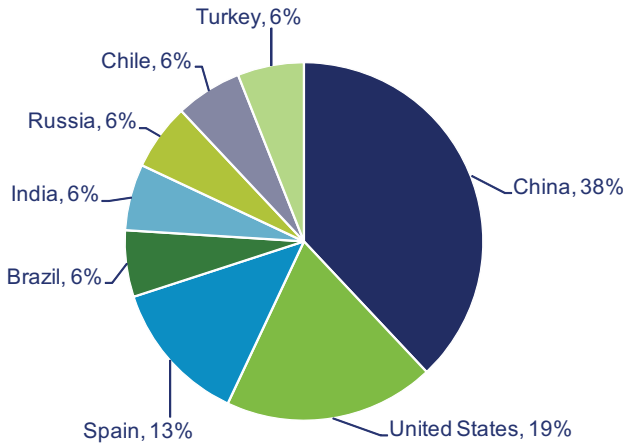
There’s no way to know for sure how the steel industry will look in the years to come. But the playing field is sure to hold fewer players, as consolidation regains its pace. And with this reality comes the imperative to develop the capabilities that will allow a company to make the most of their acquisitions. Those who don’t master M&A may disappear from the field altogether—while those who do, emerge as the next industry leaders.

**About the study**

Deloitte Touche Tohmatsu's (Deloitte) Global Manufacturing Industry Group global steel consolidation study sought the perspectives of major players in the steel industry to learn more about their overall M&A business strategies, the impact of the credit crisis and economic downturn, and the challenges they face in planning and executing acquisitions. A global online survey and case study interviews were conducted, including 10 of the top 15 largest global steel producers. The online survey was conducted from 15 October to 24 November 2008 and completed by 16 execu-

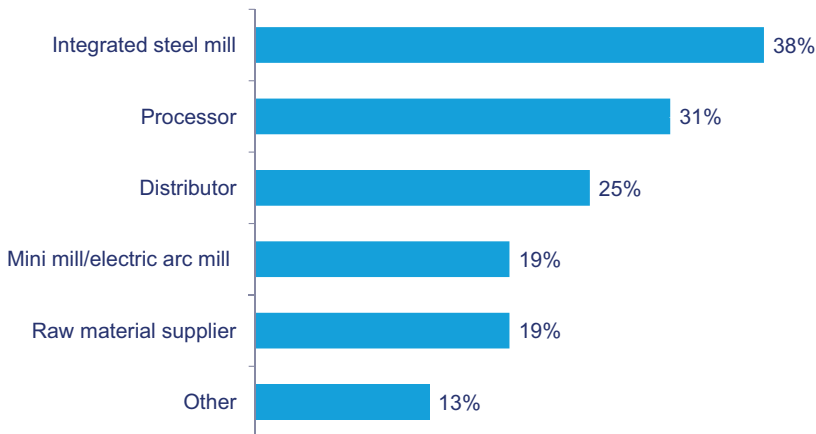
tives, with a significant representation of major companies: 14 companies with annual revenues of US\$1 billion or more and 9 companies with annual revenues of US\$5 billion or more. To gain further insight on how major players are addressing M&A and the new challenges presented by today's economy, the survey was complemented by one-on-one interviews with senior executives from ArcelorMittal, POSCO, Severstal, Tata Steel, and U.S. Steel, from 11 November 2008 to 6 April 2009. Finally, the report draws on the extensive experience of Deloitte leaders in steel industry M&A.

**Figure 9: Survey participant by headquarters location**



Source: Deloitte's Global Manufacturing Industry Group

**Figure 10: Survey participant primary business activities**



Source: Deloitte's Global Manufacturing Industry Group  
 Other: Metals service centers; Seamless stainless steel tube & pipe facility  
 Note: Percentages total to more than 100 percent because respondents could make multiple selections.

# Deloitte Touche Tohmatsu

## Global Manufacturing Industry Group

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Role	Name	Phone	Email
Global Managing Partner	Hans Roehm	+49 711 16554 7130	hroehm@deloitte.de
Chairman	Craig Giffi	+1 216 830 6604	cgiffi@deloitte.com
Global Marketing Director	Mimi Lee	+61 7 3308 7116	mimilee@deloitte.com.au

### Global Sector Leaders

Role	Name	Phone	Email
Aerospace & Defense	Tom Captain	+1 206 716 6452	tcaptain@deloitte.com
Automotive	Martin Hoelz	+49 711 16554 7305	mhoelz@deloitte.de
	Michelle Collins	+1 313 396 3219	micollins@deloitte.com
Industrial Products & Services	John Bava	+1 973 602 6039	jbava@deloitte.com
Process	Claude Martin	+27 11 806 5496	clmartin@deloitte.co.za
– Chemicals	Tim Hanley	+1 414 977 2520	thanley@deloitte.com
– Forest, Paper & Packaging	Luc Martin	+1 514 393 6558	lmartin@deloitte.com
– Steel	Nick Sowar	+1 513 784 7237	nsowar@deloitte.com

### Global Services Leaders

Role	Name	Phone	Email
Assurance & Enterprise Risk Services	Nick Sowar	+1 513 784 7237	nsowar@deloitte.com
Consulting	Kevin Gromley	+86 21 6141 2228	kegromley@deloitte.com.cn
Mergers & Acquisitions	Dan Schweller	+1 312 486 2783	dschweller@deloitte.com
Tax Services	Jerry Wiley	+1 513 784 7353	jwtiley@deloitte.com

## Americas

Region/Location	Name	Phone	Email
Americas Region	Craig Giffi	+1 216 830 6604	cgiffi@deloitte.com
Brazil	Jose Othon Tavares de Almeida	+55 11 5186 1000	joalmeida@deloitte.com
Canada	Luc Martin	+1 514 393 6558	lmartin@deloitte.com
Chile	Chris Lyon	+56 2 729 7000	clyon@deloitte.com
LATCO Region (Argentina, Uruguay, Paraguay, Peru, Ecuador, Colombia, Venezuela, Guatemala, Costa Rica, Panama and Nicaragua)	Claudio Giaimo	+54 11 4320 2716	cgiaimo@deloitte.com
Mexico	Gabriel Renero	+52 55 5080 7082	grenero@deloittemx.com

## Asia Pacific

Region/Location	Name	Phone	Email
Asia Pacific Region	Kevin Gromley	+86 21 6141 2228	kegromley@deloitte.com.cn
Australia	Tom Imbesi	+61 3 9208 7329	timbesi@deloitte.com.au
China	John Hung	+86 21 6141 1828	johnhung@deloitte.com.cn
India	Kumar Kandaswami	+91 44 5213 1124	kkumar@deloitte.com
Indonesia	Hartiadi Santoso	+62 21 2312879 ext.6070	hsantoso@deloitte.com
Japan	Toshihiko Matsumiya	+81 3 6213 3066	toshihiko.matsumiya@tohatsu.com.jp
Korea	Tae Hwan Oh	+82 2 6576 1511	taoh@deloitte.com
New Zealand	Steve Wakefield	+64 3 363 3807	swakefield@deloitte.co.nz
Singapore	Hugo Walkinshaw	+65 62327 112	hwalkinshaw@deloitte.com
Taiwan	Vita Kuo	+886 2 2545 9988 ext.3345	vitakuo@deloitte.com.tw
Thailand	Nuanjai Gittisriboongul	+66 2 676 5700 ext.5086	ngittisriboongul@deloitte.com
Vietnam	John Andes	+84 8 3910 0751	jandes@deloitte.com

## Europe, Middle East & Africa (EMEA)

Region/Location	Name	Phone	Email
EMEA Region/Belgium	Eric Desomer	+32 2 749 56 91	edesomer@deloitte.com
Central Europe	Bronislav Panek	+420 246 042 264	bpunek@deloitteCE.com
Commonwealth of Independent States	Graham Povey	+7 495 787 0600 x2031	gpovey@deloitte.ru
Denmark	Mikkel Boe	+45 36 10 2494	mikboe@deloitte.dk
Finland	Marko Toivari	+358 20 755 5504	marko.toivari@deloitte.fi
France	Antoine Reiss Betrand Delain	+33 1 55 61 60 68 +33 1 58 37 96 02	areiss@deloitte.fr bdelain@deloitte.fr
Germany	Hans Roehm	+49 711 16554 7130	hroehm@deloitte.de
Ireland	Kieran Devery	+353 1 417 2532	kdevery@deloitte.ie
Italy	Marco Martina	+39 0115597246	mmartina@deloitte.it
Netherlands	Cees Jorissen	+31 882 88 2593	cjorissen@deloitte.nl
Norway	Kjetil Nevstad	+47 23 27 92 98	knevstad@deloitte.no
Portugal	Luis Belo	+351 21 042 76 11	lbelo@deloitte.pt
South Africa	Claude Martin	+27 11 806 5496	clmartin@deloitte.co.za
Spain	Mariano Cabos	+34 94 444 70 00 ext.8810	mcabos@deloitte.es
Sweden	Per-Ola Olsson	+4 685 067 2328	poolsson@deloitte.se
Turkey	Gaye Senturk	+90 212 366 60 84	gsenturk@deloitte.com
United Kingdom/Switzerland	David Raistrick	+44 113 292 1707	draistrick@deloitte.co.uk

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