

PREMIUMS WITHOUT PERIL

While bidding high to beat rivals for a target can be an acquirer's undoing, some have developed valuation tools to help them safely offer more.

BY VINCENT RYAN

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OME CALL IT "THE WINNER'S CURSE." When two or more parties vie for a company, one bidder sharply overestimates the value of the target—perhaps reflecting its desire to send rivals home empty-handed. But as the victor begins to assimilate its trophy, it may soon discover that its winning bid was costly indeed.

In this year's overstimulated mergers-and-acquisitions market, such one-upmanship has become common. Mining concern Rio Tinto offered \$32 billion for Canada's Alcan, for example, topping U.S. aluminum giant Alcoa's rival bid by fully \$10 billion. The 67 percent premium that Rupert Murdoch's News Corp. offered for Dow Jones served the same purpose, preempting others who might like to own its *Wall Street Journal*.

For a time, bidding high may seem like a smart move, especially when it is part of a deal with a "go-shop" clause, which gives the target board a period to attract other suitors. But "topping bids" like Rio Tinto's require some tricky decision-making—and careful calculations of synergies and intangibles—if the winner is to avoid financial difficulties later.

The main problem: market-clearing, preemptive pricing often flies in the face of valuation science, which is usually based on fundamentals tied to discounted cash flow and asset analyses. Sophisticated acquirers view valuation and pricing as two separate topics. "No one is a price maker. We're all price takers," says Justin Pettit, a partner at Booz Allen Hamilton.



SYMANTEC SVP JAMES SOCAS ESCHEWS BIDDING HIGH IN M&A, BECAUSE "THE PREMIUM REFLECTS WHAT SOMEONE ELSE IS PAYING."

ARE BUYERS WISER?

In the M&A boom of 1998 to 2001, the mania for Internet franchises produced merger premiums 30 to 40 percent above public companies' market caps. The environment also helped spawn some disasters, led by the creation of AOL Time Warner Inc., which eventually had to take write-downs just under \$100 billion. Now, average premiums hover near 20 percent.

But buyers are not necessarily wiser. They still pay high multiples for operating cash flow, usually measured as earnings before interest, taxes, depreciation, and