Session 1: Orientation, overview of company and merger valuation

Clark Literature review on Company Valuation Methods from Time is Value

Models we use for valuation may be quantitative but inputs leave plenty of room for subjective judgment. In many valuations, price gets set first and valuations follow.

Three valuation methods

- DDM (Dividend Discount Method)
- DCF (Discounted Cash Flow)
- Price-to-Earnings multiples (Multiples)

Gordon Formula (GF) is the prevailing method to estimate Terminal value (TV) in the 2nd stage in Discounted Cash Flow method (DCF2S). DDM shares common ancestry with the 2nd stage TV calculation.

Primary difference between DDM and DCF is whether dividends appear in that ratio’s numerator (DDM) or Free Cash Flows (FCF).

Terminal value period (TVP) or continuing period refers to the second stage in the Two Stage DCF valuation method (DCF2S).

Gordon Formula Assuming Perpetuity (GFAP) represents today’s prevailing methodology for estimating company terminal value (TV).

GFAP perpetuity assumption disregard company’s longevity’s role as a variable affecting value in all enterprises, allowing GFAP to be calculated with 3 variables only.

DCF version comprises of FCF, WACC, g

Further challenger to GFAP is an adaptation of GF itself which includes valuation life span (time, t) as fourth variable with company-specific projections of t.

By 2001, DCF methods prevailed over accrual accounting.

P/E Price to Earnings Multiples

- are often based on a single year’s forward estimate of reported earnings per share (EPS)
- Technique is based on a fraction of the forecast information usually contained in the Explicit Projection Period (EPP) analysis of stage 1 of DCF2S.
- Particularly vulnerable to bubbles and extremes of business cycles
- Ex. A triple digit P/E seemed suitable for Lehman Bro’s pricing of Lastminute.com Initial Public Offering (IPO) in mid March 2000, based on recent market pricing of comparable Net-oriented firms. 6 weeks later when the Internet Bubble burst, Dot com valuations based on Jan-Feb 2000 P/E appeared overvalued.
- Minimally visible in academic literature, viewed as non-scholarly
- Primarily a managerial pricing rule-of-thumb, ad hoc company pricing technique
- Users are usually positioned at the lower end of practitioner spectrum in terms of company size and manager’s level of financial sophistication and knowledge
- Numerator and denominator of P/E ratio can be distorted at ease
- Common example of a multiple is the average of the comparable’s market price per share divided by their earnings before interest, taxes, depreciation and amortization (EBITDA)
Multiples tend to depend on single reference ratio but comparable companies are non-existent or non-comparable. Multiples can only be used as preliminary screen to identify broad upper and lower range of possible acquisition cost but promising targets are reanalyzed using DCF analysis. Liu et al argue for Multiples and say that pricing errors are within 15% of stock prices for half the sample.

**Dividend Discount Method (DDM)**

- Leading accrual accounting-based method
- By Lintner and Gordon & Shapiro
- Assumes management’s dividend payout intent is a reliable indicator of company’s future financial and operating performance
- However, some share (stock) dividends are vulnerable to unforeseen events or changing mindsets of directors
- Dividends are subjected to management discretion
- Dividends payout ratios vary widely among corporations and depend on firm’s fund requirements for investment purposes and levels of debt financing
- Dividends payout ratio may become erratic if management’s basis for setting out payout ratio change from one year to the next
- Rentokil firm may be profitable but cancel dividend payout in order to conserve cash
- Infinite time span assumption
- Limitation: For going concerns with no liquidating dividend, forecasting payout is not necessarily related to value
- Implicit in the GFAP, time is irrelevant to value so regardless of company’s lifespan, t for valuation purpose is set to infinity for all companies and under all circumstances.
- But time or company longevity is actually a variable-determinant of company value

**Two Stage Discounted Cash Flow Method (DCF2S)**

- Duration of initial stage is Explicit Projection Period (EPP)
- Second stage: Terminal Value Period (TVP)
- DCF2S Stage 2 Terminal Value is not calculated using operating budget-quality information as in the case of Stage 1 EPP
- TV is generated by the interaction of the assumption of the 3 broadly defined acknowledged variables in GFAP
- 3 variables are: continuing period initial year annualized Free Cash Flow, cost of capital and FCF future growth rate g
- Because it is an estimation technique, TV is at times viewed as excessive
- Overly optimistic TV calculations using Gordon Formula
- Valuation academicians seems uncomfortable when TV exceeds 70% of CV
- TV percentages vary from industry to industry and influenced by level and pattern of investment, pricing flexibility, competition intensity etc
- Literature on company valuation embraced DCF with the publication of Stern’s article that Earnings don’t count
- Damodaran states that perceptions of value has to be backed with reality and price that is paid for any asset should reflect the cashflows it is expected to generate
- Copeland et al suggests that DCF-based methods are closer aligned to market value (MV) than accrual accounting-based methods
Prevailing practice is estimating **Terminal Value (TV)** using DCF version of the 3 variable **Gordon Formula**

- Terminal Value (TV) often comprises more than half of a company's total estimated value (CV)
- FCF annualized amount at the end of the EPP is often assumed to be identical to the FCF annualized rate as of beginning of TVP, thus becoming FCF variable of Gordon formula
- Growing popularity of DCF methods and persuasiveness of Lundholm and O'Keefe against accrual accounting valuation equivalence contention
- **Copeland et al** regressed analyst-generated discounted cash flow estimates and have $R^2$ of 94%
- **Near perfect correlation** between the DCF/book value ratios for 31 large companies and those companies’ market value to book value (MV/BV) ratio

**Alternative TVP methodologies**

- Assume **alternative finite analysis of time span**
- Unlike the perpetuity assumption since *eventual death of companies is an unavoidable organic reality*
- For ex. Calculations based on lifespan of selected plant and equipment assets credible as amount for $t$ than infinity
- Currently, possible alternatives are incomplete
- Analysis of company's longevity suggests a **median lifespan for all companies of approx. 7 years**
- Or look at company bespoke estimation: Finance director dictate appropriate valuation analysis time horizon
- Look at **comparative advantage period (CAP)** which relates to firm’s financial, operating viability as indicated as CFROI
- **Mauboussin Johnson** proposition is that the company’s timing as a viable entity ends when Cash Flow Return on Investment (CFROI) rate no longer exceeds firm’s cost of capital rate
- **Company’s days are numbered if returns from investment do not exceed costs**
- But company may continue daily trading despite firm’s effective death
- Ex. General Motors languished in a state of effective company demise over 2 years before formal filing for bankruptcy
- Furthermore, there may be inconsistent pattern of intersection points where CFROI falls below WACC
- Or replace infinite $t$ with duration of long term capital (long term US bonds or UK gilts)
- Alternative TVP can also be value driver type GFAP alternatives which are directed at incremental investments
**Initial Period Free Cash Flow (FCF) Running Rate**

**VARIABLE 1:** Estimate of company initial period FCF amount ('rate') as of the beginning of the horizon period

Estimation accuracy issues: amount

Typical calculation basis: Rate at end of 'pre-horizon' Explicit Projection Period (EPP), other.

Projection issues: Sustainable FF at end of EPP, sometimes to years, occurring in volatile early launch competitive stages.

\[ PV = \frac{1}{WACC - g} \left( \frac{FCF}{(t+1)} \right) \]

Perpetuity notation. Usually a 4th variable, time is transformed into a unchanging assumption, exaggerating any over estimations in Variables 1-3.

**Weighed Average Cost of Capital**

**VARIABLE 2:** Estimate(s) of company's cost of capital over its infinite life span

Estimation accuracy issues: level, variability

Typical calculation methods: CAPM-based analysis (from debt and equity parts), expectations-based, other

Multiplier effect: Combine an unrealistically low WACC with Total FCF (Variable 1 x Variable 2), and consequence may be unreasonable result derived from what appear to be 3 reasonable variables.

Projection issues: (a) capital structure (D.E) changes over company life stages, (b) changes in operational and financial risks with maturity, (c) Pickens's high debt model

**Subsequent Period FCF Growth Rate**

**VARIABLE 2:** Projection of future FCF growth rate (%) to infinity

Estimation accuracy issues: level, variability

Typical calculation methods: industry, or company change rates, comparable, analysis

Multiplier effect: When combined with an oversized Initial FCF (Variable 2), can quickly become an unachievable amount

Projection issues: (a) percentages of small base year amounts, (b) radical steady state (0% growth), (c) curve shape over time

**Value**

\[ Value = \frac{X^t}{WACC - g} \]

Gordon 1962
Gordon and Shapiro 1956
Williams 1938

**Notes:**

A Net Operating Profit After Tax or comparable (e.g., net income, Earnings Before Interest and Taxes (EBIT), EBIT further adjusted for depreciation, amortisation (EBITDA))

B FCF= NOPAT plus non-cash items (D, A) plus changes in certain deferred items, minus period investment (i)

X refers to annualised amount as of the beginning of the valuation period. Future growth rates (g) pertain only to that specific X. WACC refers to Weighed Average Cost of Capital.
<table>
<thead>
<tr>
<th>METHOD</th>
<th>Academic</th>
<th>Non-Academic</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>MULTIPLES</strong> (P/E)</td>
<td><strong>Minimal</strong> mention in academic literature. Treated by some as secondary,</td>
<td>A leading value estimation approach of SMEs and some larger firms led by MDs/FDs with</td>
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<td></td>
<td>default method for estimating terminal (continuous) value component. (Thomas</td>
<td>limited background in finance.</td>
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<td></td>
<td>and Gup 2009, Cornell, 1993)</td>
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<tr>
<td><strong>DDM</strong></td>
<td><strong>Declining</strong> mention in corporate finance journals, although some</td>
<td>Still a primary valuation technique in industries where: (i.), valuation</td>
</tr>
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<td></td>
<td>continuing presence in accounting</td>
<td>by investors is primarily based on yield considerations; and (ii.), dividend</td>
</tr>
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<td></td>
<td>research journals, some others (Penman 2008)</td>
<td>payout patterns tend to be highly predictable, e.g., <em>utilities</em>.</td>
</tr>
<tr>
<td></td>
<td>*Long-standing method (since 1938). Declining to secondary role compared</td>
<td></td>
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<tr>
<td></td>
<td>to DCF because of (i.) Copeland-Kaplan-Ruback, (ii.) emergence of</td>
<td></td>
</tr>
<tr>
<td></td>
<td>separate DCF valuation academics sub-group.</td>
<td></td>
</tr>
<tr>
<td><strong>DCF2S INFINITY</strong></td>
<td>Prominently featured in academic literature or equivalent, increasing</td>
<td>Infinite version is today’s theoretical basis for valuation of companies’</td>
</tr>
<tr>
<td></td>
<td>with qualifications about results and/or interpretation: Mauboussin 2007,</td>
<td>second stage; distortions when combined with other variables, TVP excesses</td>
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<tr>
<td></td>
<td>Mills 2005, Copeland <em>et al.</em>, 2000.</td>
<td>mean that infinite version is rarely used all on its own, outside of the</td>
</tr>
<tr>
<td></td>
<td>*Prevaling methodology from Lintner (1956) and Gordon and Shopiro (1956)</td>
<td>classroom.</td>
</tr>
<tr>
<td></td>
<td>till 1994-2001 transition period (Penman, 2001).*</td>
<td><em>Ad hoc</em> use of company finite term versions (Penman 2007)</td>
</tr>
<tr>
<td><strong>DCF2S AFL</strong></td>
<td>Not yet articulated in academic literature as a method. Closest is serial</td>
<td></td>
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<tr>
<td></td>
<td>version of Gordon model. (<em>Appendix C</em>).</td>
<td></td>
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</tbody>
</table>


<table>
<thead>
<tr>
<th>TYPE</th>
<th>NON-SCHOLARLY Historical</th>
<th>SCHOLARLY, Projection-Based</th>
</tr>
</thead>
<tbody>
<tr>
<td>Typical User</td>
<td>Company non-financial executive, operating, officers</td>
<td>Academic valuation theorists / practitioners</td>
</tr>
<tr>
<td>Groups include:</td>
<td>Some transaction intermediaries</td>
<td>(1) DCF (2) DDM (accrual accounting)</td>
</tr>
<tr>
<td>Analysis Priorities</td>
<td>Extreme simplicity, appearance of comparability (industry basis)</td>
<td>‘Fit to purpose’—consistent with the purpose of the valuation</td>
</tr>
<tr>
<td>(non-ranked)</td>
<td>Based upon historical accrual accounting measures</td>
<td>Based on projections into future</td>
</tr>
<tr>
<td>Example Applications</td>
<td>May appear to suggest ‘under-’ or ‘over-valuation’</td>
<td>Apparent simplicity</td>
</tr>
<tr>
<td>Multiples:</td>
<td><em>Price / Sales (P/S) (e.g., Boehringer-Ingehelm 02, Pharm 04)</em></td>
<td>Defying near-term dismissal on basis of gross inaccuracy</td>
</tr>
<tr>
<td></td>
<td><em>Price / Earnings (P/E) (e.g., Gartmore 09)</em></td>
<td></td>
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<tr>
<td></td>
<td><em>Price / Book</em></td>
<td></td>
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<tr>
<td>Adaptations of Two-Stage DCF Single Equation Methods</td>
<td>DDM (DVM) RIM</td>
<td>Company life-span projection based (CAP)</td>
</tr>
</tbody>
</table>
Joven Liew Jia Wen  
MSIN3004 M&V Notes

Size of Firm, Other Factors*  
In-Company Level of Financial Sophistication

Accrual Accounting: MULTIPLES  
SME** Business Brokers  
Deal Instigators Business Media / Some Analysts

Two Stage DCF  
DCF Academic Valuation P/T Practitioners  
Buy Side Valuation Boutiques  
Cos. Led by Former FDs / CFOs

Accrual Accounting Incl. DDM  
‘Accounting Group’ Evaluators  
Analysts Covering Some Utilities

Valuation Methodological Categories (3)

CFROI (2) (1)  
WACC (3)

Four Determinants  
(1) Investment \( (i) \)  
(2) Returns  
(3) Cost of Capital  
(4) Longevity or Term \( (t) \)
<table>
<thead>
<tr>
<th>Method</th>
<th>Continuous Period</th>
<th>Value-Driven</th>
<th>Dir. Comparison</th>
</tr>
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<tbody>
<tr>
<td>Description</td>
<td>Gordon Formula</td>
<td>GFAP adaptation, directed at incremental investment, related returns</td>
<td>Accounting-based multiples, compared to reference company</td>
</tr>
<tr>
<td></td>
<td>Assuming Perpetuity (GFAP)</td>
<td></td>
<td></td>
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<tr>
<td>Advantages</td>
<td>Simplistic, minimalist limited variable equation, does not require serial period recalculation</td>
<td>Relatively simple equation, may not require serial period re-calculations</td>
<td>Easily understood, particularly by non-financial managers</td>
</tr>
<tr>
<td></td>
<td>Possible to derive ECF from historical accounting data, adapted for EPP experience.</td>
<td>Based in part on analysis of existing accounting information.</td>
<td>Limited calculations</td>
</tr>
<tr>
<td></td>
<td>Precedent of perpetual annuity formula as one means of dealing with indefinite t</td>
<td>Managerial focus on incremental investment and returns.</td>
<td>Aspirational comparables (may also be disadvantage)</td>
</tr>
<tr>
<td>Dis-advantages</td>
<td>Lacks period-by-period detail of Stage 1 EPP, despite TVP often being largest % of calculated overall value, “equilibrium” concept</td>
<td>Consistent marginal returns to i inconsistent with Co. life cycle</td>
<td>In search for comparables, may disregard important differences</td>
</tr>
<tr>
<td></td>
<td>Exaggerated values for component variables, time variable disregarded, variables themselves involve complex calculations</td>
<td></td>
<td>Dealing with mis-valued comparables (tech, bank bubbles)</td>
</tr>
<tr>
<td></td>
<td>Variables are calculation components but not causal</td>
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</tbody>
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- Companies create value through their operations.
- Operational excellence is key to maximizing shareholder value.
- But in recent years, mergers, acquisitions, share buybacks etc have increasingly affected shareholder returns.
- These financial transactions depend critically on company’s ability to accurately determine its value and assess market impact of its valuation decision.
- Managers can destroy value if they repurchase over-valued shares or issue new shares when market is undervaluing their stock.
- Annual valuation decision: proceeds from issuance of new shares, value of new shares issued in exchange of shares mergers, cash paid for share buybacks, cash paid for mergers and acquisitions, cash paid for other equity investments and proceeds from equity carves out.
- Next divide the sum of these valuation decisions by company’s beginning of year market capitalization.
- Get valuation quotient = sum of a company’s annual valuation decisions divided by its beginning-of-year market cap.
- Large valuation quotient means that valuation is a meaningful factor in shaping shareholder's returns. Ex. AT&T one is 50%.
- Hence, businesses that face extreme uncertainty and substantial mispricing (companies with high valuation quotient) need valuation expertise to create long term shareholder value.
- Potential impact of valuation activities = valuation quotient x estimated mispricing percentage.
- This gives the potential gains and losses from valuation decisions. The higher the numbers, the more shareholders will be affected by company’s valuation decisions.
- Valuation is important since stock market returns averaged about 10% per year.

Damodaran (2012) Chapter 1-2

Key to successfully invest and manage assets lies in understanding not only what the value is but the sources of value.

- ‘Bigger fool’ theory of investing argues that the value of an asset is irrelevant as long as there is a ‘bigger fool’ around willing to buy the asset from them. This is a dangerous game to play as no guarantee there is such an investor around when the time to sell comes.
- Sound investing: an investor does not pay more for an asset than it’s worth. Financial assets are acquired for the cash flows expected on them.

Perceptions of value have to be backed with reality. Price that is paid for any asset should reflect the cash flows it is expected to generate.

Myth 1: Since valuation models are quantitative, valuation is objective.

- Valuation may be quantitative but inputs leave plenty room for subjective judgment.
- Final value is coloured by bias.
- Usually, price is set first and valuation follows.
- To reduce bias, we can avoid taking strong public positions on the value of a firm before valuation is complete.
To reduce bias, **minimize the stake we have in whether the firm is under- or overvalued before valuation**

**Institutional concerns:** equity research analysts are more likely to find firms undervalued than overvalued

**Bias of analyst should be considered**

**Myth 2:** A well-researched and well done valuation is timeless

- **Value is affected by firm-specific and marketwide information**
- **Value will change when new info is revealed**
- Given the constant flow of information into financial markets, a **valuation done on firm ages quickly and has to be updated to reflect current information**
- Social media companies like Linkedin received enthusiastic market responses in 2010. They offer tremendous promise because of large member bases but still in early stages of commercializing that promise
- Information specific to firm, information that affect valuations of all firms in a sector and information about state of economy

**Myth 3:** A good valuation provides a precise estimate of value

- Unrealistic to expect absolute certainty in valuation due to the assumptions we make
- Depending on where the firm is in life cycle, mature firms tend to be easier to value than growth firms. **Young start up companies are more difficult**
- Difficulties in making estimates for the future

**Myth 4:** The more quantitative a model, the better the valuation

- **As models become more complex, no. of inputs needed increase and this increases potential for input error**
- Need to adhere to principle of parsimony: do not use more inputs than you absolutely need to value an asset
- **Recognise the tradeoffs between benefits of adding more detail and estimation cost**
- Models don’t value the companies, you do. Need to be able to separate info that matters and info that do not

**Myth 5:** To make money on valuation, you have to assume that markets are inefficient but that they will become efficient

**Myth 6:** The product of valuation is what matters and the process of valuation is not important

- **Process is informative due to determinants of value**

Underlying theme in fundamental analysis: True value of firm is related to its financial characteristics such as its growth prospects, risk profile and cash flows.

Underlying assumptions: Relationship between value and underlying financial factors can be measured, relationship is stable over time, deviations from the relationship are corrected in a reasonable time period

Philosophy of Franchise Buyer like Warren Buffett is that we stick to business we believe we understand. If business is complex, it is difficult to predict future cash flows
Franchise buyers wield influence on management of these firms and can value them correctly. Franchise buyers are attracted to undervalued good business and how much additional value they can create.

Chartists believe that prices are driven as much by investor psychology. They believe that average investor in the market is driven more by emotion than by rational analysis.

Information traders anticipate information announcements and gauge the market reaction to them better than the average investor. They are interested in the relationship between info and changes in value rather than value per se.

Market timers note that payoff to calling turns in market is much greater than the returns from stock picking so they use valuation model to value all stocks and decide whether market is overvalued.

Efficient marketers believe that market price at any point in time represents the best estimate of the true value of firm. Valuation is a useful exercise to determine why a stock sells for the price it does.

Valuation in acquisition analysis

- Bidding firm has to decide on a fair value for target firm before making a bid
- Target firm need to determine a reasonable value for itself before deciding to accept the offer
- Effects of synergy on combined value of two firms
- Effects on value of changing management and restructuring
- But there are bias: Target firms may be overly optimistic in estimating value

Conclusion: Valuation is not an objective exercise and any preconceptions and bias an analyst has will be in the value.

Discounted Cash Flow (DCF) valuation

- Relates value of asset to present value (PV) of expected future cash flows on that asset
- Value is the sum of $CF/(1+r)^t$
- $r$ is the discount rate reflecting the riskiness of estimated cash flows
- higher rates for riskier assets
- dividend discount model is a special case of equity valuation where value of equity is present value of expected future dividends
- Value of firm is usually sum of $CF/(1+ \text{WACC})^t$
- Avoid mismatching cash flows and discount rates
- Discounting cash flows to equity at cost of capital will lead to upward biased estimate of value of equity
- Cost of capital = Cost of equity + Pretax cost of debt
- Since debt has tax deductibility of interest expenses but debt will increase likelihood of default and bankruptcy
- Total cash flow is estimating the PV of all cash flows generated by that asset at a discount rate
- Excess cash flow models, only cash flows earned in excess of required return are viewed as value creating and PV of these excess cash flows are added to amount invested in asset to estimate its value
Approach is easiest for firms with cash flows that are currently positive and can be estimated with some reliability for future periods.

More difficult for distressed firms with negative earnings and strong possibility of bankruptcy since method values firm as going concern providing positive cash flows to investors.

Earnings and cash flows of cyclical firms tend to follow economy and it is difficult to predict timing and duration of economic recessions and recoveries.

Difficult for firms with unutilized assets, unutilized patents or product options and difficult for firms in the process of restructuring.

Difficult for firms involved in acquisitions because not sure whether there is synergy and how its value is estimated.

**Relative Valuation**

- Value of asset is derived from pricing of comparable assets.
- Industry average price-earnings ratio to value firm.
- Price-book value ratio or revenue multiple.
- Usually compare with similar firms priced by market or how firm was valued in prior periods.
- Multiples are simple and easy to relate to and allow us to obtain estimates of value quickly for firms and assets.
- Particularly useful when there is a large number of comparable firms.
- Multiples are also easy to misuse and manipulate and there may be no comparable firm available in terms of risk and growth.
- Multiples also build in errors that the market might be making in valuing these firms.

**Contingent claim valuation / Option pricing models**

- Allow the valuation of an asset as an option.
- Ex. The oil company will only develop the oil reserve only if oil prices go up and will not if oil prices decline.
- Option pricing model would yield a value that incorporate that right.

**Clarks and Mills Chapter 6**

*Today's social networking (SN) boom means emergence of 2nd top tier group of internet segment leaders such as Facebook, LinkedIn and Twitter.*

With their own business models dependent on revenues from merger activity rather than merger success, bankers are the 'straw that stirs the drink' when it comes to generating business and merger expansion enthusiasm.

Deal intermediaries and arrangers have a vital financial self interest in ensuring continuing levels of M&A transactions since they rely on it for livelihood.

It is now necessary for any deal's advocates to demonstrate that their proposed transaction can succeed based on financial returns realizable by the acquiring firm's shareholders.

**Social networking and 2011-19 merger megaboom**

- Facebook $1 billion acquisition deal of Instagram.
Those supporting the move praised FB for anticipating the sector’s next major evolutionary change towards mobile Internet.

Detractors bemoaned fact that FB cannot develop an Instagram like service internally.

**FB watershed acquisition marks the return of the speculative merger.**

Rising share prices spur increased merger activity due to signature novel IPOs, people have more cash from increased share price and they buy more shares.

Sometimes, company is essentially the same in terms of ultimate determinant of worth or internal discounted cash flows but share price has gone up as business-merger cycle progresses.

As share price increase, so does pressure to acquire today to avoid being excluded tomorrow.

Concern arises in the aspiring acquirer organisations that its target may become too expensive in future periods if they continue to delay.

Therefore, share price rises lead to them acting early and market indices receive upward impetus.

**Rising merger transaction volume supports overall share prices as bidding prices (APP) rise and acquisition war chest announced.**

Firm’s CEO may make media proclamations on future strategic acquisitions and share prices of companies rumoured to be possible targets rise.

10 plus % acquisition anticipation premium.

This may be due to CEO hubris and ego has its price. Negotiating leverage is impaired as acquiring CEO signaled that he is too eager.

Share prices in target industries have risen due to regrettable war chest announcement.

**Significant correlation between increase in stock price and increased levels of merger activity.**

**Target company price goes up and acquirer’s goes down due to uneven distribution of efficiency gains.**

3 types of acquisitions: Expansion-defensive (use inflated ‘currency’ to secure future areas of growth), emerging consolidation (company cannot be leader so rush to consolidate), bricks-to-SN (broadening product offering).

FB used its shares as acquisition currency to strengthen core.

Twitter acquired Canadian startup Summify to facilitate management of massive amounts of information continually entering activity streams.

Zynga acquired OMGPOP Inc to expand company’s scale through mergers.

For executive management in industry company stuck with low growth, being part of something of universal appeal may prove to be irresistible. Hence, company may rush to be part of the Next Big Thing and have acquisition in the social networking space to enhance overall valuation.

**New paradigm illusion** that the market generates when unexplainable wealth arises.

Irrational pricing prevails and for the patient there are opportunities to pick up companies at bargain price but only after a shake out.

Anticipated purchase premiums (APP).

**Vapor/whisper numbers:** pre-IPO price guesses by financial press do not represent the true valuation of the firm. ‘Valuation’ surged in unattributed reference to purported ‘knowledgeable source’ even though there is no material improvement in company’s projected future internal CF generation.

Continuing shareholders of acquiring company should be the ones to set criteria for valuation measures.