A WORLD OF MEGA MERGERS

TIM SHACKLOCK OF DRESDNER KLEINWORT WASSERSTEIN'S RECENT SPRING PAPER FOR MEMBERS OF THE ACT ON THE MERGERS AND ACQUISITIONS MARKET HIGHLIGHTS SOME INTERESTING TRENDS.

Against a backdrop of being in the middle of the largest downturn in merger and acquisition (M&A) activity in history, Tim Shacklock, Dresdner Kleinwort Wasserstein's worldwide head of mergers and acquisitions (M&A), gave the audience assembled in Merchant Taylor's Hall on Wednesday 27 March a clear and interesting perspective on current trends in the M&A market.

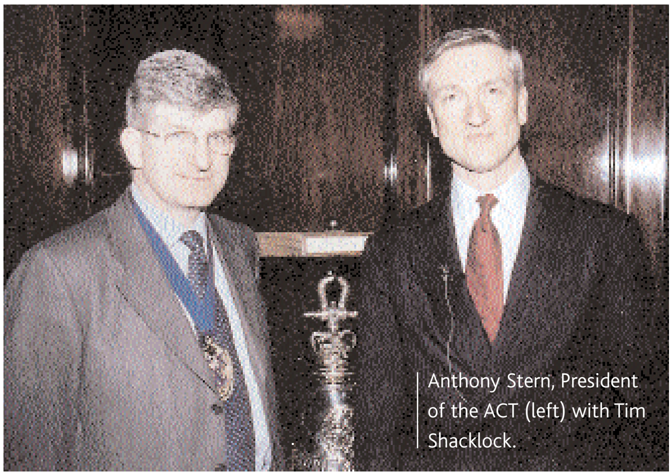
Tim started with an overview of recent M&A activity and outlined the magnitude and value of deals in the past decade. Most M&A transactions originate in the US but the UK is a sizeable second and accounts for a greater number of deals than the rest of Europe put together. Until this year, the growth in the largest M&A deals had been significant. For example, in 1992, there were five transactions greater than €5bn, while, by 2000, the number of these mega deals had reached 94. Of the largest 10 deals, it was interesting to note than only two were hostile and that only two were cross-border.

Even during the current downturn, Tim maintained that two key elements are needed for a successful merger or acquisition: a strong commercial rationale and a supportive market environment. He went on to outline three technical challenges for achieving a successful M&A:

- structuring the transaction;
- implementing appropriate financing; and
- managing uncertainty and risk.

STRUCTURING THE TRANSACTION. A sound M&A structure reflects many things, such as tax considerations, overall desired capital structure, goodwill and governance. Tim is a strong advocate of dual-listed company (DLC) structures for cross-border transactions, whereby the combined group is managed jointly, while retaining separate legal entities and shareholding structures. He described how DLCs had been successfully implemented during recent Rio Tinto and BHP Billiton transactions, but noted that there has yet to be a DLC for a US M&A deal.

While historically companies having made a significant acquisition would retire quietly to 'digest' them, in recent years there has been a spate of rapid fire transactions driven by structural changes within an industry. An example is Orange. It was acquired by Mannesmann, which in turn was bought by Vodafone, which in turn sold Orange to France Telecom – all within 200 days.



Anthony Stern, President of the ACT (left) with Tim Shacklock.

IMPLEMENTING APPROPRIATE FINANCING. Tim began this section by reminding the audience that, while debt is the cheapest form of financing, the downside of using debt is its impact on gearing. The consolidation in the banking industry has meant that banks can now underwrite larger credits and have enhanced syndication capabilities for selling down risk.

While in the past few months, there has been an upturn in rights issues (mainly to shore up balance sheets where companies had over-expanded with debt finance), prior to this, share exchanges have been commonly used, rather than new equity. In cross-border transactions, explained Tim, local shareholders are often reluctant to receive overseas shares. Fund manager are often unable or unwilling to hold shares in overseas companies because their own performance is measured against local indices. The resulting 'flowback' could have a material impact on a transaction because it can take up to a year for shares to be repurchased by local shareholders. DLCs eliminate these flowback problems.

MANAGING UNCERTAINTY AND RISK. Tim described today's environment as increasingly volatile and went on to explain that greater attention is now being paid to the part that hedge funds, rating agencies and regulators can play in the success of a transaction. While hedge funds represent a small proportion of the funds undermanagement, they can account for 20%-40% of daily trading activity on a share. Therefore, increasingly, companies and their investment bankers need to think about what position hedge funds are likely to take and the impact of this on their deal. Equally, companies may want to solicit the views of rating agencies on a deal to assess the likely resulting impact on their corporate rating.

Anti-trust regulation can block a transaction or cause it to fail. Tim said that increasingly companies are making regulatory or competition clearance a precondition when the deal is announced.

To manage economic risk, he added, derivatives are being used, a trend he expects will continue as banks become more sophisticated in what they can offer their clients and companies are likewise becoming more sophisticated about what risks they want to eliminate. Tim also described how contingent value rights (CVRs) are being more frequently used to ensure that shares perform in line with expectations post acquisition.

AN EYE TO THE FUTURE. In the last part of the presentation, Tim gave his outlook for cross-border M&A. During 2002, he expects deal volumes to remain as a percentage of previous years due to the weaker economic conditions, reduced corporate earnings and increased stock market volatility. As confidence recovers and the markets stabilise, he expects an upturn in M&A activity. Tim's other predictions were that:

- the adoption of the euro will eliminate currency risk and accounting issues, leading to greater pan-European consolidation;
- anti-trust and regulatory issues will continue to play an important part in the success of deals;
- some countries will see a notable increase in M&A activity (for example, Germany due to changes in capital gains tax);
- there will be a greater use of DLCs and he expects to soon see the first one involving a US company; and
- there will be a reduction in flowback as stock exchanges consolidate.

Various questions followed from the floor, covering Tim's views on the importance of culture in a successful merger or acquisition, whether sterling remaining outside the euro would have an impact on flowback in European deals, to what extent deals are initiated by companies or by their bankers, whether indeed the majority of M&A deals destroy value as claimed by academic studies and whether investment bankers follow through deals with 'after sales' service. Tim declined to be drawn on the likely chances of success of the then current HP/Compaq deal.

Tim Shacklock is Deputy Chairman at Dresdner Kleinwort Wasserstein.

This write-up was provided by Gloriana Marks de Chabris, Chief Executive of Centradia Group and a member of the Association's Programme Committee.