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## INTRODUCTION

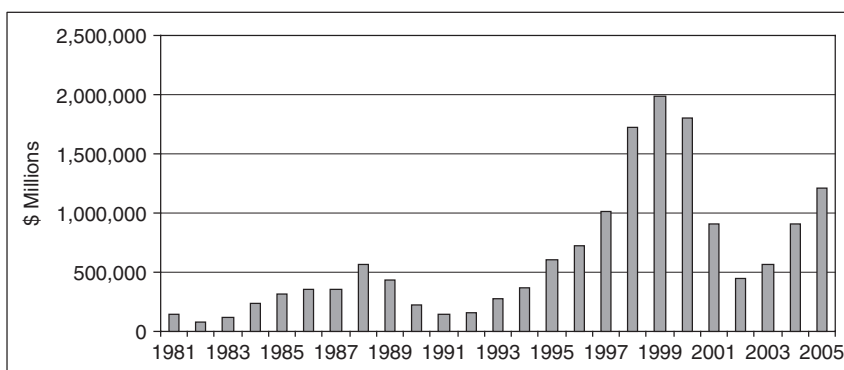
### RECENT M&A TRENDS

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 prior 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 1990–91 recession, many felt that it would be a long time before we would see another merger wave like it. However, after a relatively short recession and an initially slow recovery, the economy picked up speed in 1993, and by 1994 we were on a path to another record-setting merger period. This one would feature deals that would make the ones of the 1980s seem modest. There would be many megamergers and many cross borders involving U.S. buyers and sellers, but also many large deals not involving U.S. firms. In the fifth wave the large-scale M&A business had become a global phenomenon. This was in sharp contrast to prior merger periods when the major players were mainly U.S. companies.

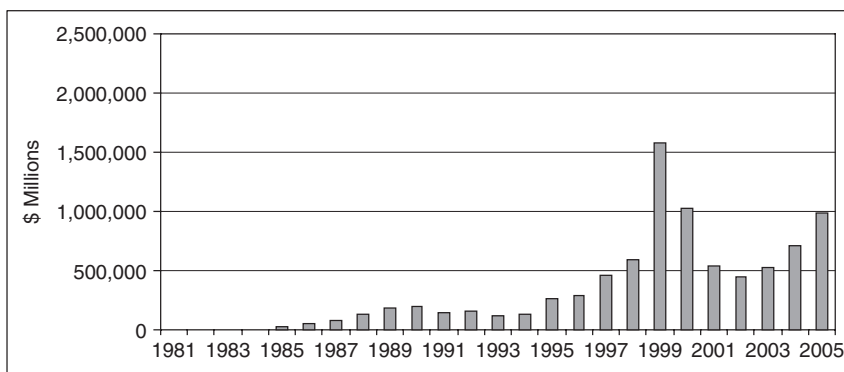
Starting in the early 1980s and the beginning of the fourth merger wave, we see the M&A area business mainly centered in the United States with the vast majority of transactions taking place within the continental United States. From a global perspective, the most pronounced increase in M&A volume in the fifth merger wave took place in Europe. After a short falloff at the end of the fourth merger wave, European M&A volume picked up dramatically starting in 1995, when it doubled (see Exhibit 1.1). The value of European deals peaked in 1999, when it equaled 38% of total global M&A deal value. There are several reasons why Europe became the scene for such an increased volume of deals. First, the same factors that caused M&A volume to pick up in the United States, such as the increase in worldwide economic demand, also played a key role in Europe. However, similar economic conditions prevailed in the 1980s, and Europe failed to produce a comparable increase in mergers as it did in the 1990s. The reasons why the European response was much different this time was that the European economy had structurally changed. The European Union had been established and artificial regulatory

barriers were being dismantled. In the past, many European corporations were controlled by large blockholders such as those owned by individual families. However, by the fifth merger wave, these holdings had become somewhat less significant and more shares were in the hands of other parties who would be more receptive to M&As. The fact remains, though, that family control of European corporations still is greater than in the United States. Examples include the Benetton family, which controls the Italian clothing company of the same name; Francois Pinault, who controls a large French retail empire that includes Gucci; the German family-controlled Bertelsmann empire; and the Wallenberg family's holdings in Swedish companies such as Ericsson and ABB. As these holdings get passed on to later generations, the companies will more likely become takeover targets.

Exhibit 1.1 clearly shows that the fifth merger wave peaked in 1999 and the value of M&As declined significantly in 2001 and even more so in 2002. Similar trends are apparent in both Europe and the United States. The magnitude of the fifth wave deals is very apparent when we look at Table 1.1, which shows that all of the largest deals of all time occurred in the years 1998–2001. This table also reveals another interesting trend of this period. A disproportionate number of the deals came from certain sectors of the economy. In particular, telecommunications, media, and banking and finance featured a



(a)



(b)

**EXHIBIT 1.1** VALUE OF M&As 1980–2004: (a) UNITED STATES AND (b) EUROPE

Source: Thomson Securities Financial Data.

RECENT M&A TRENDS

Date Announced	Date Effective	Value of Transaction (\$Million)	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	164,746.46	Time Warner	United States	America Online Inc.	United States
10/5/1999	—	113,643.77	Sprint Corp.	United States	MCI WorldCom	United States
11/4/1999	6/19/2000	89,167.72	Warner-Lambert Co.	United States	Pfizer Inc.	United States
4/18/1999	—	81,527.62	Telecom Italia SpA	Italy	Deutsche Telekom AG	Germany
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
211/4/1999	—	75,563.15	Warner-Lambert Co.	United States	American Home Products Corp.	United States
10/28/2004	—	74,349.15	Shell Transport & Trading Co.	United Kingdom	Royal Dutch Petroleum Co.	Netherlands
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, December 6, 2005.

disproportionate amount of total deal volume. These sectors were red hot in the 1990s. There are several reasons for this. One was the “irrational exuberance” that overwhelmed some of these sectors, such as parts of the technology sectors. We will discuss this further in Chapter 2. Other industries, such as banking, continued a process of consolidation that had begun in the prior decade when industry deregulation began.

The very important role of Europe in the M&A market is underscored by the fact that the largest deal in history was the \$203 billion acquisition of Mannesmann AG by Vodafone Airtouch PLC in June 2000. The value of this deal was more than double the next largest European transaction, which was the \$82 billion acquisition of Telecom Italia SPA by Deutsche Telekom AG (see Table 1.2).

In the Asian markets we see that with the exception of Australia, which has participated in both the fourth and fifth merger wave, Asian countries, including Japan, have generally not had much M&A activity within their borders (see Exhibit 1.2). In Japan, which is the world’s second largest economy, this changed dramatically in 1999, when the country’s deal volume skyrocketed. The number of deals slowed in the few years that followed but started to rebound in 2003. A similar trend is apparent in South Korea. Both nations had very restrictive and interlocked corporate structures that began to unravel toward the end of the 1990s—partly in response to the pressures of an economic downturn. As both economies began to restructure starting in the late 1990s, selloffs and acquisitions became more common.

In Exhibit 1.2 we have combined the deal volume data for China and Hong Kong, but both are significant. However, Table 1.3 shows the important role of Hong Kong, as the largest Asian deal was the August 2000 acquisition of Cable and Wireless HKT by Pacific Century CyberWorks—both Hong Kong firms. The deal is also noteworthy in that it was a hostile takeover. Pacific Century CyberWorks, led by Internet investor Richard Li, who is the son of Hong Kong tycoon Li Ka-shing, outbid Singapore Telecommunications Ltd. It is interesting that the combination of Cable and Wireless and Pacific Century CyberWorks created a telecom and media conglomerate that was second in size only to AOL Time Warner, which itself was the product of a failed megamerger.

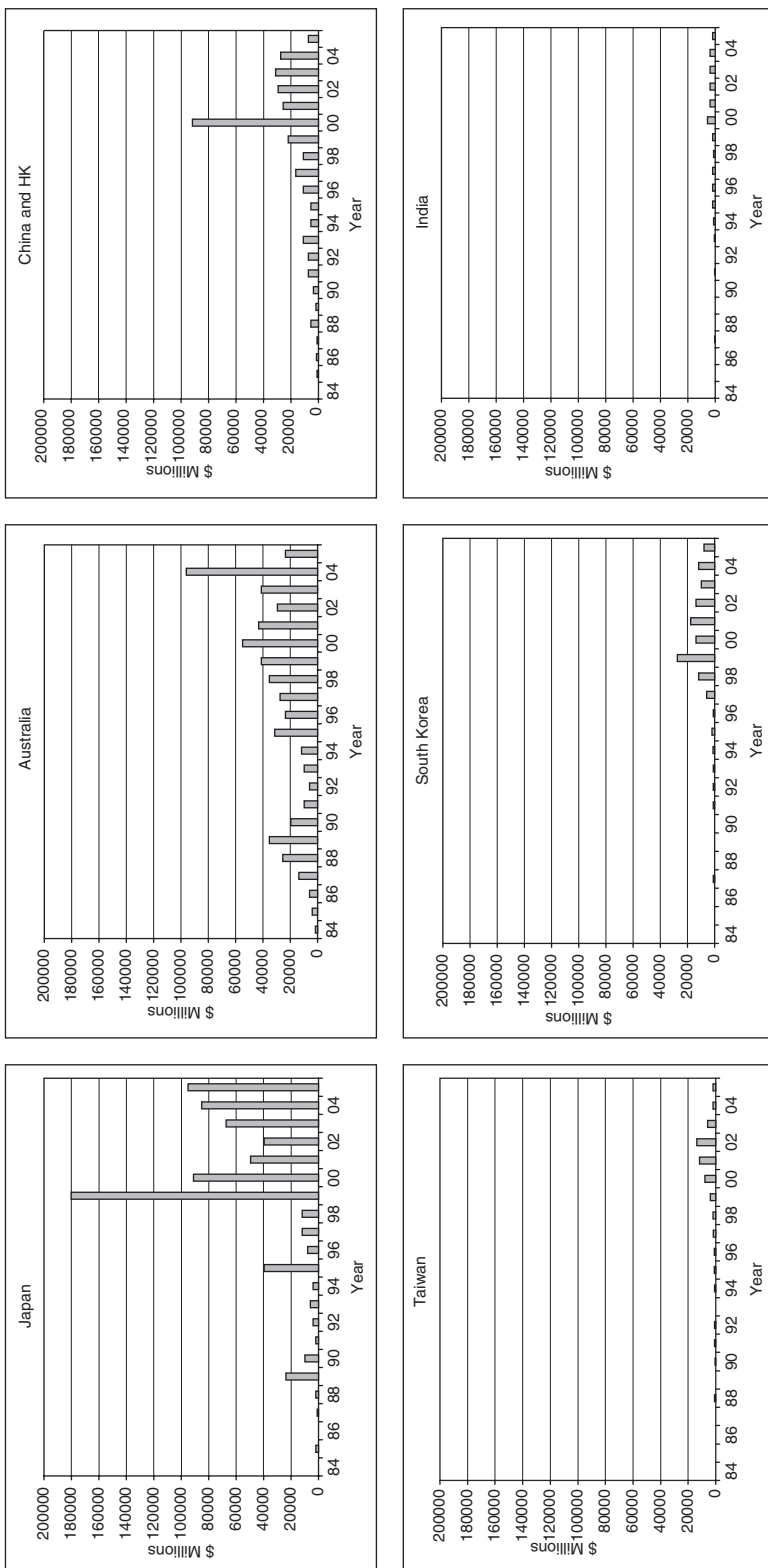
As the Chinese economy continues to grow dramatically, it has begun to increasingly look outside its borders for acquisition candidates. The 2005 acquisition of IBM’s PC business by Lenovo is an example. However, acquisitions of Chinese companies by non-Chinese firms are difficult and risky as that country is still in the early stages of becoming less centralized and more of a free market economy. Deal volume in Taiwan is relatively small, but that is mainly due to the comparatively smaller size of the economy. India remains a relatively small player in the worldwide M&A market, although this may change over the coming years.

After the United States, Europe, and Asia, the next largest M&A markets are Central and South America. In 2000, the highest deal volume year for M&A in many regions including South America, deal volume in South America was approximately equal to Australia, somewhat higher than Hong Kong and roughly double deal volume in South Korea. While deal volume in both South and Central America varies, the volume in South America has been roughly double that of Central America (see Exhibit 1.3 and Table 1.4).

<b>Date Announced</b>	<b>Date Effective</b>	<b>Value of Transaction (\$Million)</b>	<b>Target Name</b>	<b>Target Nation</b>	<b>Acquirer Name</b>	<b>Acquirer Nation</b>
11/14/1999	6/19/2000	202,785.13	Mannesmann AG	Germany	Vodafone AirTouch PLC	United Kingdom
4/18/1999		81,527.62	Telecom Italia SpA	Italy	Deutsche Telekom AG	Germany
1/17/2000	12/27/2000	75,960.85	SmithKline Beecham PLC	United Kingdom	Glaxo Wellcome PLC	United Kingdom
10/28/2004		74,349.15	Shell Transport & Trading Co.	United Kingdom	Royal Dutch Petroleum Co.	Netherlands
1/26/2004	8/20/2004	60,243.38	Aventis SA	France	Sanofi-Synthelabo SA	France
7/19/1999		51,135.18	Total Fina SA	France	Elf Aquitaine	France
7/5/1999	3/27/2000	50,070.05	Elf Aquitaine	France	Total Fina SA	France
5/30/2000	8/22/2000	45,967.07	Orange PLC	United Kingdom	France Telecom SA	France
6/20/2000	12/8/2000	40,428.19	Seagram Co. Ltd.	Canada	Vivendi SA	France
9/24/1999		38,814.91	National Westminster Bank PLC	United Kingdom	Bank of Scotland PLC	United Kingdom

**TABLE 1.2** TOP TEN EUROPEAN M&AS BY VALUE OF TRANSACTION

Source: Thompson Financial, December 6, 2005.



**EXHIBIT 1.2** ASIAN M&A VOLUME  
Source: Thompson SDC.

Date Announced	Date Effective	Value of Transaction (\$Million)	Target Name	Target Nation	Acquirer Name	Acquirer Nation
2/29/2000	8/17/2000	37,442.15	Cable & Wireless HKT	Hong Kong	Pacific Century CyberWorks Ltd.	Hong Kong
10/4/2000	11/13/2000	34,007.71	Beijing Mobile, 6 others	China	China Telecom Hong Kong Ltd.	Hong Kong
3/19/2001	6/29/2001	11,510.99	Billiton PLC	United Kingdom	BHP Ltd.	Australia
5/16/2002	7/1/2002	10,335.27	CH Mobile HK(BVI)-Mobile	China	China Mobile (Hong Kong) Ltd.	Hong Kong
7/14/2003	12/31/2003	9,675.83	China Telecom-Fixed Line Asset	China	China Telecom Corp. Ltd.	China
3/26/2001	9/17/2001	8,491.12	Cable & Wireless Optus Ltd.	Australia	Sing.Tel.	Singapore
3/8/2005	6/17/2005	7,363.58	WMC Resources Ltd.	Australia	BHP Billiton Ltd.	Australia
11/16/2001	4/22/2002	6,868.85	LG Electronics Inc.-Electronics	South Korea	Shareholders	South Korea
10/28/2004		6,522.59	WMC Resources Ltd.	Australia	Xstrata PLC	Switzerland
1/7/2000	6/30/2000	6,447.97	Worldwide Semiconductor	Taiwan	Taiwan Semiconductor Mnfr. Co.	Taiwan

**TABLE 1.3** TOP TEN ASIAN M&AS BY VALUE OF TRANSACTION

Source: Thompson Financial, December 6, 2005.

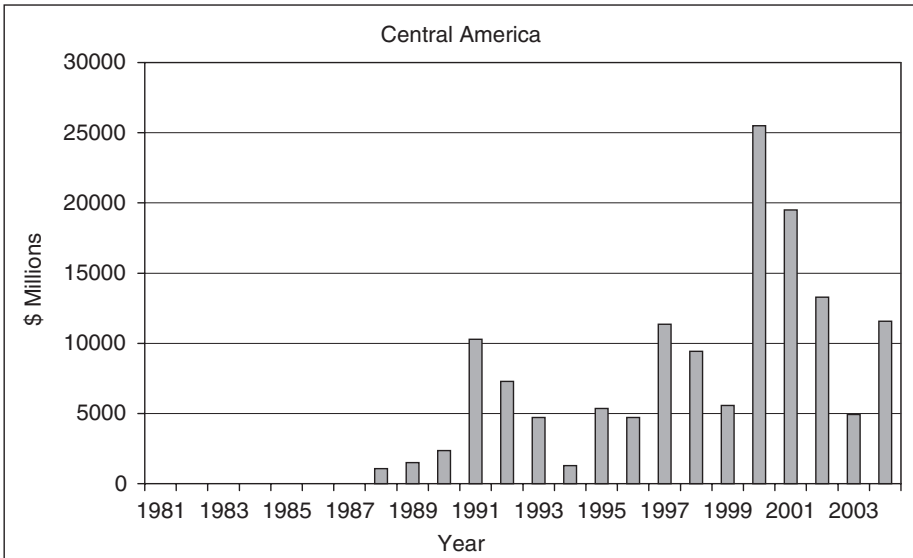
Top Five Central American M&As by Value of Transaction						
Date Effective	Value of Transaction (\$Million)	Target Name	Target Nation	Acquirer Name	Acquirer Nation	
2/7/2001	15,098.66	America Movil SA	Mexico	Shareholders	Mexico	
8/6/2001	12,821.00	Banacci	Mexico	Citigroup Inc.	United States	
3/22/2004	3,887.89	Grupo Financiero BBVA Bancomer	Mexico	BBVA	Spain	
5/6/2003	3,692.04	Panamerican Beverages Inc.	United States	Coca-Cola FEMSA SA CV	Mexico	
5/2/2002	3,217.45	America Telecom SA de CV	Mexico	Shareholders	Mexico	

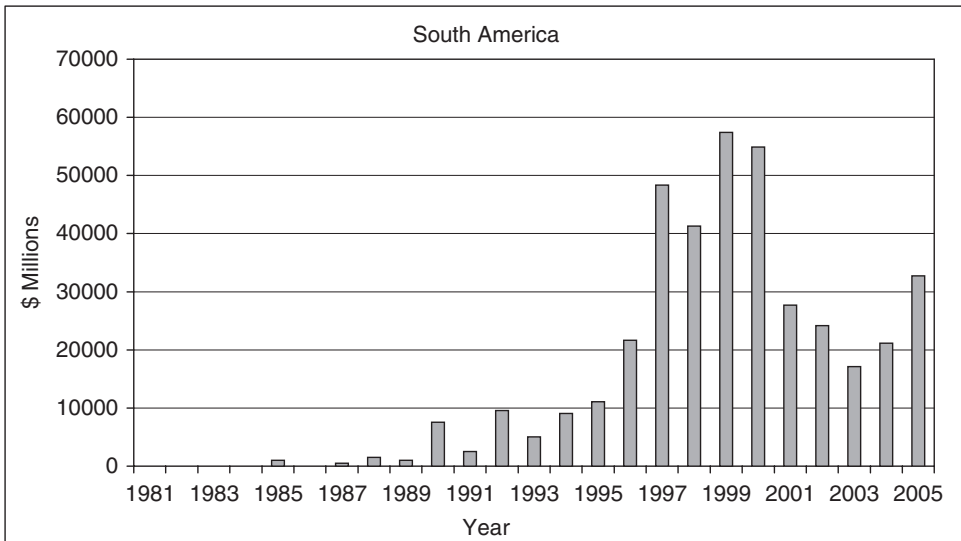
Top Five South American M&As by Value of Transaction						
Date Effective	Value of Transaction (\$Million)	Target Name	Target Nation	Acquirer Name	Acquirer Nation	
6/24/1999	13,151.70	YPF SA	Argentina	Repsol SA	Spain	
7/10/2000	10,213.31	Telecomunicacoes de Sao Paulo	Brazil	Telefonica SA	Spain	
8/30/2004	7,758.01	John Labatt Ltd.	Canada	Ambev	Brazil	
9/1/1997	6,200.67	Correo Argentino SA	Argentina	Investor Group	Argentina	
1/23/1998	5,134.14	Argentina-Airports (33)	Argentina	Aeropuertos Argentina 2000	United States	

**TABLE 1.4** TOP FIVE M&AS BY VALUE OF TRANSACTION: (a) CENTRAL AMERICA AND (b) SOUTH AMERICA

Source: Thompson Financial, December 6, 2005.



(a)



(b)

**EXHIBIT 1.3** M&A VOLUME, 1981–2005: (a) CENTRAL AMERICA AND (b) SOUTH AMERICA

Source: Thompson Financial, May 13, 2005.

Having reviewed the recent trends in the field, let us begin with our study of the subject of M&As. This will begin with a discussion of the basic terminology used in the field.

## 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 used to refer to this type of business transaction. It basically means that the merger is being done consistent with a specific state statute. The most common statute for mergers is the Delaware one, as so many companies are incorporated in that state.

A statutory merger differs from a *subsidiary merger*, which is a merger of two companies in which the target company becomes a subsidiary or part of a subsidiary of the parent company. The acquisition by General Motors of Electronic Data Systems, led by its colorful Chief Executive Officer Ross Perot, is an example of a subsidiary merger. In a *reverse subsidiary merger*, a subsidiary of the acquirer is merged into the target.

A merger differs from a *consolidation*, which is a business combination whereby two or more companies join to form an entirely new company. All of the combining companies are dissolved and only the new entity continues to operate. For example, in 1986, the computer manufacturers Burroughs and Sperry combined to form UNISYS. In a consolidation, the original companies cease to exist and their stockholders become stockholders in the new company. One way to look at the differences between a merger and a consolidation is that with a merger  $A + B = A$ , where company B is merged into company A. In a consolidation,  $A + B = C$ , where C is an entirely new company. Despite the differences between them, the terms *merger* and *consolidation*, as is true of many of the terms in the M&A field, are sometimes used interchangeably. In general, when the combining firms are approximately the same size, the term *consolidation* applies; when the two firms differ significantly by size, *merger* is the more appropriate term. In practice, however, this distinction is often blurred, with the term *merger* being broadly applied to combinations that involve firms of both different and similar sizes.

Another term that is broadly used to refer to various types of transactions is *takeover*. This term is vaguer; sometimes it refers only to hostile transactions, and other times it refers to both friendly and unfriendly mergers.

## VALUING A TRANSACTION

Throughout this book we cite various merger statistics on deal values. The method used by Mergerstat is the most common method relied on to value deals. Enterprise value is defined as the base equity price plus the value of the target's debt (including both short and long term) and preferred stock less its cash. The *base equity price* is the total price less the value of the debt. The buyer is defined as the company with the larger market capitalization or the company that is issuing shares to exchange for the other company's shares in a stock-for-stock transaction.

## TYPES OF MERGERS

Mergers are often categorized as horizontal, vertical, or conglomerate. A *horizontal merger* occurs when two competitors combine. For example, in 1998, two petroleum companies, Exxon and Mobil, combined in a \$78.9 billion merger. If a horizontal merger causes the combined firm to experience an increase in market power that will have anti-competitive effects, the merger may be opposed on antitrust grounds. In recent years, however, the U.S. government has been somewhat liberal in allowing many horizontal mergers to go unopposed.

*Vertical mergers* are combinations of companies that have a buyer–seller relationship. For example, in 1993, Merck, the world’s largest drug company, acquired Medco Containment Services, Inc., the largest marketer of discount prescription medicines, for \$6 billion. The transaction enabled Merck to go from being the largest pharmaceutical company to also being the largest integrated producer and distributor of pharmaceuticals. This transaction was not opposed by antitrust regulators even though the combination clearly resulted in a more powerful firm. Ironically, regulators cited increased competition and lower prices as the anticipated result. Merck, however, might have been better off if the deal had been held up by regulators. Following this acquisition, and other copycat deals by competitors, great concerns were raised about Merck’s effect on consumer drug choice decisions. While Merck saw the deal as a way to place its drugs in the hands of patients ahead of competitors, there was a backlash about drug manufacturers using distributors to affect consumer drug treatment choices. When this problem emerged, there were few benefits of the deal and Merck was forced to part with the distributor. This was a good example of a bidder buying a company in a similar business, one which it thought it knew well, where it would have been better off staying with what it did best—making and marketing drugs.

A *conglomerate merger* occurs when the companies are not competitors and do not have a buyer–seller relationship. One example would be Philip Morris, a tobacco company, which acquired General Foods in 1985 for \$5.6 billion, Kraft in 1988 for \$13.44 billion, and Nabisco in 2000 for \$18.9 billion. Interestingly, Philip Morris, now called Altria, has used the cash flows from its food and tobacco businesses to become less of a domestic tobacco company and more of a food business. This is because the U.S. tobacco industry has been declining at an average rate of 2% per year (in shipments), although the international tobacco business has not been experiencing such a decline.

Another major example of a conglomerate is General Electric (GE). This company has done what many others have not been able to do successfully—manage a diverse portfolio of companies in a way that creates shareholder wealth. GE is a serial acquirer and a highly successful one at that. As we will discuss in Chapter 4, the track record of diversifying and conglomerate acquisitions is not good. We will explore why a few companies have been able to do this while many others have not.

## REASONS FOR MERGERS AND ACQUISITIONS

As discussed in Chapter 4, there are several possible motives or reasons that firms might engage in M&As. One of the most common motives is expansion. Acquiring a company in a line of business or geographic area into which the company may want to expand can be quicker than internal expansion. An acquisition of a particular company may provide certain synergistic benefits for the acquirer, such as when two lines of business complement one another. However, an acquisition may be part of a diversification program that allows the company to move into other lines of business. In the pursuit of expansion, firms engaging in M&As cite potential synergistic gains as one of the reasons for the transaction. Synergy occurs when the sum of the parts is more productive and valuable than the individual components. There are many potential sources of synergy and they are discussed in Chapter 4.

Financial factors motivate some M&As. For example, an acquirer's financial analysis may reveal that the target is undervalued. That is, the value of the buyer may be significantly in excess of the market value of the target, even when a premium that is normally associated with changes in control is added to the acquisition price. Other motives, such as tax motives, also may play a role in an acquisition decision. These motives and others are critically examined in greater detail in Chapter 15.

## MERGER FINANCING

Mergers may be paid for in several ways. Transactions may use all cash, all securities, or a combination of cash and securities. Securities transactions may use the stock of the acquirer as well as other securities such as debentures. The stock may be either common stock or preferred stock. They may be registered, meaning they are able to be freely traded on organized exchanges, or they may be restricted, meaning they cannot be offered for public sale, although private transactions among a limited number of buyers, such as institutional investors, are permissible.

If a bidder offers its stock in exchange for the target's shares, this offer may either provide for a fixed or floating exchange ratio. When the exchange ratio is floating the bidder offers a dollar value of shares as opposed to a specific number of shares. The number of shares that is eventually paid by the bidder is determined by dividing the value offered by the bidder's average stock price during a prespecified period. This period, called the pricing period, is usually some months after the deal is announced and before the closing of the transaction. The offer could also be defined in terms of a "collar" which provides for a maximum and minimum number of shares within the floating value agreement.

Stock transactions may offer the seller certain tax benefits that cash transactions do not provide. However, securities transactions require the parties to agree on the value of the securities. This may create some uncertainty and may give cash an advantage over securities transactions from the seller's point of view. For large deals, all-cash compensation may mean that the bidder has to incur debt, which may carry with it unwanted adverse risk consequences. Although such deals were relatively more common in the 1980s, securities transactions became more popular in the 1990s.

## MERGER PROFESSIONALS

When a company decides it wants to acquire or merge with another firm, it typically does so by using the services of outside professionals. These professionals usually include investment bankers, attorneys, accountants, and valuation experts. Investment bankers may provide a variety of services, including helping to select the appropriate target, valuing the target, advising on strategy, and raising the requisite financing to complete the transaction. During the heyday of the fourth merger wave in the 1980s, merger advisory and financing fees were a significant component of the overall profitability of the major investment banks. Table 1.5 shows a ranking of M&A financial advisors.

Investment banks derive fees in various ways from M&As. They may receive advisory fees for their expertise in structuring the deal and handling the strategy—especially in hostile bids. These fees may be contingent on the successful completion of the deal. At that point investment bankers may receive a fee in the range of 1 to 2% of the total value of the transaction. Investment banks also may make money from financing work on M&As. In addition, the investment bank may have an arbitrage department that may profit in ways we will discuss shortly.

The role of investment banks changed somewhat after the fourth merger wave ended. The dealmakers who promoted transactions just to generate fees became unpopular. Companies that were engaged in M&As tended to be more involved in the deals and took over some of the responsibilities that had been relegated to investment bankers in the 1980s. More companies directed the activities of their investment bankers as opposed to merely following their instructions as they did in the prior decade. Managers of corporations decided that they would control their acquisition strategy and for a while this resulted in more strategic and better conceived deals. However, as we will see, managers themselves began to make major merger blunders as we moved through the fifth merger wave.

Rank	Financial Advisor	Total Invested Capital of Deals Worked (\$ Billions)	Total Number of Deals
1	Goldman Sachs & Co.	528.218	192
2	Morgan Stanley	458.262	152
3	JP Morgan Chase & Co., Inc.	331.625	147
4	Merrill Lynch & Co., Inc.	296.304	125
5	Lehman Brothers Holdings, Inc.	294.455	113
6	UBS AG	279.358	137
7	Citigroup, Inc.	271.075	145
8	Credit Suisse First Boston, Inc.	238.222	137
9	Deutsche Bank Securities, Inc.	159.243	87
10	Bear, Stearns & Co., Inc.	125.521	50

**TABLE 1.5** U.S. FINANCIAL ADVISOR RANKINGS, 1/1/05-12/31/05

Source: *Mergerstat Review*, 2006

Rank	Legal Advisor	Total Invested Capital of Deals Worked (\$ Billions)	Total Number of Deals
1	Simpson Thacher & Bartlett LLP	385.5	118
2	Wachtell Lipton Rosen & Katz	315.5	65
3	Skadden, Arps, Slate, Meagher & Flom LLP	312.9	189
4	Sullivan & Cromwell LLP	299.7	119
5	Shearman & Sterling LLP	273.7	116
6	Weil Gotshal & Manges LLP	269.5	169
7	Cleary Gottlieb Steen & Hamilton LLP	261.6	79
8	Davis Polk & Wardell	239.6	76
9	Latham & Watkins LLP	232.5	208
10	Dewey Ballantine LLP	216.5	101

**TABLE 1.6** U.S. LEGAL ADVISOR RANKINGS, 2005

Source: *Mergerstat Review*, 2006.

Given the complex legal environment that surrounds M&As, attorneys also play a key role in a successful acquisition process. Law firms may be even more important in hostile takeovers than in friendly acquisitions because part of the resistance of the target may come through legal maneuvering. Detailed filings with the Securities and Exchange Commission (SEC) may need to be completed under the guidance of legal experts. In both private and public M&As, there is a legal due diligence process that attorneys should be retained to perform. Table 1.6 shows the leading legal M&A advisors in 2000. Accountants also play an important role in M&As. They have their own accounting due diligence process. In addition, accountants perform various other functions such as preparing pro forma financial statements based on scenarios put forward by management or other professionals. Still another group of professionals who provide important services in M&As are valuation experts. These individuals may be retained by either a bidder or a target to determine the value of a company. We will see in Chapter 14 that these values may vary depending on the assumptions employed. Therefore, valuation experts may build a model that incorporates various assumptions, such as revenue growth rate or costs, which may be eliminated after the deal. As these and other assumptions vary, the resulting value derived from the deal also may change.

## MERGER ARBITRAGE

Another group of professionals who can play an important role in takeovers is arbitrageurs (arbs). Generally, arbitrage refers to the buying of an asset in one market and selling it in another. Risk arbitrageurs look for price discrepancies between different markets for the same assets and seek to sell in the higher-priced market and buy in the lower one. Practitioners of these kinds of transactions try to do them simultaneously, thus locking in their gains without risk. With respect to M&A, arbitrageurs purchase stock of companies

that may be taken over in the hope of getting a takeover premium when the deal closes. This is referred to as risk arbitrage, as purchasers of shares of targets cannot be certain the deal will be completed. They have evaluated the probability of completion and pursue deals with a sufficiently high probability.

The merger arbitrage business is fraught with risks. When markets turn down and the economy slows, deals are often canceled. This occurred in the late 1980s, when the stock market crashed in 1987 and the junk bond market declined dramatically. The junk bond market was the fuel for many of the debt-laden deals of that period. In addition, when merger waves end, deal volume dries up, lowering the total business available.

Some investment banks have arbitrage departments. However, if an investment bank is advising a client regarding the possible acquisition of a company, it is imperative that a *Chinese wall* between the arbitrage department and the advisors working directly with the client be constructed so that the arbitragers do not benefit from the information that the advisors have but that is not yet readily available to the market. To derive financial benefits from this type of *inside information* is a violation of securities laws.

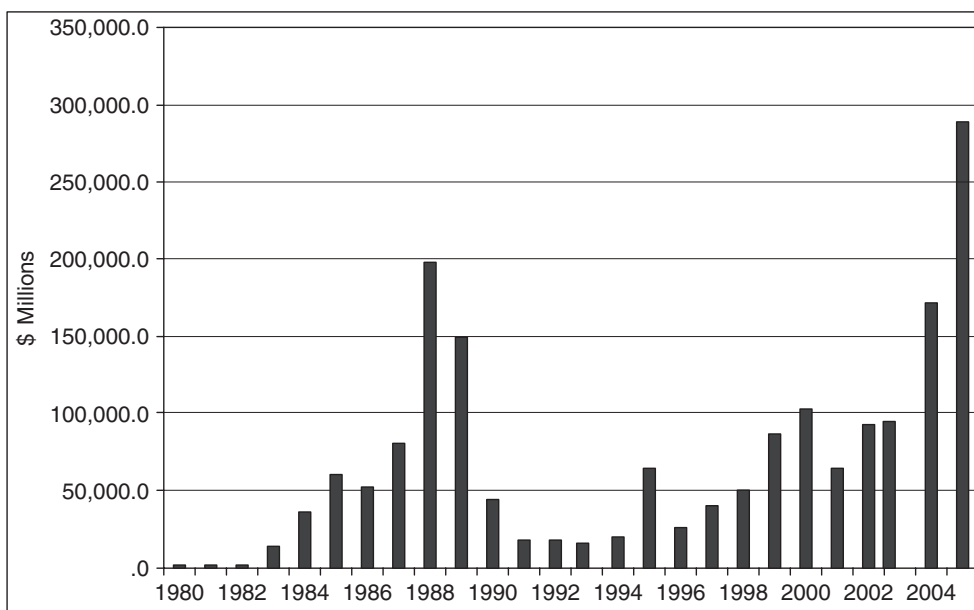
The arbitrage business has greatly expanded over the past five to ten years. Several active funds specialize in merger arbitrage. These funds may bet on many deals at the same time. They usually purchase the shares after a public announcement of the offer has been made. Shares in these funds can be an attractive investment because their returns may not be as closely correlated with the market as other investments (except in cases of sharp and unexpected downturns).

## LEVERAGED BUYOUTS AND THE PRIVATE EQUITY MARKET

In a leveraged buyout (LBO), a buyer uses debt to finance the acquisition of a company. The term is usually reserved, however, for acquisition of public companies where the acquired company becomes private. This is referred to as *going private* because all of the public equity is purchased, usually by a small group or a single buyer, and the company is no longer traded in securities markets. One version of an LBO is a *management buyout*. In a management buyout, the buyer of a company, or a division of a company, is the manager of the entity.

Most LBOs are buyouts of small and medium-sized companies or divisions of large companies. However, in what was then the largest transaction of all time, the 1989 \$25.1 billion LBO of RJR Nabisco by Kohlberg Kravis & Roberts shook the financial world. The leveraged buyout business declined after the fourth merger wave but rebounded somewhat in the fifth wave (Exhibit 1.4). There are several reasons for this, including the collapse of the junk bond market. These issues are discussed at length in Chapters 7 and 8. However, the LBO business rebounded in the fifth merger wave and then took off in the mid-2000s. In 2005 and 2006, we saw the return of the mega-LBO. In addition, this business became a truly global one by that time.

LBOs utilize a significant amount of debt along with an equity investment. Often this equity investment comes from investment pools created by *private equity* firms. These firms solicit investments from institutional investors. The monies are used to acquire equity positions in various companies. Sometimes these private equity buyers acquire



**EXHIBIT 1.4** WORLDWIDE LEVERAGED BUYOUTS IN DOLLAR VALUE, 1980–2004

Source: Thomson Financial Securities Data.

entire companies, while in other instances they take equity positions in companies. Sometimes they may use some of their equity, which they may combine with a significant amount of debt to pursue an LBO. The private equity business has grown significantly in recent years. We will discuss this further in Chapter 8.

## CORPORATE RESTRUCTURING

Users of the term *corporate restructuring* usually are referring to asset selloffs such as *divestitures*. Companies that have acquired other firms or have developed other divisions through activities such as product extensions may decide that these divisions no longer fit into the company's plans. The desire to sell parts of a company may come from poor performance of a division, financial exigency, or a change in the strategic orientation of the company. For example, the company may decide to refocus on its *core* business and sell off noncore subsidiaries. This type of activity increased after the end of the third merger wave as many companies that engaged in diverse acquisition campaigns to build conglomerates began to question the advisability of these combinations. There are several forms of corporate selloffs, with divestitures being only one kind. Spin-offs enjoyed increased popularity in the early 1990s, while equity carve-outs provided another way that selloffs could be accomplished. The relative benefits of each of these alternative means of selling off part of a company are discussed in Chapter 10.

Other forms of corporate restructuring are cost and workforce restructuring. In the 1990s, we saw many companies engage in *corporate downsizing* as they strove to become

more efficient. This was encouraged by several factors, including the 1990–91 recession and the international competitive pressure of the globalization of world markets. Another form of corporate restructuring is *financial restructuring*, which refers to alterations in the capital structure of the firm, such as adding debt and thereby increasing financial leverage. Although this type of restructuring is important in corporate finance and is often done as part of the financing activities for M&As, it is not treated in this text as a form of corporate restructuring. Rather, the term *restructuring* is reserved for the more physical forms of restructuring such as divestitures.

## MERGER NEGOTIATIONS

Most M&As are negotiated in a friendly environment. The process usually begins when the management of one firm contacts the target company's management, often through the investment bankers of each firm. The management of both firms keep the respective boards of directors up-to-date on the progress of the negotiations because mergers usually require the boards' approval. Sometimes this process works smoothly and leads to a quick merger agreement. A good example of this was the 1995 \$19 billion acquisition of Capital Cities/ABC Inc. by Walt Disney Co. In spite of the size of this deal, there was a quick meeting of the minds by management of these two firms and a friendly deal was completed relatively quickly. Perhaps the speed with which these managers pushed this deal through was too fast, as the combination left much to be desired and the synergies between the two companies were often hard to see. A quick deal may not be the best. The AT&T acquisition of TCI is another good example of a friendly deal where the buyer did not do its homework and the seller did a good job of accommodating the buyer's (AT&T's) desire to do a quick deal at a higher price. Speed may help ward off unwanted bidders but it may work against a close scrutiny of the transaction.

Sometimes friendly negotiations may break down, leading to the termination of the bid or a hostile takeover. An example of a negotiated deal that failed and led to a hostile bid was the 1995 tender offer by Moore Corporation for Wallace Computer Services, Inc. Here negotiations between two archrivals in the business forms and printing business proceeded for five months before they were called off, leading to a \$1.3 billion hostile bid. In other instances a bid is opposed by the target right away and the transaction quickly becomes a hostile one. A good example was the 2004 hostile bid by Oracle for PeopleSoft. This takeover battle was unusual for its protracted length. The battle went on for approximately a year before PeopleSoft finally capitulated and accepted a higher Oracle bid.

Except for hostile transactions, mergers usually are the product of a negotiation process between the managements of the merging companies. The bidding firm typically initiates the negotiations when it contacts the target's management to inquire whether the company is for sale and to express its interest in buying the target. This interest may be the product of an extensive search process to find the right acquisition candidates. However, it could be a recent interest inspired by the bidder's investment bank approaching it with a proposal that it believes would be a good fit for the bidder. For small-scale acquisitions, this intermediary might be a business broker.

Most merger agreements include a *material adverse change* clause. This clause may allow either party to withdraw from the deal if a major change in circumstances arises that would alter the value of the deal. This occurred in late 2005, when Johnson & Johnson (J&J) stated that it wanted to terminate its \$25.4 billion purchase of Guidant Corporation after Guidant's problems with recalls of heart devices it marketed became more pronounced. J&J, which still felt the criticism that it had paid too much for its largest prior acquisition, Alza, which it acquired in 2001 for \$12.3 billion, did not want to overpay for a company that might have unpredictable liabilities that would erode its value over time. J&J and Guidant exchanged legal threats but eventually agreed on a lower value of \$21.5 billion. J&J's strategy of using the material adverse change clause to get a better price backfired, as it opened the door for Boston Scientific to make an alternative offer and eventually outbid J&J for Guidant with a \$27 billion final offer.

Both the bidder and the target should conduct their own valuation analyses to determine what the target is worth. As discussed in Chapter 14, the value of the target for the buyer may be different from the value of that company for the seller. Valuations can differ due to varying uses of the target assets or different opinions on the future growth of the target. If the target believes that it is worth substantially more than what the buyer is willing to pay, a friendly deal may not be possible. If, however, the seller is interested in selling and both parties are able to reach an agreement on price, a deal may be possible. Other important issues, such as financial and regulatory approvals, if necessary, would have to be completed before the negotiation process could lead to a completed transaction.

When two companies engage in M&As they often enter into confidentiality agreements which allow them to exchange confidential information that may enable the parties to better understand the value of the deal. Following the eventual sale of Guidant to second bidder Boston Scientific for \$27 billion, J&J sued Boston Scientific and Abbott Laboratories in September, 2006. J&J alleged that Guidant leaked confidential information to Abbott which had agreed to purchase Guidant's cardiac stent business for approximately \$4 billion thereby reducing antitrust concerns. J&J alleged Guidant's release of this information violated its original agreement with J&J. This underscores another risk of M&A—the release of valuable internal information.

### **Disclosure of Merger Negotiations**

Before 1988, it was not clear what obligations companies involved in merger negotiations had to disclose their activities. However, in 1988, in the landmark *Basic Inc. v. Levinson* decision, the U.S. Supreme Court made it clear that a denial that negotiations are taking place when the opposite is the case is improper. Companies may not deceive the market by disseminating inaccurate or deceptive information, even when the discussions are preliminary and do not show much promise of coming to fruition. The Court's position reversed earlier positions that had treated proposals or negotiations as being immaterial. The *Basic v. Levinson* decision does not go so far as to require companies to disclose all plans or internal proposals involving acquisitions. Negotiations between two potential merger partners, however, may not be denied. The exact timing of the disclosure is still not clear. Given the requirement to disclose, a company's hand may be forced by

the pressure of market speculation. It is often difficult to confidentially continue such negotiations and planning for any length of time. Rather than let the information slowly leak, the company has an obligation to conduct an orderly disclosure once it is clear that confidentiality may be at risk or that prior statements the company has made are no longer accurate. In cases in which there is speculation that a takeover is being planned, significant market movements in stock prices of the companies involved—particularly the target—may occur. Such market movements may give rise to an inquiry from the exchange on which the company trades or from the National Association of Securities Dealers (NASD). Although exchanges have come under criticism for being somewhat lax about enforcing these types of rules, an insufficient response from the companies involved may give rise to disciplinary actions against the companies.

## MERGER APPROVAL PROCEDURES

In the United States, each state has a statute that authorizes M&As of corporations. The rules may be different for domestic and foreign corporations. Once the board of directors of each company reaches an agreement, they adopt a resolution approving the deal. This resolution should include the names of the companies involved in the deal and the name of the new company. The resolution should include the financial terms of the deal and other relevant information such as the method that is to be used to convert securities of each company into securities of the surviving corporation. If there are any changes in the articles of incorporation, these should be referenced in the resolution.

At this point the deal is taken to the shareholders for approval. Friendly deals that are a product of a free negotiation process between the management of two companies are typically approved by shareholders. A recent exception to that was the refusal of a majority of the shareholders of VNU NV, a Dutch publishing company, to approve the 2005 \$7 billion proposed acquisition of IMS Health, Inc., a pharmaceutical research publisher. VNU shareholders questioned the logic of the acquisition, and this left VNU in the difficult position of having to back out of the deal without having to pay IMS for the expenses it incurred. It is ironic that VNU shareholders turned down an acquisition of IMS, as this is just what IMS shareholders did in 2000 when its own shareholders turned down a sale of the company to the Tri-Zetto Group, Inc.

Following shareholder approval, the merger plan must be submitted to the relevant state official, usually the secretary of state. The document that contains this plan is called the *articles for merger or consolidation*. Once the state official determines that the proper documentation has been received, it issues a certificate of merger or consolidation. SEC rules require a proxy solicitation to be accompanied by a Schedule 14A. Item 14 of this schedule sets forth the specific information that must be included in a proxy statement when there will be a vote for an approval of a merger, sale of substantial assets, or liquidation or dissolution of the corporation. For a merger, this information must include the terms and reasons for the transaction as well as a description of the accounting treatment and tax consequences of the deal. Financial statements and a statement regarding relevant state and federal regulatory compliance are required. Fairness opinions and other related documents also must be included.

## Special Committees of the Board of Directors

The board of directors may choose to form a special committee of the board to evaluate the merger proposal. Directors who might personally benefit from the merger, such as when the buyout proposal contains provisions that management directors may potentially profit from the deal, should not be members of this committee. The more complex the transaction, the more likely that a committee will be appointed. This committee should seek legal counsel to guide it on legal issues such as the fairness of the transaction, the business judgment rule, and numerous other legal issues. The committee, and the board in general, needs to make sure that it carefully considers all relevant aspects of the transaction. A court may later scrutinize the decision-making process, such as what occurred in the *Smith v. Van Gorkom* case (see Chapter 14). In that case the court found the directors personally liable because it thought that the decision-making process was inadequate, even though the decision itself was apparently a good one for shareholders.

## Fairness Opinions

It is common for the board to retain an outside valuation firm, such as an investment bank or a firm that specializes in valuations, to evaluate the transaction's terms and price. This firm may then render a fairness opinion in which it may state that the offer is in a range that it determines to be accurate. This became even more important after the *Smith v. Van Gorkom* decision, which places directors under greater scrutiny. Directors may seek to avoid these legal pressures by soliciting a fairness opinion from an accepted authority.

According to one survey, for deals valued at less than \$5 billion, the average fairness opinion fee was \$600,000, whereas for deals valued at more than \$5 billion, the average fairness opinion fee was \$4.6 million.<sup>1</sup> These opinions may be somewhat terse and usually feature a limited discussion of the underlying financial analysis. As part of the opinion that is rendered, the evaluator should state what was investigated and verified and what was not. The fees received and any potential conflicts of interest should also be revealed.

## Voting Approval

Upon reaching agreeable terms and receiving board approval, the deal is taken before the shareholders for their approval, which is granted through a vote. The exact percentage necessary for stockholder approval depends on the articles of incorporation, which in turn are regulated by the prevailing state corporation laws. Following approval, each firm files the necessary documents with the state authorities in which each firm is incorporated. Once this step is completed and the compensation has changed hands, the deal is completed.

## SHORT-FORM MERGER

A short-form merger may take place in situations in which the stockholder approval process is not necessary. Stockholder approval may be bypassed when the corporation's

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1. *The Daily Deal*, February 28, 2001. Source: CommScan/Computsoft Research Ltd., New York.

stock is concentrated in the hands of a small group, such as management, which is advocating the merger. Some state laws may allow this group to approve the transaction on its own without soliciting the approval of the other stockholders. The board of directors simply approves the merger by a resolution.

A short-form merger may occur only when the stockholdings of insiders are beyond a certain threshold stipulated in the prevailing state corporation laws. This percentage varies depending on the state in which the company is incorporated, but it usually is in the 90 to 95% range. Under Delaware law the short-form merger percentage is 90%.

### **FREEZEOUTS AND THE TREATMENT OF MINORITY SHAREHOLDERS**

Typically, a majority of shareholders must provide their approval before a merger can be completed. A 51% margin is a common majority threshold. When this majority approves the deal, minority shareholders are required to tender their shares, even though they did not vote in favor of the deal. Minority shareholders are said to be *frozen out* of their positions. This majority approval requirement is designed to prevent a *holdout problem*, which may occur when a minority attempts to hold up the completion of a transaction unless they receive compensation over and above the acquisition stock price. This is not to say that dissenting shareholders are without rights. Those shareholders who believe that their shares are worth significantly more than what the terms of the merger are offering may go to court to pursue their *shareholder appraisal rights*. To successfully pursue these rights, dissenting shareholders must follow the proper procedures. Paramount among these procedures is the requirement that the dissenting shareholders object to the deal within the designated period of time. Then they may demand a cash settlement for the difference between the “fair value” of their shares and the compensation they actually received. Of course, corporations resist these maneuvers because the payment of cash for the value of shares will raise problems relating to the positions of other stockholders. Such suits are very difficult for dissenting shareholders to win. Dissenting shareholders may file a suit only if the corporation does not file suit to have the fair value of the shares determined, after having been notified of the dissenting shareholders’ objections. If there is a suit, the court may appoint an appraiser to assist in the determination of the fair value.

### **PURCHASE OF ASSETS COMPARED WITH PURCHASE OF STOCK**

The most common form of merger or acquisition involves purchasing the stock of the merged or acquired concern. An alternative to the stock acquisition is to purchase the target company’s assets. In doing so, the acquiring company can limit its acquisitions to those parts of the firm that coincide with the acquirer’s needs. When a significant part of the target remains after the asset acquisition, the transaction is only a partial acquisition of the target. When all the target’s assets are purchased, the target becomes a corporate shell with only the cash or securities that it received from the acquisition as assets. In these situations, the corporation may choose to pay stockholders a liquidating dividend and dissolve the company. Alternatively, the firm may use its liquid assets to purchase other assets or another company.

## STRUCTURING THE DEAL

Most deals employ a *triangular structure* utilizing a subsidiary corporation that is created by the buyer to facilitate the acquisition of the target. The acquirer creates a shell subsidiary whose shares are purchased with cash or stock of the parent. This cash or stock is then used to acquire either the assets or the stock of the target company. If the assets of the target are acquired, then the surviving target corporation is usually liquidated. If the shares of the target are acquired, the target corporation then merges with the subsidiary, which now has the assets and liabilities of the target. When the subsidiary survives the merger, this structure is sometimes referred to as a forward triangular merger. Another alternative is a reverse triangular merger, where the subsidiary is merged with the target and does not survive the merger but the target corporation does. The advantage of using subsidiaries and this triangular structure is that the acquirer gains control of the target without directly assuming the known, and potentially unknown, liabilities of the target.

## ASSUMPTION OF THE SELLER'S LIABILITIES

If the acquirer buys all the target's stock, it assumes the seller's liabilities. The change in stock ownership does not free the new owners of the stock from the seller's liabilities. Most state laws provide this protection, which is sometimes referred to as *successor liability*. An acquirer may try to avoid assuming the seller's liabilities by buying only the assets rather than the stock of the target. In cases in which a buyer purchases a substantial portion of the target's assets, the courts have ruled that the buyer is responsible for the seller's liabilities. This is known as the *trust funds doctrine*. The court may also rule that the transaction is a *de facto* merger—a merger that occurs when the buyer purchases the assets of the target, and, for all intents and purposes, the transaction is treated as a merger. The issue of successor liability may also apply to other commitments of the firm, such as union contracts. The National Labor Relations Board's position on this issue is that collective bargaining agreements are still in effect after acquisitions. As we have noted, sellers try to separate the target corporation's liabilities from their own by keeping them in a different corporation through the use of a triangular deal structure that utilizes a subsidiary corporation.

## ADVANTAGES OF ASSET ACQUISITIONS

One of the advantages of an asset acquisition, as opposed to a stock acquisition, is that the bidder may not have to gain the approval of its shareholders. Such approval usually is necessary only when the assets of the target are purchased using shares of the bidder and when the bidder does not already have sufficient shares authorized to complete the transaction. If there are not sufficient shares authorized, the bidder may have to take the necessary steps, which may include amending the articles of incorporation, to gain approval. This is very different from the position of the target company, where its shareholders may have to approve the sale of a substantial amount of the company's assets. The necessary shareholder approval percentage is usually the same as for stock acquisitions.

## ASSET SELLOFFS

When a corporation chooses to sell off all its assets to another company, it becomes a corporate shell with cash and/or securities as its sole assets. The firm may then decide to distribute the cash to its stockholders as a liquidating dividend and go out of existence. The proceeds of the assets sale may also be distributed through a *cash repurchase tender offer*. That is, the firm makes a tender offer for its own shares using the proceeds of the asset sale to pay for shares. The firm may also choose to continue to do business and use its liquid assets to purchase other assets or companies. Firms that choose to remain in existence without assets are subject to the Investment Company Act of 1940. This law, one of a series of securities laws passed in the wake of the Great Depression and the associated stock market crash of 1929, applies when 100 or more stockholders remain after the sale of the assets. It requires that investment companies register with the SEC and adhere to its regulations applying to investment companies. The law also establishes standards that regulate investment companies. Specifically, it covers:

- Promotion of the investment company's activities
- Reporting requirements
- Pricing of securities for sale to the public
- Issuance of prospectuses for sales of securities
- Allocation of assets within the investment company's portfolio

If a company that sells off all its assets chooses to invest the proceeds of the asset sale in Treasury bills, these investments are not regulated by the Act. There are two kinds of investment companies: *open-end investment companies* and *closed-end investment companies*. Open-end investment companies, commonly referred to as mutual funds, issue shares that are equal to the value of the fund divided by the number of shares that are bought, after taking into account the costs of running the fund. The number of shares in a mutual fund increases or decreases depending on the number of new shares sold or the redemption of shares already issued. Closed-end investment companies generally do not issue new shares after the initial issuance. The value of these shares is determined by the value of the investments that are made using the proceeds of the initial share offering.

## REVERSE MERGERS

A reverse merger is a merger in which a private company may go public by merging with an already public company that often is inactive or a corporate shell. The combined company may then issue securities and may not have to incur all of the costs and scrutiny that normally would be associated with an initial public offering. The private company then has greatly enhanced liquidity for its equity. Another advantage is that the process can take place quickly. In addition, the private company's shares are publicly traded after the deal, and that can be more attractive to other targets that the bidder may be pursuing. Most reverse mergers involve smaller companies that are looking for a less expensive way of going public. An example of a recent reverse merger was the March 2001 \$229 million reverse merger involving Ariel Corporation and Mayan Network Corp. Under this deal, Mayan acquired Ariel. Mayan shareholders owned 90% of the combined company, while

Ariel shareholders owned the remaining 10%. One unusual aspect of this reverse merger was its size, as most such deals involve smaller firms. The deal presented benefits for both companies because it allowed Mayan, a company that only recently had signed up its first two customers, to tap public markets, while giving Ariel, whose stock price and financing were weak, an opportunity to improve its financial condition.<sup>2</sup>

## HOLDING COMPANIES

Rather than a merger or an acquisition, the acquiring company may choose to purchase only a portion of the target's stock and act as a *holding company*, which is a company that owns sufficient stock to have a controlling interest in the target. Holding companies trace their origins back to 1889, when New Jersey became the first state to pass a law that allowed corporations to be formed for the express purpose of owning stock in other corporations. If an acquirer buys 100% of the target, the company is known as a *wholly owned subsidiary*. However, it is not necessary to own all of a company's stock to exert control over it. In fact, even a 51% interest may not be necessary to allow a buyer to control a target. For companies with a widely distributed equity base, effective working control can be established with as little as 10 to 20% of the outstanding common stock.

### Advantages

Holding companies have certain advantages that may make this form of control transaction preferable to an outright acquisition. Some of these advantages are:

- *Lower cost.* With a holding company structure, an acquirer may be able to attain control of a target for a much smaller investment than would be necessary in a 100% stock acquisition. Obviously, a smaller number of shares to be purchased permits a lower total purchase price to be set. In addition, because fewer shares are demanded in the market, there is less upward price pressure on the firm's stock and the cost per share may be lower. The acquirer may attempt to minimize the upward price pressure by gradually buying shares over an extended period of time.
- *No control premium.* Because 51% of the shares were not purchased, the control premium that is normally associated with 51 to 100% stock acquisitions may not have to be paid.
- *Control with fractional ownership.* As noted, working control may be established with less than 51% of the target company's shares. This may allow the controlling company to exert certain influence over the target in a manner that will further the controlling company's objectives.
- *Approval not required.* To the extent that it is allowable under federal and state laws, a holding company may simply purchase shares in a target without having to solicit the approval of the target company's shareholders. As discussed in Chapter 3, this has become more difficult to accomplish because various laws make it difficult for the holding company to achieve such control if serious shareholder opposition exists.

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2. Danny Forsten, "Mayan Snares Ariel in \$229 Million Reverse Merger," *The Daily Deal*, 30 March 2001, p. 1.

## Disadvantages

Holding companies also have disadvantages that make this type of transaction attractive only under certain circumstances. Some of these disadvantages are:

- *Multiple taxation.* The holding company structure adds another layer to the corporate structure. Normally, stockholder income is subject to double taxation. Income is taxed at the corporate level, and some of the remaining income may then be distributed to stockholders in the form of dividends. Stockholders are then taxed individually on this dividend income. Holding companies receive dividend income from a company that has already been taxed at the corporate level. This income may then be taxed at the holding company level before it is distributed to stockholders. This amounts to *triple taxation* of corporate income. However, if the holding company owns 80% or more of a subsidiary's voting equity, the Internal Revenue Service allows filing of consolidated returns in which the dividends received from the parent company are not taxed. When the ownership interest is less than 80%, returns cannot be consolidated, but between 70 and 80% of the dividends are not subject to taxation.
- *Antitrust issues.* A holding company combination may face some of the same antitrust concerns with which an outright acquisition is faced. If the regulatory authorities do find the holding company structure anticompetitive, however, it is comparatively easy to require the holding company to divest itself of its holdings in the target. Given the ease with which this can be accomplished, the regulatory authorities may be more quick to require this compared with a more integrated corporate structure.
- *Lack of 100% ownership.* Although the fact that a holding company can be formed without a 100% share purchase may be a source of cost savings, it leaves the holding company with other outside shareholders who will have some controlling influence in the company. This may lead to disagreements over the direction of the company.

## Special Purchase Acquisition Vehicles

Special purchase acquisition vehicles (SPACs) are companies that raise capital in an initial public offering (IPO) where the funds are earmarked for acquisitions. Usually between 80% to 90% of the funds are placed in a trust which earns a rate of return while the company seeks to invest the monies in acquisitions. The remainder of the monies are used to pay expenses. Shareholders usually have the right to reject proposed deals. In addition, if the company fails to complete acquisitions the monies are returned to investors less expenses and plus an return earned in the capital.

Such investments can be risky for investors as it is possible that the company may not complete an acquisition. If that is the case investors could get back less monies than they originally invested. Even when the company does complete deals they do not know in advance what targets will be acquired.

The IPO offerings of SPACs are unique and differ in many ways from traditional IPOs. In addition to the differences in the nature of the company which we have discussed,

they usually sell in “units” which include a share and one or two warrants which usually detach from the shares and trade separately a couple of weeks after the IPO. Because the market for these shares can be illiquid, they often trade at a discount—similar to many closed end funds. The post-IPO securities can be interesting investments as they represent shares in an entity which hold a known amount of cash but which trades at a value that may be less than this amount.