

LINDE | PRAXAIR

AN AMBITIOUS DEAL – by Sylvia Blount



Following the footsteps of French rival Air Liquide (ENXTPA:AI), as a wave of consolidation, American Praxair Inc. (NYSE:PX) and German Linde Group (DB:LIN) could not keep sitting on the bench, and yet the two gas powerhouses went full force in a merger that is rather viewed farfetched by many. Yet, in our opinion this transaction can happen and provide good abnormal returns to the arbitrageur.

After a tumultuous deal process, Linde and Praxair finalized on June 1st a merger of equals with an implied value for Linde of \$42 billion. Both companies' stocks went up after Linde's shareholders' voted in favor of the deal, but not enough to show a good market sentiment on the transaction as indicated by the current merger spread. Hence, there is still some uncertainty on the closing, primarily due to the missing approval from Praxair's shareholders and the timing of the transaction that is expected to be consummated only in the second part of 2018. Furthermore, at least 75% of Linde's shareholders would still need to tender their shares to NewCo for the merger to go through. Finally, the two companies will have to comply with anti-trust laws, which is painful subject due to major divestments that could hinder the transaction and the expected synergies. Putting it all together, it is understandable why the market still views the combination of these two industrial gas leaders as a difficult achievement. Nonetheless, if completed, this merger will form the most influential global force in this sector.



Linde CEO Aldo Belloni, Linde Chairman of the Board Wolfgang Reitzle, and Praxair CEO Steve Angel shaking hands at a news conference in Munich.

Praxair's consideration to Linde's shareholders of 1.54 shares per 1 share of NewCo implies a control premium of approximately 37% as of June 7th. This premium reflects significant synergies expectations as the two companies are planning to achieve savings for \$1.2 billion annually. In fact, if earnings are going to be higher just by \$1.2 billion, with a WACC of about 7%, the capitalized value is \$17 billion or about 40% of the purchase price. A percentage that is even greater than the implied premium. This makes it probable that in the next five years, Linde and Praxair will create an entity with an enterprise value of \$100 billion (currently, jointly they are at about \$90 billion) since this implies a CAGR of only 2%.

"This transaction can happen and provide good abnormal returns."

Definitely a not too implausible achievement as many analysts are suggesting at the moment.



Linde Group gas separation plant in Germany.

For a sector that has already started to consolidate, the Linde-Praxair merger represents a great opportunity for these companies to fight the inevitable slow growth in the gas markets while creating operational efficiencies.

As of June 7th, the merger spread between Praxair's offer and Linde's price per share at \$175.85 is approximately 16%, which implies

an annualized return of 15% – the annualized

return is lower than the spread due to the longer expected timing for completing the deal.

All things considered, based on the economics in place, this transaction offers an enticing abnormal return due to the good chances of the deal closing despite the doubts that the market still displays. Therefore, in our view this is an arbitrage opportunity that is worth pursuing by shorting Praxair and going long Linde.

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