Merger Waves (Boom Periods)

- Horizontal Consolidation (1897-1904)
- Increasing Concentration (1916-1929)
- The Conglomerate Era (1965-1969)
- The Retrenchment Era (1981-1989)
- Age of Strategic Megamerger (1992-2000)
- Age of Cross Border and Horizontal Megamergers (2003-2007)

1

2

Horizontal Consolidation (1897-1904)

- Spurred by
  - Drive for efficiency,
  - Lax enforcement of antitrust laws monopoly.
  - Westward migration, and
  - Technological change
- Resulted in concentration in metals, transportation, and mining industry
- M&A boom ended by 1904 stock market crash and fraudulent financing

3

Increasing Concentration (1916-1929)

- Spurred by
  - Entry of U.S. into WWI
  - Post-war boom
- Boom ended with
  - 1929 stock market crash
  - Passage of Clayton Act which more clearly defined monopolistic practices

4

The Conglomerate Era (1965-1969)

- Conglomerates buy earnings streams to boost their share price
  - Overvalued firms acquired undervalued high growth firms
  - Number of high-growth undervalued firms declined as conglomerates bid up their prices
  - Higher purchase price for target firms and increasing leverage of conglomerates brought era to a close

5

The Retrenchment Era (1981-1989)

- Strategic U.S. buyers and foreign multinationals dominated first half of decade
- Second half dominated by financial buyers
  - Buyouts often financed by junk bonds
  - Drexel Burnham provided market liquidity

Risk assets.

- Era ended with bankruptcy of several large LBOs and demise of Drexel Burnham

6

Age of Strategic Megamerger (1992-2000)

- Dollar volume of transactions reached record in each year between 1995 and 2000
- Purchase prices reached record levels due to
  - Soaring stock market
  - Consolidation in many industries
  - Technological innovation
  - Benign antitrust policies
- Period ended with the collapse in global stock markets and worldwide recession

7

Age of Cross Border & Horizontal Megamergers (2003 – 2007)

- Average merger larger than in 1980s and 1990s, mostly horizontal, and cross border
- Concentrated in banking, telecommunications, utilities, healthcare, and commodities (e.g., oil, gas, and metals)
- Spurred by
  - Continued globalization to achieve economies of scale and scope;
  - Ongoing deregulation;
  - Low interest rates;
  - Increasing equity prices, and
  - Expectations of continued high commodity prices
- Period ended with global credit market meltdown and 2008-2009 recession

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Causes & Significance of M&A Waves

- Factors contributing to merger waves:
  - Shocks (e.g., technological change, deregulation, and escalating commodity prices)
  - Ample liquidity and low cost of capital
  - Overvaluation of acquirer share prices relative to target share prices
- Why it is important to anticipate M&A waves:
  - Financial markets reward firms pursuing promising opportunities early on and penalize those that follow later in the cycle.
  - Acquisitions made early in the wave often earn substantially higher financial returns than those made later in the cycle.

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Similarities & Differences Among Merger Waves

- Similarities
  - Occurred during periods of sustained high economic growth
  - Low or declining interest rates
  - Rising stock market
- Differences
  - Emergence of new technology (e.g., railroads, Internet)
  - Industry focus
  - Type of transaction (e.g., horizontal, vertical, conglomerate, strategic, or financial)

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Acq ≠ Bidding war. ≠ Target

Winners Curse

11

Winners Curse

- The winner's curse is a tendency for the winning bid in an auction to exceed the intrinsic value or true worth of an item.
- Because of incomplete information, emotions or any other number of factors regarding the item being auctioned, bidders can have a difficult time determining the item's intrinsic value. Valuation.
- As a result, the largest overestimation of an item's value ends up winning the auction.

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Hubris

"Investors came in and increased the price. We have to pay for getting the company. As a prudent management, we had taken a view that we would not go beyond a point. We did not reach that point. Had we reached, we would have walked away. Overbidding or not is subjective when it comes to a judgement call."

Ratan Tata

(Source: Business Standard)

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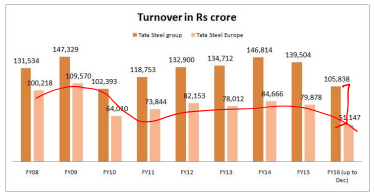

- The share of Tata Steel Europe's turnover in the total turnover of the group has declined steadily
  - In 2007-08, it stood at 76.2%
  - In 2014-15, the share was down to 57.3%
- Tata Steel group witnessed a 6% growth in turnover over the period, Tata Steel Europe saw a 20% decline in turnover

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LBO

- Tata Steel group saw a decline of 30% between 2007-08 and 2014-15 in operating profit
  - Tata Steel Europe, meanwhile witnessed a sharper 53% decline
- In 2007-08, a year before the global financial crisis started, the foreign subsidiary had a 50% contribution to overall Ebitda
  - The share in 2014-15 stood at 33.6%

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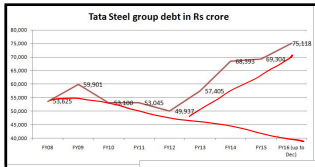
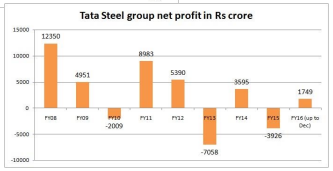


LBO



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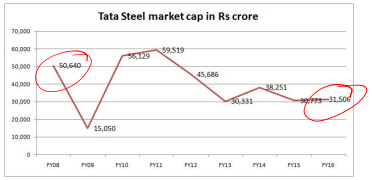

- Tata Steel share price on the BSE has more than halved from Rs 693.15 in 2007-08 to Rs 324.4 currently
- Its market cap eroded 38% during the period from Rs 50,640 crore to Rs 31,506 crore currently
- After the company announced the decision to sell the UK business the stock has gained 5.26%

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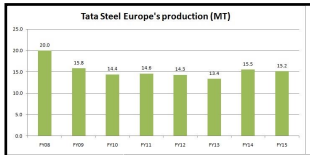

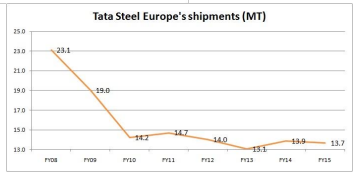

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Discounted Cash Flow.

Cost & Gains

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Gains From Merger Value Creation

- A + B == AB

Acq Target Merged.

- V(A) + V(B) < V(AB)
- GAIN == V(AB) -- [V(A) + V(B)] == WEALTH CREATION

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Value Creation

- Acquisition always at a premium over market price
- Value Creation Must for Successful Merger
- A Merger that Fails to Provide Economic Gain (Additional Value) Makes the Bidder Vulnerable

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Estimating Cost & Gains

- Gain = PV_{AB} -- (PV_A + PV_B) where PV stands for true value
- If Gain is Positive There is an Economic Justification for the Merger

Cost = Price of acq B - Valuation of B

- Cost of Acquiring Firm B = Cost of Acquiring Firm B -- the Value of B as Separate Entity

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Estimating Cost & Gains

- Gain = PV_{AB} -- (PV_A + PV_B)
- Cost = Cash Paid Out -- PV_B
- NPV of Merger == Gain -- Cost

  == [PV_{AB} -- (PV_A + PV_B)] -- [(Cash -- PV_B)]

  == PV_{AB} -- PV_A -- Cash

Equity + Debt

- One Should Go Ahead with Merger if NPV is Positive

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Example of Cost & Gains

25 = x - 150

Gain = PV_{AB} -- (PV_A + PV_B)
Cost = Cash Paid Out – PV_B
NPV of Merger == Gain -- Cost
NPV of Merger == PV_{AB} -- PV_A -- Cash

Acq
Targ

- PV_A == Rs. 100 mill.
- PV_B == Rs. 50 mill.

150 mn

- Gain == + Rs. 25 mill
- PV_{AB} == Rs. 175 mill. 175 mn
- If B is bought for Rs. 65 mill. Then
- Cost == Cash -- PV_B 75 mn. 25 - 15 = 10 mn.

  == 65 -- 50 = Rs. 15 mill

- NPV == 25 -- 15 = Rs. 10 mill

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Example of Cost & Gains

- Thus Shareholders of the target Firm B have Captured Rs. 15 mill of the Total gain of Rs. 25 mill Acq 10 m
- ***Bidding Firm Shareholders Gain is Rs. 10 mill. They Start with a Firm Worth Rs. 100 mill., Pay Rs. 65 mill in Cash to Acquire Firm B, and End with Combined Firm Value of Rs. 175 mill.*** 100 +

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Cost & Gains

- Suppose the merger was unanticipated. The announcement will cause the value of firm B to rise from Rs. 50 mill to Rs. 65 mill.(30 % increase)
- If the market is able to correctly assess the merger gain (= Rs. 25 mill), market value of firm A will rise from Rs. 100 mill to Rs. 110 mill (10%)

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Cost & Gains

- 10 mn. Estimating Gains 75 − 65
  - * DCF Value of Target with Merger Benefits -- cash for Acquisition
- * ***A Risky Method of Estimating Gains Since Analyst Can make large Errors in Estimating Value of Business***
- * Better to Start with MV_A, and estimate the changes in the cash flow due to Merger

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Integration

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Implementation Issues

Europe | India | US

Structure, Control, and Compensation

M&A activity requires responses to these issues:

- M-form structure is typically used.
- Management controls and compensation policies are similar to those used in diversification strategies.

Managers must decide on the level of integration:

- Target firm may remain somewhat autonomous.
- Target firm may be completely integrated.

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Implementation Issues

Cultural Differences

- High levels of integration require greater cultural blending.
- Cultural blending may be a matter of:
  - combining elements of both cultures
  - essentially replacing one culture with the other
- Integration may be very costly, often unanticipated.
- The ability to integrate efficiently may be a source of competitive advantage.

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Managing Mergers and Acquisitions

why? Synergy? Valuation

- Challenges of Pre-merger Planning
  - Careful identification of the goals of M&A
  - Difficulties in estimating the benefits of M&A: on average cost savings overestimated by 25%, revenue increases by 70%
- Challenges of Post-Merger integration
  - Problems of integration: incompatible management systems; clash of cultures; adjustment difficulties by employees of acquired company
  - Building acquisition capability—managing the learning process to ensure that acquisition experience builds capability
  - Marching post-merger management to the strategic goals of the merger: leveraging the firm's existing business model (e.g. Walt Disney and Pixar) vs. reinventing the business model (e.g. HP and Autonomy)

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Five stage process of M&A

1 Corporate strategy development

2 Organizing for acquisition — who value synergy.

3 Deal structuring & negotiations — Debt Equity Price

4 Post-acquisition integration

5 Audit & organizational learning — learning.

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Post merger approaches

Western Eastern

	INTEGRATION	PARTNERING
Structure	Absorb acquired company	Keep acquired company separate
Activities	Integrate core and supporting activities	Selectively coordinate a few key activities
Top Executives	Replace	Retain
Autonomy	None, or very limited	Near total
Speed of Integration	Rapid	Gradual

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Post merger approaches

	INTEGRATION	PARTNERING
What kind of resources does the acquired company have?	The same or similar resources	Complementary, superior, or unique resources such as brands or technologies
What will create value after the takeover?	Reduction of costs by combining assets and activities, or gaining economies of scale	Growth in revenues by entering new markets or new products, and sharing best practices
What kind of company is the acquirer?	Hierarchical, with a low tolerance for ambiguity; a desire to teach; an emphasis on getting results	Collaborative, with a high tolerance for ambiguity; a willingness to learn; a long-term player

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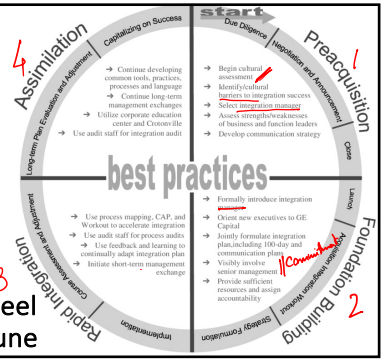

GE: Wheel of Fortune

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Acquisition integration

- Acquisition integration is not a discrete phase of a deal and does not begin when the documents are signed.
  - It is a process that begins with due diligence and runs through the ongoing management of the new enterprise
- Integration management is a full-time job
  - It needs to be recognized as a distinct business function, just like operations, marketing, or finance

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Acquisition integration

- Decisions about management structure, key roles, reporting relationships, layoffs, restructuring and other career affecting aspects of the integration should be made, announced, and implemented as soon as possible after the deal is signed
- A successful integration melds not only the various technical aspects of the business but also the different cultures
  - The best way is to get people working together quickly to solve business problems and accomplish results that could

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Cultural barriers

- Decision-making style
  - consensus contrasted with top-down
    - Effective integration requires rapid decision-making.
    - Different decision-making styles can lead to slow decision-making, failure to make decisions, or failure to implement decisions.
- Leadership style
  - dictatorial or consultative, clear or diffuse
    - A shift in leadership style can generate turnover among employees who object to the change. This is especially true for top talent, who are usually the most mobile employees.
    - Loss of top talent can quickly undermine value in an integration by draining intellectual capital and market contacts.

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Cultural barriers

- Ability to change
  - willingness to risk new things, compared with focus on maintaining current state and meeting current goals
    - Unwillingness to implement new strategies.
    - Unwillingness to work through the inevitable difficulties in creating a new company
- How people work together
  - based on formal structure and role definitions or based on informal relationships
- Beliefs regarding personal "success"
  - organizations that focus on individual "stars," or on teamwork, or where people rise through connections with senior practitioners

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