Takeovers - Do Investors Profit?

You may have wondered over the years about all the company takeovers and mergers that occur from time to time. The obvious question they raise is: Do investors in the company orchestrating the takeover or merger actually profit from the exercise?

An article by Brendan Lau in *The Australian Financial Review* on 30 August 2010 headed *Beware the Value Trap in Takeovers* gave some clue from the headline. However, there was much more in the article that was driven by research.

Lau begins by asserting that most takeovers are not productive for the shareholders of the acquirer, which is why, when companies announce takeovers, their share price usually falls. He quotes Paul Kerin, professor of strategy at Melbourne Business School:

Acquisitions do create value on average, but ... [it all] *goes to the target's shareholders*.

This suggests to me very strongly something that I have used as a rule of thumb for many years based on my own experience: It is better to own shares in a company that is taken over than in a company that makes takeovers. Lau quotes Frank Villante, chief investment manager at Celeste Funds Management:

There are some companies that are quite good at doing acquisitions ... but they are in a minority.

Villante is also reported as opining that about two thirds of takeovers destroy value for the acquirer's shareholders. This is because they are driven by ego rather than cool calculation.

Instead, Lau suggests that special dividends or capital returns are more likely to give shareholders a better return. Professor Kerin's research points out that **real value more often flows from demergers and spin-offs** rather than takeovers.

Lau goes on to pull together some guidelines for investors to judge takeovers by looking at the structure of the takeover proposal. The studies he quotes suggest that cash takeovers are more likely to be sound than those involving scrip. The studies Lau quotes suggest that cash takeovers lead on average to a 14% growth in market capitalisation. There is only a 3% growth for scrip takeovers.

Lau also quotes professor Kerin as suggesting that hostile takeovers give better results for the acquirer than friendly or agreed takeovers. He thinks that this is because there is greater discipline exerted through having to substantiate the argument in favour of doing the hostile takeover. My thought on this point is rather different, but amounts to the same result: That a friendly takeover is usually too generous in order to get agreement from the target board, whereas a hostile takeover is at a price lower than is acceptable to the target's board and may therefore be a cheaper takeover.

The conclusion I draw here is that we should look for companies in which we own shares to make hostile takeovers for cash rather than agreed takeovers and mergers or scrip bids.

The other thing to look for is well known: that the acquisition of businesses in the same industry and sector are more likely to be sound.

Naturally, we should do our own thinking on takeovers and take little notice of what the board of companies we own say in justification of a takeover they are attempting. Bidder statements are sales brochures aimed at both the target's shareholders and the acquirer's own shareholders.

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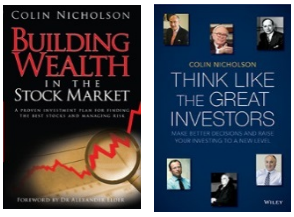

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