

To the student:
How to follow current developments in
Mergers and Acquisitions

By Robert F. Bruner

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It is less important to know everything, and much more important to know what matters. My basic advice is that you should place yourself squarely in the news stream about M&A, and then retain only those bits that meet one or more of the following tests:

1. **The deal breaks the strategic pattern of usual transactions.** These are “paradigm shift” deals and are worthy of more careful study than the rest. Dramatically large deals garner a lot of attention in the media, though size may not be worth that much share of mind. Consider, instead, deals that suggest
 - a) big changes in regulation (changes in antitrust policy are almost always signaled by the deals that the authorities oppose or let through, e.g. Exxon and Mobil are permitted to merge);
 - b) changes in the value chain (i.e., changes in the degree of integration among stages of the value chain e.g. Sony buys Columbia Pictures);
 - c) unusual combinations of technology (e.g., AOL and Netscape combine);
 - d) globalization (e.g., Repsol buys YPF); and
 - e) generally the liberalization of markets (i.e., unusual new players enter the field, for instance, ATT, a telephone company, buys MediaOne, a cable TV company.)
2. **The deal is in an industry that matters to you.** Most practitioners who follow M&A care greatly about their sector of the economy. Scholars, too, can learn a lot from following a few industries closely. This industry focus can help alert you to creeping changes in the M&A field that by themselves may not mean much, but in the aggregate mean a lot. For example, the U.S. commercial banking industry has shrunk through acquisition from about 16,000 enterprises in 1990 to about 12,000 today—the vast bulk of these acquisitions are unremarkable individually, though combined they signal a dramatic change in the financial services industry in the U.S.
3. **Markets move dramatically in response.** When Mattel bought Fischer-Price Toys, Mattel’s share price increased sharply, which differed from the usual experience of buyers, i.e., a slight decline in share price. Sharp rises or declines in securities prices (debt and equity) upon announcement of the deal invite further investigation.
4. **The deal structure catches your attention.** The best way to learn about engineering M&A transactions is to study them. It is the outliers that teach you the most. Pay careful attention to deals involving unusual financing, unusual forms of payment, unusual changes in governance, unusual tax or accounting choices, etc.
5. **The deal eventually blows up.** I’m a big believer in the value of studying pathological cases in M&A as a means of learning how to perform successfully in the field. Looking into the past can warn about steps to be avoided in the future. Cendant’s acquired CUC International and much later discovered massive accounting fraud. The lessons from this will arrive for years to come, but will probably contribute to our understanding of

good due diligence research, accounting games that managers can play, and generally, the need for professional skepticism in evaluating acquisition targets.

To place oneself in the middle of the stream of information about M&A is to scan the following kinds of sources, which I have listed here in descending order of priority:

- **Business newspapers.** The *Wall Street Journal* is the pre-eminent reporting source for M&A transactions. *Investor's Daily* also does a creditable job. Some kind of daily scanning is very useful. At the announcement of interesting transactions, one can follow up the same day with Internet-based research on the two firms.
- **Internet.** See the page on this site regarding [Useful websites in M&A](#).
- **M&A magazines.** The following two titles are useful for fine detail and big picture analysis of the field: *Mergers & Acquisitions* and *Investment Dealers' Digest*.
- **General business magazines.** These are useful mainly for background color and general commentary. The constraints of this format mainly restrict writers in terms of both depth of reporting and immediacy. But if you have trouble keeping up with the first three bullet points, then these magazines are indispensable.

A grasp of recent news in M&A is valuable for building a frame of reference for your own development. The daily financial press and/or websites offer the means for this kind of framing. Several leading newspapers, such as the *Wall Street Journal* and *New York Times*, have online editions that can be set up to send you email about big announcements. I have found www.thedeal.com to offer valuable insights into pending deals and information about arbitrage spreads. One should also focus on recently *completed mergers*: as deals come along, they almost inevitably leave a trail of informative paper with regulators. Proxy statements, especially, give a good glimpse into the guts of current practice. See the SEC's website, www.sec.gov to download these documents. Consider drawing together a discussion group of team-mates or peers to discuss current events. Seven key questions to ask about a new deal announcement between public companies are:

1. **What are the terms?** A useful exercise at the outset is to sketch the term sheet of the deal in as much detail as you can.
2. **What is the bid premium?** Compare the bid price to the target's price prevailing before the bid—you might scrutinize the time-trend of the target's share price leading up to the bid. If there was leakage of information or rumors before the deal, you may need to go back in time to get a true *ex ante* share price for calculating the bid premium.
3. **What are the espoused motivations and synergies in this deal?** How realistic are they? Many merger announcements express some quantitative targets for synergy value. You could produce a quick DCF valuation of these and then compare the synergy values to the total pre-announcement market capitalization of the two firms. Where the synergy value is relatively large, you should scrutinize its sources closely.
4. **Does the deal create value for the buyer?** The best way to answer this is with a detailed valuation analysis. But you can get reasonably close to the answer with a quick calculation. In essence, value is created for the buyer if the "gets" are greater

than the “gives.” The buyer gives a premium over the *ex ante* share price to get the target and have a shot at gaining synergies. Thus, the deal is economically attractive for the buyer if:

$$V_{Stand\ Alone} + V_{Synergies} > (P_{Ex\ Ante} \times N_{Shares}) + \Pi_{Bid}$$

Where V is the DCF value of the target and synergies respectively, P is the share price, N is the number of shares, and Π is the bid premium.

In efficient markets for securities, the stand alone value of the firm should equal its market capitalization. If this assumption is reasonable in the deal you are studying, then the test for value creation reduces to:

$$V_{Synergies} > \Pi_{Bid}$$

5. **Are there competitors or the likely intervention** from governments or regulatory bodies which might affect the development of the deal? To determine the probability of success, you can backsolve from the arbitrage spread
6. **How has the market reacted to the deal?** Look at the share price response for both the buyer and target. If there are competing bidders, look at their price reactions as well. Ideally, the price reaction should be net of the market movement that day—in effect, your calculations will generate a cumulative abnormal return around the announcement of the deal. Here, too, consider the arbitrage spread and what it tells you.
7. **What is your “view” of the announced deal?** If you take into account your answers to the foregoing questions, you should be able to develop your own “view.” What are the strengths, weaknesses, opportunities, and threats in the environment surrounding the buyer and target? How have these developed the deal? What are the prospective outcomes? Can these companies reasonably generate the good outcomes?