Commercial

Mergers and Acquisitions for Listed Companies: Valuation, Executing the Deal and Risk of Failure (Article 3 of 3)

Valuation

In deciding whether the M&A will be profitable, it is necessary to find out how much the company being acquired is really worth. The seller will tend to value the company as high as possible, while the buyer will try to get the lowest price that it can.

There are many ways to value companies. The most common method is to look at comparable companies in an industry, but deal-makers employ a variety of methods and tools when assessing a target company.

Usually, acquiring companies pay a substantial premium over the stock market value of the companies they buy. The justification for doing so is the notion of synergy; a merger benefits shareholders when a company's post-merger share price increases by the value of the potential synergy.

Executing the deal

The M&A deal starts with the tender offer from the CEO and top managers of a company. The process begins with the acquiring company carefully and quietly buying up shares in the target company, or building a position. The tender offer is often advertised in the business press, stating the offer price and the deadline by which the shareholders in the target company must accept or reject it.

The target company now has the option to do the following:

- Accept the terms of the offer.
- Attempt to negotiate. Highly sought-after target companies that are the object of several bidders will have greater scope for negotiation.
- Execute a hostile takeover defense. The target company may grant all shareholders – except the acquiring company – options to buy additional stock at a dramatic discount, which dilutes the acquiring company's share and intercepts its control of the company.
- Find a 'White Knight'. The target company may seek out a friendlier potential acquiring company who will offer an equal or higher price for the shares than the hostile bidder.

Finally, once the target company agrees to the tender offer and regulatory requirements are met, the merger will be executed.

Why the M&A deal can fail

Historical trends show that about two-thirds of big mergers will disappoint on their own terms, meaning they will lose value on the stock market. The motivations driving the M&A can be flawed and efficiencies from economies of scale may not be realised.

Coping with M&A deals can make managers spread their time too thinly and neglect their core business. The chances for success are further reduced if the corporate cultures of the companies are very different. Merging companies can focus on integration and cost-cutting so much that they neglect day-to-day business, thereby prompting nervous customers to go elsewhere.

Failure can be expensive. The failed deal between Britvic and AG Barr, the makers of Irn-Bru in 2012/2013 cost AG Barr £4.9m. In this case, the proposed merger was first put on hold when the Office of Fair Trading referred the merger to the Competition Commission, which is a good example of how the regulatory bodies can get involved. However, although the deal was cleared, the companies could not agree on new terms and the merger collapsed. Whilst the exact reasons behind the failure may never be known, probably down to the commercially sensitive nature of the information, it is a cautionary tale for any company seeking to enter into an M&A.

Should you have any queries relating to this, or any of the articles on M&A deals, please do not hesitate to contact the Commercial team at 3HR Legal.

Shamina Chowdhury
Solicitor
E: shamina.chowdhury@3hrlegal.com