M&A activity can trickle down to shareholder level

Acquisitions can affect company value, for the good or the bad

By MICHELLE PARK LAZETTE

If business leaders' answers to one recent survey are a harbinger of deals to come and mega-deals keep getting inked, this year's robust volume of mergers and acquisitions is likely to stay brisk.

The May 2014 KeyBank Middle Market Business Sentiment Survey found that one-third of middle-market business executives surveyed said they are likely to complete an acquisition in the next six months.

As companies change hands, the value of their stock often changes, too, immediately and long-term. Thus, shareholders have reason to gauge whether deals make sense and are fair.

"The value of the company will be influenced by the merger or acquisition," said Michael Nowacki, owner of Nowacki Asset Management, a Pepper Pike investment advisory firm.

"The company being acquired rarely gets a bad deal," he added, citing how the acquirer pays a premium to where the target's stock is trading.

The other advantage to the acquired entity's investors is they get liquidity, noted Ben Mackovak, founder and portfolio manager of Cavalier Capital LLC, a Cleveland hedge fund that invests primarily in small-cap companies.

"Especially for companies that don't trade at high volume, this allows them to monetize that investment," he said.

The greatest disadvantage, Mackovak said, is having to put that money back to work elsewhere.

Cavalier Capital has felt the impact of recent M&A: It held stock in one company that was acquired this year and in three acquired last year. From Mackovak's perspective, while shareholders "still did well" on one particular deal, the price could have been higher.

"When you're trying to figure out if this deal is fair, you need to look at where it's coming from," Mackovak said.

"If it's a strategic buyer, there's a greater likelihood that it's a fair deal; they're willing to pay a higher price for the synergies. If it's a private equity deal, it could be a fair deal, it could be opportunistic, and if it's a management-led buyout, it's probably opportunistic."

"I'd caution shareholders when they see a management-led buyout — that's when you should probably do the work and find out if it's a fair deal," he stressed.

Is it good or bad?

To gauge a deal, Mackovak suggests using the valuation to determine what multiple of cash flow is being paid, then comparing that multiple to those of comparable deals. So, if a shareholder owns stock in a widget company, he said, and it's selling for five times cash flow when another was acquired for 10 times, the lower price could be unfair.

Nowacki suggested valuing both companies individually, and then considering what the given deal affords the acquirer, be it new customers and/or cost savings.

"The company that's doing the acquiring sometimes will make bad decisions," Nowacki said. "Usually, it's hard to tell when it's announced. If people do think it's a bad deal, it'll be reflected in the stock price.

"A warning sign of a poor acquisition is when your company acquires a company that has no operational strategic basis for being acquired," Nowacki wrote in an email. "If Coca-Cola buys a movie production studio you should view it with skepticism; if they buy a bottled water company, tea, energy drink company or Green Mountain Coffee there are clear synergies. However, even when there are clear synergies, companies can still overpay or make mistakes."

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>
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Talking to other investors, watching for what the media reports about a deal and reading the reactions of sell-side analysts, who tend to know the companies the best, are other ways of gauging whether a deal is perceived to be good for a company, said Lisa Rose, the senior managing director who leads the investor relations practice at Dix & Eaton in Cleveland.

That said, the ultimate success of a deal and its impact on stock price are unknowns until they aren't.

"Everyone knows that acquisitions are difficult to integrate," Rose said. "When you're bringing companies together, you're blending cultures."

All about timing

Marc Morgenstern, who invests in private operating businesses through the firm he founded, Blue Mesa Partners, says environments like that in 2014 — with cheap and plentiful capital combined with an appetite for acquisitions — are when companies should be sellers. From his perspective, people actually forget that one makes an investment to get in, but more importantly to get out.

"When you can get liquid, you should get liquid," he said. "I think people should have a predisposition to sell rather than to hold. When everybody desperately wants what you have, that's a very good time to sell.

"Most companies, there are very logical buyers of them — might be three, might be 20," Morgenstern added. "It's not thousands. Timing really is 99% of life, and you can't just say to somebody … 'Buy me in three years.'"

The management team making the decision to sell knows more than most, he also asserted.

When deals are done right at the right price and integration happens successfully, stock value typically appreciates, Rose noted. When integration is difficult and a company culture is damaged, you can bet there will be an impact on stock price, she added.

Decided you don't like a deal? There's not much small shareholders can do, according to Nowacki. Options are limited to selling one's shares or voting against the deal.

"The biggest thing a shareholder has to decide is do I stick it through until the acquisition is complete, or do I take the price that's currently available now and run," agreed Kevin H. Myeroff, CEO and president of NCA Financial Planners in Maple Heights.

"Most people stick it out because often in negotiations, the price will go up."

No end in sight

There are shareholders — typically those who hold larger positions in companies — who can influence decisions, and most investment professionals expect an increase in shareholder activism, wherein investors approach management with concerns and the intention of forcing change or attaining a board seat, among other things.

"Every single day, there's a story in the paper about an activist coming after a company," Dix & Eaton's Rose said. "A number of clients that we have worked with have had situations where activists have come to them. Sometimes it's public, and sometimes it's not."

And according to what she's hearing from advisers about this year's proxy season, there are signs that activism is accelerating.

"Activists have become louder because they've been unhappy with results or decisions that management has been making with respect to M&A activity — or lack of M&A activity," Rose said. "I think activism is becoming more the norm than it used to be."

Most investment professionals say they aren't attempting to guess which companies will be acquired in order to buy stock in them.

"You can't predict the markets, you can't predict how it will do for one sector and you certainly can't predict acquisition candidates," said Charlie Crowley, managing director at independent securities, asset management and investment banking firm, Boenning & Scattergood.

"The key is to find good companies at good values," Crowley said. "You can never count on an acquisition helping, but if you're a patient, long-term investor, and you're backing a good management team and getting in on the front end at a reasonable valuation, you should do well in the long run." ■

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