Expediting M&A Deal Processes Via Negotiations Vs. Auctions

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Even under normal conditions — that is to say, prepandemic — any transaction is subject to event risk. A look at merger arbitrage spreads of recent pending deals serves to highlight the difficulties being encountered in closing and underscore the importance of having a transaction strategy that addresses the increased event risk during the pandemic.

For example, during the recent bear market, the S&P 500 index closed at 2,237.40 on March 23, 28% below its level on March 2. On the same day, pending M&A deals had an average merger arbitrage spread of 13.2%,[1] implying abnormally high deal uncertainty.

A faster sales process could help decrease exposure of a deal to event risk. A newly available dataset sheds light on the timeline of the sales process — both before and after a deal is announced — and on the associated exposure to event risk.

To compile this unique dataset, professors Tingting Liu from Iowa State University and Micah Officer from Loyola Marymount University reviewed proxy filings of over 1,300 transactions completed between 1994 and 2016. As they point out in their paper, this research allows one to look "inside the 'black box' of prepublic merger negotiations and [describe] how, on average, bidding for the target evolves during [the] pre-public period that is shielded from public scrutiny."[2]

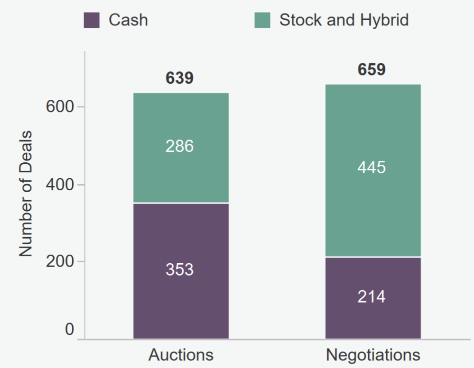
The data presented are based on a subset of M&A deals with deal value greater than $100 million. We review the data to see if they provide insights about the M&A sales process that may be particularly useful during the economic fallout from the pandemic.

No Clear Winner in Terms of Auctions Versus Negotiations

A sale process is categorized as an auction if more than one potential bidder executes a confidentiality agreement. This method of distinguishing auctions from negotiations is consistent with prior studies.[3]

Figure 1 shows that there is roughly a 50-50 split between auctions and negotiations, so on the surface neither sale process is more popular than the other. However, the dataset indicates that negotiated transactions involve about twice as many stock and hybrid deals when compared with cash-only deals. Auctions, on the other hand, are slightly more likely to be done for cash than to involve stock and hybrid deals.

Figure 1: M&A Deal Frequency
Auctions vs. Negotiations



Note: Deals completed between 1994 and 2016 with deal values greater than $100 million

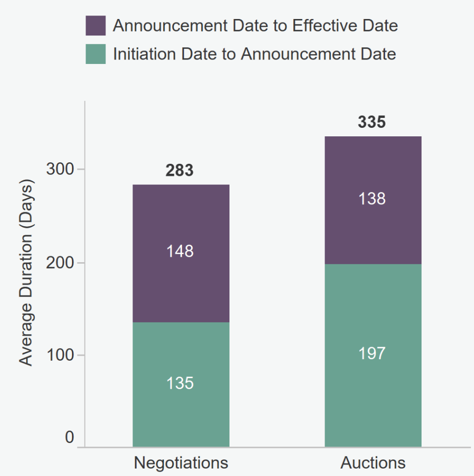
Source: Tingting Liu and Micah S. Officer, "Inside the 'Black Box' of Private Merger Negotiations," SSRN working paper (2020)

But Negotiations Are Faster Before the Deal Goes Public

Figure 2 compares the time from the initiation of a sales process — defined as the first time the target and a bidder discuss a potential transaction — to the final completion of a transaction. The figure shows that:

- On average, negotiations allow parties to reach an agreement regarding deal terms and publicly announce the deal much more quickly than auctions. It takes an average of 135 days from deal initiation to public announcement when the target negotiates exclusively with a single bidder, while the same process takes an average of 197 days when a target conducts an auction.

Figure 2: Average Duration of Stages in M&A Deal Process



Note: Deals completed between 1994 and 2016 with deal values greater than $100 million and with data available for first bid price, first public bid price and target stock price one day before initiation date

Source: Tingting Liu and Micah S. Officer, "Inside the 'Black Box' of Private Merger Negotiations," SSRN working paper (2020)

- However, the time from announcement to deal completion is about the same for both processes, with negotiations taking an average of 148 days and auctions taking 138 days to complete.

Consequently, the total time from initiation to completion is almost two months shorter for negotiations (283 days) than for auctions (335 days). A faster deal process decreases the risk of encountering general market shocks that may derail merger deals, such as the market fluctuations caused by COVID-19.

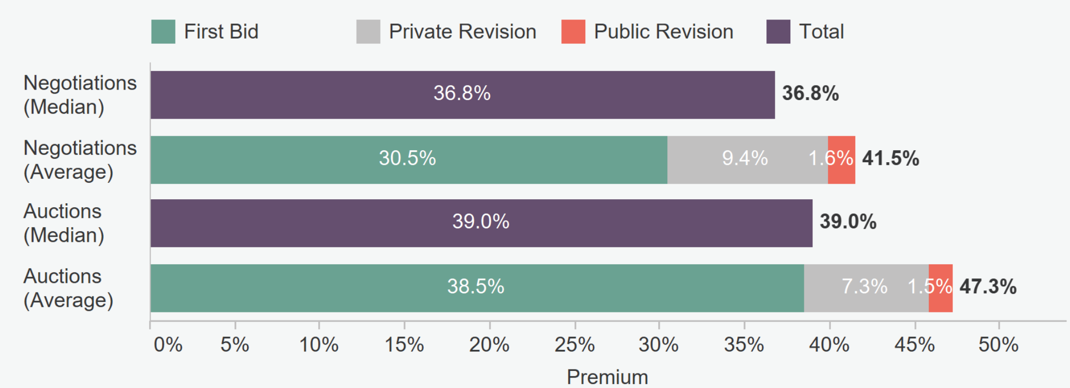
Final Bid Premiums Are About the Same for Auctions and Negotiations, but the Value Creation Processes are Different

Figure 3A compares and decomposes deal premiums. It shows an interesting dynamic: While the final premium at which the target is acquired is similar, when one compares targets sold via auctions and those sold via negotiations, the evolution of the premium over the deal process is different.

The deal premium associated with the first bid in the sales process is lower for negotiations than for auctions. On average, the first bid premium is 30.5% for negotiations and 38.5% for auctions.

However, targets are able to realize higher bid revisions when negotiating with a single bidder. Figure 3A shows that for negotiations, bid revisions during the private phase increase the deal premium by 9.4 percentage points, bringing it to 39.9% by the time the deal is announced.

Figure 3A: Components of M&A Deal Premium
Auctions vs. Negotiations



Note: Deals completed between 1994 and 2016 with deal values greater than $100 million and with data available for first bid price, first public bid price and target stock price one day before initiation date

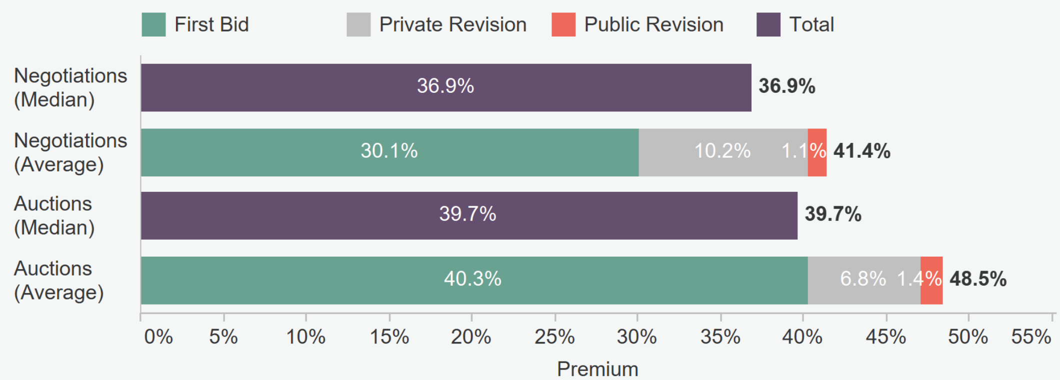
Source: Tingting Liu and Micah S. Officer, "Inside the 'Black Box' of Private Merger Negotiations," SSRN working paper (2020)

This increase is higher than the average 7.3 percentage point increase in deal premium that is realized during auctions. It is worth noting that these larger increases also are realized during a more compressed time frame for negotiated transactions.

The majority of deals see no increase in deal premium subsequent to the public announcement of a transaction, but some deals receive a topping bid. On average, bid revisions after a public announcement increase in deal premium by 1.6 percentage points for negotiations and 1.5 percentage points for auctions.

Figure 3B focuses on deals with cash-only considerations, and shows a similar evolution of deal premiums for negotiations and auctions.

Figure 3B: Components of M&A Deal Premium (Cash-Only Deals)
Auctions vs. Negotiations



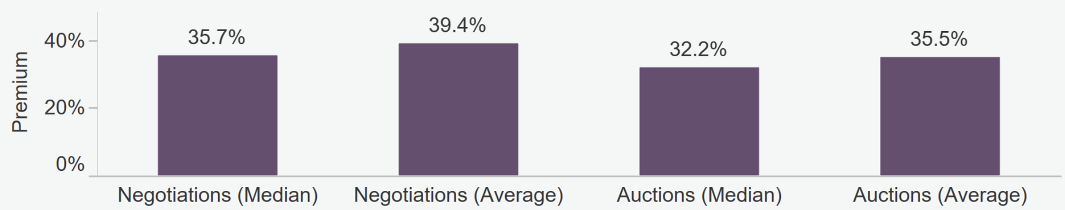
Note: Deals completed between 1994 and 2016 with deal values greater than $100 million and with data available for first bid price, first public bid price and target stock price one day before initiation date

Source: Tingting Liu and Micah S. Officer, "Inside the 'Black Box' of Private Merger Negotiations," SSRN working paper (2020)

The deal premiums shown in Figures 3A and 3B are the percentages by which the initial or final bid exceeds the target's stock price on the day prior to the transaction initiation date.

In Figure 3C, we compare deal premiums on cash deals that are based on the target's stock price four weeks before the public announcement of the transaction. Figure 3C shows that the four-week deal premiums of negotiations and auctions are similar.

Figure 3C: 4-Week M&A Deal Premium (Cash-Only Deals)
Auctions vs. Negotiations



Note: Deals completed between 1994 and 2016 with deal values greater than $100 million and with data available for first bid price, first public bid price and target stock price one day before initiation date

Source: Tingting Liu and Micah S. Officer, "Inside the 'Black Box' of Private Merger Negotiations," SSRN working paper (2020)

Finally, Table 1 shows that topping bid activity — that is, increases to the deal premium after a transaction has been publicly announced — is about the same for deals that are the products of either negotiations or auctions. The average size of the topping bid is also similar between negotiation deals and auction deals.

Table 1: Frequency of Topping Bids

	Count	Frequency	Average Premium Size
Panel A: Auctions			
Topping Bid	82	14.8%	14.8%
No Topping Bid	473	85.2%	–
Panel B: Negotiations			
Topping Bid	61	14.3%	13.0%
No Topping Bid	366	85.7%	–

Note: Deals completed between 1994 and 2016 with deal values greater than $100 million and with data available for first bid price, first public bid price, deal price, and target stock price one day before initiation date

Source: Liu and Officer; SDC Platinum

Conclusion

The COVID-19 pandemic has brought increased attention to M&A deal uncertainty and event risk as the ability to expedite the deal process becomes even more important in an uncertain market. A closer look at the deal process, particularly the preannouncement stage of deals, sheds light on an important determinant of deal timeline.

On average, deals conducted via negotiations take two months less between sale initiation and deal completion while achieving a similar premium for the target company. While many factors go into determining the choice between auction and negotiation, in some cases the faster deal process may make negotiation a more attractive choice during heightened market uncertainty.

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Loyola Marymount University professor Micah Officer contributed M&A deal data, and Analysis Group analyst Grace Kwon contributed research assistance for this article.

Endnotes

1 The sample contains M&A deals that were announced on or after July 1, 2019 and were still pending as of March 23, 2020. Similar deal filters as those in Liu and Officer (2020) are applied. The top and bottom 5% of the deals, based on estimated arbitrage spread, are excluded when computing the average to account for potential outliers.

2 Tingting Liu and Micah S. Officer, Inside the 'Black Box' of Private Merger Negotiations, SSRN working paper (2020).

3 Audra L. Boone and J. Harold Mulherin, "How Are Firms Sold?" The Journal of Finance, Vol. 62, No. 2 (2007).