FIFTH EDITION

Mergers, Acquisitions, and Corporate Restructurings

PATRICK A. GAUGHAN

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Preface

The field of mergers and acquisitions has undergone tumultuous changes over the past 10 to 15 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 credit slump that came in its wake. However, the business of M&A is one which will be ever present in the corporate world. As the economy expands M&As go along with it.

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 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&As 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&As activity has given rise to the growth of academic research in this area. 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. I wish the reader an enjoyable and profitable trip through the world of M&As.

Patrick A. Gaughan

1

BACKGROUND

1

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 had reached levels comparable to their peaks of the fifth wave. Deal volume began to decline in the United States in 2007 while it continued to rise in Europe. However, by 2008 the effects of the global recession and the subprime crisis began to take hold. The recession, which began in 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. While the number and dollar value of M&As in 2009 were well below 2008 levels, which, in turn, were well below 2007 levels, there were some signs of a rebound in the latter half of the year of 2009. As is often the case in economic downturns, bidders with strong balance sheets and abundant cash reserves found some opportunities in the weak M&A market.

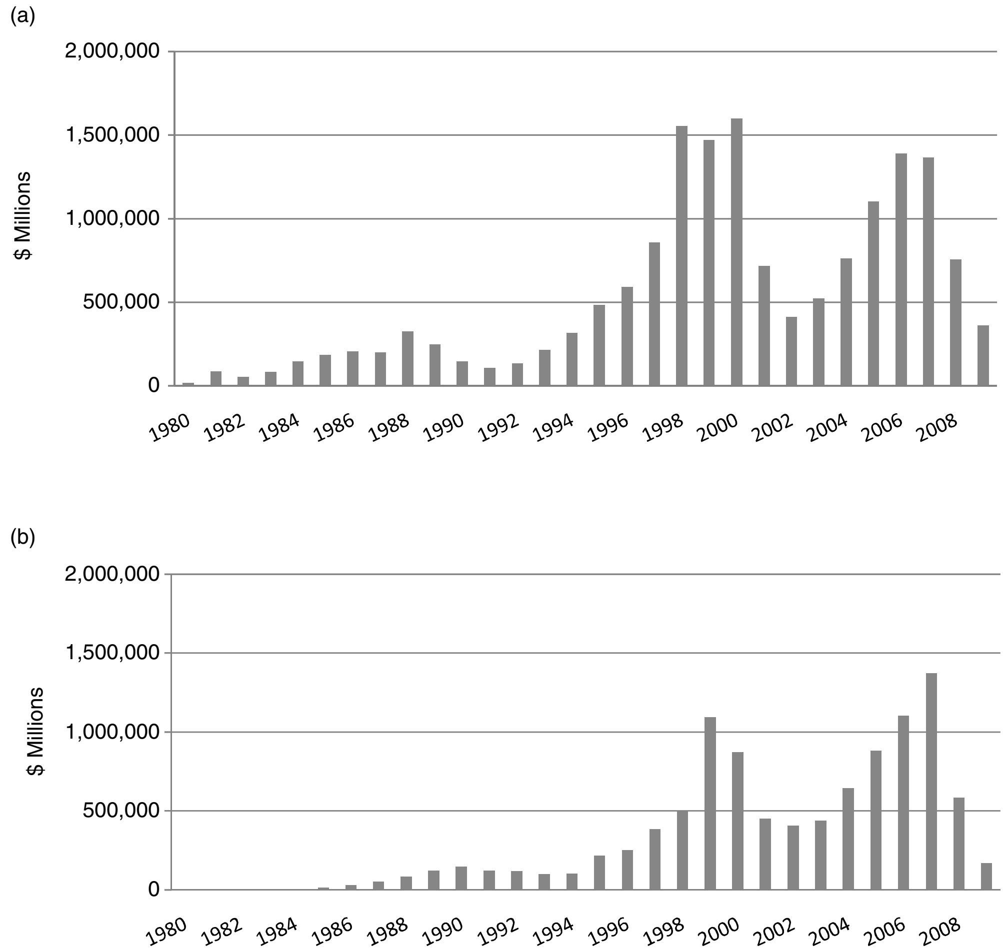

FIGURE 1.1 VALUE OF M&As 1980–2009: (A) UNITED STATES AND (B) EUROPE
Source: Thomson Financial, January 7, 2010.

Deal volume in most regions of the world generally tended to follow the patterns in the United States and Europe. Huge mega-mergers took place in both the United States and Europe (see Tables 1.1 and 1.2). 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 but is still about one-quarter the size of the U.S. economy. 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.

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 (see Figure 1.2). In Japan, other factors help explain the trend in deal volume. Although Japan is the world's second 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. This helped create some M&A opportunities over the period 1999–2007. Deal volume fell after 2007 as it did elsewhere in the world.

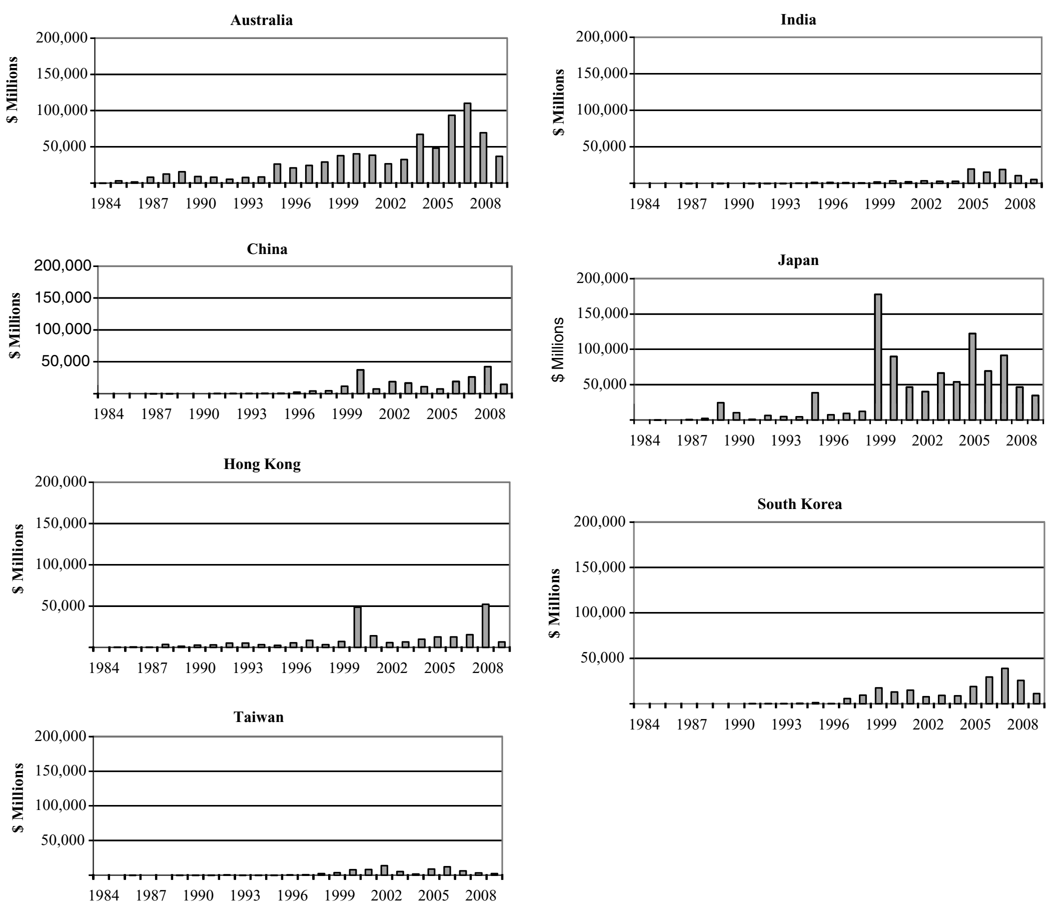

FIGURE 1.2 VALUE OF M&AS, 1984–2009: BY NATION

Source: Thomson Securities Financial Data, January 7, 2010.

Date Announced	Date Effective	Value of Transaction ($ Millions)	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
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
4/6/1998	10/8/1998	72,558.18	Citicorp	United States	Travelers Group Inc	United States

Table 1.1 Top Ten Worldwide M&As by Value of Transaction

Source: Thompson Financial, January 7, 2010.

Date Announced	Date Effective	Value of Transaction ($ Millions)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
11/14/99	06/19/00	202,785.134	Mannesmann AG	Germany	Vodafone AirTouch PLC	United Kingdom
08/29/07	03/28/08	107,649.948	Philip Morris Intl Inc	Switzerland	Shareholders	Switzerland
04/25/07	11/02/07	98,189.193	ABN-AMRO Holding NV	Netherlands	RFS Holdings BV	Netherlands
01/17/00	12/27/00	75,960.847	SmithKline Beecham PLC	United Kingdom	Glaxo Wellcome PLC	United Kingdom
10/28/04	08/09/05	74,558.583	Shell Transport & Trading Co	United Kingdom	Royal Dutch Petroleum Co	Netherlands
02/25/06	07/22/08	60,856.454	Suez SA	France	Gaz de France SA	France
01/26/04	08/20/04	60,243.38	Aventis SA	France	Sanofi-Synthelabo SA	France
07/05/99	03/27/00	50,070.051	Elf Aquitaine	France	Total Fina SA	France
05/30/00	08/22/00	45,967.068	Orange PLC	United Kingdom	France Telecom SA	France
11/29/99	03/13/00	38,412.856	National Westminster Bank PLC	United Kingdom	Royal Bank of Scotland Group	United Kingdom

Table 1.2 Top Ten European M&As by Value of Transaction

Source: Thompson Financial, January 7, 2010.

CASE STUDY

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 to agree to maintain the Mannesmann name after the completion of the deal. It appeared that Vodafone would do so but eventually they chose to go with the Vodafone name—something that made good sense in this age of globalization as maintaining multiple names would inhibit common marketing efforts.

Up until the mid-1990s, Germany, like many European nations, had a limited market for corporate control. The country was characterized as having corporate governance institutions which made hostile takeovers difficult to complete. However, a number of factors began to change starting in the second half of the 1990s and continued through the 2000s. First, the concentration of shares in the hands of parties such as banks, insurance companies, and governmental entities, who were reluctant to sell to hostile bidders, began to decline. In turn, the percent of shares in the hands of more financially oriented parties, such as money managers, began to rise. Another factor that played a role in facilitating hostile deals is that banks had often played a defensive role for target management. They often held shares in the target and even maintained seats on the target's board and opposed hostile bidders while supporting management. One of the first signs of this change was apparent when WestLB bank supported Krupp in its takeover of Hoesch in 1991. In the case of Mannesmann, Deutsche Bank, which had been the company's bank since the late 1800s,[b] had a representative on Mannesmann's board but he played no meaningful role in resisting Vodafone's bid. Other parties who often played a defensive role, such as representatives of labor who often sit on boards based on what is known as codetermination policy, also played little role in this takeover.

The position of target shareholders is key in Germany, as antitakeover measures such as poison pills (to be discussed at length in Chapter 5) are not as effective due to Germany's corporate law and the European Union (EU) Takeover Directive, which requires equal treatment of all shareholders. However, German takeover law includes exceptions to the strict neutrality provisions of the Takeover Directive which gives the target's board more flexibility in taking defensive measures.

It is ironic that Vodafone was able to take over Mannesmann as the latter was much larger than Vodafone in terms of total employment and revenues. However, the market, which was at that time assigning unrealistic values to telecom companies, valued Mannesmann in 1999 at a price/book ratio of 10.2 (from 1.4 in 1992), while Vodafone had a price/book ratio of 125.5 in 1999 (up from 7.7 in 1992).[c] This high valuation gave Vodafone "strong currency" with which to make a stock-for-stock bid that was difficult for Mannesmann to resist.

The takeover of Mannesmann was a shock to the German corporate world. Parties that were passive began to become more active in response to a popular outcry against any further takeover of German corporations. It was a key factor in steeling the German opposition to the EU Takeover Directive which would have made such takeovers easier.

[a] Simi Kidia, "Vodafone Air Touch's Bid for Mannesmann," Harvard Business School Case Study #9-201-096, August 22, 2003.
[b] Martin Hopner and Gregory Jackson, "More In Depth Discussion of the Mannesmann Takeover," Max Planck Institut für Gesellschaftsforschung, Cologne, Germany, January 2004.
[c] Martin Hopner and Gregory Jackson, "Revisiting the Mannesmann Takeover: How Markets for Corporate Control Emerge," *European Management Review* 3 (2006): 142–155.

The 2000 $34 billion takeover of Cable & Wireless HKT Ltd. by Pacific Century CyberWorks Ltd., both Hong Kong companies, was a signal to the Asian market that U.S.-type takeovers had come to that continent (see Table 1.2). Pacific Century CyberWorks was an Internet and technology company founded by Richard Li, the young scion of Hong Kong tycoon Li Ka-Shing. The deal was clearly the largest Asian takeover.

The takeover allowed Cable & Wireless to stay in Hong Kong hands as Pacific Century outbid Singapore Telecommunications Ltd., which was the government-owned telephone company of Singapore. The deal also underscored the buying power of Internet companies during that time period.

Given the rapid growth of the Chinese economy, we would expect there to be many more M&As—especially takeovers of Chinese companies by non-Chinese. The fact that we do not see this in Table 1.3 is attributable to the reluctance of the Chinese government to allow unrestricted takeovers of Chinese companies. Nonetheless, the M&A market between Chinese companies has been quite robust. Chinese industries have been consolidating under the watchful eye of the Beijing government, which favors the building of large, internationally powerful enterprises, and if M&A is the best way to achieve this, most deals will receive government support.

Three of the top ten Asian deals involve Australian companies. The largest Australian deal, a merger between two of that nation's largest banks, resulted in the formation of the largest Australian bank by market capitalization.

The total volume of deals in South and Central America (see Figure 1.3) is comparatively small compared to the United States and Europe. However, in South America, M&A volume has grown steadily from 2003 even into 2008 when most of the rest of the world were scaling back on deals. While countries such as Argentina have continued to deal with stagnant economies, others such as Brazil have shown impressive growth. In 2009, however, we begin to see more retrenchment in the South American M&A activity. In Central America, a much smaller combination of national economies relative to South America, deal volume spiked in 2006 but fell off dramatically in 2008 and 2009.

Date Announced	Date Effective	Target Name	Target Nation	Acquirer Name	Acquirer Nation	Value of Transaction ($mil)
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	34,161.791
05/25/08	10/15/08	China Netcom Grp (HK) Corp Ltd	Hong Kong	China Unicom Ltd	Hong Kong	25,416.136
05/12/08	11/17/08	St George Bank Ltd	Australia	Westpac Banking Corp	Australia	17,932.977
04/11/07	07/25/07	SK Corp-Petrochemical Business	South Korea	Shareholders	South Korea	16,984.454
07/02/07	11/23/07	Coles Group Ltd	Australia	Wesfarmers Ltd	Australia	15,287.793
10/27/06	07/16/07	Rinker Group Ltd	Australia	Cemex SAB de CV	Mexico	14,247.733
02/11/07	05/08/07	Hutchison Essar Ltd	India	Vodafone Group PLC	United Kingdom	12,748.00
05/16/02	07/01/02	CH Mobile HK(BVI)-Mobile	China	China Mobile (Hong Kong) Ltd	Hong Kong	10,335.271
07/14/03	12/31/03	China Telecom-Fixed Line Asset	China	China Telecom Corp Ltd	China	9,675.828

Table 1.3 Top Ten Asian M&As by Value of Transaction

Source: Thompson Financial, January 7, 2010.

Top Five Central American M&A by Value of Transaction

Date Effective	Value of Transaction ($ Millions)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
11/07/06	31,756.677	America Telecom SA de CV	Mexico	America Movil SA de CV	Mexico
11/14/07	16,170.822	Telmex-International Operation	Mexico	Shareholders	Mexico
09/06/00	15,098.655	America Movil SA	Mexico	Shareholders	Mexico
05/17/01	12,821.001	Banacci	Mexico	Citigroup Inc	United States
02/02/04	3,887.891	Grupo Financiero BBVA Bancomer	Mexico	BBVA	Spain

Top Five South American M&A by Value of Transaction

Date Effective	Value of Transaction ($ Millions)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
04/29/99	13,151.70	YPF SA	Argentina	Repsol SA	Spain
02/20/08	10,309.087	Bovespa Holding SA	Brazil	BM&F	Brazil
01/13/00	10,213.31	Telecommunicacoes de Sao Paulo	Brazil	Telefonica SA	Spain
11/03/08	8,464.769	Unibanco Holdings SA	Brazil	Banco Itau Holding Financeira	Brazil
09/01/97	6,200.669	Correo Argentino SA	Argentina	Investor Group	Argentina

TABLE 1.4 TOP FIVE CENTRAL AMERICAN AND SOUTH AMERICAN M&As BY VALUE OF TRANSACTION
Source: Thompson Financial, January 7, 2010.

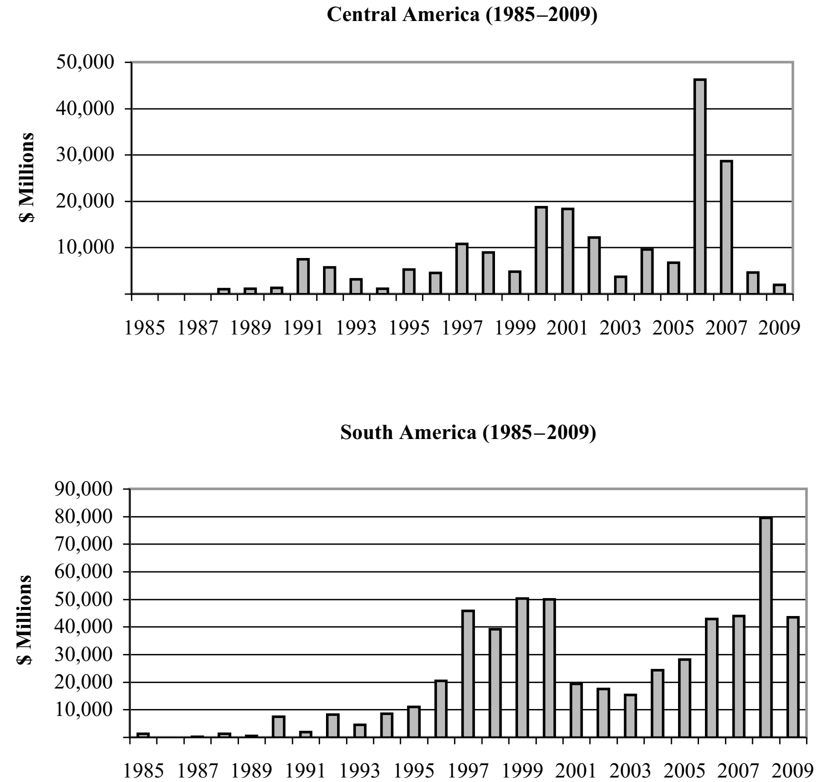

FIGURE 1.3 CENTRAL AMERICA AND SOUTH AMERICA, 1985–2009
Source: Thomson Securities Data, January 7, 2010.

With Mexico as the largest economy in Central America and Brazil and Argentina as two of the top three economies in South America, it is not surprising to see that these three nations account for the largest deals in these regions. The largest deals in Mexico come from the telecommunications industry. One in particular involved the spinoff of América Móvil, Telmex's cellular subsidiary. Telmex was controlled by the very successful investor Carlos Slim—who *Forbes* magazine found to be the world's richest man in 2010.[1] América Móvil then went on to pursue a series of M&As to expand the reach of its network. In doing so it became one of the largest mobile operators in the world.

DEFINITIONS

A merger is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. In a merger, the acquiring company assumes the assets and liabilities of the merged company. Sometimes the term *statutory merger* is

1. Steve Bertoni, "Billionaires," *Forbes*, March 29, 2010, 185 (5), 69–76.