M&A Activity Heats Up

By Michael Bobelian
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With the presidential election over and the economy continuing to move steadily forward, the market for mergers and acquisitions has begun to heat up, according to some experts.

Lawyers in the field say they expect to see growth in mergers and acquisitions as concerns over traditional barriers like active government oversight and geopolitics wane.

Some challenges do remain.

Because some investors, particularly institutional investors, remain wary of M&A activity, companies have had to be more convincing in justifying their deals to skeptical investors.

And corporate governance concerns, although they have not blocked corporations from moving ahead with a deal, have led to a renewed focus on due diligence.

Of course, nothing is certain. An unexpected event such as a major terrorist attack in this country could put a damper on deal making.

Dennis Block, one of the most prominent lawyers in the field, says M&A activity will continue upward, boosted by a cooperative stock market. "There's been a lot of activity ... immediately after the election," and there is much more to come that has not been publicly announced, says Block, of New York's Cadwalader, Wickersham & Taft.

Elections produce uncertainty, because businesses want predictability in government policy. With President George W. Bush about to begin another term, corporations have a better sense of what to expect from policy makers, says Block.

It helps that the Republican administration favors tax and antitrust policies favorable for consolidation, he says.

"The choppy market slows people down," says Jeffrey Rosen, co-head of M&A at Debevoise & Plimpton in New York. This has slowed down interest in public transactions and has pushed a sizable portion of investment dollars to private equity deals.

That may soon change as the stock market has grown steadily since the election, with the Dow Jones Industrial Average gaining 500 points.

The key indicator for Block was the announcement of the Kmart-Sears merger in mid-November.

"It got a good reception," he says, pointing to the rise in the stock prices of both companies after they announced their plans.

"People are moving away from the conservatism" of the last few years, he says.

The numbers confirm his assessment. According to FactSet, a financial data provider for investors, the number of deals announced through the end of September climbed to 7,419, compared to 6,200 announcements during the same time period last year. The total value of the deals also rose from $312 billion to $530 billion. The growth is not limited to the United States but is applicable to Europe, and this quarter seems like it will do even better.

The late 1990s saw one of the biggest booms in M&A history. But with many big-name busts, it left investors -- particularly institutional investors -- skeptical of big deals.

The Time Warner merger with AOL of 2000 ended disastrously for investors. The stock price of the combined company dropped drastically from near $100 to below $20 this year. Its executives were reshuffled and a U.S. Securities and Exchange Commission [SEC] investigation over alleged accounting fraud still hangs over the company.

Likewise, Vivendi Universal expanded its media empire by buying up companies at premium prices during the late 1990s. When the value of these assets receded, the French-based conglomerate found itself heavily in debt. Its erstwhile celebrity CEO, Jean-Marie Messier, resigned, and the company was forced to sell off many of its prized acquisitions.

More Scrutiny

Corporate governance advocates, including Patrick McGurn of Institutional Shareholder Services, a proxy service provider, have said that deals will face additional scrutiny, even if they are friendly. That is the new regime faced by corporate executives.

Institutional investors will not automatically react negatively, Block says, but will need to be convinced that a deal works during this time of added skepticism.

"You really have to show today why the synergies are real and the savings, which are one-time savings, are real," he says.

Company leaders always explained their strategy to large investors before. Now, it is a more systematic and active process as more institutional shareholders flex their muscle, says Debevoise's Rosen.

Morton Pierce, head of the corporate department at New York's Dewey Ballantine, offered an example from a deal he worked on earlier this year.

His client, MONY Group, was the target of a friendly takeover from French insurer AXA. MONY voluntarily reduced severance payments to top executives whose departures were caused by the takeover to appease dissenting hedge fund investors. Ultimately, the parties consummated the deal but "it's a classic example of institutions' becoming more involved," Pierce says. "I think it will be a continuing trend."

Corporate governance has also led companies to act more cautiously when pursuing acquisitions, particularly when conducting due diligence.

The experience of the Dutch food giant Royal Ahold's purchase of U.S. Foodservice in April 2000 underscored this concern. Suspicion of accounting fraud at the subsidiary was the focal point of an SEC investigation. Royal Ahold settled the matter in October without paying a fine, but its experience showed that an acquiring company may be buying problems along with a valuable asset.

M&A lawyers have long searched for potential liabilities in the books of companies under consideration for acquisition. The difference now is one of degree, explained Pierce.

Company leaders want to make sure there is enough time to conduct due diligence and ensure that the compliance and financial reporting systems used by two companies can be smoothly integrated.

Section 404 of the Sarbanes-Oxley Act increased the pressure on acquirers by requiring executives to vouch for the internal controls used to prevent fraud. That certification extends to any acquired companies.

"If I'm buying something, I want to be able to certify," says Pierce.