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# INVESTOR'S BUSINESS DAILY

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ARTICLE TITLE: "In M&A Deals, Various Factors Determine Bids

AUTHOR: Mike Angell

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It's a common complaint among investors that companies, especially techs, pay too much when they acquire another firm.

So what goes into valuations?

It's a mix of science and art, say merger and acquisition deal makers. Prices reflect many things, including ability to head off rivals, future efficiencies the two firms may realize when joined, hidden assets and the value of similar deals.

It comes down to "what's its value to us, what's its value to the market and what can we afford," said Michael Cody, who's led 14 acquisitions for storage computer maker EMC.

According to FactSet Mergerstat, the average acquisition price was 35% greater than the stock price. Cody says most deals he's seen have had a 30% to 45% premium.

Cingular is offering AT&T Wireless shareholders \$15 a share cash, 26% over AT&T's Friday closing price. This month, Juniper Networks paid \$3.7 billion for security company NetScreen Technologies, 56% over the market price the day before the deal's announcement. EMC's \$1.7 billion acquisition of software firm Documentum was 29% higher than the market price. J.P. Morgan Chase's \$58 billion offer for Bank One Corp. was 14% over market prices.

But why pay more?

Market prices reflect a minority stake in a business, Cody says. By purchasing shares, an investor becomes a part owner. But an acquirer wants the whole thing. That means paying for complete control of a company.

Paltry Offers

The target firm's board of directors has that control to begin with. Directors look for a price close to their -month high, with some kind of premium tacked on for giving up ownership.

Cody says hefty premium signals to the board that a buyer is serious about its bid. The acquirer also wants shareholders to approve the deal quickly. So a significant premium often pre-empts other bidders.

Lately, boards have mostly rejected offers from would-be buyers who have offered paltry premiums. For instance, in June, software Oracle offered to pay rival PeopleSoft \$16.50 a share, only 9% over its market price.

Since then, Oracle's bid has risen to \$26 a share. But with PeopleSoft shares trading at 22.70, that only represents a 14% premium.

Last week, Comcast's offer to Disney was \$26.47 a share, only a 9% premium over Disney's closing price of \$24.08 the day before the bid was announced. Disney shares have risen since that bid, meaning that Disney shareholders believe the company is worth a higher price.

In the cases of PeopleSoft and Disney, the acquisition prices offered aren't near the highs the stocks hit in the past year. Paul **Deninger**, chairman of M&A advisory firm Broadview International, says target firms often refer to their shares' 12-month highs when trying to determine their value to a buyer.

"If in the prior 12 months, a target firm has traded above the price being offered, they'll figure that was the **Deninger** said.

During 2001, PeopleSoft and Disney have traded as high as 53 and 43 respectively. NetScreen was hovering around its 12-month high of 29 a share when Juniper made its offer.

Another consideration in coming up with acquisition value is the "comparables". That is, buyers and sellers look at similar transactions to get a fix on the price.

Usually that means comparing price-earnings ratios or price-sales ratios of companies in similar industries to help determine what the acquisition price should be.

For instance, **Deninger** cites Comcast's bid for Disney. Comcast offered a multiple of 14 times Disney's operating earnings per share. That's roughly where other media firms, such as Time Warner, are trading.

But how do you know that the companies being benchmarked are indeed comparable? An analysis of ratios such as price-to-earnings ignores whether the two companies have the same profit margins or operate as efficiently.

"I can't tell you how many times I've had software companies say they should get the same multiples as Microsoft," Deninger said. "I have to go back and tell them they are not Microsoft."

Acquisition prices also reflect whether two firms would be more valuable together than separately. Presumably, a company that wants to buy another recognizes that the combination could create efficiencies in selling or manufacturing.

An example would be Hewlett-Packard's merger with Compaq Computer, completed in 2002. Although originally dismissed as unwieldy, the combined company has boosted profit margins thanks to lower manufacturing costs.

#### Make Or Buy?

There's also the hidden value of stealing market share from competitors. While Juniper's main reason for buying NetScreen was to have a deeper product line to offer customers, its other intent was to head off big rival Cisco Systems.

"You have to look at the impact on competitors," Cody said. "The buyer will pay a higher price as a pre-emptive move."

There's also the "make or buy" decision. When a firm wants to expand its product offerings, it has to figure out how much it would cost to make the new product from scratch, or buy another firm that already has that capability. Even with a share price premium, it's often less expensive to buy the other firm.

Finally, buyers often see value that the general public doesn't know about, says Ben Duster, an investment banker with Wachovia Securities from 1997 to 2001. Acquisition talks, he says, can include potential new technologies, new products or new customers.