

THE RISING TIDE OF FINANCIAL BUYERS...

...the line between financial and strategic buyers is becoming increasingly blurred.

With the announcement by Texas Instruments about its \$3 billion cash sale of the sensors and controls business to Bain Capital, and similar high-profile acquisitions by private equity funds in the recent months, it seems that the M&A line between financial and strategic buyers is becoming increasingly blurred. According to Kevin March, the CFO of Texas Instruments, [the following is a quote from the Dow Jones Newswires article on January 9 with emphasis added,] “the unit received a lot of interest **from both strategic and financial suitors**, but Texas Instruments opted to go with Bain because it made the most attractive offer and **recognized the strategic value** of the business.”

That a financial buyer would recognize the strategic value of an acquisition to a larger degree than competing strategic buyers, is noteworthy and a fairly novel occurrence. In addition to the Texas Instruments deal described, other high profile transactions announced or currently contemplated by financial buyers include the acquisition of Borders by a syndicate consisting of Apollo, Bain again, and Texas Pacific Group; the acquisition of the DreamWorks film library by affiliates of Soros Fund Management; the acquisition of Computer Sciences by Blackstone and Hewlett-Packard; and many others.

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While it is entirely likely that financial buyers are nowadays well positioned to “recognize strategic value,” given the high degree of industry specialization housed in many of these firms – and sector-specific sophistication and broad network of industry contacts such specialization constitutes – it is hardly possible for a financial buyer, no matter how sophisticated, to replicate the economic advantages of a strategic. For example, duplicate costs cannot be eliminated, new products cannot be pushed through existing sales channels, and risks cannot be diversified by combining assets and revenue-streams. These and others have historically been the principal reasons that, as a rule, strategic buyers have not only been able to out-bid financial buyers in auctions, but have served as a primary exit vehicle for financial buyers. (It is not insignificant that, according to multiple surveys and statistical reports, financial buyers nowadays act as a primary exit source for each other... an interesting topic for a future article.)

How to explain this phenomenon? Perhaps growing liquidity in the private equity community, combined with growing competition among financial buyers for cash-flow positive targets, makes it both possible and necessary for private equity funds to escalate valuation ranges. They may also be outbidding strategic buyers because they are not restrained by the quarterly demands of institutional shareholders, Sarbanes Oxley, and

the ever present risk of shareholder lawsuits. The financial backgrounds and deep banking contacts of private equity funds may also enable them to structure their deals more creatively, and perhaps aggressively. Perhaps again, it isn't only a matter of creativity or risk appetite, but rather one of focus... in the following sense: It may be that the conglomeration and synergy development cycle in M&A is shifting to one of high specialization and streamlining. If so, few shareholders have historically been as inclined as private equity funds to implement and monitor strict management controls, to shed marginal assets, and squeeze incremental value from core businesses. And perhaps this, in the last analysis, is the reason for private equity's increasing position of financial strength, and the message inherent in current money flows.

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