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PATRICK A. GAUGHAN

MERGERS, ACQUISITIONS, & CORPORATE RESTRUCTURINGS

SEVENTH EDITION

WILEY

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Preface

The field of mergers and acquisitions has undergone tumultuous changes over the past four decades. The fourth merger wave of the 1980s featured a fascinating period of many hostile deals and leveraged buyouts along with many more "plain vanilla" deals. 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 initially slow, so too was the rebound in M&A activity. However, by 2013 and 2014, M&A volume rebounded strongly and has continued in the years that followed.

Over the past quarter of a century, we have noticed that merger waves have become 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 field has evolved we see that many of the methods that applied to deals of prior years are still relevant, but new techniques and rules are also in effect. These new methods and techniques consider the mistakes of prior periods along with the current economic and financial conditions. Participants in M&As tend to be an optimistic lot and often focus on the upside of deals while avoiding important issues that can derail a transaction. There are many great lessons that can be learned from the large history of M&As that is available. What is interesting is that, as with many other areas of finance, learning from past mistakes proves challenging. Lessons that are learned tend to be short-lived. For example, the failures of the fourth merger wave of the 1980s 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 beenintegrated 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 tends not to receive the attention it needs, as a proper valuation can be the key between a successful and a failed transaction. 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. It is amazing that senior managers and the boards regularly approve deals or take other actions in supporting or opposing a transaction without any knowledge on the voluminous body of high-quality research on the effects of such actions. 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, in general, much of M&A research has a pragmatic focus. For decision makers, this research contains a goldmine of knowledge. The peer-reviewed research process has worked to produce a large volume of quality studies that can be invaluable to practitioners who will access it. We have endeavored to integrate the large volume of ongoing research into an expansive treatment of the field. 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

1

Introduction

RECENT M&A TRENDS

The pace of mergers and acquisitions (M&As) picked up in the early 2000s after collapsing in the wake of the subprime crisis. M&A volume was quite strong over the period 2003–2007. This strength was apparent globally, not just in the United States. However, the United States entered the Great Recession in 2008 and the recovery from this strong economic downturn would prove difficult. A number of deals that were planned in 2007 were canceled.

Figure 1.1 shows that the aforementioned strong M&A volume over the years 2003 to 2007 occurred in both Europe and the United States. M&A volume began to rise in 2003 and by 2006–2007 had reached levels comparable to their peaks of the fifth wave. With such high deal volume, huge megamergers were not unusual (see Tables 1.1 and 1.2). In the United States, M&A dollar volume peaked in 2007, whereas in Europe, this market peaked in 2006. Fueled by some inertia, the value of total M&A was surprisingly strong in 2008 when one considers that we were in the midst of the Great Recession. The lagged effect of the downturn, however, was markedly apparent in 2009 when M&A volume collapsed.

The rebound in U.S. M&A started in 2010 and became quite strong in 2011, only to weaken temporarily in 2012 before resuming in 2013. The U.S. M&A market was very strong in 2014, and in 2015 it hit an all-time record, although, on an inflation-adjusted basis, 2000 was the strongest M&A year. In 2016, the M&A market was still strong in the United States, although somewhat weaker than 2015.

The story was quite different in Europe. After hitting an all-time peak in 2006 (it should be noted, though, that on an inflation-adjusted basis, 1999 was the all-time

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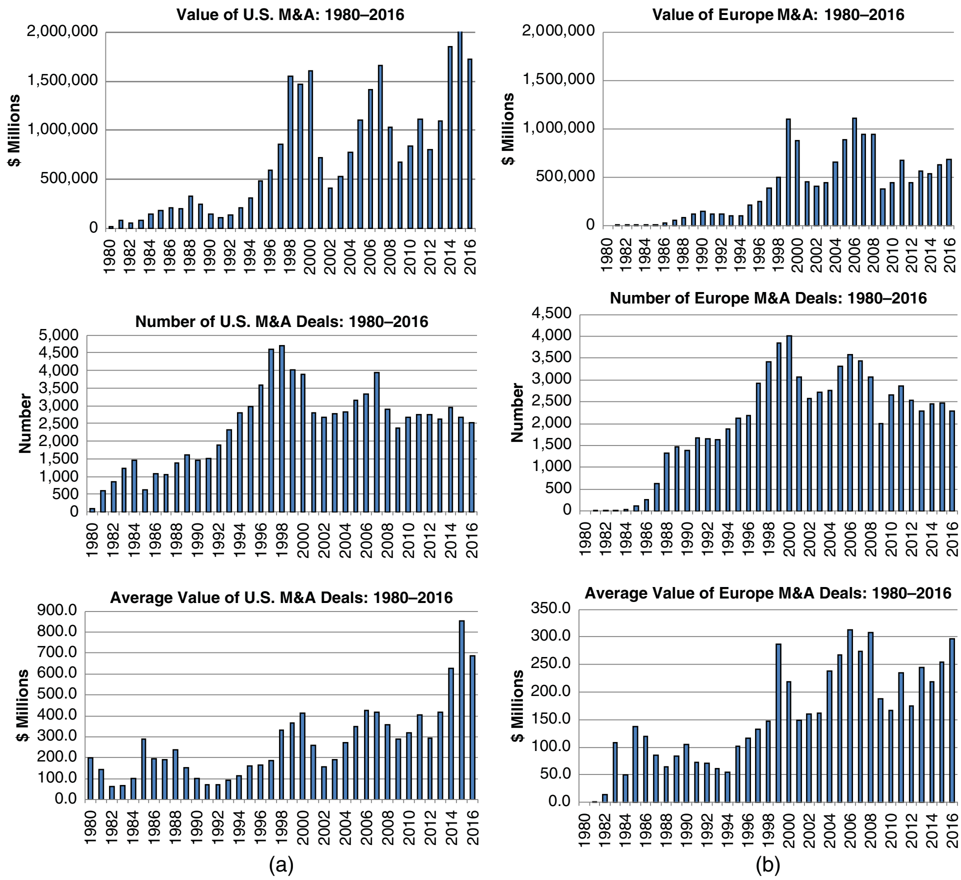

FIGURE 1.1 Value of M&As 1980–2016: (a) United States and (b) Europe.

peak in M&A for Europe), the market weakened a little in 2007 and 2008, although it was still relatively strong. However, Europe's M&A business shrank dramatically in 2009 and 2010 as Europe was affected by the U.S. Great Recession and also its financial system also suffered from some of the same subprime-related issues that affected the U.S. financial system.

The M&A business rebounded well in 2011, only to be somewhat blunted by a double-dip recession in Europe, which was partly caused by the European sovereign debt problems. The Eurozone had a 15-month recession from the second quarter of 2008 into the second quarter of 2009, but then had two more downturns from the fourth quarter of 2011 into the second quarter of 2012 (9 months) and again from the fourth quarter of 2012 into the first quarter of 2013 (18 months). M&A volume was more robust in 2015 and 2016 but unlike in the United States, Europe remained well below the level that was set in 2006.

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

Date Announced	Date Effective	Value of Transaction ($ Millions)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
11/14/1999	4/12/2000	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
6/26/2015	8/9/2015	145,709.25	Altice SA	Luxembourg	Altice SA	Luxembourg
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
9/16/2015	10/4/2016	101,100.89	SABMiller PLC	United Kingdom	Anheuser-Busch Inbev SA/NV	Belgium
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

Source: Thomson Financial Securities Data, January 12, 2017.

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
11/14/99	06/19/00	202,785.13	Mannesmann AG	Germany	Vodafone AirTouch PLC	United Kingdom
6/26/2015	8/9/2015	145,709.25	Altice SA	Luxembourg	Altice SA	Luxembourg
08/29/07	03/28/08	107,649.95	Philip Morris Intl Inc	Switzerland	Shareholders	Switzerland
9/16/2015	10/4/2016	101,100.89	SABMiller PLC	United Kingdom	Anheuser-Busch Inbev SA/NV	Belgium
04/25/07	11/02/07	98,189.19	ABN-AMRO Holding NV	Netherlands	RFS Holdings BV	Netherlands
01/17/00	12/27/00	75,960.85	SmithKline Beecham PLC	United Kingdom	Glaxo Wellcome PLC	United Kingdom
10/28/04	07/20/08	74,558.58	Shell Transport & Trading Co	United Kingdom	Royal Dutch Petroleum Co	Netherlands
04/08/15	02/15/16	69,445.02	BG Group PLC	United Kingdom	Royal Dutch Shell PLC	Netherlands
09/29/14	09/01/15	65,891.51	UBS AG	Switzerland	UBS AG	Switzerland
02/25/06	07/22/08	60,856.45	Suez SA	France	Gaz de France SA	France

Source: Thomson Financial Securities Data, January 12, 2017.

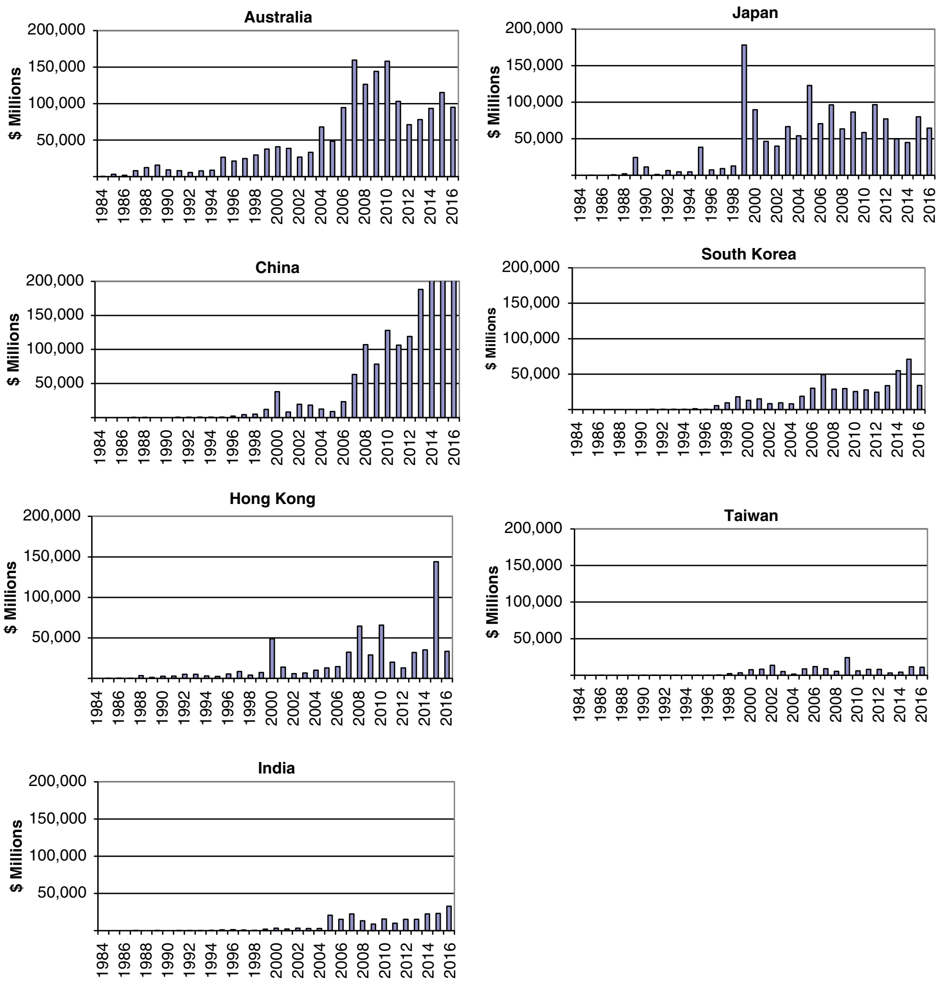

FIGURE 1.2 Value of M&A 1984–2016: By nation. *Source:* Thomson Financial Securities Data, January 12, 2017.

Deal volume in most regions of the world generally tends to follow the patterns in the United States and Europe (see Figure 1.2). Australia, for example, exhibits such a pattern, with deal volume growth starting in 2003 but falling off in 2008 and 2009 for the same reason it fell off in the United States and Europe. Australian deals rebounded in 2013 and have grown since except for a modest decline in 2016.

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 (although on a purchasing power parity basis it is approximately the same size). Economic growth slowed in recent years from double-digit levels to just under 7% per year even with significant government efforts to try to return to prior growth levels.

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)
03/26/14	08/25/14	CITIC Ltd	China	CITIC Pacific Ltd	Hong Kong	42,247.47
01/09/15	06/03/15	Cheung Kong (Hldg) Ltd-Ppty	Hong Kong	Shareholders	Hong Kong	36,890.56
02/29/00	08/17/00	Cable & Wireless HKT	Hong Kong	Pacific Century CyberWorks Ltd	Hong Kong	37,442.15
10/04/00	11/13/00	Beijing Mobile, 6 others	China	China Telecom Hong Kong Ltd	Hong Kong	34,161.79
05/25/08	10/15/08	China Netcom Grp (HK) Corp Ltd	Hong Kong	China Unicom Ltd	Hong Kong	25,416.14
01/09/15	06/03/15	Huchinson Whampoa Ltd	Hong Kong	Cheung Kong (Holdings) Ltd	Hong Kong	23,639.61
10/14/15	10/31/15	China-Telecommun Tower Assets	China	China Tower Corp	China	18,349.33
08/22/12	12/31/12	China Telecom Corp-3G Assets	China	China Telecom Corp Ltd	China	18,047.28
05/12/08	11/17/08	St George Bank Ltd	Australia	Westpac Banking Corp	Australia	17,932.98
04/11/07	07/25/07	SK Corp-Petrochemical Business	South Korea	Shareholders	South Korea	16,984.45

Source: Thomson Financial Securities Data, January 12, 2017.

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). Nonetheless, the M&A business in China over the past few years has been at its highest levels. While Chinese demand for foreign targets rose to impressive heights in 2016, in the second half of 2016 and 2017 the Chinese government took measures to limit capital from leaving China—something that is necessary to complete most foreign deals. Financing for such deals became more difficult, and the Chinese Commerce Ministry began taking a hard line on some large deals.

In Hong Kong, the number of deals has been rising over the past three years and the outlook remains positive. The same is true of Taiwan and South Korea.

The M&A business has been increasing in India, as that nation's economy continues to grow under the leadership of its very probusiness Prime Minister Modi. The demographics of the Indian economy imply future economic growth, and are the opposite of Japan. This helps explain why the Japanese economy has been in the doldrums for the past couple of decades. Since 2011, M&A volume in Japan has been steady, but without major growth or a return to the pre-subprime crisis days.

VODAFONE TAKEOVER OF MANNESMANN: LARGEST TAKEOVER IN HISTORY

Vodafone Air Touch's takeover of Mannesmann, both telecom companies (and actually alliance partners), is noteworthy for several reasons in addition to the fact that it is the largest deal of all time (see Table 1.1). Vodafone was one of the world's largest mobile phone companies and grew significantly when it acquired Air Touch in 1999. This largest deal was an unsolicited hostile bid by a British company of a German firm. The takeover shocked the German corporate world because it was the first time a large German company had been taken over by a foreign company—and especially in this case, as the foreign company was housed in Britain and the two countries had fought two world wars against each other earlier in the century. Mannesmann was a large company with over 100,000 employees and had been in existence for over 100 years. It was originally a company that made seamless tubes, but over the years had diversified into industries such as coal and steel. In its most recent history, it had invested heavily in the telecommunications industry. Thus, it was deeply engrained in the fabric of the German corporate world and economy.

It is ironic that Vodafone became more interested in Mannesmann after the latter took over British mobile phone operator Orange PLC. This came as a surprise to Vodafone, as Orange was Vodafone's rival, being the third-largest mobile operator in Great Britain. It was also a surprise as Vodafone assumed that Mannesmann would pursue alliances with Vodafone, not move into direct competition with it by acquiring one of its leading rivals.[a]

Mannesmann tried to resist the Vodafone takeover, but the board ultimately agreed to the generous price paid. The Mannesmann board tried to get Vodafone

(*continued*)