

## When The Facts Change

Regular readers may have noticed that at Credo, our perspective peers through the lens of long-term value. Low turnover of our portfolios is an essential part of this approach. However, we continuously review our positions and no commitment is ever safe from scrutiny. From time to time the facts change and, to borrow from Keynes, when the facts change, we change our opinions. After Monsanto made an offer for Syngenta, the facts changed. On balance, we viewed the risk as skewed to the downside and we decided to close our position whilst we remained in the middle of fortune's favours.

Monsanto approached Syngenta in early May with a \$45 billion bid, of which 45% was payable in cash and the remainder in Monsanto stock. Despite the hostility of Syngenta's board to the deal, we originally held our position as we saw the deal as strategically sound, while also offering over \$1 billion of annual cost synergies. Overall, such a deal would add over \$10 billion to the valuation of the merged entity, the majority of which could be paid to Syngenta as a takeover premium. We believed Syngenta's board was simply playing coy in anticipation of a higher offer. In the intervening weeks, however, the facts – and hence our opinion – changed.

What we first took as demurring on Syngenta's part was rather recalcitrance; the board has refused to enter talks with Monsanto, to open their books, or even to analyse Monsanto's books. While the majority of Syngenta's shareholders are in favour of a deal, there is little evidence of a rising activist tide; the largest holders are comprised of "long only" mutual funds with little appetite for belligerence. Neither, in our view, is Monsanto likely to embark on a hostile takeover and launch a tender offer.

Ironically, the greater threat to a successful outcome comes not from Syngenta, but Monsanto. Given the 55% stock structure of the deal, the would-be acquirer is using its own stock as currency. Since the deal was announced, Monsanto's shares have slipped over -20%. This debasement of their share price has made the deal roughly 12% more expensive for them. Therefore, the chances of Monsanto increasing their offer has decreased, while the risk that they walk away has increased.

In spite of the board's hostility, a recent survey suggested that the majority of Syngenta shareholders were looking for a sweetening of the offer in the region of 10%. At that time, Syngenta already traded at a discount of ~9% to the original offer price, which reflected the risk of the deal breaking and the financing costs over the period prior to the deal closing. Given that deals facing similar regulatory scrutiny (due to anti-trust and tax redomicile concerns) tend to trade at similar discounts, we believe that a renewed bid could offer only slight compression of this discount, thus limiting the upside potential to the region of 10%. Alternatively, suppose negotiations break down. Under such circumstances, we believe Syngenta would "de-rate" from a current P/E of approximately 22x to 16x, in line with peers. This implies a downside in the region of 30%.

If for a moment we take these two scenarios as granted, we would have to be at least 75% certain of the deal passing to warrant our position in Syngenta. Uncertainty abounds and, whilst the deal may still pass, our confidence has waned. As such, the prudent course of action was to close our position. At Credo, our conclusions change with circumstances. Yet one fact will not change: over the past year our analysis of Syngenta has been rewarded with a relative outperformance of 17% over the MSCI World Index.

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