Wiley Corporate F&A

PATRICK A. GAUGHAN

Mergers, Acquisitions, and Corporate Restructurings

SIXTH EDITION

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Preface

THE FIELD OF MERGERS and acquisitions has undergone tumultuous changes over the past 20 years. The 1990s witnessed the fifth merger wave—a merger wave that was truly international in scope. After a brief recessionary lull, the merger frenzy began once again and global megamergers began to fill the corporate landscape. This was derailed by the subprime crisis and the Great Recession. When the economic recovery was slow, so too was the rebound in M&A activity. However, by 2013 and 2014 M&As began to rebound more strongly.

Over the past quarter of a century we have noticed that merger waves have become longer and more frequent. The time periods between waves also has shrunken. When these trends are combined with the fact that M&A has rapidly spread across the modern world, we see that the field is increasingly becoming an ever more important part of the worlds of corporate finance and corporate strategy.

As the M&A field has evolved we see that many of the methods that applied to deals of prior years are still relevant, but new rules are also in effect. These principles consider the mistakes of prior periods along with the current economic and financial conditions. It is hoped that these new rules will make the mergers of the future sounder and more profitable than those of prior periods. However, while dealmakers have asserted that they will pursue such goals, we would be remiss if we did not point out that when deal volume picked up dramatically such intentions seemed to fall by the wayside and M&A mistakes started to occur. In fact, as with many other areas of finance, learning from past mistakes proves challenging. Lessons that are learned tend to be short-lived. The failures of the fourth merger wave were so pronounced that corporate decision makers loudly proclaimed that they would never enter into such foolish transactions. However, there is nothing like a stock market boom to render past lessons difficult to recall while bathing in the euphoria of rising equity values.

The focus of this book is decidedly pragmatic. We have attempted to write it in a manner that will be useful to both the business student and the practitioner. Since the world of M&A is clearly interdisciplinary, material from the fields of law and economics is presented along with corporate finance, which is the primary emphasis of the book. The practical skills of finance practitioners have been integrated with the research of the academic world of finance. In addition we have an expanded chapter devoted to the valuation of businesses, including the valuation of privately held firms. This is an important topic that usually is ignored by traditional finance references. Much of the finance literature tends to be divided into two camps: practitioners and academicians. Clearly, both groups have made valuable contributions to the field of M&As. This book attempts to interweave these contributions into one comprehensible format.

The increase in M&A activity has given rise to the growth of academic research in this area. In fact, M&A seems to generate more research than other areas of finance. This book attempts to synthesize some of the more important and relevant research studies and to present their results in a straightforward and pragmatic manner. Because of the voluminous research in the field, only the findings of the more important studies are highlighted. Issues such as shareholder wealth effects of antitakeover measures have important meanings to investors, who are concerned about how the defensive actions of corporations will affect the value of their investments. This is a good example of how the academic research literature has made important pragmatic contributions that have served to shed light on important policy issues. It is unfortunate that corporate decision makers are not sufficiently aware of the large body of pragmatic, high-quality research that exists in the field of M&A. One of the contributions we seek to make with this book is to render this body of pragmatic research readily available, understandable, and concisely presented. It is hoped then that practitioners can use it to learn the impacts of the deals of prior decision makers.

We have avoided incorporating theoretical research that has less relevance to those seeking a pragmatic treatment of M&As. However, some theoretical analyses, such as agency theory, can be helpful in explaining some of the incentives for managers to pursue management buyouts. Material from the field of portfolio theory can help explain some of the risk-reduction benefits that junk bond investors can derive through diversification. These more theoretical discussions, along with others, are presented because they have important relevance to the real world of M&As. The rapidly evolving nature of M&As requires constant updating. Every effort has been made to include recent developments occurring just before the publication date. We wish the reader an enjoyable and profitable trip through the world of M&As.

Patrick A. Gaughan

PART ONE

Background

CHAPTER ONE

Introduction

RECENT M&A TRENDS

The pace of mergers and acquisitions (M&As) picked up in the early 2000s after a short hiatus in 2001. The economic slowdown and recession in the United States and elsewhere in 2001 brought an end to the record-setting fifth merger wave. This period featured an unprecedented volume of M&As. It followed on the heels of a prior record-setting merger wave—the fourth. This one in the 1990s, however, was very different from its counterpart in the previous decade. The fifth wave was truly an international one, and it featured a heightened volume of deals in Europe and, to some extent, Asia, in addition to the United States. The prior merger waves had been mainly a U.S. phenomenon. When the fourth merger wave ended with the 1990–1991 recession, many felt that it would be a long time before another merger wave like it would occur. However, after a relatively short recession and an initially slow recovery, the economy picked up speed in 1993, and by 1994 the world was on a path to another record-setting merger period. This wave would feature deals that would make the ones of the 1980s seem modest. There would be many megamergers and many cross-border deals involving U.S. buyers and sellers, but also many large deals not involving U.S. firms.

Figure 1.1 shows that both European and U.S. M&A volume began to rise in 2003 and by 2006–2007 had reached levels comparable to their peaks of the fifth wave. Similar trends were apparent in Europe. With such high deal volume huge megamergers were not unusual (see Table 1.1 and 1.2). However, by 2008 the effects of the global recession and the subprime crisis began to take hold. The U.S. recession, which began in

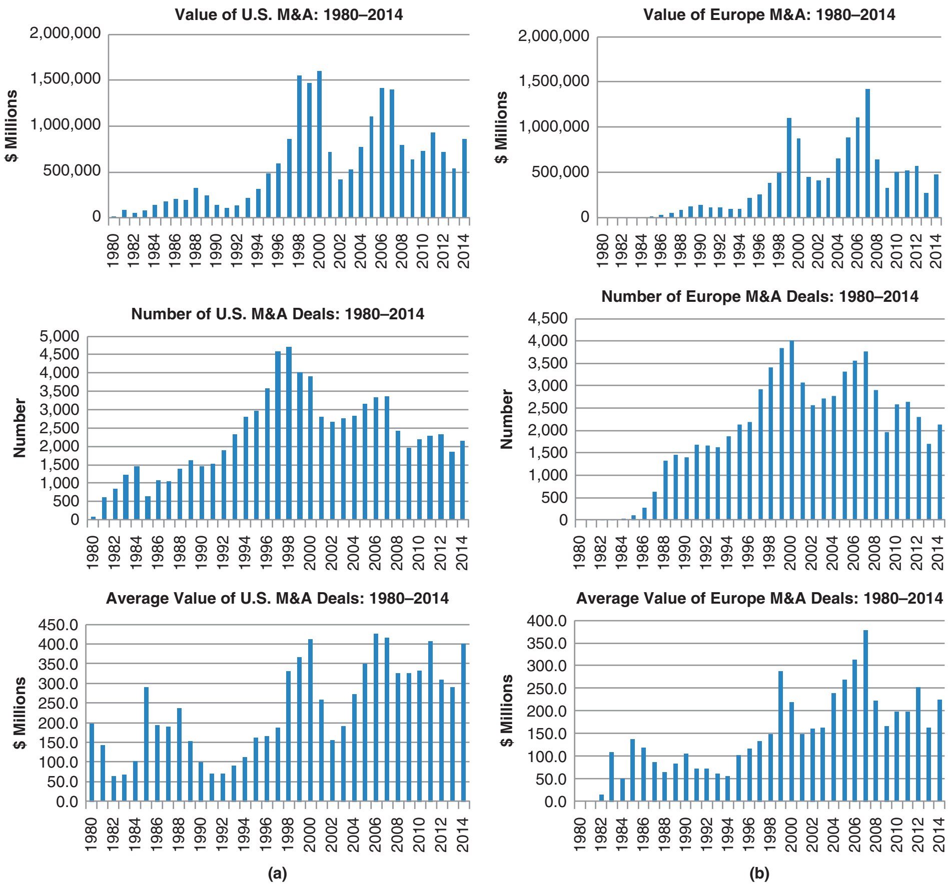

FIGURE 1.1 Value of M&As 1980–2014: (a) United States and (b) Europe. *Source*: Thomson Financial Securities Data, March 6, 2015.

January 2008, caused potential acquirers to reign in their acquisition-oriented expansion plans. Those bidders who were still inclined to go ahead with proposed deals found that their access to financing was sharply curtailed. Many bidders who had reached agreements with targets sought to renegotiate the deals or even back out altogether. Deals were canceled with increased frequency.

Deal volume in most regions of the world generally tended to follow the patterns in the United States and Europe. Australia, for example, exhibited such a pattern, with deal volume growing starting in 2003 but falling off in 2008 and 2009 for the same reason it fell off in the United States and Europe. The situation was somewhat different in China and Hong Kong. The value of deals in these economies has traditionally been well below the United States and Europe but had been steadily growing even in 2008, only to fall off sharply in 2009. China's economy has realized double-digit growth for a number of years and is now more than one-half of the size of the U.S. economy

TABLE 1.1 Top 10 Worldwide M&As by Value of Transaction

Date Announced	Date Effective	Value of Transaction ($ mil)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
11/14/1999	6/19/2000	202,785.13	Mannesmann AG	Germany	Vodafone AirTouch PLC	United Kingdom
1/10/2000	1/12/2001	164,746.86	Time Warner	United States	America Online Inc	United States
9/2/2013	2/21/2014	130,298.32	Verizon Wireless Inc	United States	Verizon Communications Inc	United States
8/29/2007	3/28/2008	107,649.95	Philip Morris Intl Inc	Switzerland	Shareholders	Switzerland
4/25/2007	11/2/2007	98,189.19	ABN-AMRO Holding NV	Netherlands	RFS Holdings BV	Netherlands
11/4/1999	6/19/2000	89,167.72	Warner-Lambert Co	United States	Pfizer Inc	United States
12/1/1998	11/30/1999	78,945.79	Mobil Corp	United States	Exxon Corp	United States
1/17/2000	12/27/2000	75,960.85	SmithKline Beecham PLC	United Kingdom	Glaxo Wellcome PLC	United Kingdom
10/28/2004	8/9/2005	74,558.58	Shell Transport & Trading Co	United Kingdom	Royal Dutch Petroleum Co	Netherlands
3/5/2006	12/29/2006	72,671.00	BellSouth Corp	United States	AT&T Inc	United States

Source: Thomson Financial Securities Data, February 19, 2015.

TABLE 1.2 Top 10 European M&As by Value of Transaction

Date Announced	Date Effective	Value of Transaction ($ mil)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
11/14/1999	06/19/2000	202,785.134	Mannesmann AG	Germany	Vodafone AirTouch PLC	United Kingdom
08/29/2007	03/28/2008	107,649.948	Philip Morris Intl Inc	Switzerland	Shareholders	Switzerland
04/25/2007	11/02/2007	98,189.193	ABN-AMRO Holding NV	Netherlands	RFS Holdings BV	Netherlands
01/17/2000	12/27/2000	75,960.847	SmithKline Beecham PLC	United Kingdom	Glaxo Wellcome PLC	United Kingdom
10/28/2004	08/09/2005	74,558.583	Shell Transport & Trading Co	United Kingdom	Royal Dutch Petroleum Co	Netherlands
02/25/2006	07/22/2008	60,856.454	Suez SA	France	Gaz de France SA	France
01/26/2004	08/20/2004	60,243.380	Aventis SA	France	Sanofi-Synthelabo SA	France
07/05/1999	03/27/2000	50,070.051	Elf Aquitaine	France	Total Fina SA	France
05/30/2000	08/22/2000	45,967.068	Orange PLC	United Kingdom	France Telecom SA	France
06/15/2014	01/26/2015	42,729.867	Covidien PLC	Ireland-Rep	Medtronic Inc	United States

Source: Thomson Financial Securities Data, February 19, 2015.

TABLE 1.3 Top 10 Asian M&A by Value of Transaction

Date Announced	Date Effective	Target Name	Target Nation	Acquirer Name	Acquirer Nation	Value of Transaction ($ mil)
03/26/2014	08/25/2014	CITIC Ltd	China	CITIC Pacific Ltd	Hong Kong	42,247.47
02/29/2000	08/17/2000	Cable & Wireless HKT	Hong Kong	Pacific Century CyberWorks Ltd	Hong Kong	37,442.15
10/04/2000	11/13/2000	Beijing Mobile, 6 others	China	China Telecom Hong Kong Ltd	Hong Kong	34,161.79
05/25/2008	10/15/2008	China Netcom Grp (HK) Corp Ltd	Hong Kong	China Unicom Ltd	Hong Kong	25,416.14
08/01/2012	12/31/2012	China Netcom Corp-3G Assets	China	China Telecom Corp Ltd	China	18,047.28
05/12/2008	11/17/2008	St George Bank Ltd	Australia	Westpac Banking Corp	Australia	17,932.98
04/11/2007	07/25/2007	SK Corp-Petrochemical Business	South Korea	Shareholders	South Korea	16,984.45
07/02/2007	11/23/2007	Coles Group Ltd	Australia	Wesfarmers Ltd	Australia	15,287.79
10/27/2006	07/16/2007	Rinker Group Ltd	Australia	Cemex SAB de CV	Mexico	14,247.73
02/11/2007	05/08/2007	Hutchison Essar Ltd	India	Vodafone Group PLC	United Kingdom	12,748.00

Source: Thomson Financial Securities Data, February 19, 2015.

(although on a purchasing power parity basis it is approximately the same size). However, there are many regulatory restrictions imposed on M&As in China that inhibit deal volume from rising to levels that would naturally occur in a less controlled environment. The Chinese regulatory authorities have taken measures to ensure that Chinese control of certain industries and companies is maintained even as the economy moves to a more free market status. This is why many of the larger Asian deals find their origins in Hong Kong (see Table 1.3).

In the rest of Asia, deal volume generally expanded starting in 2003 and declined with the global recession in 2008 and 2009. This was the case in India and South Korea

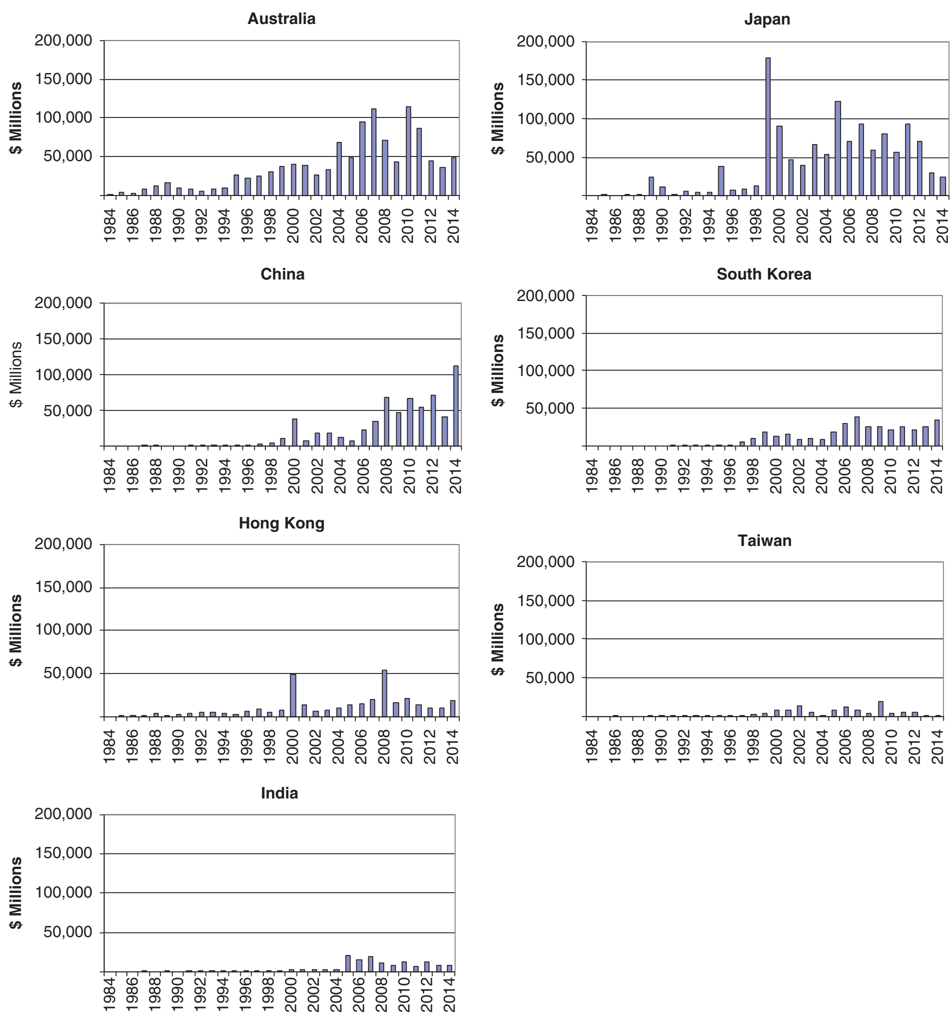

FIGURE 1.2 Value of M&A 1984–2014: By Nation. *Source*: Thomson Financial Securities Data, March 6, 2015.

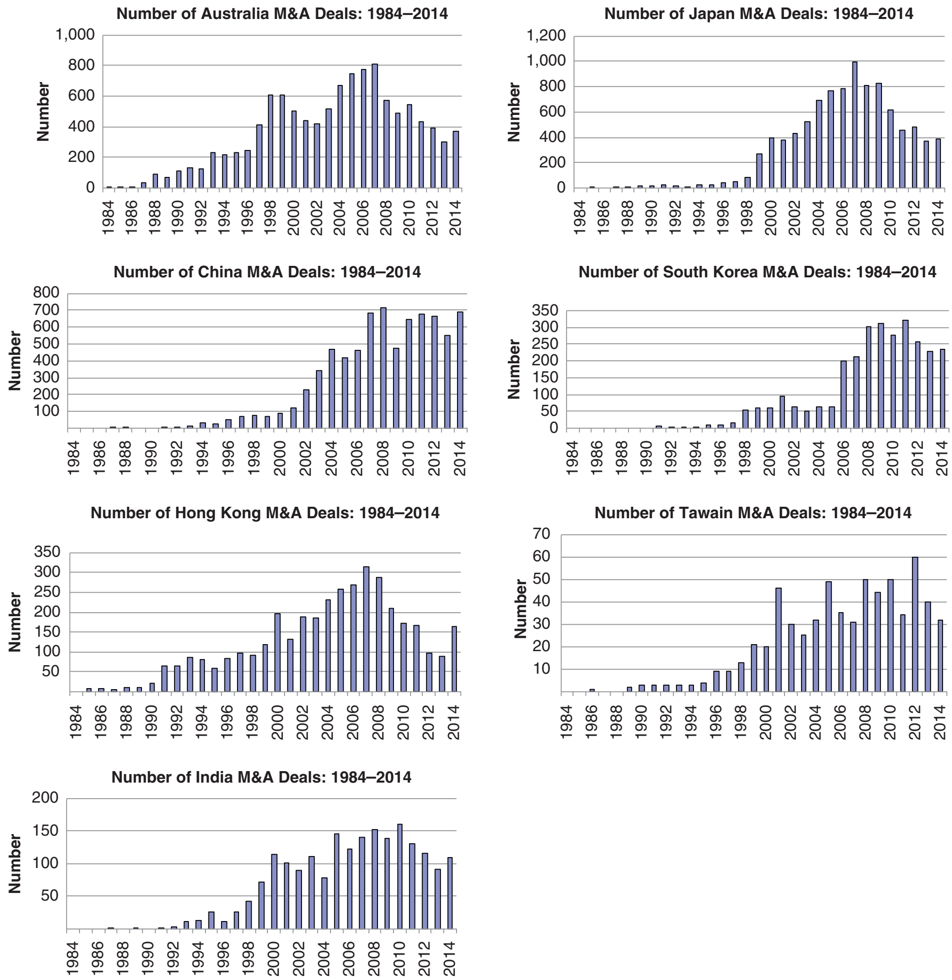

FIGURE 1.2 *(continued)*

(see Figure 1.2). In Japan, other factors help explain the trend in deal volume. Although Japan is the world's third largest national economy, it suffered a painful decade-long recession in the 1990s that has had lasting effects, some of which remain even today. The government has sought to deregulate the economy and take apart the myriad restrictive corporate interrelationships that had kept alive many businesses that otherwise would have failed. The country under Prime Minister Shinzo Abe and his Abenomics has tried various policies to stimulate the economy, but the nation suffers long-term problems, such as the aging of its population and the country's reluctance to allow immigrants to make up this shortfall.