Mergers and Acquisitions

OVERVIEW

- Differences between Merges and Acquisitions
- Difference between hostile and friendly taking over.
- Motives behind M & A

Definitions

- **Merger:** One firm absorbs the assets and liabilities of the other firm in a merger. The acquiring firm retains its identity. In many cases, control is shared between the two management teams. Transactions were generally conducted on *friendly* terms.
- In a **consolidation**, an entirely new firm is created.
- Mergers must comply with applicable state laws. Usually, shareholders must approve the merger by a vote.

- <u>Acquisition:</u> Traditionally, the term described a situation when a larger corporation purchases the assets or stock of a smaller corporation, while control remained exclusively with the larger corporation.
- Often a tender offer is made to the target firm (*friendly*) or directly to the shareholders (often a *hostile* takeover).
- Transactions that bypass the management are considered hostile, as the target firm’s managers are generally opposed to the deal.

Merger negotiations

Friendly Acquisition:

The acquisition of a target company that is willing to be taken over. Usually, the target will accommodate overtures and provide access to confidential information to facilitate the scoping and due diligence processes.

- **Hostile Takeover**:

A takeover in which the target has no desire to be acquired and actively rebuffs the acquirer and refuses to provide any confidential information.

The acquirer usually has already accumulated an interest in the target (20% of the outstanding shares) and this preemptive investment indicates the strength of resolve of the acquirer.

- **Target:** the corporation being purchased, when there is a clear *buyer* and *seller*.
- **Bidder**: The corporation that makes the purchase, when there is a clear *buyer* and *seller*. Also known as the acquiring firm.
- **Friendly:** The transaction takes place with the approval of each firm's management
- **Hostile:** The transaction is not approved by the management of the target firm.

Types of Mergers

- Horizontal Mergers

- Between competing companies

- Vertical Mergers

- Between buyer-seller relation-ship companies

- Conglomerate Mergers

- Neither competitors nor buyer-seller relationship

- 1. Synergy: The most used word in M&A is synergy, which is the idea that by combining business activities, performance will increase and costs will decrease. Essentially, a business will attempt to merge with another business that has complementary strengths and weaknesses.

- Revenue Synergy :
- Market power , larger company will attract more customers (more brand awareness).
- Complementary products .
- Reduce competion.

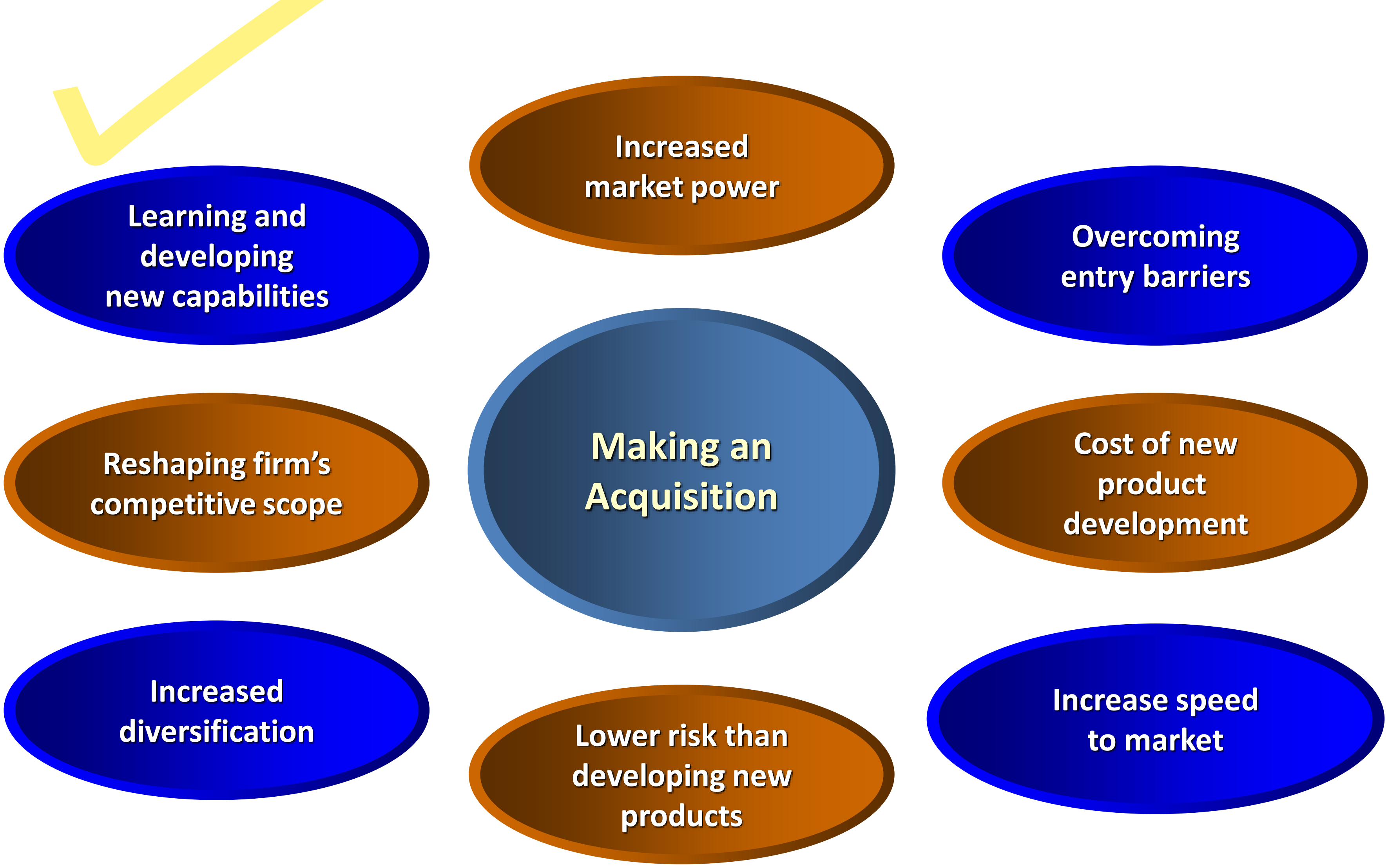
Cost Synergy

- Bulk discounts : be able to attract better prices.
- Market efficiency : one entity doing advertisements instead of two.
- Reduced fixed overhead costs : overlapping departments and resources.

Financial Synergy

- Borrow in Bulk : get better rates (borrowing interest rates)
- Save in Bulk : get better rates (deposit saving rates)
- Diversification of Risk : more companies in portfolio , less systemic risk.
- Offsetting tax losses.

- **Growth:** Mergers can give the acquiring company an opportunity to grow market share without having to really earn it by doing the work themselves - instead, they buy a competitor's business for a price. Usually, these are called horizontal mergers.
- For example, a beer company may choose to buy out a smaller competing brewery, enabling the smaller company to make more beer and sell more to its brand-loyal customers.


Increased market power
Learning and developing new capabilities
Overcoming entry barriers
Making an Acquisition
Reshaping firm's competitive scope
Cost of new product development
Increased diversification
Lower risk than developing new products
Increase speed to market

- **Diversification:** "Don't put all your eggs in one basket."
- Current finance literature seriously questions the merits of this reasoning: Why does the management know better than the shareholders how to achieve diversification?
- It is usually the case that shareholders can diversify much more easily than can a corporation.
- Individuals can easily diversify by buying shares in mutual funds.

Merger financing

How the Deal is Financed

- Cash Transaction
  - The receipt of cash for shares by shareholders in the target company.
- Share Transaction
  - The offer by an acquiring company of shares or a combination of cash and shares to the target company's shareholders.
- Going Private Transaction (Issuer bid)
  - A special form of acquisition where the purchaser already owns a majority stake in the target company.

Leveraged buyouts

- In a LBO a buyer uses debt to finance the acquisition of a company (usually LBOs are a way to take a public company private, or put a company in the hands of the current management, MBO).

Corporate restructuring

- Reasons: poor performance of a division, financial exigency, or a change in the strategic orientation of the company.
- Different forms of corporate selloffs: *disinvestitures, corporate downsizing* (cost and workforce restructuring), *financial restructuring* (alternation in the capital structur of the firm).

Merger Approval Procedures

- In the United States, each state has a statute that autorizes merges and acquisitions of corporations.
- Special Committees of the Board of Directors:

the board of directors may choose to form a special committee of the to evaluate the merger proposal.

- Fairness Options:

It's common for the board to retain an outside valutation firm.

Purchase of assets compared with purchase of stock

- The most common form of merger and acquisition involves purchasing the stock of the merged or acquired concern.
- An alternative is to purchase the target company's assets.

Assumption of the seller's liabilities

- If the acquirer buys all the target's stock, it assumes the seller's liabilities (*successor liability*).
- In cases in which a buyer purchases a substantial portion of the target's assets, the courts have ruled that the buyer is responsible for the seller's liabilities (*de facto* merger).

Reverse mergers

- A reverse merger is a merger in which a private company may go public by merging with an already public company that often is inactive or a corporate shell.

Holding Companies

- The acquiring company may choose to purchase only a portion of the target's stock and act as a *holding company,* which is a company that owns sufficient stock to have a controlling interest in the target.

Advantages of holding companies

- *Lower cost*. With a holding company structure, an acquired can attain control of a target for a much smaller investment than would be necessary in a 100% stock acquisition.
- *No control premium*. Because 51% of the shares were not purchased.
- *Control with fractional ownership.* As noted, working control may be established with less than 51% of the target company's shares.
- *Approval not required*. To the extent that it is allowable under federal and state laws, a holding company may simply purchase shares in a target without having to solicit the approval of the target company's shareholders.

Disadvantages

- *Multiple taxation*. The holding company structure adds another layer to the corporate structure. Normally, stockholders income is subject to double taxation.
- *Antitrust problems.* A holding company combination may face some of the same antitrust concerns with which an outright acquisition is faced.
- *Lack of 100% ownership.* Although the fact that a holding company can be formed without a 100% share purchase may be a source of cost savings, it leaves the holding company with other outside shareholders who will have some controlling influence in the company. This may lead to disagreements over the direction of the company.

Strategic Alliances

- An alternative to joint venture.
- More flexible concept than joint venture. The added flexibility allows to the firms to quickly establish links when they are needed.
- The downside of alliances is the greater potential for opportunistic behavior by the partners.
- Given the usual loose nature of alliances, there is a tendency to have posturing by the partners so that they create a need for each other.

History of Merger Waves

- 1^{st} wave 1895-1905 Horizontal mergers
  End with the passage and enforcement of antitrust legislation.
- 2^{nd} wave 1920-1929 Vertical mergers
  Ends with stock market crash.
- 3^{rd} wave 1960-1971 Conglomerate mergers
  Ends with recession and oil shocks of early 1970s.
- 4^{th} wave 1982-1989 Hostile takeovers, LBOs, MBOs
  Ends with recession of late 1980s
- 5^{th} wave 1993-2000 Stock-based friendly mergers
  May have ended with the burst of internet bubble

The fifth Wave 1992-1999

- 1992-1999 Strategic Mergers

  Very large in size and number

  1998: over $1.5 trillion in deals

  Driven by: Deregulation, economic forces, technology, globalization

  Most done in cash (unlike 1980s)

Examples:

- Deutsche Bank – Bankers Trust
- Citicorp – Travelers Insurance
- (Reigle –Neal 1994, Bliley Act 1999)
- AOL – Netscape