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ECONOMIC NEWS UPDATE

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Where are the Americans? That's what Europeans are asking as their companies snap up cross borders to snap up companies once thought to be safely ensconced in their home markets. UK companies, once the special targets of America's acquisition-minded executives who believed they spoke the same language as the Brits, and whose wives hankered after frequent visits to Harrod's are falling to acquirers almost every day. It seems that acquirers from Asia to Europe are bidding furiously for any British company with reasonable prospects. Spain's Banco Santander snaps up Abbey and Ferrovial stalks BAA; Germany's Linde will swallow BOC unless the competition authorities object; Japan's Toshiba acquires Westinghouse and Nippon Glass picks off venerable Pilkington. But the Americans sit on their hands or, more precisely, their cash piles.

The merger wave is now at levels not seen since the boom of 1999-2000. The value of announced merger and acquisition (M&A) deals involving euro area companies has been running at about \$10 billion per day, and all global

deals about \$20 billion per day. Executives once reluctant to get involved in hostile takeover bids are shedding their inhibitions, and joining the bidding wars. Companies that once contentedly cultivated their local and national markets are joining the rush to globalize their operations and tap new markets. This newest merger wave is washing across Europe, with UK companies among the leading targets, and the Americans nowhere in sight.

It's not too difficult to see what makes UK targets so enticing. British companies have attractively high levels of profitability. The return on equity for British businesses is running at around 19%. That compares with 11% in Germany, and 16% in both France and the euro area as a whole (excluding the German laggard). As a result of their higher profits, British companies are throwing off cash flows that are mouth-wateringly attractive to potential acquirers. The premiums they are paying have shareholders cheering.

But the Americans are sitting on the sidelines. Which requires a bit of explaining. For one thing, many

American companies already have substantial assets in the UK; the rest of the world is playing catch-up with the Americans.

More important is the internal dynamic operating in America's board rooms. Like their UK counterparts, America's companies are awash in cash. In the past, this was an invitation to acquire other companies, most often with disastrous results. Corporate chiefs, flush with cash, had a choice: return it to the shareholders who own the company, or use it to expand their empires. Empire maximization topped profit maximization on their list of priorities.

Not any longer. American companies are in the process of what is called deleveraging – the paying down of outstanding debt. They are also using the cash to buy back their own shares, which increases earnings per share by reducing the number of shares over which earnings have to be spread. Both the deleveraging and the share-buybacks keep share prices high, which CEOs now are eager to do.

They are getting the message that failure to maintain the value of their shares can mean premature, unwelcome retirement, and on less generous terms than in the good old days before shareholder activists, as they are known, began to raise a fuss about the levels of golden goodbyes, especially in the case of executives who had failed to deliver value to shareholders.

So when Morgan Stanley enclosed a check for \$44 million, and threw in a promise of a pension after its chief, Philip Purcell resigned under fire, and Hewlett-Packard dropped a check for \$21 million in Carly Fiorina's handbag when she left the building, the

usual silence was replaced with an uproar. Warren Buffett, in his letter to shareholders, moaned. "Today, in the executive suite, nothing succeeds like failure." And a trade union group criticized mutual funds (unit trusts) for supporting shareholder motions to rein in executive pay only 27.6% of the time. Abuses still occur, but CEOs are aware of the increasing trend to relate compensation to profit performance, rather than to the ability to complete flashy mergers.

An equally important explanation of the failure of Americans to join the buying frenzy is their nemesis, Eliot Spitzer. Corporate executives tempted to enhance their standing in their country clubs by increasing the size of their empires are now looking over their shoulders to make sure that they don't end up on Spitzer's list of executives to be shamed, or even prosecuted, for not serving the interests of the shareholder-owners of their companies.

Then there is Sarbanes Oxley, the much derided law that has forced a restructuring of corporate boards. Those boards now must be composed of a majority of independent directors, rather than chums or dependencies of the CEO. These independent directors ask questions not often heard in board rooms in "the good old days" when the CEO's wish was treated as a command by the directors. Since many proposed acquisitions cannot withstand close examination, fewer are being approved.

So America's non-financial companies are concentrating on strengthening their balance sheets, and have reduced the ratio

of their debt to the GDP they generate to levels not seen since 1998/1999. That has shareholders sufficiently happy to keep share prices at high levels, even

though the Federal Reserve Board's monetary policy committee decided to raise rates again last week, signaled as clearly as the Fed can that it will do so again when next it meets, and created the prospect that the so-called "5% solution" – the level of interest rates at which the Fed will say "enough" – may turn out to be the 5¼% solution before the year is out.

But the Americans are not entirely absent from the game that is being played between European and Asian acquirers and their British targets. Goldman Sachs, Morgan Stanley, Lehman Brothers, and Bear Stearns all report that their first quarter earnings hit record levels. The smiles have returned to the faces of investment bankers, who confidently expect the pace of takeovers to continue at record levels for the rest of the year.

Smiling investment bankers produce smiling property agents and high-end car dealers. From there, it is an easy leap to smiling butchers, bakers, and the candlestick makers who light the tables in the best restaurants and private dining rooms.

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