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CROSS - INDUSTRY MERGERS AND ACQUISITIONS: SMART OR SENSELESS?

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ABSTRACT

Businesses have strategically decided to use Mergers & Acquisitions (M&A) in order to increase firm value since the beginning of U.S. history. While some companies choose to acquire competitors or other companies along their supply chain, others choose a different route and deliberately merge with or acquire companies that are in a completely different industry. This study analyzed three different 'cross-industry' M&A deals in U.S. history using a range of dimensions set forth. Ultimately, this study aims to determine whether or not 'cross-industry' mergers and acquisitions hold value. Taking into account the value creation or destruction of the deal will help in determining if these deals are 'smart or senseless.' Results of the study suggest that there is no one definitive answer to this question. While there are circumstances that promote this type of transaction, in many cases two companies in different industries joining together will create unanticipated problems, and eventually lead to disassembly.

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Chapter 1

Introduction

Business decisions, specifically mergers and acquisitions (M&A), have been prevalent in U.S. history since its inception. Dating back to 1821, with the merger of the Hudson Bay Company and North West Company, M&As have impacted American business, in some cases with significant industry transformations. Merger waves have shaped the way in which the American economy has evolved throughout history. Today, developments in technology have resulted in a myriad of cross-industry business, obliging companies to seek external knowledge and experience in order not only to stay competitive, but also to stay viable in this day and age.

Companies have mastered the application of M&As in order to advance and gain considerable market share in the economy. As seen through portfolio management, diversification allows for investors to mitigate risk, while seeking reward. Examining this concept through an executive's perspective, company diversification through M&A, when done strategically, can result in substantial gains and complete industry transformation. Understanding this type of diversification is fundamental to having a competitive advantage and will be done so by this thesis by analyzing previous mergers and acquisitions of American companies, specifically those in different industries. The ultimate goal of this research is to determine the value in 'cross-industry' mergers and acquisitions and whether they are smart or senseless from both a financial and logistical perspective.

This thesis is separated into five sections. The first is a tactical examination of different types of mergers and acquisitions. Subsequently, there will be an in-depth analysis of ‘cross-industry’ mergers and acquisitions. In that section, ‘cross-industry’ will be clearly defined in order to properly continue with the analysis of whether or not this type of business decision holds value. Next, specific criteria will be introduced in order to formalize what makes a merger or acquisition successful. Using the outlined criteria, the next section will look at case studies of ‘cross-industry’ mergers and acquisitions. The case studies will be explored using SWOT analysis in order to determine the strengths and weaknesses, possible opportunities and threats. Finally, a conclusion will be provided in order to summarize the findings and provide suggestions for future ‘cross-industry’ mergers and acquisitions.

Chapter 2

Mergers and Acquisitions Defined

Throughout history, implementation of M&A regulation has unintentionally led to the blending of the terms ‘merger’ and ‘acquisition.’ In order to properly explore the success of an M&A deal, it is essential to understand what makes mergers and acquisitions different, and the specific methodologies used to implement those deals in U.S. business. Choosing the best M&A strategy is detrimental to the ultimate value of the deal as there are distinctive differences and drivers that each deal-type emphasize. Brief overviews of the most relevant M&A deal structures are provided below.

Mergers

A merger describes a business deal involving two previously existing entities, which through a “voluntary fusion,” *merge* the companies into a singular new entity (Hargrave, 2019). The decision to merge is first created by the board of directors, who then subsequently present the deal in hopes of gaining shareholder approval. In order for two companies to synergize their businesses, precise valuation goals must be determined prior to joining together as one. Different types of mergers focus on those specified goals.

Horizontal Merger: Horizontal mergers occur amongst companies that work in the same or relatively similar industries. Typically these companies are competitors of one another, and commonly offer products or services that are closely related. Due to the similarities between the two companies, horizontal merger deals must take anti-trust and anti-monopoly legislation into consideration; for this reason, horizontal mergers are rigorously regulated and monitored by the U.S. government. As Figure 2-1 depicts, a merger between Textile Producer A and Textile Producer B would be a horizontal merger, assuming each of the textile producers are competitors (“Horizontal Merger - Understanding How Horizontal Mergers Work, 2019). Ultimately horizontal mergers aim to increase product offerings to an existing customer base without the challenge of developing those new products through internal research and development. Combining two companies in such a deal can also potentially create value by expanding the existing customer base. Horizontal mergers focus on creating value through economies of scale and scope.

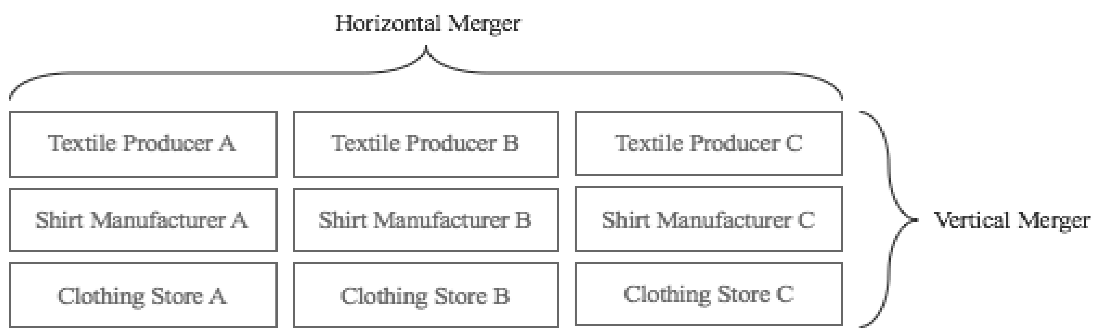

Figure 2-1: Horizontal Merger vs. Vertical Merger

Source: Corporate Finance Institute (CFI), 2015-2019

Vertical Merger: Vertical mergers involve two companies that share comparable supply chains. To be more specific, vertical mergers occur when companies with similar production and distribution processes combine in order to create synergies. Just like in a horizontal merger, in a vertical merger the two companies combine under one single entity. To illustrate, in Figure 2-1, a vertical merger would take place if Shirt Manufacturer B and Clothing Store B decided to combine under single ownership. Different than horizontal mergers, which aim to gain value through attaining economies of scale and scope by focusing on merging with an existing competitor, vertical mergers seek value in cost reduction and increased production efficiency by joining forces with a pre-existing piece of their supply chain ("Types of Merger and Acquisitions, 2015).

Congeneric Merger: Congeneric mergers focus on bringing together companies that possess overlapping characteristics in terms of the industry in which they do business, but not in the products they offer. To exemplify, in a congeneric merger, "the acquirer and the target may have overlapping technology or production systems," while providing two completely different products or services (Kenton, 2019). Using Figure 2-1 as a template, an example of a congeneric merger would be if Clothing Store A and Shoe Store B (not shown) merged; both stores are in the retail industry, but offer different products. To be more specific, these deals aim to promote product extension by adding product lines from one company to an existing product line of another company. Congeneric mergers accumulate value by expanding product lines, or by capturing a larger market share than what the two companies alone would be able to attain.

Conglomerate: There are two different types of conglomerate deals: a pure conglomerate and a mixed conglomerate. Mixed conglomerate deals have to do with two companies that, while currently unrelated, are involved with new product exploration or even market extension by combining. On the other hand, a pure conglomerate involves two completely unrelated firms. There are several ways in which conglomerate mergers can create value – increasing market share, cross-selling opportunities, and diversification are a few of these potential areas (Kenton, 2018).

A goal of this thesis is to dissect and analyze the feasibility in creating value with a pure conglomerate merger (also referred to as ‘cross-industry’)

Acquisitions

It is important to understand the critical differences concerning mergers and acquisitions. As previously stated, a merger involves two stand-alone companies coming together to form an entirely new entity. Acquisitions, however, result in the “takeover of one entity by another” (Majaski, 2019). Subsequent to the deal concluding, one of the two companies completely ceases to exist. Typically, the smaller of the two companies is consumed by the larger, who would have had to gain more than fifty percent (majority) ownership in the smaller company. There are friendly and hostile acquisitions and as their names suggest, friendly acquisitions occur when the target firm (one which will eventually cease to exist) is vocal in its approval in being acquired, whereas hostile acquisitions involve target firms that do not consent to the deal. Often an expanding company will decide to acquire another company when it is more cost effective than building the growth organically.

Mergers and Acquisitions Throughout U.S. History

The landscape of American business has been shaped by mergers and acquisitions and can be specifically seen through several defined ‘merger waves.’ Though the exact dates and causes for these waves are debated by academics and industry professionals, the number of mergers and acquisitions in the U.S. have grown significantly in both value and quantity since the end of the 19th century. This can be seen below in Figure 2-2 and Table 2-1.

Figure 2-2: Mergers and Acquisitions in the U.S.

Source: Institute for Mergers, Acquisitions and Alliances (IMAA)

First Wave (1895-1905)

The first U.S. wave, known as the 'Great Merger Wave,' began around 1895 and lasted until 1905. This merger wave was characterized by heavy monopolistic growth, stemming from the rising stock market and introduction of the Sherman Antitrust Act. In fact, the first wave saw the disappearance of 1800 companies and seventy-one previously competitive industries became monopolies (Owen, 2006).

Second Wave (1916 to 1934)

The second wave, which spanned from 1916 to 1934, saw government actively utilize its force in efforts to dissolve monopolies. The Clayton Act, which was introduced in 1914, discouraged monopolies and rather pushed the creation of oligopolies (Owen, 2006). Essentially this promoted the implementation of vertical integration. In fact, the advances in transportation (motor vehicles and passenger airlines) in this time period encouraged the merging of suppliers and customers even further. The second wave saw a focus in creating synergies within supply chains.

Third Wave (1963-1974)

The third wave began after the Great Depression and WWII, lasting from 1963 to 1974. This time period experienced a large increase in horizontal diversification, which essentially created a multitude of conglomerates (Cretin, Dieudonné, Bouacha, 2015). In fact, "companies actively sought to expand into new markets and areas" (Owen, 2006). A study that focused on Fortune 500 firms indicated that there was an increase in conglomerate firms from 8.3 percent in 1959 to 18.7 percent ten years later in 1969 (Rumelt,1974). This wave saw its decline as the world plummeted into recession due to the quadrupling of oil prices in 1973.

Fourth Wave (1981-1991)

As exemplified in Table 2-1 the fourth merger wave, which began at the beginning of the 1980s and lasted for approximately ten years, saw a dramatic increase in average number of M&A transactions per year throughout the wave. Many industry analysts believe that this increase in volume was in reaction to increased industrial deregulation combined with increased costs in both inputs (oil, etc.) and technology. Additionally, this merger wave saw a significant increase in the amount of hostile takeovers. Even more noteworthy than that is the “size and prominence” of the targeted companies: Gulf Oil, Kraft and Nabisco, three extremely well-known companies, were acquisition targets in the 1980s (Cordeiro, 2014).

Fifth Wave (1992-2002)

The dot-com boom was a large factor in the fifth merger wave, which began around 1992 and lasted roughly ten years. The fifth merger wave exceeded all other waves to date in terms of number of M&A transactions. As seen in Table 2-1, 1992-2002 experienced almost three times the amount of M&A deals as the fourth wave, although both the fifth wave and fourth wave lasted ten years.

Table 2-1: M&A Transaction Analysis by Merger Wave

Merger Wave	Total # of Deals	# of Years	Average # of Deals / Year / Wave
1st Wave (1897-1904)	2,696	7	385
2nd Wave (1916-1934)	9,043	18	502
3rd Wave (1955-1975)	51,539	20	2,577
4th Wave (1981-1991)	46,114	10	4,611
5th Wave (1992-2002)	123,904	10	12,390
6th Wave (2003-2009)	80,717	6	13,453
7th Wave (2012-now)	90,780	7	12,969

Source: Original chart using data from Institute for Mergers, Acquisitions and Alliances (IMMA)

Sixth Wave (2003-2009)

After the world recovered from the 1973 oil crisis, the United States saw fairly rapid growth in terms of M&A transactions. As seen in Figure 2-3, there was halt in that growth starting in the early 2000s. The downfall of the dot-com bubble, in conjunction with the 2001 September 11 attacks, led to a slow economy that saw little effort in M&A business investments. The sixth wave was the first to see an overall decline in the number of transactions and ultimately ended with the Great Recession of 2008.

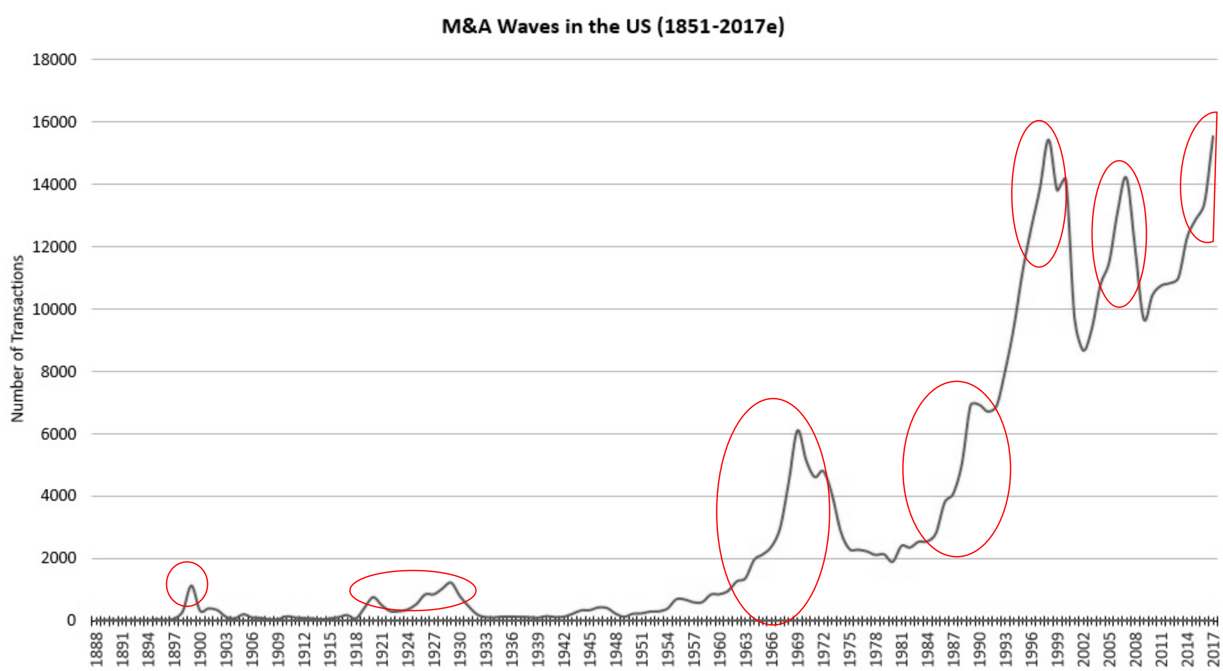

Figure 2-3: Graph of Merger Waves Throughout U.S. History

Source: Original graph using data from IMAA

Seventh Wave (2012-Present)

It was not until 2012, the beginning of the seventh merger wave, that the U.S. began to see positive growth in M&A transaction value again (see Figure 2-2). A report conducted by Camaya Partners in September of 2014 suggested that the risk aversion initiated by the business environment after the 2008 crisis was finally dissipating, and that industry leaders were promoting the idea that buying growth was easier than building it (Cordeiro, 2014). There is no definitive answer as to when this merger wave will end. This year (2019) has already seen multiple M&A transactions, with many "mega-merger" speculations on the nearing horizon.

Understanding some of the diverse strategies in M&A, as well as a general knowledge of the history of M&A in the United States, is imperative in determining the ultimate success of an M&A deal. As exemplified by the merger waves, there is not one defined factor (or set of factors for that matter) that impact the way in which M&A transactions have progressed throughout history.

Chapter 3

Diversification in M&A Deals

Many companies, across varying industries, pursue diversification opportunities. The decision to explore different industries through diversification is often done with the hope of creating value while mitigating risk. As previously stated, the overall goal of M&A is to create synergy, so are synergistic benefits plausible through diversifying M&A deals?

In order to delve into that question, it is important to properly define what characteristics a diversifying or 'cross-industry' M&A would have. The third merger wave, which took place around the 1960s was influenced heavily by conglomerate M&A deals, as exemplified in Chapter 2's brief merger wave breakdown. Subsequent to increased government anti-trust regulation, conglomerate deals blossomed as they were ideal candidates for early approval by the Federal Trade Commission. Horizontal, and surprisingly enough, vertical M&A considerations were quickly challenged. Therefore, if companies wanted to use M&A in their growth structures, they were pushed to seek opportunities outside of their current industry. Due to this influx of 'cross-industry' M&A activity, most of the data from this study will be derived from that time period.

Definition of 'Cross-Industry' M&A

In order for a company to truly be considered 'cross-industry,' the target and acquirer must take part in dissimilar business dealings. In 1997 the North American Industry Classification System (NAICS) was introduced in order to systematically categorize companies in the U.S., Canada and Mexico. As seen in Table 3-1, the system, which was an update of the original U.S. Standard Industrial Classification System (SIC), assigns each company a 6-digit code, and then sorts companies into 20 very broad sector categories. The subsequent four digits aim to further categorize the companies into different subsectors.

Table 3-1: North American Industry Classification System (NAICS) Coding Structure

Code	Industry Title	Number of Businesses
11	Agriculture, Forestry, Fishing and Hunting	344,810
21	Mining	29,033
22	Utilities	35,661
23	Construction	1,381,624
31 - 33	Manufacturing	603,605
42	Wholesale Trade	669,008
44 - 45	Retail Trade	1,715,825
48 - 49	Transportation and Warehousing	544,912
51	Information	326,566
52	Finance an insurance	723,572
53	Real Estate Rental and Leasing	799,569
54	Professional, Scientific and Technical Services	2,083,645
55	Management of Companies and Enterprises	65,818
56	Administrative and Support and Waste Management and Remediation Services	1,786,052
61	Educational Services	370,782
62	Health Care and Social Assistance	1,569,612
71	Arts, Entertainment, and Recreation	333,106
72	Accommodation and Food Services	841,963
81	Other Services (except Public Administration)	1,758,714
92	Public Administration	212,637
	Total Business Establishments	16,196,514

Source: NAICS Association, 2018

The NAICS is a useful tool when exploring whether or not the companies in an M&A deal are dissimilar enough for the transaction to be considered 'cross-industry. For the purpose of this research, as long as the target and acquirer's NAICS codes begin with different two-digit numbers, it will qualify as a diversification opportunity.

For the purpose of this study, diversified M&A will not include deals of related diversification. In theory, it is possible to diversify into fields that are in actuality related to the industry of the buyer. To be more specific, consider a potential acquisition of Ben and Jerry's, an American ice cream, frozen yogurt, and sorbet manufacturer, by PepsiCo, a food, snack and beverage manufacturer. As previously stated, (for the purpose of this study) in order for a potential M&A deal between the two to be considered 'cross-industry,' the first two numbers of their NAICS code must be different. Although the two companies produce different food products, their NAICS codes (Ben and Jerry's: 315520 and PepsiCo: 312111), both begin with '31', thus making a merger between the two ineligible for 'cross-industry' classification (Class Codes).

That being said, the relatedness of two companies is extremely subjective and sometimes difficult to determine with certainty. Additionally, it is likely that potential acquirers in such deals are already conglomerates by nature. As depicted in Table 3-2, the number of diversified M&A deals beginning in 1960 increased rapidly. Within fifteen years, the number of firms operating in three or more industries increased from six percent to 15.4 percent (Servaes, 1996). For the context of this study the acquirer will be categorized by the primary industry of business that they conduct business in.

Table 3-2: Companies Split by Number of Segments

Number of Segments	1961	1964	1967	1970	1973	1976
1	54.5	55.2	53.2	51.2	35.8	28.4
2	26.3	25.8	24.7	22.9	28.8	22.2
3	11.3	12.2	13.6	13.5	16.7	19.7
4	6.0	5.4	5.8	7.2	10.5	15.4
5	1.5	1.4	2.3	4.0	7.4	10.2
6	.4	0.0	.5	1.1	.8	4.0
Total Firms	**266**	**353**	**397**	**445**	**514**	**518**

Source: Servaes, 1996

Chapter 4

Factors Impacting M&A

In exploring the plausibility of value-creation through cross-industry M&A, it is important to determine what pieces of criteria will be evaluated. There are many reasons why a company may choose to seek value in M&A deals. Rather than spend years developing organic growth, “many companies use M&A to grow in size and leapfrog their rivals” (Picardo, 2018). Ultimately, as is consistent with most M&A deals, a company will only choose a diversified M&A strategy when they are confident the value of the two companies together will be greater than the sum of the two companies when valued as independents. Being aware of the motives behind an M&A deal can at times provide insight to the potential value-creation for the deal as well. As a preface to the case studies, which will be presented in Chapter 5, this chapter will set a framework for how those M&A deals will be evaluated.

Motivations for ‘Cross Industry’ M&A

Synergies

As previously mentioned in earlier chapters, one of the main goals of M&A is to find synergies between the target and the acquirer. In M&A, synergies are “achieved when the value added from the joining of two companies is greater than that of the companies operating as separate entities” (Corporate Finance Institute, 2019). Firms can capitalize on synergies in both financing and operating activities.

Operational synergies include those of economies of scale and scope. While the two revolve around a similar theory, they have distinct differences that can amount to huge growth potential. Economies of scale has to do with volume. More specifically, these advantages are gained through an increase in production level. Subsequently, there are decreased variable costs, and lower per-unit fixed costs, as a result of a more efficient production process. As Figure 4-1 shows, when output is increased, average costs decrease.

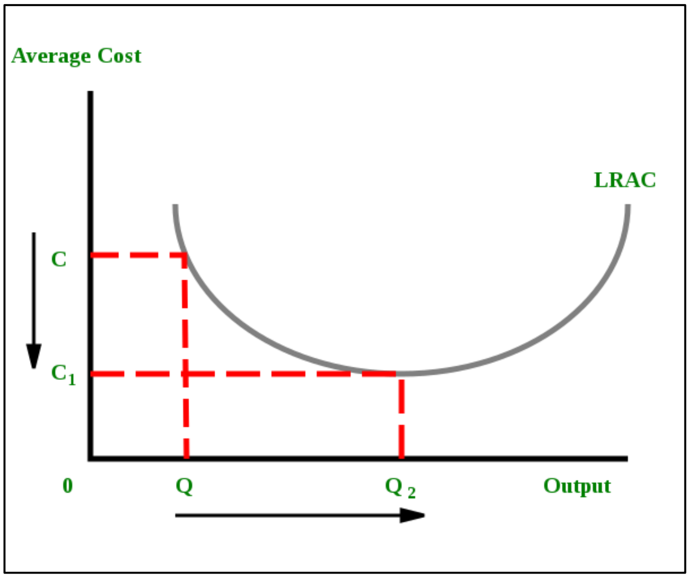

Figure 4-1: Benefits Derived from Economies of Scale

Source: Corporate Finance Institution's *Financial Analysis Courses*

But does this hold true in diversified M&A deals as well - is the newly formed company typically able to capitalize on the addition of the target's assets? In a diversified M&A deal, this growth is not as easy to find as in a vertical integration merger for example. Nonetheless, it could potentially be seen by an increase in production volume due to acquired plants, machines and sometimes even full production capabilities. The new enterprise hopes to see lower costs than the two would have shared as separates. The amount saved in production costs is then seen as greater revenues for the company.

Additionally as economies of scope shows, M&A deals often expose an expanded group of consumers to a greater assortment of products. With vastly different customer bases, and products with very little to no correlation, would the newly diversified company be able to gain value through economies of scope? The key to achieving economies of scope in a 'cross-industry' M&A deal is to see how the two companies have been able to expand their products into one another's previously existing consumer base, without cannibalizing their original demand.

There are multiple ways to see if an M&A deal has capitalized on economies of scale and scope. Looking at unit costs after integration, and the cross-integration of products to pre-existing consumer bases, will help in determining whether or not the deal was able to achieve these operational synergies. This often can be seen by a reduction in prices, as companies may try to entice their new customer base with low prices, or with increased marketing to increase consumer awareness.

Financial synergies can also be created through diversified M&A deals. Financial synergies that are positive lead to increased tax, profitability and debt capacity benefits (Corporate Finance Institution, 2018). Highly profitable companies tend to attain the benefits of financial synergies more easily than that of smaller companies. Most specifically to 'cross-industry' M&A, is the idea that financial synergies can lead to diversification and reduced cost equity. To be more specific, "the diversification effect may reduce the cost of equity for the combined firm" (Corporate Finance Institution, 2018). Lastly by combining two firms from completely different industries, one would hope the customer loyalty would transpire to the newly acquired company and its offerings as well.

More Profitable Industries

Another argument to be made for intentions behind ‘cross-industry’ M&A is the idea that the acquirer’s primary market of business is saturated, or almost saturated, and therefore in order for them to continue to grow, they must seek business in a new industry. Rather than obtaining natural growth or progression into that new venture, which can often be costly without guaranteed success, when funding is available, merging or acquiring a pre-existing business can provide cost-savings for the acquirer as well as lessen the barriers to entry. Entering these otherwise ‘hard-to-enter’ markets with dedicated teams that are familiar with the practices of the new industry, advances the firm above competition that otherwise would be entering the industry ‘blind.’ The potential diversification discount/ premium, which will be explained later in this chapter, will emphasize this concept.

Minimize Risk

While the practice of diversifying M&A is risky, as most M&A deals are, ‘cross-industry’ M&A has the opportunity to exploit constraints in other competitor’s strategies. The way in which it does this is through the idea that if one industry is not doing well, by diversifying into another industry, the company may be able to stay afloat, and in some cases still produce positive returns. In doing this, the acquiring company must be confident in its ability to manage both pieces of their business. There are many times throughout history when ‘cross-industry’ acquisitions are attempted, but turn out to be unsuccessful because of the highly specialized nature of the target firm’s type of business.

Value Creation through 'Cross Industry' M&A

The following value-determining strategies will be used in analyzing the success of various case studies presented in Chapter 5.

Market Reaction

One of the key determinants to the success of a 'cross-industry' M&A deal is how the market reacts to the news of the transaction. A fairly accurate way of estimating the market's reaction is to track the stock prices around announcement date. It is important to remember that corrupt business dealing such as 'insider trading,' can sometimes skew this information. To further explain, details about such dealings can be leaked to the media before they are formally announced. For that reason, it is important to go far enough back into the data that any outside influences would not have impacted the stock price. Tracking how the stock has changed from the start of the 'bid window' to just after the initial public announcement will provide an influx of information on the market's approval or disapproval of the deal. This can also sometimes be used to make predictions about future stock prices.

Diversification Discount / Premium

Another possible measure of M&A value is through a concept known as the diversification discount. This theory aims to provide support as to whether or not the newly formed company raises value in relation to what the two companies would have been valued at as individual businesses (Gaughan, 2013). If the combined value is less than that of the company's values as individuals, it is said to have a diversification discount, although if it is greater, then it is said to be trading at a premium. The intrinsic value of each company, along with the market capitalization, are used in calculating this figure (Corporate Finance Institute).

Longevity of the Entity

Intuitively, if an M&A deal is not producing results as expected, in due time, the organization will decide to sell off its subsidiaries in a process known as divestment. Taking a look at the financials of the company, as well as the stock price, can often provide an early indication of these formally merged companies becoming divestitures. Despite the high costs of M&A deals, sometimes it is in the best interest of the shareholders to undo the transaction and divest the companies back to two separate entities. Although this is not looked highly upon, it is better for executives to recognize their mistakes and cut costs as soon as they can.

Intentions behind the Deal

It is important to restate the idea that the intentions behind M&A are extremely important when analyzing the deal's success. Typically when company executives negotiate the specificities of the deal, goals will be discussed. Those set goals, along with the intentions the acquirer has when going into the deal, are extremely important in determining the inherent value in the deal. To exemplify, if the ultimate goal was to create a new product, but with the success of creating the new product the stock price plummets, the deal is not necessarily considered a failure. This idea will be further shown in Chapter 5 through the 2000 AOL's acquisition of Time Warner.

Chapter 5

Case Studies

Utilizing the framework for understanding value-creation (presented in Chapter 4), this chapter will examine multiple examples of ‘cross-industry’ M&A in the United States. Understanding the acquirer’s motives for the deal as well as the outcomes of the deal are essential in identifying the deal’s overall value. Two of the case studies will focus on specific organizations that have utilized the ‘cross-industry’ M&A model for an extended period of time throughout their company’s history. Additionally, one of the case studies will be provided in order to see how one specific M&A transaction has impacted a company. The final study will provide a more in-depth and comprehensive analysis, whereas the first two will go over larger, more generalized value-creation concepts.

Case Study 1

United Technologies Corporation

United Technologies Corporation Company Profile

Originating in the aerospace industry, United Technologies Corporation (UTC) (NYSE: UTX.N) has been a leader in providing technology products all over the world. Since 1934, the company has used its diverse company structure in order to provide advanced solutions to many different industries. With NAICS code 334511, UT is placed in the manufacturing industry, with a focus in "search, detection, navigation, guidance, aeronautical, and nautical system and instrument manufacturing" (SICCODE.com).

'Cross – Industry' Representation

After breaking off from its original company in 1934, UTC decided to expand outside of its industry in its 1970 acquisitions of Otis Elevator and Carrier Refrigerator. As seen in Figure 5-1 and Table 5-1, over the years UTC has been able to successfully find synergies between the most abstract of industries. The diversified acquisitions brought UTC significant revenue development with revenues growing from $24 billion (1999) to $59 billion only ten years later in 2009. UTC's stock also saw returns of almost 650 percent during that time period as well, thus indicating significant public interest and approval of their diversified M&A choices (Sharoodi, 2014). Throughout its history, UTC has been able to capitalize greatly by attaining economies of scale and scope by incorporating production techniques of its most successful practices into its less-mature acquisitions.

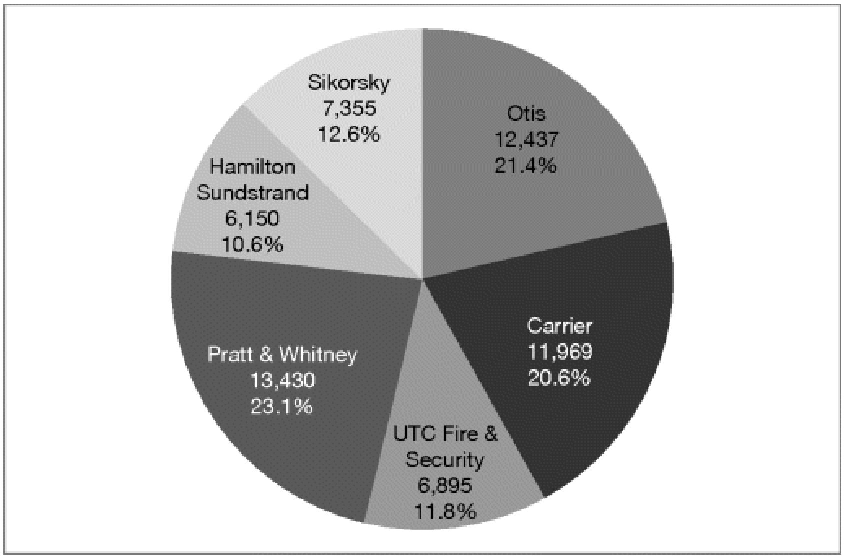

Figure 5-1: United Technologies Corporation, Inc. Split by Subsidiaries

Source: Gaughan, 2013

Table 5-1: United Technologies Corporation, Inc. Subsidiaries by Year Acquired

UTC Subsidiary	Year Acquired	Industry
Otis	1976	Elevators
Carrier	1979	Refrigeration
Chubb Security	1999	Fire and Security
Hamilton Sundstrand	1999	Aircraft Control Systems/ Aerospace
Sikorsky	2004	Helicopters
Pratt & Whitney	2005	Engines

Source: Original table with data from Gaughan, 2013

Current Analysis

While the peak of UTC saw huge growth in revenue and stock prices, in recent years it has not seen the same results. In a statement on November 26, 2018, UTC publicly announced that it would be splitting into three separate companies: United Technologies (including Collins Aerospace Systems and Pratt & Whiney), Otis and Carrier. Gregory Hayes, UTC CEO and Chairman stated that this decision to split UTC “is a pivotal moment in our history and will best position each independent company to drive sustained growth, lead its industry in innovation and customer focus, and maximize value creation (United Technologies Corporation, Inc., 2018). He continued by stating that he believes the split will allow for each company to focus specifically on their given industry.

One of the biggest strengths throughout the history of UTC was their “overall management of each well-performing unit” (Gaughan, 2013). This management allowed for the company to show high performance in various economies. Additionally, their management’s strategic decisions have been a huge asset to the organization. Being able to recognize value in disassembly, cutting losses, and ultimately creating value is something that UTC, as a diversified company, has excelled in. There are a myriad of opportunities the three companies will be able to capitalize on now that they will have higher focus in their given areas of expertise. One threat to this split is the overall stock performance of UTC. After the announcement on November 26, 2018, UTC stock price dropped significantly (5-2). While the stock price has increased since then, it will be interesting to follow the price through the deal, which is said to be finalized in 2020.

Figure 5-2: United Technologies Corporation, Inc. Stock Price after Announcement

Source: Yahoo Finance

Overall, UTC's strategy to take part in 'cross-industry' M&A brought them significant success for many years. Ultimately, UTC's decision to split provides insight that diversification in M&A does not necessarily hold long-term value for a company.

Case Study 2

America Online Inc. and Time Warner Inc.

America Online Inc. Company Profile

America Online (AOL) was founded in 1985 as an internet service provider. In the late 1990s and early 2000s, AOL was seen as the leader in the dot-com industry.

Time Warner Inc. Company Profile

Time Warner (TWX), which was first listed in 1999, has a diversified history in “media industries, including published, broadcast and other entertainment media” (Malone, Turner). Time Warner made previous attempts at gaining an online presence, but was unsuccessful in doing so (McGrath, 2015).

The AOL and Time Warner Deal

On January 10, 2000, AOL announced its plans to acquire Time Warner, Inc. The AOL Time Warner group “held dominant positions in every type of media, including music, publishing, news, entertainment, cable and the Internet” (History.com, 2009). More specifically, the merger was thought to combine all areas of media in the most obscure of ways. The ‘cross-industry joining of these two companies came with a great deal of brand recognition. When the Internet bubble burst, the newly merged company experienced a severe loss; one year later in 2002, they reported a quarterly loss of $54 billion (History.com, 2009). Soon after this, the company split.

Intentions Behind the Deal

One of the most significant aspects of this M&A deal was the intentions behind it. The executives knew that the share price of their stock was going to plummet, so they made this strategic decision to acquire Time Warner with that thought in order to gain positive momentum around the company. While the merger of the two companies was short-lived, the executives were able to save the shareholders from a complete loss.

Current Analysis:

Having an AOL Time Warner Company was without a doubt not an ideal fit in that time, but the business itself was not necessarily a bad choice. By keeping the shareholder's best interests in mind, the executives were able to devise this plan. While ultimately it did not exceed their expectations, it was not a complete loss either.

Case Study 3

Amazon's Acquisition of Whole Foods

Amazon.com Company Profile

Since its founding in 1994, Amazon.com, Inc. (NASDAQ: AMZN) has become the largest "e-commerce marketplace" as measured by both revenue and market capitalization. While the company began as an online bookstore, over the years it has transformed into a retail giant, providing just about anyone, with just about anything. Amazon.com, Inc.'s NAICS code is '454110', placing it under the Retail Trade Industry.

Whole Foods Market Company Profile

The first Whole Foods Market, Inc. (previously traded as, NASDAQ: WFM) store opened in 1980, just two years after its founding in 1978. Thirty-six years later in 2016, the single-segment, grocery empire that focuses on natural and organic foods, had over 456 stores all over North America and the UK. In addition to its dedication to well-sourced food products, in 2016 Whole Foods launched an 'own-brand' called 365, which piggybacked off their passion for organic products (Chaboud, 2018). Whole Foods Market falls under the NAICS code of '445299', placing it under the Organic Food Retailer Industry.

For the purpose of this study, given that the two companies fall within different initial industry categorization, they can be evaluated as a 'cross-industry' M&A example.

The Whole Foods/ Amazon.com Deal

A detailed report released by the United States Securities and Exchange Commission (SEC) breaks down the process by which the acquisition of Whole Foods by Amazon.com was created and finally completed. In 2016 Whole Foods Market executives began strategic conversation about the company's future. In order to plan ahead, "the Company's board of directors and management continued to actively assess rapidly evolving industry dynamics, intensifying competitive conditions, deflationary price pressure and technology changes" that were currently affecting Whole Foods' business (U.S. SEC, 2017). In looking toward the future, Whole Foods noted that they would have to make significant changes in order to stay competitive in their industry and also accelerate prospective business initiatives.

It was noted that Amazon.com had once before shown an interest in M&A dealings with Whole Foods Market, but nothing had transposed from the initial conversation. After multiple meetings between the two companies, on April 27, 2017 Whole Foods Market and Amazon.com "entered into a non-disclosure agreement" (U.S. SEC, 2017). Shortly after that in June of 2017, the acquisition was formally announced.

Ultimately, the board of directors from Whole Foods Market unanimously decided that the $42.00 per share cash price that Amazon.com offered provided their shareholders with "attractive value." Compared to the June 15, 2017 and March 31, 2017 closing prices, the $42.00 per share stock price represented twenty-seven percent and forty-one percent premiums respectively. After the transaction was completed, WFM stock would cease to exist as a publicly traded company on the NASDAQ, and therefore would become a subsidiary of Amazon.com.

Market Initial Response

In order to get an accurate depiction of the response to the deal, it is imperative to go well beyond the time of any public speculation of the deal. As stated in the report done by the U.S. SEC, there was some public speculation of the deal prior to the announcement, so it is important to take that into account when considering a ‘bid window’ for the Amazon.com and Whole Foods Market transaction.

As exemplified in Figure 5-3, both the stock price of Amazon.com and the stock price of Whole Foods Market increased. This is atypical of normal stock prices after an M&A announcement; typically, the “price of the target company stock rises and the price of the acquirer company stock falls” (Nadar, 2018). The fact that the stock prices of both the target and acquirer increased, is definitely a positive sign that the market favors such a transaction.

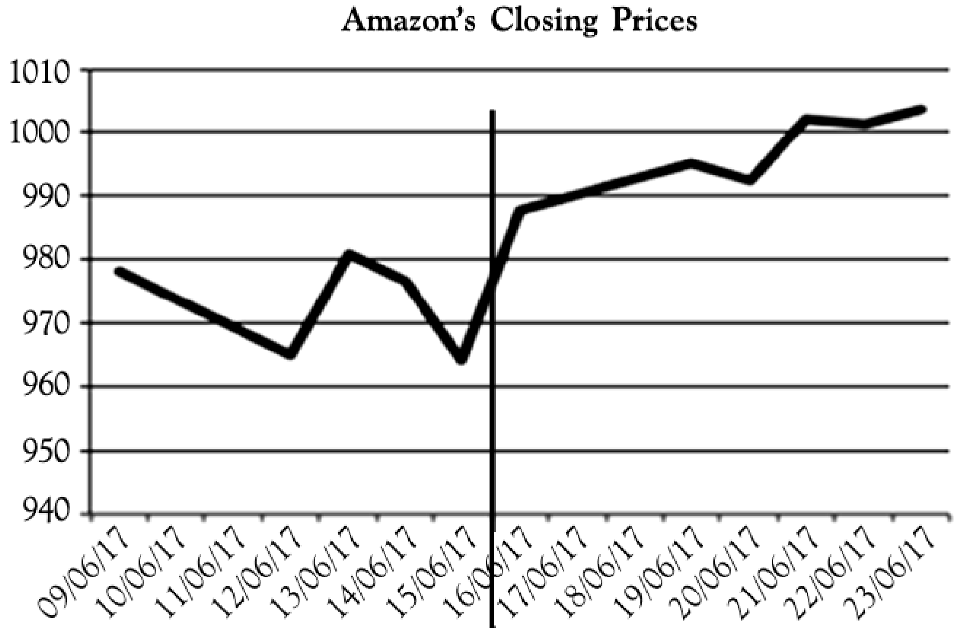

Figure 5-3: Amazon & Whole Food's Closing Stock Prices After Announcement Date

Source: ProQuest

Interestingly, another indicator of public perception is how the market reacts to the announcement. In this particular example and as seen in Figure 5-2, Walmart, Target and Kroger, all leaders (and competitors) in the Food industry, saw drops in their stock price after the announcement, while the two companies involved had positive stock returns (Kowitt, 2017).

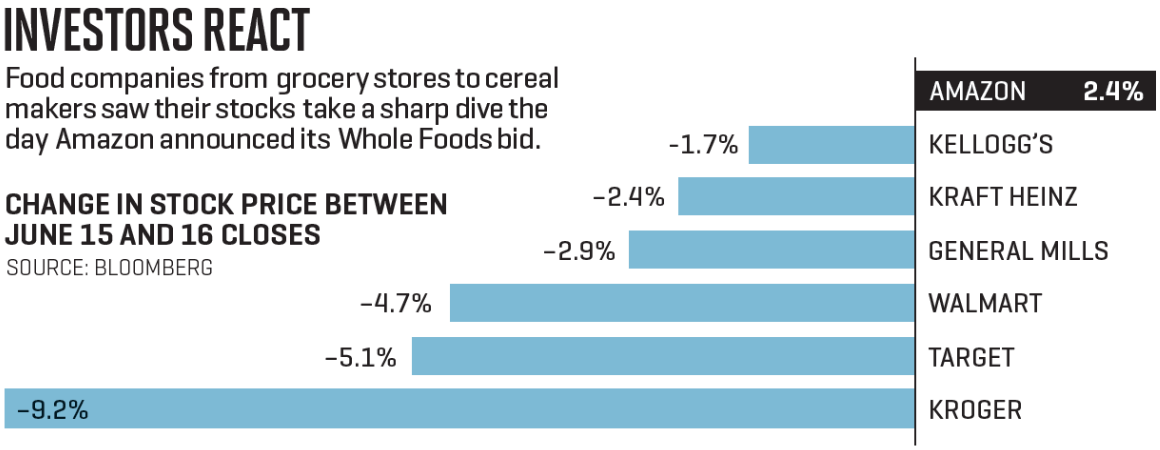

Figure 5-4: Investors Reactions as seen by Competitor Stock Prices

Source: Fortune.com

Today, almost two years after the initial announcement of the Amazon.com Whole Foods Market acquisition deal, Amazon is the 2nd most valuable company with market capitalization well over $760 billion. This value just continues to rise, and the addition of Whole Foods has (presently) only created great value opportunities for the company. From a supply chain perspective, Amazon.com, as a leader in distribution networks, has been able to differentiate itself from its competitors. Whole Foods Market has been integrated into this business model, now offering grocery delivery services as a functionality of Amazon Prime Subscription. One area in which Amazon will have to continue to learn is in the brick and mortar business model. After attempting to enter the brick and mortar model with AmazonFresh, the company realized it was not there yet. A potential opportunity for the company is through the food industry's more stable and less cyclical sales patterns. Presently, Amazon has thirty-three percent of all of its sales occurring in the fourth quarter of the calendar year. By acquiring Whole Foods Market, Amazon.com may in the future see more consistent sales data. Lastly, the largest threat to Amazon.com's acquisition of Whole Foods is Walmart. While acquiring Whole Foods Market has put Amazon.com on the Food industry horizon, it still does not nearly add up to its fiercest competitor, which holds the "largest share of the U.S. food market with about 14.5% of total sales" (Chaboud, 2018). Whole Foods Market and Amazon trail Walmart by well over ten percent. It will be interesting to see the changes which Amazon decides to make in the coming years in order to stay competitive with Walmart.

Based on the evaluating criteria, Amazon.com's acquisition of Whole Foods Market can be viewed as a successful 'cross-industry' M&A deal. Given that the pair continues to see synergies in the coming years, this may become one of the most valuable acquisitions of the 2010-2019 decade.

Chapter 6

Future Predictions

In a study conducted by Deloitte Development, Inc. between September 4 and September 14, 2018, 1000 company executives were surveyed in order to get their thoughts on M&A for the upcoming year. In the survey, which was conducted by OnResearch, they also gave insight on their most recent M&A deals as well. The executives that were interviewed represented firms with revenues of at least $10 million and were from more than twenty different industries.

One of the main goals of their study was to gain insight on the future of M&A transactions. Almost ninety percent of the companies expected the "current level of M&A to continue or even grow in 2019" (Thomson, Dettmar, Garay, 2018).

Another goal of the study, one directly relating to the topic of this thesis, was to understand the main driver of M&A in the upcoming year. One surprising result of their study showed that many executives believe acquiring technology-based companies (solely for their technology) will not be at the forefront of M&A deals in the year 2019. Rather, corporations will focus on deals that "expand and diversify their products and services" (Thomson, Dettmar, Garay, 2018). One of the explanatory reasons for this shift is the rising cost in technology.

With the idea that technology may no longer be the main purpose of M&A, respondents were asked about their options on which two industries will likely converge in 2019. While some of their answers were in line with previous years' predictions (and therefore less exciting), as seen in Figure 6-1, there were also a handful of new predictions as well. One of the most intriguing predictions was the increased prediction in M&A deals between the Banking & Securities industry and Energy and Resources industry. There is clear direction and outlook in many of these combinations, due to the increased expectation in diversifying products, specifically to broader consumer groups.

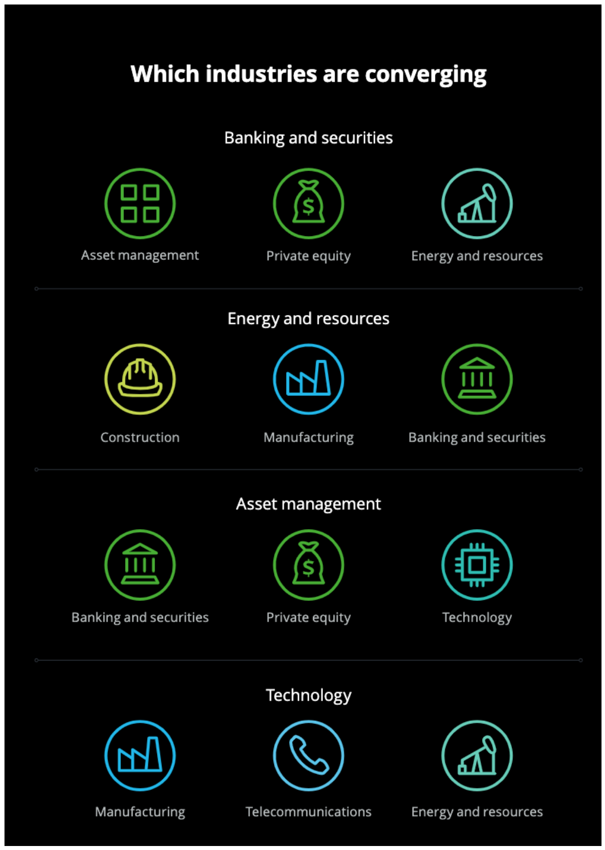

Figure 6-1: Industry Convergence Predictions

Source: Deloitte Development, Inc. 2018

With this given information, it is interesting to note that although ninety percent of the executives questioned believe that M&A deals in 2019 are on the rise, forty percent of the "survey respondents believe that half of their deals fail" (Thomson, Dettmar, Garay, 2018). This is an interesting paradox because it alludes to the fact that many companies go into these deals with the anticipation that they may in fact ‘fail.’ Based on the study, there is an increased expectation that the market will see ‘cross-industry’ M&A in hope of diversifying products and consumers.

Chapter 7

Conclusion

As exemplified throughout the study, every M&A deal is accompanied by a plethora of benefits and constraints, especially M&A deals that combine two companies in completely different industries. These 'cross-industry' deals are puzzling because while in theory they should be flawless due to diversification's typical mitigation of risk, in countless examples that does not hold true. In fact, by looking through the research in this study, it is concluded that in most cases while 'cross-industry' M&A may create value in the short-term, is not effective in creating long-term value for a company. That being said, even an unsuccessful M&A deal may bring opportunities for the acquirer. A key piece to the 'cross-industry' M&A puzzle is determining when (if ever) disassembly should occur.

Additionally, as seen through the study, the success of an M&A deal is heavily focused on the intentions of the deal, and this must be remembered. In analyzing the value creation in an M&A deal the financial synergies are important, but the operational synergies are equally as important and often forgotten. It will be interesting to see the direction in which 'cross-industry' M&A is headed. With huge advances in Artificial Intelligence (AI) and other technologically focused projects, the possibilities for expansion into immensely different areas of business is seemingly limitless. Whether or not these industries can find adequate synergies is another question, and one that will be heavily monitored in the coming years.

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EDUCATION

The Pennsylvania State University Smeal College of Business **University Park, PA**
Schreyer Honors College May 2019
Bachelor of Science in Finance; Emphasis in Supply Chain Management
Honors: Deans List (6 out of 6 semesters)

ACTIVITIES

Alpha Sigma Alpha Sorority *President* 2017-2018
Alpha Sigma Alpha THON *Committee Liaison* 2015-2016
Alpha Sigma Alpha Recruitment *Team Member* 2015-2016
Chabad of the Undergrads *Class Coordinator* 2015-2018
Hillel of Penn State *Campus Engagement Intern* 2016-2016
Semester Abroad Sydney, Australia Spring 2018
Penn State THON Independent Dancer Spring 2019

EXPERIENCE

MLM Family Enterprises, LLC. (Gabrielle & G-Lizzy) **Bala Cynwyd, PA**
Director of Buying and Store Operations December 2017- January 2018, June 2018 - August 2018
Worked directly with store owner to assess operational issues in order to employ new systems and increase productivity
Researched and coordinated with eight (8) new brands resulting in purchase orders in excess of $100,000
Actively applied organizational skills in order to increase daily store productivity
Implemented three (3) new alteration department systems to enhance customer experience
Cultivated relationships with several international designers to create brand and design exclusives
Redesigned logo and website to be used as part of a rebranding campaign
Actively managed all procedural issues with vendors and customers, including day-to-day operations

URBN, Inc. (Free People) **Philadelphia, PA**
Bottoms Buying Intern June 2017 - August 2017
Worked alongside buyers for jeans, pants, shorts & skirts to assist in daily buying activities
Successfully placed over 200 purchase orders within first month
Improved sample coordination by implementing new organizational system
Aligned buying decisions with Free People customer profile (e.g. Wholesale Assortment Decisions)
Created a new system, 'My FP Closet,' as an interactive marketing technique to increase customer-brand engagement

Beauty and Wellness Buying Intern May 2016 - June 2016
Worked directly with the head buyer in preparation for inaugural season of Free People Beauty & Wellness
Proficiency in Island Pacific - specifically keying Purchase Orders for Direct & Retail
Proficiency in utilizing Free People's Merchandise Tracking System (MTS)
Developed mood boards to educate customers on FP Beauty & Wellness

J2 Communications **Lafayette Hill, PA**
Social Media Intern September 2014 – June 2015
Mentored by the company's owner to learn the fundamentals of the Public Relations industry
Engaged with J2's clients including Krispy Kreme Philadelphia, Velodyne, ToughTested, and Salon Rosa M
Afforded personal contact via phone, email and in-person with clients
Informed the public about our clients through social media

SKILLS

Advanced knowledge in Microsoft Office programs: Word, Excel, PowerPoint, Publisher & Outlook
Mac and PC software proficiency
QuickBooks
Proficiency in Island Pacific (IP) and Blue Cherry