



DEBATE PACK

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Proposed takeover of GKN by Melrose

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Debate sponsored by Adrian Bailey MP

On 12 January 2018, GKN's Board [announced](#) that it had received a proposal from Melrose to acquire GKN, four days earlier.

Under the terms of the [Proposal](#), GKN shareholders would hold approximately 57% of the enlarged company and Melrose shareholders would hold 43%.

GKN's Board unanimously rejected Melrose's proposal, 'having concluded that the Proposal is entirely opportunistic and that the terms fundamentally undervalue the Company and its prospects.'

Subsequently, on 12 March 2018, Melrose [increased](#) its final offer, offering GKN shareholders to own 60% of Melrose, valuing GKN at 467 pence per share, or £8.1 billion in total. The final offer too was [rejected](#) by the Board of GKN.

Unless an extension is granted by the Takeover Panel, the last business day on which GKN shareholders can accept the Melrose Offer is 29 March 2018.

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1. Background

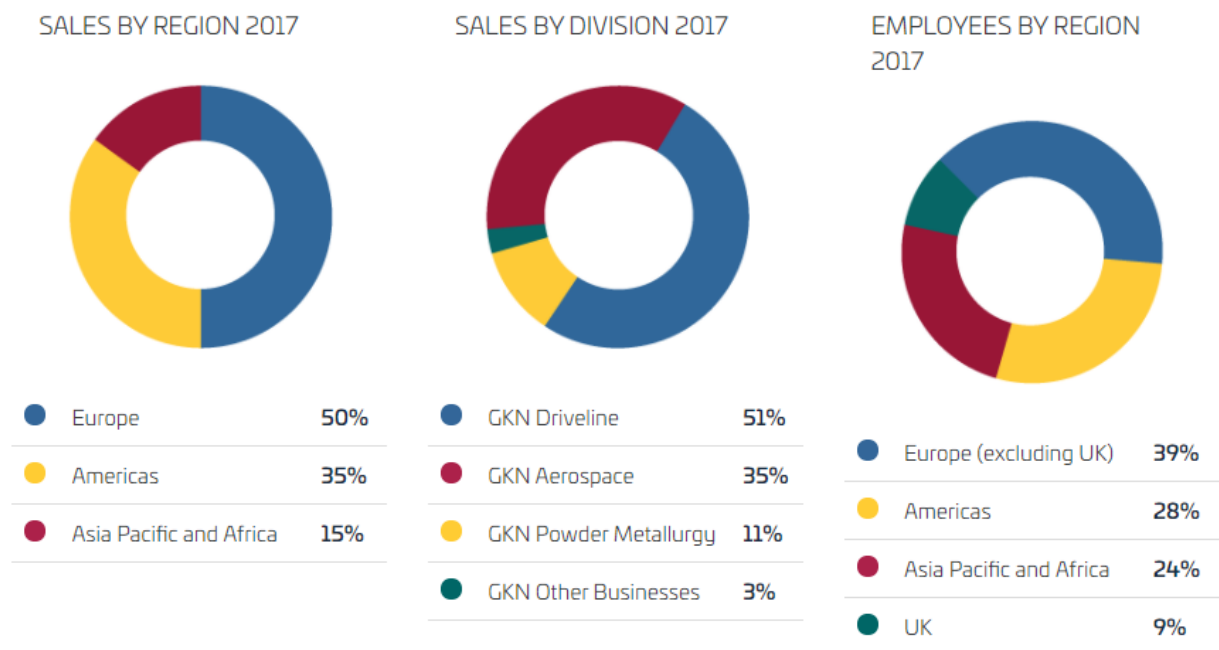
1.1 GKN

[GKN](#) was founded in 1759 as an ironworks in South Wales.¹

Today, GKN designs, manufactures and services systems and components for aircraft, vehicle and machinery manufacturers.

GKN operates three divisions: GKN Aerospace, GKN Driveline and GKN Powder Metallurgy. Approximately 59,800 people work in GKN companies and joint ventures in more than 30 countries, with around 6,000 staff in the UK.²

The pie charts below break down the company’s activities by region and division.³



GKN announced its [2017 results](#) on 28 February 2018. The latest annual sales figure was £10.4 billion in 2017, up from £9.4 billion in 2016. But trading margins fell at the same time, from 8.2% in 2016 to 6.4% in 2017.

New strategy and “Project Boost”

On 14 February 2018, the Board of GKN announced it had concluded a wide-ranging strategic and operational review, which started in 2017.⁴ Key goals are to:

¹ GKN, [GKN's history](#), accessed 6 March 2018
² GKN, [GKN at a Glance](#) and [GKN in Europe](#), accessed 6 March 2018
³ GKN, [GKN at a Glance](#), accessed 6 March 2018
⁴ GKN, [Strategy and transformation plan](#) (RNS Number : 8366E), 14 February 2018

- improve cash flow and margin (“Project Boost”)
- create different strategies for different core product segments

The overall aim is to generate significant cash returns to GKN shareholders. The strategy includes a plan to sell one of GKN’s divisions, Powder Metallurgy, as well as a number of other non-core businesses, shown in the table below.⁵

Business division	Core product segments			Non-core segments
	Improve	Grow	Develop	
Aerospace	<ul style="list-style-type: none"> • Speciality Aerostructures • Aero Aftermarket • Aero Specialist Positions 	<ul style="list-style-type: none"> • Aero Engines 	<ul style="list-style-type: none"> • Aero Additive Manufacturing 	<ul style="list-style-type: none"> • US Standard Aerostructures • Fuel and Flotation Tanks • Engine and Aircraft Servicing
Driveline	<ul style="list-style-type: none"> • Driveshafts • All-Wheel Drive (AWD) 	<ul style="list-style-type: none"> • Driveline China 	<ul style="list-style-type: none"> • eDrive Systems 	<ul style="list-style-type: none"> • Wheels³ • Cylinder Liners³ • Off-Highway Powertrain

Sale of GKN Driveline

On 9 March 2018, GKN announced that it had reached agreement to sell GKN Driveline to Dana Incorporated, an American vehicle drive systems company.⁶

Together with the planned divestments of Powder Metallurgy and other non-core businesses, this would leave GKN as an aerospace-only company.

1.2 Melrose

[Melrose](#) was listed on AIM in October 2003. It entered the FTSE 250 index in 2005, and FTSE 100 in 2012. It left the FTSE 100 index in 2014, after distributing a special dividend of £595 million to shareholders, following the sale of five of its businesses.⁷ Melrose describes itself as follows:

Melrose buys good manufacturing businesses with strong fundamentals whose performance can be improved. Melrose finances its acquisitions using a low level of leverage, improves the businesses by a mixture of investment and changed management focus, sells them and returns the proceeds to shareholders.⁸

Melrose’s [Track Record](#) page presents a number of statistics, including:

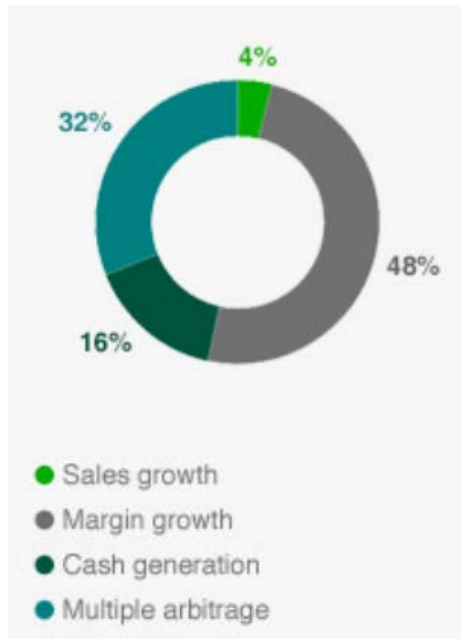
- Average annual return on investment of 25% since the first deal in 2005
- 48% of the value created by Melrose is attributed to margin growth, and only 4% to sales growth:

⁵ Ibid.

⁶ GKN, [Proposed combination of GKN Driveline and Dana](#), 9 March 2018

⁷ Melrose, [History](#), accessed 7 March 2018

⁸ Melrose, [About us](#), accessed 7 March 2018



1.3 Takeovers: rules and process

General principles and minimum rules governing takeovers of listed companies were laid down in the EU's [Takeovers Directive](#) of 2004.

The Directive is implemented in the UK by the Companies Act 2006 ([Part 28](#)) and by the [City Code on Takeovers and Mergers](#) (the "Takeover Code"). The Code is administered by the [Takeover Panel](#).

The Code is based on six general principles that must be applied in spirit:

1. All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.
2. The holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business.
3. The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.
4. False markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.
5. An offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.

6. An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.⁹

The majority of the rules relating to takeovers are contained in the Code. These rules shape the form, structure and timetable of takeovers. Although takeovers can fail because of infringements of the rules, the rules do not constitute, in and of themselves, powers to stop takeovers.

A small number of authorities have the statutory power, under the [Enterprise Act 2002](#), to intervene in takeovers. The power and the grounds on which it can be exercised are discussed in [section 3](#).

⁹ The Panel on Takeovers and Mergers, [The Takeover Code](#), 8 January 2018, p. 47

2. The proposed takeover

On 12 January 2018, GKN's Board announced that it had received a proposal from Melrose to acquire GKN, four days earlier:

The Board confirms that on 8 January 2018 it received a preliminary and unsolicited proposal from Melrose to acquire the entire issued and to be issued share capital of GKN at a price of 405 pence per share, comprising 80% in new Melrose shares and 20% in cash (the "Proposal").¹⁰

Under the terms of the Proposal, GKN shareholders would hold approximately 57% of the enlarged company and Melrose shareholders would hold 43%.

GKN's Board unanimously rejected Melrose's proposal, 'having concluded that the Proposal is entirely opportunistic and that the terms fundamentally undervalue the Company and its prospects.'¹¹

Melrose confirmed it made the Proposal, and stated:

The terms represent a premium of approximately 24% over the closing share price of GKN on 5 January 2018, the last business day prior to the approach. The cash element of the consideration would be funded with a new debt facility, which is in an agreed form. It is expected that the combined group's net leverage will be in line with Melrose's declared strategy of 2.5x.¹²

In accordance with Rule 2.6(a) of the Takeover Code, Melrose was required to either announce a firm intention to make an offer for GKN or announce that it does not intend to make an offer, by no later than 9 February 2018.

On 17 January 2018, Melrose announced its hostile cash and share offer for GKN. The terms of the offer were unchanged from Melrose's unsolicited proposal of 8 January 2018. All documents related to the offer are available on Melrose's website, [Proposed acquisition of GKN plc](#).

Melrose stated that the terms of its offer represent a premium of approximately 32% over the closing share price of GKN on 5 January 2018, based on the value of Melrose shares on 16 January 2018 (being the last business day before the announcement of the firm offer).¹³

GKN disputed the 32% premium figure:

GKN's Board considers 32% to be a fake premium. Melrose's market capitalisation on 5 January was significantly smaller than GKN's on the same day, Melrose is proposing to fund 80% of the offer consideration in shares and Melrose brings no industrial synergies. Instead, GKN's shareholders are themselves funding the majority of this premium. The true, delivered premium is less than 11%.¹⁴

¹⁰ GKN, [Statement re Possible Offer](#), 12 January 2018

¹¹ Ibid.

¹² Melrose, [Response to statement re possible offer](#) (RNS Number: 7437B), 12 January 2018

¹³ Melrose, [2.7 Announcement](#), 17 January 2018

¹⁴ GKN, [Statement regarding rejection of unsolicited offer](#), 18 January 2018

GKN also argued that Melrose's management team lacks relevant experience to lead GKN in the long term:

Melrose is not the right owner for GKN. It lacks experience in relevant high technology businesses and of investing for the long-term. GKN is a much larger and more complex business than anything acquired by Melrose in the past. In addition, Melrose has very limited experience at Board level of managing Tier 1 Aerospace and Automotive suppliers.¹⁵

On 12 March 2018, Melrose increased its offer to GKN shareholders, stating the following terms:

- Final offer valued at 467 pence per share, valuing GKN at £8.1 billion
- GKN shareholders to own 60% of Melrose, a UK listed manufacturing powerhouse, and receive £1.4 billion in cash
- Attractive immediate premium of 43%
- Deadline for acceptances is 1.00 p.m. on Thursday, 29 March 2018
- Offer will not be increased under any circumstances¹⁶

This revised and final offer was also rejected by the Board of GKN.¹⁷

As stated by Melrose above, the last business day on which GKN shareholders can accept the Melrose Offer is 29 March 2018, unless an extension is granted by the Takeover Panel.

On 6 March 2018, the Chair of the BEIS Committee sent a [letter](#) to Melrose asking whether Melrose was going to apply for clearance from the Pensions Regulator prior to acquiring the GKN (as strongly encouraged by the Regulator). The Chair also asked Melrose to state what binding commitments it was prepared to make in respect of the future of GKN (known as "post-offer undertakings").

Melrose sent two letters in response, on 13 March:

- [Letter regarding Melrose's intentions and undertakings](#)
- [Letter regarding pensions](#)

¹⁵ GKN, [Response to Offer](#), 1 February 2018

¹⁶ Melrose, [Increased and Final Offer Announcement](#), 12 March 2018

¹⁷ GKN, [Rejection of Melrose's Revised and Final Offer](#), 12 March 2018

3. Powers to stop takeovers

A small number of authorities have the statutory power, under the [Enterprise Act 2002](#), to intervene in takeovers. The power can only be exercised on certain specified grounds.

The authorities that can stop takeovers and the grounds on which they can exercise their powers are:

- The Competition and Markets Authority (CMA), on the ground that a takeover will lead to a substantial lessening of competition. For more information, see the Library's briefing, [The UK competition regime](#).
- The Secretary of State for Business, Energy & Industrial Strategy, on grounds of national security and financial stability. For more information, see the Library's briefing, [Mergers & takeovers: the public interest test](#).
- The Secretary of State for Digital, Culture, Media & Sport, on grounds of media quality, plurality and standards. For more information, see the Library's briefing, [Media ownership: the 21st Century Fox/Sky merger](#).

3.1 The case of GKN

The ground that could potentially apply to the takeover of GKN is that of national security, because GKN supplies parts for defence products.

On 7 February 2018, the Chair of the Business, Energy & Industrial Strategy (BEIS) Committee wrote to the BEIS Secretary of State to ask whether an intervention on the grounds of national security might be justified. Greg Clark, BEIS Secretary, responded:

Public interest interventions are quasi-judicial in nature; it is therefore important that Ministers act, and are seen to be acting, impartially, on the basis of an open mind and on the evidence available. For this reason, it is not appropriate for me to comment on individual cases.¹⁸

However, GKN's Finance Director, Jos Sclater, noted that GKN was not a direct defence supplier in the UK (oral evidence to the BEIS Committee, see [section 4](#)):

Chair: But are there [national security] grounds to do so [whether the Secretary of State should call in this takeover bid]? You know the extent to which you are integrated in Government defence contracts both here and in the United States.

Jos Sclater: We are not highly integrated into UK Government defence contracts directly. We just make military parts for other people, like BAE, or parts of engines for Rolls-Royce or Airbus. In the US, our programmes are very much more sensitive. We are on things like the F/A-18. We make large parts of the engine for the F-35. We make the stealth coating for the F-35. We make parts of the black programme. We have been named on the B-21 bomber, which is the stealth bomber for the US. Our US military presence is very important to the US.

¹⁸ Greg Clark, [Letter from SoS to the Chair regarding GKN](#), 16 February 2018

That is why we have special security arrangements with our boards in the US, which are quasi-independent of GKN management in the UK. But I cannot take a view on what CFUS will do through the process. I would say our US military presence is a lot more significant than our UK presence.¹⁹

The Chief Executive of Melrose, Simon Peckham, later commented that no national security investigations have involved a UK bidder in the past:

Simon Peckham: Under the Enterprise Act 2002, as you know, the Government have the power to look at things from a national security point of view. There have been seven investigations under that. None have involved a UK bidder or a UK buyer of an asset. They have all been overseas companies. Actually, all have been approved, with undertakings being given by the buyer. We would make clear to you that, if the MoD had any concerns about national security in respect of this bid, we would of course do everything we can to alleviate them.²⁰

However, the Unite the Union was of the view that the Secretary of State should intervene:

Vernon Coaker: What is Unite's view about the Secretary of State's powers to intervene, and why would you say that he or the Government should be intervening?

Steve Turner: Our view is that he should intervene; absolutely he should intervene.

Vernon Coaker: Just for the benefit of the record, can you outline why, please?

Steve Turner: There are very clear national security implications from this. It is not just about what GKN is involved in now; it is also about our future defence capabilities moving forward. [...]

We have the P-8 Poseidon aircraft, which is being built in the United States but is being procured for use here. We have the Joint Strike Fighter; we are going to buy the F-35 for our aircraft carriers. GKN is an instrumental tier 1 supplier to that. We have the Stealth Bomber; we have the Apache; we have the Chinook helicopters; we have the Black Hawk programme. We have a whole series of programmes that are key not just to the UK's defence strategy moving forward. Unfortunately, we would argue, the MoD prefers to buy off the shelf in the United States than build here; that is a different argument for a different Committee, perhaps, but the reality is that these products are being procured by the MoD for use by our armed services to defend our national security interests. [...]

Vernon Coaker: But it is one UK company taking over another UK company. Is the concern you have, on national security grounds, that you do not believe or do not trust what Melrose is saying?

Steve Turner: We do not believe it. National security works over a 10, 15 or 20-year development period, let alone the manufacturing process, which will go on for 30 or 40 years in service.²¹

¹⁹ BEIS Committee, Oral evidence: [The Future of GKN](#), HC 844, 6 March 2018, Q52

²⁰ BEIS Committee, Oral evidence: [The Future of GKN](#), HC 844, 6 March 2018, Q127

²¹ BEIS Committee, Oral evidence: [The Future of GKN](#), HC 844, 6 March 2018, Q188-190

4. Oral testimony to BEIS Committee

The Business, Energy & Industrial Strategy Committee questioned GKN, Melrose and Unite the Union as part of a short inquiry, [The future of GKN](#).

The Committee explored the potential impact of the takeover on jobs, research and development, defence supply chains and for pension holders in the context of the Government's industrial strategy. Exchanges covering national security are reported in the previous section of this briefing.

The overall view on the takeover of the current GKN executives was:

Anne Stevens, Chief Executive of GKN: From what I know of Melrose, I can say it is a buy/sell short-term business model. We have a very long-term business model where we invest in technologies for the long term. [...] We are a technical company. It takes technology and long-term relationships with universities, customers and communities to run this business. I do not see how a short-term business model works, but I do not know what their plan is.

Jos Sclater, Finance Director of GKN: Yes, it is short-term capitalism versus long-term capitalism. To give you a couple of good examples, take the A350 wing spar in Western Approach, which is a brand new factory we have built. We spent £160 million just on research and development for the carbon fibre wing spar there. We spent £250 million overall on that factory. We will be making carbon fibre wing spars for the A350 for hopefully the next 20 years or more.

Similarly, take the Rolls-Royce Trent engine. We spent £125 million on development and capitalising in order to help launch the Rolls-Royce Trent engine. That will have maybe a 30 or 40-year payback as those engines hang on the wings. Those types of investments are completely incompatible with a five-year timescale. You are investing for your grandchildren. That is what we have been doing; that is what we want to carry on doing.²²

Melrose's view was:

Simon Peckham, Co-founder and Chief Executive of Melrose: We accept that GKN is a great British business. However, we would say that it is a business that has lost its way, partly due to the way it has been managed.

Our ambition is to merge GKN and Melrose together to make a bigger British manufacturing powerhouse that can better compete on the world stage. Melrose is a highly successful UK-listed company in its own right. We buy businesses to improve them. We have an outstanding track record on pension schemes, which no doubt we will cover later. We invest in research and development. It may surprise you to find out that we invest more than GKN does. We also invest in skills and capital in our businesses, and we have a model that says we manage and invest in businesses as if we are going to own them for ever.

²² BEIS Committee, Oral evidence: [The Future of GKN](#), HC 844, 6 March 2018, Q20-21

Our actions, we believe, are in line with the Government's industrial strategy. Essentially, the question here is, which is the best management team to run GKN for the interests of everyone going forward?

[...]

We think we have a different strategy for GKN. We think its strategy is wrong. We can start with its current strategy, which seems to be to sell lots of the businesses we would not sell at this time. If you step back more fundamentally, we think GKN has a concentrated business model of sucking things up to the centre and running everything from the centre. We do not agree with that. What we believe in, and the way we run businesses, is putting the power to run those businesses back into the hands of the operational management.

We tend to find those operational managers know what is wrong and know they are being obstructed by the operations of a central bureaucracy. When you free them up and incentivise them, we find it drives performance and improves a business.²³

The Union's view was:

Steve Turner, Unite's Assistant General Secretary for Aerospace: I found it quite incredible to listen to Melrose this morning, as if you can get rid of the board and miraculously the organisation will transform itself overnight. It will not work like that. [...] I agree with comments that were made about how you should look at deeds as opposed to your promises, because the reality is, if you look at Melrose's track record, it is exactly that three to five-year transformation. That is what Melrose would call it; we would more rightly define it as asset-stripping. It takes over businesses, breaks those businesses up, compartmentalises them and flogs them off to the highest bidder, in order to maximise shareholder value.

That is the nature of the business. I am not criticising the nature of the business; I just want to be open about it. [...] If all that you are interested in is shareholder value, and all the bid spoke of was maximising shareholder value—there was not a sentence, in terms of its proposed bid, that spoke about employees, growth in the business, the communities that are supported by the business, or any other stakeholders—that is done by compartmentalising and flogging off bits of the business, bit by bit, for maximum value.²⁴

²³ BEIS Committee, Oral evidence: [The Future of GKN](#), HC 844, 6 March 2018, Q55

²⁴ BEIS Committee, Oral evidence: [The Future of GKN](#), HC 844, 6 March 2018, Q123

5. Parliamentary Questions

This link provides a [live list of PQs](#) about GKN and Melrose.

A number of PQs ask whether the Government or Secretary State intend to stop the takeover in the public interest. For example, [HL5716](#) (answered 1 March 2018):

Question (Lord Blencathra): To ask Her Majesty's Government whether they plan to block in the national interest the hostile takeover bid by Melrose for GKN.

Answer (Lord Henley): Public interest interventions under the Enterprise Act 2002 are quasi-judicial in nature and it is important that Ministers act, and are seen to be acting, impartially. For this reason, the Government does not comment on the use of these powers in individual cases.

Concerns raised in PQs about the takeover of GKN include:

- Protecting jobs (e.g. [126799](#))
- The impact on domestic defence supply chains (e.g. [126992](#))
- National security (e.g. [127801](#))
- Industrial strategy (e.g. [635 c822](#) and [635 c1494](#))
- Pensions (e.g. [125351](#))

6. Press articles

This link provides a [live list of news articles](#) about the proposed takeover of GKN. Some commentators have argued in favour of blocking the takeover and some against. One example of each is shown below.

The *Financial Times* wrote an editorial against blocking the takeover, [The GKN debate reflects loss of trust in markets](#) (6 March 2018):

The fuss is, from one point of view, surprising. It is not just that both companies are British, a strange sort of deal to block on national security grounds. There is also the fact that the military units of the business (as well as 90 per cent of its overall workforce) are not located in the UK. In addition, whatever Mr Corbyn might suggest, Melrose does not have a reputation for “asset-stripping”. Finally, the current management’s plans, which include the eventual sale of the auto division, look very much like Melrose’s. There may be deals that are threats to national security. But the GKN deal simply does not look like one of them.

The *Guardian* wrote an editorial in favour of blocking the takeover, [The Guardian view on hostile takeovers: creating value for bankers](#) (6 February 2018):

On Wednesday Greg Clark, the business secretary, will meet unions to discuss the bid. They worry that an earlier Melrose buyout of an engineering firm threatens hundreds of British jobs. Ministers can intervene where mergers raise public interest concerns, including that of national security – plausible as GKN is a key defence supplier. Labour has urged Mr Clark to act. He should do so to satisfy the law and to signal a return to Mrs May’s vision. The UK is too hospitable to hostile takeovers. It rewards clever readers of the stock market rather than industrial innovation. This is not because big mergers add value or deliver social and economic benefits – rather the reverse. It is because for 30 years the country has been in ideological hock to the City – whose bankers, lawyers and accountants rake in huge fees in takeover battles.

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