

P&O's takeover bid

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The second largest holding in the PRU Global Basics Fund - P&O (or Peninsular & Oriental Steam Navigation Co.)^[1] has been the subject of a fierce takeover battle over the last few weeks. Two suitors, Dubai's DP World and Singapore's PSA, both government-owned entities and competitors of P&O, have made increasingly high bids for UK's largest port operator. As at 26 January 2006, DP World has outbid PSA with its offer at 520p per share (US\$ 6.9 billion). PSA must now offer more than 546p or DP World's offer will be presented to P&O's shareholders on 13 February. With a successful takeover, DP World can then become the world's third largest port operator. P&O currently controls 29 terminals in Europe, Asia and the Americas. If PSA wins the battle, it will be propelled to the position of being the largest port operator worldwide.

The P&O takeover bid is a particularly strong story for the 5-star Mercer rated PRU Global Basics Fund, which feeds into the M&G Global Basics Fund ^[2]. The stock typifies the sort of company the fund manager, Graham French ^[3] likes: the market perception of the company was that of a struggling ferry operator, yet the reality is that it owns global container ports around the world at a time when shipping volumes are growing exponentially. Demand for raw materials from countries like China and India have had a huge impact on global shipping volumes. Additionally, while we are not an M&A fund, holding shares in a fundamentally attractive company where the takeover potential has not yet been priced in, has worked to our advantage.

As had been the case with other holdings in the M&G Global Basics Fund such as WM Resources, Falconbridge, Reebok, BPB, Allied Domecq and Robert Mondavi Wines, with P&O, we seem to have again benefited from the M&A premium.

The magnitude of a takeover premium can be high, as the P&O example shows. The magnitude of a takeover premium can be high, as the P&O example shows: Graham first bought P&O in May 2002 at 240p. Before October 2005 when takeover rumours first hit the market, P&O was traded at a level of about 300p. With the last bid by DP world on 26 January which valued P&O at a PE of 29 or at 520p, P&O is now traded at 547p4. The difference of 27p factors in the possibility that PSA counters DP World with an even higher bid. 2 February 2006 Whether the value per share will remain above 520p now depends on PSA's priorities – P&O's high valuation (with a PE of more than 30 in any future bid) has to be weighted against the opportunity of Singapore becoming the global leading port operator, and its increased ability to maintain the position as the world's largest transshipment port.

[1] As at end November 2005, P&O is the second largest holding in the Fund, weighted at 3.9%.

[2] M&G Global Basics Fund is 5-star rated by Morningstar and S&P. Source: Morningstar and S&P, as at January 2006.

[3] Graham French is an award-winning fund manager, rated AAA by Citywire and voted "Hottest of the Hot" manager in Professional Adviser, as at August 2005. Source: Citywire and Professional Adviser

[4] As at 31 January 2006. Source: Bloomberg and London Stock Exchange.

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