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MASTER OF MANAGEMENT IN FINANCE & INVESTMENT (MMFI)

2015 RESEARCH REPORT



VALUATION OF TARGET COMPANIES IN MERGERS AND ACQUISITIONS: THE CASE OF

ASPEN PHARMACARE AND ADCOCK INGRAM

SUBMITTED TO:

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COMPILED BY:

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DEDICATION

I dedicate this research paper to my beloved son and husband who have been a constant source of knowledge, inspiration and strength in my life.

DECLARATION

STUDENT NO: 9809965D

I, NOMPUMELELO (MPUMI) THEMBEKILE MADISA, declare that this dissertation is my own unaided work. It contains no work submitted previously as a dissertation or thesis for any degree at any University.

I further declare that I have acknowledged all sources that I have referenced in the study.

Signature: ---------- Date: 4 August 2015

ACKNOWLEDGEMENTS

This study could not have been possible without the support, involvement and cooperation of a number of individuals. I specifically take this opportunity to express my sincere and heartfelt gratitude to the following:

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To my family and friends, thank you for your unconditional love and support, your encouragement and for being part of my life throughout my academic journey.

ABSTRACT

This paper assesses shareholder wealth creation in target and acquiring companies as a result of an acquisition, in particular, a hostile takeover. The paper reviews existing mergers and acquisitions literature and also considers a case study in order to review some practical results. The case study of the Bidvest Group hostile takeover of Adcock Ingram Pharmaceuticals that took place in January 2014 in South Africa is reviewed. A detailed qualitative and quantitative analysis is conducted to ascertain and quantify shareholder wealth creation after the takeover. The analysis conducted included a financial assessment using relevant financial indicators, an analysis of existing literature and interviews with key board directors of Adcock Ingram Pharmaceuticals. To ascertain whether the results of the target company, Adcock Ingram Pharmaceuticals, are either in line, below or above industry performance after the takeover, Adcock Ingram Pharmaceuticals' results are benchmarked against Aspen Pharmacare Holding's results. Majority of the findings literature reviewed are that target company shareholder gains exceed acquiring company shareholder gains post an acquisition. The findings of this research are that target company (Adcock Ingram Pharmaceuticals) shareholders are worse off whilst acquiring company (Bidvest Group) shareholders continue to increase their wealth after the takeover. Possible reasons for these results, which contradict majority of the existing literature on wealth gains post a merger or acquisition, are given.

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CHAPTER 1: INTRODUCTION

1.1 INTRODUCTION

The global market for corporate control is characterised by various activities such as mergers and acquisitions, equity/debt offerings, private equity, venture financing, etc. This research focuses on corporate control strategies specifically related to mergers and acquisitions. It analyses value creation as a result of an acquisition, in particular a hostile takeover, and assesses whether the perceived or expected growth and profitability is in fact realised.

In introducing the topic of the paper, it is critical that one outlines the context and origin of mergers and acquisitions. Holl (1977) defines the market for corporate control as one characterized by the relationship between: (i) the market value of a company's shares, and (ii) the asset value of the company. Holl (1977) further states that shareholder returns are reflected in a company's share price, and that a company becomes a potential acquisition target when the market value of the company's share price falls below the asset value of the company.

Holl's (1977) argument sets the scene for the emergence of mergers and acquisitions. It becomes clear that mergers and acquisitions are a route or option that corporates may choose to take in order to expand and strengthen their corporate control in the market. This potential growth and control expansion strategy is supported by Manne (1965) who states that the market for corporate control provides corporations with an opportunity to reallocate resources for better use.

To provide a practical aspect to this research, a case study of the acquisition of Adcock Ingram (Adcock) Pharmaceuticals by the Bidvest Group (Bidvest) is analysed. The analysis of these South African companies looks at value creation both from the perspective of the acquirer (Bidvest) and the target/acquired company (Adcock). Some background on this acquisition is as follows:

1.2 PROBLEM STATEMENT

As per the SENS Announcement dated 1 December 2013, effective 2 December 2013, Bidvest (on behalf of a consortium made up of Bidvest and Community Investment Holdings or CIH) made a cash offer to the shareholders of Adcock to acquire up to 34.5% of the issued ordinary shares in Adcock, during which time Bidvest already owned approximately 4% of the issued ordinary shares in Adcock. Adcock shareholders accepting the offer would receive a cash

amount of R70 per Adcock ordinary share. This investment by the Bidvest-CIH consortium was valued at approximately R4 billion and was funded using the consortium's own cash resources.

The reason for Bidvest making a direct offer to Adcock shareholders was that the Board of Adcock was supporting an alternative bid by a Chilean company called CFR Pharmaceuticals (CFR). Mokhele (2013) stated that the Adcock Board believed that an Adcock-CFR combination would be in the best interests of shareholders. This statement was contrary to the belief of Adcock's major shareholder, the Public Investment Corporation (PIC). Whilst the Adcock Board was intent on their strategic support of the CFR bid, the PIC a 20% shareholder in Adcock at the time, vehemently disapproved of this decision and acted on their non-support of the CFR bid by supporting Bidvest and voting against the CFR offer.

The direct offer to shareholders by Bidvest was successful and on 31 January 2014, a SENS announcement was released on the Johannesburg Stock Exchange stating the successful acquisition, by the Bidvest-CIH consortium of approximately 39 million Adcock ordinary shares, equating to approximately 34.5% of the issued share capital in Adcock. This acquisition was done through a hostile takeover due to Adcock Ingram's management not supporting for an acquisition by Bidvest, instead preferring and supporting an offer by CFR Pharmaceuticals.

CIH had a 10% shareholding in the consortium, and therefore their net shareholding as a result of the successful transaction was 3.45%, leaving Bidvest with the majority 31.05% shareholding. Having utilised its own cash resources to acquire approximately 39 million shares at R70 a share, Bidvest had invested approximately R2.4 billion (approximately 35 100 000 ordinary Adcock shares at R70 a share). As of 20 May 2014, the Adcock share price was R60.44 and dropped to R53.75 on 23 June 2014.

As it stands, Bidvest's R2.4 billion investment is yielding negative returns and if this situation persists and the share price does not increase to above R70 a share, Bidvest will never realise returns from this substantial investment. At the prevailing share price of R53.75 a share (as at 23 June 2014), Bidvest's investment in Adcock was valued at approximately R1.8 billion. As at 30 June 2014, Bidvest suffered an impairment of R1 056 059 as a result of its investment in Adock.

Further to the declining share price, Adcock released a trading statement on 20 May 2014 (4 months after the acquisition), of an expected loss per share of between 24 cents and 25 cents. Adcock's half year results for the period ending 31 March 2014 were as follows (2013 – 2014 comparison):

- Turnover up 3.36% (relatively flat) year on year;
- Operating expenses up by 24.74% year on year;
- Gross profit margins down from 42% (2013) to 34.9% (2014);
- Operating profit down by 99.6% from R425m in 2013 to R1.9m in 2014. (Operating profit for the previous financial year ending 30 September 2013 was R890m.)

The decline in Adcock's profitability post the takeover requires further assessment to ascertain whether this decline is as a direct result of the takeover or whether, operationally, Adcock's performance was poor, notwithstanding the hostile takeover. To assess this, the performance of Adcock pre and post the acquisition has been compared to its rival competitor, Aspen Pharmacare Holdings Limited (Aspen), which experienced pure organic growth over the period of the acquisition. Comparative growth rates of key financial indicators will be analysed to assess whether the acquisition process, in fact, added greater value to the target company.

1.3 RESEARCH QUESTIONS

The key the research question is:

"*Which shareholders have benefited the most from the acquisition, Bidvest or Adcock shareholders?*"

The answer to this question also provides a view as to whether Bidvest's acquisition of Adcock Ingram was a good or bad investment decision. The sub-questions to be answered in order to solve the problem are as follows:

Table 1.1: Sub research questions

PART A: From the perspective of the *Acquiring Company*:	1. What was the impact of the acquisition on Bidvest's share price? 2. What was the impact of the acquisition on Bidvest's operating performance?
PART B: From the perspective of the *Target Company*:	3. What was the impact of the acquisition on Adcock's share price? 4. What was the impact of the acquisition on Adcock's operating performance? 5. What plans will Adcock implement to turn the company around and begin to create shareholder value?

PART C: From a *Benchmarking* perspective:	6. How does the growth rate in Adcock's share price compare with growth rate of Aspen's share price post the acquisition? 7. How does the growth in Adcock's operating performance compare to the growth in Aspen's operating performance post the acquisition?

1.4 OBJECTIVES OF THE RESEARCH

The objectives of the study are as follows:

- To assess the impact of the acquisition on operating performance;
- To assess the impact of the acquisition on shareholder wealth creation;
- To assess whether a hostile takeover in particular creates value for the acquiring and acquired company.

The above will assist in reaching a conclusion on whether acquiring a majority stake in Adcock created value for Bidvest and Adcock shareholders.

1.5 CONCLUSION

This research paper aims to analyse the impact of shareholder wealth creation within the context of hostile takeovers. The paper will add to research that exists in relation to shareholder wealth creation of both target and acquiring firms in hostile takeovers. Whilst the literature review will shed some light on this topic, the case study chosen will provide practical results for analysis purposes. The outcomes of the case study will not only shed light on target and acquiring company shareholder wealth creation, but the benchmarking process of reviewing the results of a company that has not participated in a takeover (Aspen), will further provide input on whether an acquisitive growth strategy creates more wealth than an organic growth strategy.

CHAPTER 2: THE SOUTH AFRICAN PHARMACEUTICAL INDUSTRY

2.1 INTRODUCTION

To give industry specific context to the research, a background on the general health system in South Africa (SA) is provided. In particular, the chosen case study is in the pharmaceutical industry. The current state of play of the SA pharmaceutical industry is therefore discussed, followed by a profile on the respective companies, Adcock and Aspen.

2.2 THE SA HEALTH INSURANCE SYSTEM

According to Issuu (2012), South Africa has one of the highest rates of private insurance reliance in the world at 44%. Compared to other Brazil, Russia, India China and South Africa (BRICS) countries, South Africa's health contribution, more than 9% of its total budget to public health, is second only to China which spends 10%. The South African government has launched a number of programmes, one of the key priority programmes being the National Health Insurance (NHI). From a pharmaceutical industry point of view, the NHI could represent significant growth opportunities. According to Luciano Marques, CEO and country president of Novartis South Africa, cited in the Issuu (2012) report, the implementation of NHI would increase access to medicines in South Africa. Luciano's assertion was that in 2012, 8 million people were covered by private healthcare insurance and that the introduction of the NHI would allow 42 million more people access to affordable health care.

2.3 SA PHARMACEUTICAL MARKET STATISTICS

According to MarketLine (2014), the South African pharmaceutical industry grew by 11.7% in 2013 and was valued at $2 billion. The compound annual growth rate (CAGR) from the year 2009 to 2013 was 7.3%. This market is expected to grow up to $3 billion in 2018 (50% up from 2013). Aspen holds the highest market share in this industry. The CAGR from 2013 to 2018 is expected to be 8.3%. Key to this industry is quality material, equipment, staff, and third-party clinical testing services.

Research-based drugs where the patent period has lapsed, are at risk of being substituted by cheaper generic copies. This shift to cheaper generic equivalents increases consumers' buying power.

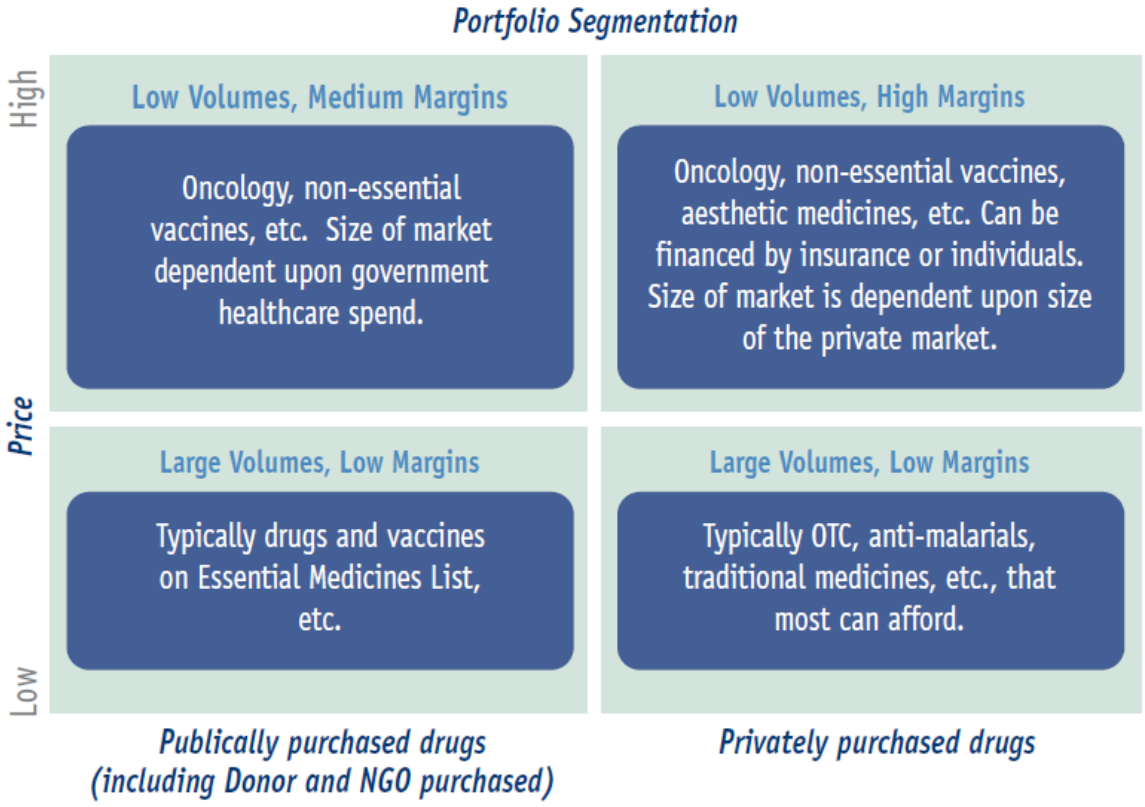
The main purchasers of drugs are the government and private-sector health insurers. Governments set drug prices directly making it illegal for pharmaceutical companies to sell the

drugs at different prices. Price-volume or profit controls which set limits to the volume of a drug that can be sold in a country, or the amount of profit a pharmaceutical company can make, can exist.

According to IMS Health (2012), 20%-30% of Africa's $30 billion opportunity in 2016 will be driven by the top 10 cities in the continent; 50% of these cities are in South Africa.

In order to maximise returns, pharmaceutical companies need to assess the demand for their products and optimise for volume/price trade-offs (IMS Health, 2012). The framework below maps the relationship between customer segments, volumes and product profitability. In the public and NGO sector, high-priced drugs for oncology and non-essential vaccines offer a low volume, medium margin opportunity. Higher margins can be achieved for these drugs in the private sector where their use can be financed by insurance or individuals. Conversely, drugs on the essential medicines list purchased by government and NGOs are high volume but low price with a low margin. Similar trends exist in over the counter (OTC), traditional and anti-malarial medicines in the private sector, reflecting their relative affordability (IMS Health, 2012).

Figure 2.1: Market segmentation of pharmaceutical drugs



Source: BroadReach Healthcare, 2012

2.4 AN INTRODUCTION TO ASPEN PHARMACARE HOLDINGS AND ADCOCK INGRAM

According to Issuu (2012), generics have overtaken branded pharmaceuticals in terms of market volumes and this trend is expected to continue, taking into account that the demand for cheaper essential drugs, including antiretroviral drugs (ARV), is set to grow. The trend in the generic penetration follows the global trend, and today South Africa has a very high usage of generics: 60% in volume, 31% in value.

Table 2.1 shows that in 2011, the top two companies leading the pharmaceutical market in South Africa were locally-based, generic companies, with Aspen Pharmacare Holdings Ltd (Aspen) leading the way, and Adcock Ingram (Adcock) in second place.

Table 2.1: Top 25 players in the total pharmaceutical market (2011)

RANK	COMPANY	MARKET VALUE RANDS (THOUSANDS)	% MARKET VALUE
1	Aspen	4 088 742	16.3%
2	Adcock Ingram	2 453 920	9.8%
3	Sanofi	1 907 517	7.6%
4	Pfizer	1 607 583	6.4%
5	Novartis	1 509 240	6%
6	Cipla Medpro	1 218 446	4.9%
7	Astrazeneca	1 191 641	4.8%
8	Johnson & Johnson	1 026 149	4.1%
9	Merck & Co	1 016 534	4.1%
10	Roche	906 295	3.6%
11	Bayer	825 411	3.3%
12	Abbott	595 075	2.4%
13	Novo Nordisk	447 274	1.8%
14	Lilly	436 530	1.7%
15	Boehringer Ingel	400 664	1.6%
16	Merck Kgaa	367 220	1.5%
17	Daiichi Sankyo	335 715	1.3%
18	Lupin Laboratories	310 702	1.2%
19	Servier	291 701	1.2%
20	Reckitt Benckiser	261 255	1%
21	Bristol-Myers SQB.	254 431	1%
22	Pharmaplan	244 199	1%
23	Inova Pharma	224 690	0.9%
24	Takeda	212 429	0.8%
25	Genop	186 020	0.7%
Total Pharmaceutical Market: 25 028 635			

Source: IMS Health, 2012

According to Aspen (2013), the company is a global supplier of branded and generic pharmaceutical products as well as consumer and nutritional products in selected territories. The Group has a proud heritage dating back more than 160 years and today its products reach approximately 150 countries. Aspen is the largest pharmaceutical company listed on the Johannesburg Stock Exchange, Limited (JSE). Aspen had a market capitalisation of R103,5 billion as at 30 June 2013 and was ranked as the number one pharmaceutical company in South Africa in the private sector, with a 16.2% market share (Aspen, 2013). It is ranked amongst the top 10 generic pharmaceutical producers globally. Aspen has a strong and growing footprint in emerging markets. The largest pharmaceutical company in Africa, Aspen has an expanding presence in Latin America and South East Asia. The annual report states that acquisitions will extend the Group's emerging market presence to Russia and the former Soviet Republics as well as to Central and Eastern Europe. Aspen is one of the leading pharmaceutical companies in Australia, and is beginning to establish a presence in other developed markets. Following the acquisition of the active pharmaceutical ingredient (API) manufacturing sites in the Netherlands and the United States on 1 October 2013, the Group had 22 manufacturing facilities at 16 pharmaceutical manufacturing sites on six continents and approximately 8 200 employees.

According to Adcock Ingram (2013), the company is a leading South African pharmaceutical manufacturer, marketer and distributor. The company has a market share of 9.4% in value and 30.1% in volume in the private pharmaceutical market in South Africa. The company is South Africa's largest supplier of hospital and critical care products. Its footprint extends to India and other territories in sub-Saharan Africa. The extensive product portfolio includes branded and generic prescription medicines, over-the-counter/fast moving consumer goods (FMCG) brands, intravenous solutions, blood collection products and renal dialysis systems. Adcock Ingram is ranked as the second largest manufacturer in the private pharmaceutical market and is the second largest supplier to the public sector. Adcock is also a supplier of antiretroviral (ARV) medicines to the public sector.

Adcock operates in three hubs in sub-Saharan Africa, being West Africa (Ghana), East Africa (Kenya) and Southern Africa (Zimbabwe). Manufacturing takes place in Ghana and Zimbabwe. Adcock has also invested in a manufacturing facility in Bangalore, India, which offers an alternative source of supply for the South African market. The company has more recently invested in a marketing operation based in Mumbai which has a nationwide coverage. Table 2.3 details the key financial indicators for Aspen and Adcock Ingram.

Table 2.3: Aspen and Adcock key financial indicators

FINANCIAL INDICATOR (2013 FY)	ASPEN	ADCOCK
Revenue	19 308,0 *(Rm)*	5 482,7 *(Rm)*
Gross Profit	9 230,7 *(Rm)*	2 236,8 *(Rm)*
Operating Profit	5 043,3 *(Rm)*	890,8 *(Rm)*
PAT	3 514,1 *(Rm)*	601,2 *(Rm)*
Gross Margin	47.8%	40.79%
Operating Profit Margin	26%	16.24%
Share Price (20/05/2014)	R275.67	R60.44
Earnings Per Share (EPS) (20/05/2014)	R788	R350.50
Price earnings ratio (20/05/2014)	32.93 times	17.65 times
Market Capitalisation (20/05/2014)	125.8 (R'billion)	10.62 (R'billion)

Source: Adcock Ingram, 2013; Aspen, 2013; JSE, 2014

The above financial indicators will be analysed in greater detail later in the report.

2.5 CONCLUSION

The SA pharmaceutical market is large and it is good to see that future prospects growth of this market continues to be positive. Whilst Aspen and Adcock hold the first and second position respectively in the industry, it is interesting to note that in terms of market capitalisation, Aspen is 12 times larger than Adcock. Aspen's growth has been strengthened by its focus on acquisitions. This growth by acquisition strategy has increased Aspen's market share in territories outside SA such as Africa, Asia and Australia. The two companies focus seems to be slightly different. Aspen's strength is the distribution of branded and generic pharmaceutical products as well as consumer and nutritional products. Adcock on the other hand focuses on the supply of hospital and critical care products and manufacturing for the private pharmaceutical market and public sector. The benchmarking of these two market leaders should yield interesting results.

CHAPTER 3: LITERATURE REVIEW

3.1 INTRODUCTION

The literature review covers eight critical themes in relation to mergers and acquisitions. Whilst the academic foundation of the research is in mergers and acquisitions, the particular aspect under review is the impact of the type of merger and acquisition, in this case, takeovers. Whilst general findings from mergers and acquisitions research are relevant to this paper, the particular focus is on research that tells us more about the impact of takeovers on both target and acquiring company performance, returns and company value post the takeover.

The following themes were reviewed:

- Motivations for mergers and acquisition;
- The role of board of directors in hostile takeovers;
- Wealth creation from mergers and acquisitions;
- Acquisitions of publically listed companies;
- Mergers and acquisitions in the pharmaceutical and biotech industries;
- The impact of the merger type on operating performance;
- The impact of a merger or acquisition on the acquiring firms performance and shareholder wealth creation; and
- The impact of hostile takeovers on stock returns and value creation.

3.2 MOTIVATIONS FOR MERGERS AND ACQUISITIONS:

Referring to the case study at hand, from an acquiring company perspective, a large majority of the companies within the Bidvest Group have been acquired either through a merger or an outright acquisition over the last 26 years. Bidvest's central strategy of growth by acquisition has in the main been driven by diversification, whilst within the operating divisions, most acquisitions have been driven by synergy. One has to ask the question, why corporates would choose mergers and/or acquisitions as a key growth strategy as opposed to the more traditional route of organic growth?

According to Alexandridis, Petmezas and Travlos (2010), the key aim of mergers and acquisitions is to enable growth of companies, boost profits, increase overall power in the market, and enhance the wealth of shareholders. Given the cited drivers, in the case of Bidvest this theory proves true, as Bidvest has over its 26-year existence, grown to a market

capitalisation of R90 billion (Bidvest, 2014), through an acquisitive growth strategy. Whilst the research of Alexandridis, *et al.* (2010) is very detailed on the drivers of mergers and acquisition, it is silent on the impact of the type of merger and acquisition and whether the tactic applied, such as a takeover, in any way affects the outcomes of growth, increased profitability, market power or enhanced shareholder wealth. Their research seems to assume that transactions within the area of mergers and acquisitions are generally by mutual agreement between the target and acquiring company and the outcome of these transactions yields growth in various areas as explained above.

The research by Cremers, Nair and John (2009) details slightly different motivations to those cited by Alexandridis, *et al.* (2010). According to Cremers, *et al.* (2009), the key motivations for acquisitions are the agency problem which is made worse when there is positive cash flow; and the extraction of synergies and efficiencies between the target and acquiring firm.

In relation to the first motivation, one must criticize the research in saying that the agency problem and positive cash flow do not automatically lead to management pushing to make constant acquisitions. Firstly, companies that expand by acquisition have growth by acquisition as a key agreed-upon and endorsed strategy. It would be very rare for a company that has always preferred for example a "green fields" type growth strategy to suddenly try its hand at buying a company when it has no skill and experience in acquisitions. Secondly, if it existed, the agency problem has a higher probability of being a driver for acquisitions in companies where management is failing to produce expected returns for shareholders through traditional organic growth. In these instances, management is more likely to view a merger or acquisition as a "quick fix" to a problem of underperformance, rather than a growth strategy that will result in higher than expected returns. Noting the agency problem as a motivator for acquisitions, Cremers, *et al*. (2009) are silent on the role of the board of directors. According to Subrahmanyam, Rangan and Rosenstein (1997), boards of directors play a critical role in decisions that need to be made on large transactions or in cases where the agency problem between management and shareholders is exacerbated. Cremers, *et al.* (2009) state that the second motivation for acquisitions is the extraction of synergies between the target and acquiring firms. This is, in the main, more probable when the target and acquiring firms are in the same industry. These synergy benefits are realised faster in this instance, as opposed to when the target and acquiring firms are in unrelated industries. Noting all the above, Cremers, *et al.* (2009) are silent on whether the two stated motivations also apply in the case of takeovers.

According to Chase, Burns and Claypool (1997), supporters of mergers argue that majority of mergers and acquisitions benefit society and therefore promote efficiency and benefit both acquiring and target company shareholders. On the other hand, Chase, *et al*. (1997) note that critics argue that the acquisition of other companies is pure greed, and as a result mergers are likely to result in economic harm. The societal benefit of mergers and acquisitions cannot be made as a blanket statement without taking into consideration certain aspects that lead to efficiency and also, from whose perspective one is viewing the merger or acquisition, i.e. shareholder, employee, labour union, government, or other stakeholders. For example, labour unions would argue that most mergers and acquisitions result in job losses rather than job gains when management, in order to keep the most efficient human resource component, decide to retrench employees due to duplication of positions, introduction of mechanized production processes, etc. In these instances, labour unions would argue that society is in fact negatively impacted due to resultant job losses (Wachmann, 2011). So whilst we note the gains from mergers and acquisitions, the potential negatives should also be taken into consideration.

Kish and Vasconcellos (1993) focused on cross-border acquisitions and found that in this case, there were various motivations for mergers and acquisitions. Countries with stronger currencies are more likely to make acquisitions of corporates in economies with weaker currencies; companies wanted to diversify their risk; adverse economic conditions such as a recession reduce merger and acquisition activity as corporates rather focus on organic growth until the economy turns; and rather than developing new technology internally, a corporate may decide to rather obtain the new technology by making an acquisition of a firm that already has the required technology.

Whilst I agree with most of the motivations for mergers and acquisitions cited by Kish and Vasconcellos (1993), I differ with the notion that generally, during adverse economic conditions like a recession, merger and acquisition activity declines. In fact, for opportunistic acquirers, this is when the merger and acquisition activity increases as during these difficult times, the chances of making cheaper acquisitions of companies in financial distress, is high (Harding, Shankar & Jackson, 2013). If we agree that in general, acquiring companies do not aim to overpay for companies, the logic of actively looking for financially distressed companies, where the probability of making a purchase at a lower price, during difficult economic times, holds. Again, having noted the abovementioned motivations for mergers and acquisitions, Kish and Vasconcellos (1993) are silent on whether these drivers remain the same for takeovers.

From the above literature, it is clear that corporates can have varying reasons for pursuing a merger or acquisition. In the end though, whatever the motivation, it is clear that there is an expectation that the merger or acquisition must add value (however the firm decides to quantify the value) to the combined firm in the case of a merger, and to the acquiring firm in the case of an acquisition. The research does not shed much light on how these drivers of mergers and acquisition either differ or remain the same in the case of hostile takeovers. The research on motivations for mergers and acquisitions treats this topic as one and does not detail the various tactics that can be applied in making an acquisition nor whether the chosen tactic has any bearing at all on the reasons behind the acquisition, nor furthermore, whether the perceived benefits continue to be realised when the acquiring tactic is hostile.

3.3 THE ROLE OF BOARD OF DIRECTORS IN HOSTILE TAKEOVERS

The role of the Board of Directors in hostile takeovers is probably one of the most important factors in this transaction because boards make the recommendation to shareholders on the preferred bid. Whilst the final decision to either vote for or against a particular offer remains the shareholders' responsibility, one cannot discount or ignore the strong influence of board recommendations in the shareholder decision making process. This assertion is supported by Dewhirst and Wang (1992) whose research found that Boards of Directors play a critical role in the probability of receiving an offer and most importantly, the eventual outcome of the offer. Their finding is that Boards must act in the best interest of shareholders. This is also a principle of the Companies Act (Republic of South Africa, 2008) and King III (Institute of Directors Southern Africa, 2009).

According to Subrahmanyam, *et al.* (1997) boards of directors play a critical role in decisions that need to be made on large transactions or in cases where the agency problem between management and shareholders is exacerbated. Subrahmanyam, *et al*. (1997) further note that the wealth accruing form mergers and acquisitions is statistically related to the composition of the board, and that target company shareholder gains are higher when the board of directors is composed of a minimum of 50% independent directors. Whilst their research details the importance of boards of directors, it does not deal with the role of the board in a hostile takeover. The research does not venture into the behaviour of the board, decisions the board would make, or the recommendations the board would make to shareholders, when the acquisition is not supported by management.

Bebchuk (2002) argues that once ways of ensuring undistorted shareholder choice have been implemented, boards of target companies should not be allowed to block acquisition offers for a period longer that what is necessary to table an alternative offer to shareholders.

Mallette and Fowler (1992) argue that whilst target firm shareholders experience wealth gains, as result of share price appreciation, of between 20% and 30% post a takeover, directors of the target firm usually do not retain their positions. This high probability of job losses provides an incentive to target firm directors to attempt to stop takeovers, even though proceeding with the takeover would be in the best interest of shareholders. The reality is that unlike a negotiated amicable engagement process and agreement for an acquisition, a takeover creates huge uncertainty. A hostile takeover where directors are not even consulted and offers are sent directly to shareholders alienates directors and management, and this fear of exclusion, alienation and uncertainty about the future can drive the behaviour described by Mallette and Fowler (1992), which also includes directors of target firms using "poison pills" as a defence mechanism. These "poison pills" are defined as provisions that impose new difficult and undesirable conditions that the acquiring company must comply with in order to effect the takeover.

According to Coff (2003), bidding wars yield high returns for shareholders, but on the other hand, create huge uncertainty for management, particularly in relation to management's ability to retain control. Some managers attempt to ensure that bidding wars do not take place by giving a favoured bidder preferential status, with the aim of discouraging a competitive bidding process. Coff (2003) further argues that in a bidding war, management is likely to favour the bidder that gives them the greatest independence rather than the highest bidder. This favour can go further to management offering their preferred bidder lock-up agreements in return for side remuneration or other types of benefits. Where has Coff (2003) taken into account the critical issue of good corporate governance in this argument? Does the corporate governance requirement of "acting in the best interest of the company and shareholders", a critical fiduciary responsibility, no longer exist when there are numerous competing bids? Coff's (2003) argument seems to make an incorrect assumption about shareholders' knowledge of best investment returns. Whilst it is possible for management to pursue their own interests at times, they are unable to accept an offer without getting shareholder approval. Would management therefore take the risk of presenting the worst offer (that provides management with side benefits) to shareholders, knowing that shareholders, whilst they take advice from management, are savvy enough to make their own sound financial analysis and judgement, especially when shareholders are private equity players, or large conglomerates which would be the case for listed companies?

Tactics identified by Holl (1977) that management of the target company can implement in an effort to discourage a takeover bid include attempts to get shareholder support and increase the share price; buying back its own shares on the open market to reduce the number of shares available for purchase by the takeover bidder, and by so doing also increasing the share price; bringing in external consultants to assist with a "defence" strategy; calling for an enquiry into the bid by the relevant governing body in that country; or taking legal action against the bidder to prevent the bidder from communicating with and making a direct offer to target company shareholders.

The above literature suggests that the board's responsibility to act in the best interest of shareholders is severely challenged when uncertainty is created and in cases where management fears loss of control and possible unemployment. Furthermore, management has various tactics that it can implement in an effort to stop a takeover. It therefore seems necessary for shareholders to play a more active role in the process of choosing the preferred bidder or acquiring company, because management is more likely to take decisions that protect their own interests as opposed to acting in the best interest of the shareholders.

3.4 WEALTH CREATION FROM MERGERS AND ACQUISITIONS:

According to Holl and Kyriazis (1997), wealth creation is assessed by reviewing share prices pre and post the acquisition to see if there is an increase in value. Other research measures wealth creation in relation to the bid premium (the deal price as a proportion of the pre-acquisition price). When considering a growth-by-acquisition strategy, one notes that Bidvest has produced growth in year on year operating profit in 25 years of its 26-year existence and today boasts a market capitalisation of R90 billion (Bidvest, 2014). Is this exceptional growth history proof that mergers and acquisitions do in fact create wealth? Datta, Pinches and Narayanan (1992) state that wealth creation from mergers and acquisitions is primarily based on event study methodology which incorporates both the present values of cash flow/securities incurred by the acquiring firm and the expected incremental cash flows as a result of combining the operations of the target and acquiring firm.

Most research seems to focus on how to measure wealth creation post an acquisition but the data on what the actual sources of wealth are is limited. Holl and Kyriazis (1997) attempt to fill this gap by stating that the source of value is as a result of economies of scale and scope after combining target and acquiring firm assets, including similar production and marketing services. This assertion is supported by Singh and Montgomery (1987) who state that acquired firms,

where the acquiring firm is in a similar or related market, experience higher returns than firms acquired by companies in unrelated markets. Datta, Pinches and Narayanan (1992) also support this notion and state that synergy benefits between the acquiring and target firm who are both in related type of businesses should result in greater wealth creation There is however limited literature on cause or reasons for unsuccessful mergers and acquisitions i.e. where wealth is in fact not created but destroyed post a merger or acquisition. McKinsey & Company (2010) state that whilst there is no formula for a perfect acquisition that ultimately creates wealth, the acquisition will only create value if the strategic intent of the acquisition is focused on enhancing the performance of the target company; eliminating excess capacity that may exist; accelerating access for additional or new products into the market; obtaining skills and or technology faster at a lower cost than if one had to build this capacity internally from scratch; and identifying successful companies at the beginning stages of their life cycle and assisting them to develop and grow their business.

The findings of McKinsey & Company (2010) are that it is highly unlikely for an acquisition to create value if one or more of the above processes are not followed.

It is further interesting to note that the literature that exists on wealth creation from acquisitions does not expand on the impact of wealth creation when the tactic used is a hostile takeover. Are we then to assume that the value creation from an acquisition remains constant regardless of whether there is board and management buy in or not?

According to Datta, Pinches and Narayanan (1992), amongst others, the following factors explain differences in shareholder wealth creation in mergers and acquisitions: Firstly, the number of bidders – the higher the number of bidding firms, the higher the competitiveness of the bidding process, the higher the bidding price, benefiting the target firm's shareholders at the expense of the acquiring firm's shareholders. The extreme result of the competition amongst bidders is that the takeover is done at a zero or even negative present value. It is interesting to note that in all the research reviewed, this is the first and only mention of takeovers done at a zero or even negative present value. There is consensus in the majority of the research that competition in a bidding process increases the bidding price and the overall winners are target company shareholders. The literature does not focus on possible alternative outcomes of takeovers such as zero or negative cash flow present values, and some of the possible reasons behind these unusual outcomes.

The second reason put forward by Datta, Pinches and Narayanan (1992), is the bidder's methodology i.e. merger or tender offer. Their research states that by definition, in a merger, the acquiring firm negotiates with the target firm's management or board of directors prior to seeking shareholder approval. On the other hand, in a tender or hostile takeover, the acquiring firm makes an offer directly to shareholders and the shareholders decide whether to accept or reject the offer. Target firm shareholders are likely to benefit more than acquiring firm shareholders for two main reasons, namely: the announcement of the tender offer can attract other bidders thus creating a highly competitive bidding process, increasing the bidding price and therefore benefiting the target firm's shareholders; and mergers allow the payment of a "control premium" to management of the target firm through favourable post acquisition contracts. In the case of a tender offer, this premium is paid to the target firm shareholders. The limitation of this assertion by Datta, Pinches and Narayanan (1992) is that it assumes that the higher offer is the better offer in terms of integration, possible synergy, or the acquisition of skill or technology.

Their assertions do not take into account that the key driver for an acquisition, should be the underlying company strategy and a critical assessment of the source of value as cited by Holl and Kyriazis (1997) and Mckinsey and Company (2010). When this is taken into account, one cannot conclude that the highest bidder will be the winner. If future value can be created by an alternative lower bidder, I believe that this would certainly influence shareholder decision making.

Datta, Pinches and Narayanan's (1992) third reason cited as a factor that explains differences in shareholder wealth creation in mergers and acquisitions is the type of merger or acquisition i.e. conglomerate or non-conglomerate. They state that synergy benefits between the acquiring and target firm which are in related types of business should result in greater wealth creation than when the acquiring and target firm are in unrelated businesses or in a conglomerate transaction. Economies of scale as a result of the merger; economies as a result of the additional scope; and economies as a result of the increased market power have been cited as factors that are known to contribute to and enhance the overall value of the transaction.

This assertion is supported by Holl and Kyriazis (1997) who state that wealth gains in related acquisition are linked to the coinsurance effect. Holl and Kyriazis (1997) argue that an acquisition driven by market relatedness will impact profitability, whilst an acquisition driven by production relatedness will impact growth. Whilst we note the above reasons provided that mergers and acquisitions contribute to wealth creation, again we note the absence of data on

whether the tactic applied in the acquisition, in particular a hostile takeover, impacts these outcomes, and also the absence of other critical growth drivers as cited by McKinsey & Company (2010).

Using a sample of 138 acquiring firms which had undertaken 3 500 acquisitions over the period 1967 to 1976, Kusewitt (1985) found that on average, the relative size of acquiring firm in relation to the target firm; the rate of the acquisition; whether the acquiring and target firms are in a common industry or not; the timing of the acquisition relative to the market cycle, and the acquiring firm's profitability before the acquisition, were statistically significant factors in determine the long term success and financial performance of an acquiring firm:

The only factor that Kusewitt (1985) states as contributing to value creation that is common to those cited by Singh and Montgomery (1987), Holl and Kyriazis (1997) and Datta, Pinches and Narayanan (1992) is the synergy benefit as a result of the target and acquiring firm being in common/related industries. The timing of an acquisition relative to the market cycle is a factor that could have contributed to the results of the study by Conn (1976) on performance of acquired firms post a merger, which showed a reduction in mean profit rates from 6,7% before the merger, down to 4,2% after the merger. It must, however, be noted that the study found no conclusive evidence that this diminished performance was poorer than the overall industry performance.

Whilst Kusewitt (1985), Singh and Montgomery (1987), Holl and Kyriazis (1997), Datta, Pinches and Narayanan (1992) and McKinsey & Company (2010) focus on the positive outcomes of acquisitions and the key drivers required in order to be able to enjoy the potential positive cash flows, there is generally very little literature on the negative wealth effects of acquisitions. Hall (2013) states that it is possible for acquisitions to destroy both the target and acquiring company, particularly when the excitement of the deal dominates a clear thinking process that takes into account the inherent risks of the transaction. Some of the reasons cited as contributors to failed acquisition transactions were that companies did not stick to their core strategy and competency when making an acquisition; most acquisitions failed because of differences that could not be reconciled in relation to the culture of the target and acquiring firms; a poor due diligence could result in unexpected events post the acquisition that can negatively impact financial performance; and not taking the time required (however long that might be) to conclude the transaction. Patience is important and thinking through all possibilities is vital in managing potential unforeseen risk.

Another contributor to wealth creation that has not as yet been cited in the literature reviewed thus far is the impact of competition. One of the findings of the research by Alexandridis, Petmezas and Travlos (2010) is that there is a negative relationship between competition and the acquiring firm's returns and a positive relationship between competition and the target firms returns and premiums (after controlling for institutional characteristics, the deal, the other firm, market legal characteristics as well as other country fixed effects). Again, the limitation of this finding is that it inherently assumes that the highest bid, as a result of the competition, will be the winning bid, which is not necessarily the case.

It is interesting to note the common drivers of value creation cited in the various research papers, and also the other factors that contribute to value creation that are not common across various studies. One thing we can highlight is that these factors play a critical role in shareholder decision making, and the conclusion that the highest bidder wins is not necessarily true. The absence of the impact of the tactic or method utilised to make the acquisition is glaring and it is unclear as to whether a takeover would materially impact value creation in the short term period post the acquisition. Whilst mergers and acquisitions are primarily driven by a need to increase growth and profitability, Forbes (2013) highlights the possible downfalls that can lead to an unsuccessful acquisition.

3.5 ACQUISITIONS OF PUBLICLY LISTED COMPANIES

The Bidvest acquisition of Adcock is further intriguing as it entails the acquisition of one publically listed company by another. Because of potential share price volatility in some markets, there is value in understanding some of the literature that exists in relation to the acquisition of publically listed entities.

The study by Alexandridis, Petmezas and Travlos (2010) covered completed acquisitions of publically listed companies by listed or unlisted companies over the period 1990 to 2007, where prior to the acquisition, the acquiring firm owned less than 10% of the target firm's equity, and post the acquisition, the acquiring firm increased its equity to above 50%. The sample used consisted of 13 226 transactions of listed company targets in 89 countries. The researches ran various regressions using activity-, competition- and premium-related information. This study by Alexandridis, Petmezas and Travlos (2010) states that most empirical studies found that when an acquisition of a publically listed company is announced, shareholders of the acquiring firm experience normal returns or substantial losses at the time of the announcement. This happens because the market for control of publically listed entities is highly competitive. Potential

acquirers are far more aggressive in their bidding and are willing to pay a far higher premium for the target firm. This competitiveness increases the managerial hubris related effects, and as a result of the 'winners' curse', the gains of the acquiring firm are significantly reduced. Over and above this, the fierce competition can also aggravate the harmful effects of the agency problem. The research by Alexandridis, Petmezas and Travlos (2010) is silent on whether the gains of the acquiring firm are still reduced in the case of a takeover. One would also wonder whether the competitive market for corporate control of publically listed companies encourages takeovers because in such a case, it is easier for a potential acquirer to approach shareholders and make a direct offer as shareholder information is publically available.

A study conducted by Bain and Company (2014) covering 1 600 listed companies and in excess of 18 000 deals over the period 2000 to 2010, analysed the performance of companies that engaged in mergers and acquisitions and those that did not. Whilst each transaction was unique, the study found that the following two factors, frequency and materiality, were the greatest contributors to the success of mergers and acquisitions of listed companies. One of the factors was frequency i.e. the more acquisitions a company concluded, the higher the probability of success in subsequent transactions. This study found that companies that did not engage in merger and acquisition activity over the said period recorded total shareholder returns of about 3.3% annually, whilst those that concluded more than six acquisitions per year, recorded total shareholder returns of about 5% annually. This finding means that the more experienced players in the area of acquisitions will yield higher shareholder returns. The research by Bain and Company (2014) is silent on whether the total shareholder returns remain the same when the tactic used to make the acquisition is in the form of a hostile takeover.

Datta, Pinches and Narayanan (1992) cite the factors that favour acquisitions by conglomerates as access to capital at far cheaper rates; enhanced consistency of income; a decline in the probability of bankruptcy although the combined firm has a higher market value of debt; and, in acquisitions where the acquiring and target firm are in related types of business, the target firm's gain should be higher than the acquiring firm's gain because these transactions result in a greater overall value which in the main accrues to the target firm shareholders.

Datta, Pinches and Narayanan (1992) further argue that gains from related acquisitions (acquiring and target firm in related type of business) are far greater than gains from conglomerate acquisitions with regards to shareholder wealth creation for both the acquiring and target firm.

There seem to be pros and cons for the acquiring firm when acquiring a listed company. Whilst gains in conglomerate transactions are attributed to various factors such as synergy and frequency, the research does not reveal whether the methodology utilised, and particularly a hostile takeover, has any impact on the expected outcome of the acquisition.

3.6 MERGERS AND ACQUISITIONS IN THE PHARMACEUTICAL AND BIOTECH INDUSTRIES

The pharmaceutical industry globally is a very large industry. In order to gain a benchmark, it would be of value to review results of previous mergers and acquisitions in the pharmaceutical industry.

The pharmaceutical industry is an industry where substantial growth is driven by research and development. In this light, it is interesting to note that Coff (2003) argues that for Knowledge and Research and Development (R&D) intensive industries/corporations, information asymmetry compromises good corporate governance when it comes to corporate control and takeovers. In these instances, management is likely to pursue their own profit maximisation interests by using their knowledge to discourage bidding wars. It is an open question as to why management would want to discourage a competitive bidding process because this would surely yield a higher bidding price and therefore benefit target firm shareholders (Datta, Pinches & Narayanan, 1992). Coff (2003) argues that in discouraging a competitive bidding process, management reduces the bidding price and in turn reduces the target firm's shareholder returns, thus concluding that the market for corporate control in Knowledge and R&D intensive industries/corporations is less efficient than other markets. Most research cites various tactics that management would employ to stop a hostile takeover, and these tactics in essence discourage a competitive bidding process. If one follows Coff's (2003) argument that reducing a competitive bidding process results in a less efficient market, it seems that takeovers in the pharmaceutical industry may contribute to creating inefficient markets and reduce target company shareholder returns.

Danzon, Epstein and Nicholson (2007) analysed the causes of mergers and acquisitions in the pharmaceutical and biotech industries over the period 1988 to 2001 during which time the value of mergers and acquisitions exceeded $500 billion. They note that the main reason for mergers in the pharmaceutical industry is often economies of scale and scope with respect to research and development and marketing, and also sight two studies that found mixed evidence of abnormal stock returns and the time of the announcement of the merger. In citing economies of scale and scope with respect to research and development and marketing as key drivers of mergers in the

pharmaceutical industry, Danzon, *et al.* (2007) assume that in the merger or acquisition both the target and acquiring company are in the pharmaceutical industry. Their research is limited as it does not account for mergers or acquisitions driven by diversification rather than synergy. It seems that their research also implies that, because research and development is so key in this industry, acquisitions that are not driven by synergy with the aim of unlocking economies of scale are bound to yield lower returns relative to synergy-driven acquisitions.

This study by Danzon, Epstein and Nicholson (2007) further found that, for large firms, in most instances, mergers are in response to expected excess capacity as a result of patent expirations and gaps in the production line which in turn reduce revenue generation, supporting a restructure and merger strategy. The theory of economies of scale in the pharmaceutical industry is supported by the fact that firms with high enterprise value have a higher probability of engaging in a merger although there was no evidence that mergers create long term positive value, suggesting that mergers with the key aim of addressing research and development gaps through reducing costs and taking advantage of economies of scale are generally unsuccessful in the long run. For smaller firms, mergers tend to be more of an exit strategy when a firm is in financial distress, where the financial distress is in the main caused by research and development shocks as opposed to excess capacity due to patent expirations; there was no evidence that the availability of finance, whether cash or equity, increased the likelihood of acquisitions for large or small firms, and mergers are therefore not a result of the imperfect agency problem when there are excess funds; and a merger was the most likely response of a firm that was in distress due to slow growth in sales, employees and research and development.

Danzon, *et al.* (2007) further stated that in the three years post a merger, there was no major difference in growth in firm value, sales, employees and research and development expenses for firms that merged and those that did not merge; while in the third year post a merger, a firm's growth in operating profit slowed down. Finally, in the first year of the merger, small firms that merged had slower increases in research and development compared to those that did not merge, implying that the integration process after a merger utilises cash that could have been used for research and development.

Danzon, *et al.* (2007) concluded that in the main, mergers in the pharma-biotech industry are as a response of firms being in distress. This response is, however, not a solution because in the years post the merger, firms that did not merge outperformed firms that did merge.

3.7 THE IMPACT OF THE MERGER TYPE ON OPERATING PERFORMANCE

Some of the literature reviewed thus far classifies mergers into varying categories. With Bidvest being a conglomerate, it is of interest to review whether this corporate structure in any way impacts the returns and operating performance post a merger or acquisition.

Mantravadi and Reddy (2008) analysed the impact of the various forms of mergers on the performance of the acquiring/merged firms in India over the period 1991 to 2003, by analysing financial ratios before and after a merger. Only stock-for-stock mergers of publicly listed companies were included in the sample. They analysed which type of mergers resulted in a higher improvement in the performance of merging firms, by looking at the following types of mergers: horizontal mergers, vertical mergers, and conglomerate mergers. The study compared performance before and after a merger by looking at ratios such as Operating profit margin (EBITD/Net Sales); Gross profit margin (EBIT/Net Sales); Net profit margin (EAT/Net Sales); Return on net worth (EAT/Net Worth); Return on capital employed (EBIT/Capital Employed); and Debt equity ratio (Book value of Debt/Book value of Equity).

The above ratios were compared using a paired t-test for two samples, where the first sample was based on a 3-year average before the merger and the second sample a 5-year average after the merger. To assess the merger types, the mean differences in ratios before and after the merger were compared for the following combinations: horizontal vs. vertical; vertical vs. conglomerate, and horizontal vs. conglomerate. Again a two sample t-test for means was used to test for statistical significance of differences.

The results of the study by Mantravadi and Reddy (2008) showed that in India, mergers resulted in a decline in net profitability, return on net worth and return on capital employed, indicating that overall, mergers in India did not enhance the operating performance of listed companies.

To assess the impact of the different types of mergers on performance, the operating profit ratios before and after a merger showed that the biggest reduction in operating performance of merged firms was for horizontal mergers, followed by conglomerate mergers and vertical mergers. The reductions were more in relation to return on net worth and capital employed and to a lesser degree on net profit margin. The reductions in operating and gross profit margins were not substantial. Overall the study found that after a merger, operational performance stagnated or was reduced.

Waldman's (1983) study focused on assessing whether conglomerate acquisitions resulted in higher growth rates of acquired firms. In analysing pre and post-merger growth of 27 acquired companies, the study found evidence of a strong relationship between the acquired firm's growth post the merger and the financial support provided by the acquiring firm. The study further found that acquired firms grew faster if they were acquired by a profitable company. On the other hand, growth rates of acquired firms were far lower if the acquiring firm was significantly larger than the acquired firm.

3.8 THE IMPACT OF A MERGER OR ACQUISITION ON THE ACQUIRING FIRM'S PERFORMANCE AND SHAREHOLDER WEALTH CREATION

The key question of the research is whether acquiring Adcock was a good or bad investment for Bidvest. It is therefore vital that research on the impact of a merger or acquisition on acquiring firms and their shareholders is reviewed in detail.

From a sample of 138 acquiring firms who had undertaken 3 500 acquisitions over the period 1967 to 1976, Kusewitt (1985) found that the method of payment for the transaction, whether cash or stocks, was not statistically significant when measuring the acquiring firm's performance post an acquisition.

By sampling 278 acquisitions of industrial firms over the period 1980 to 1996, Walker's (2000) study on stock price performance of acquiring firms post an acquisition found that shareholders of an acquiring firm earned, on average, normal returns post an acquisition. The study further found no evidence that the share price of the acquiring firm performed better post the acquisition than its competitors. Walker's (2000) research is silent on whether the findings continue to hold when the tactic used for acquisition is a hostile takeover.

In analysing whether acquisitions do indeed add value to the acquiring firm, Lubatkin (1983) stated that for industrial companies, synergies in relation to technical ability, diversification and financial standing add value to the acquiring firm, and based on the Capital Asset Pricing Model (CAPM) target firms experience far greater gains from a merger or acquisition than acquiring firms. Lubatkin's (1983) research is also silent on whether the target firm gains to be higher when the tactic used for acquisition is a hostile takeover. It would have been interesting to know how Lubatkin's (1983) some of the defence mechanism that management could have used to stop the takeover would alter, if at all, the outcomes of Lubatkin's (1983) research.

The meta analysis, a statistical technique that corrects for artefacts and aggregates results across numerous studies in order to obtain the best estimate of the relationship between two variables, conducted by King, Dalton, Daily and Covin (2004) found that the relationship between mergers and acquisitions and the financial performance of an acquiring firm is close to zero or becomes negative post the announcement of the merger or acquisition. The overall conclusion of the study by King, *et al*. (2004) was that there was no evidence that acquisitions, on average, increased the financial standing or returns of the acquiring firm post the announcement of the acquisition. This conclusion, according to King, *et al.* (2004), implies that it is possible that mergers and acquisitions are driven by non-financial motives.

Laamanen and Keil (2008) analysed the impact of engaging in multiple acquisitions on the performance of the acquiring firm. The research data was based on a sample of 611 public US-based acquiring firms, across seven industries (the pharmaceutical industry was one of the sectors selected), over the period 1990 to 1999. The selected companies had to have made a minimum of four acquisitions over the said period. Laamanen and Keil (2008) found that in the 3-years post the acquisition, the acquisition had a negative impact on the acquiring firm's performance. However, in the 10-13-year period post the acquisition, the performance of firms that frequently made acquisitions was much higher than those who engaged in less acquisition activity. The research therefore implies that over time, frequent acquirers build the requisite skill, knowledge and capacity to extract far more value from their acquisition activities than firms that engage in less acquisition activity.

In their analysis of share price performance after an acquisition, Loderer and Martin (1992) reviewed a sample of 11 020 acquisitions in the US over the period 1965 to 1986. The study found that in the five years post the acquisition, acquiring firms earned the expected rate of return, and there were no excess returns. The study, however, noted that in the 3-years post the acquisition, there was evidence of negative returns.

Yook (2004) states that, in general, existing literature assesses post acquisition performance by looking at the acquiring firm's share price 3 to 5 years post the acquisition, and analysing the acquiring firm's performance based on financial and accounting information. Yook (2004) proposed an alternative performance measure known as Economic Value Added (EVA), an approximation of a firm's true economic profit (not its accounting profit) over a 12-month period. This economic profit is the earnings left over after recognising all costs and the opportunity cost of equity capital employed.

Yook's (2004) data sample included 75 large acquisitions over the period 1989 to 1993 and EVAs pre- and post-acquisitions were compared. The research found that EVAs deteriorated sharply in the five years post the acquisition mainly due to industry effects, supporting the notion that industries with low operating performances are likely to be targets for takeovers. The research further showed that acquiring firms experienced slightly better performance than their competitors post an acquisition, but these gains were negated by high premiums paid to target firms. The study concluded that the investment net present value of an acquisition for an acquiring firm is zero.

Agrawal, Jaffe and Mandelker (1992) reviewed 937 mergers and 227 tender offers of New York Stock Exchange (NYSE) acquiring firms and NYSE/AMEX target firms between 1955 and 1987 to analyse post-merger performance of acquiring firms. The study found that the wealth of shareholders of the acquiring firm reduced by 10% during the five years post a merger. Agrawal, Jaffe and Mandelker (1992) argued that a possible reason for the negative returns could be the slow pace of the market response or adjustment to the merger.

The study by Moeller, Schlingemann and Stulz (2005) compared acquiring firm shareholders returns between the 1980s and the 1990s (including year 2000 and 2001). The study found that acquisitions concluded in the 1980s were collectively more profitable for acquiring firm shareholders until 1997. The losses experienced by acquiring firm shareholders over the period 1998 until 2001 were so substantial that they exceeded the gains made in the previous period, mainly due to the far higher costs of the transaction, than those concluded in the 1990s.

Datta, Pinches and Narayanan's (1992) assertion is that evidence from historical reviews shows that wealth created in mergers and acquisitions accrues almost entirely to shareholders of the target firm, where the target firm's average shareholder gains in the month of the merger announcement was about 22%, whilst average shareholder gains in the acquiring firm for the same period are less than half a percent.

The reviewed studies suggest that after thorough analysis, one should find that Bidvest, the acquiring firm, would be worse off and that Adcock performance and shareholder gains would be higher post the mergers.

3.9 THE IMPACT OF HOSTILE TAKEOVERS ON STOCK RETURNS AND VALUE CREATION

The acquisition of Adcock by Bidvest took the form of a hostile takeover. It is therefore central to assessing the potential impact on operating performance and wealth creations of this form of acquisition.

Choi (1991) presents a different angle and argues that when an acquiring company holds a 'toehold investment' (a shareholding of 5% or more in the target company), this increases the probability of control transfer as the acquiring company, through its toehold investment, can exert pressure on management and shareholders to initiate an acquisition or takeover process. Choi (1991) therefore defines a toehold investment as the initial phase of an inter-firm acquisition process that, in most instances, ends up in a takeover bid.

Manne (1965), Werhane (1990) and Choi (1991) provide some direction on the control transfer process that takes the form of a corporate takeover, and as to how one may identify a company at risk of being a takeover target. According to Manne (1965), the share price reflects the potential capital gain in the stock of a company. The lower the share price, relative to what it could be if the company was efficiently managed, the more at risk a company becomes for corporate takeover. Werhane (1990) supports this assertion by stating that a company becomes a target for takeover when its share price is undervalued and another corporate, in order to acquire the company, is willing to pay a price higher than the stock's prevailing market price.

The literature reviewed previously on the role of Board of Directors in takeovers suggests that in most instances, hostile takeovers are a solution of last resort for companies wanting to acquire other companies where the management, in particular the board of directors, of the target company have no interest in engaging in a potential sale negotiation process. This inability to commence a sale and due diligence process in a constructive manner, forces the acquiring company to make a direct offer to the shareholders of the target firm in the form of cash, share swaps or a combination of the two.

Schnitzer (1996) defines a hostile takeover as one where the acquiring firm make a direct offer to the shareholders of the target firm without prior management approval, whilst a friendly takeover is defined as one where management and shareholder approval is sought first by the acquiring firm. Schnitzer (1996) notes that hostile takeovers are not favourable as they tend to be expensive due to costs such as advertising and communication costs in order to communicate to

target firm shareholders, legal and merchant bank fees, and take-over defence mechanisms put in place such as "poison pills" by target firm management. Over and above this, Schnitzer (1996) notes that acquiring firms tend to pay a higher premium in a hostile takeover than in a friendly takeover. This assertion by Schnitzer (1996) implies that researchers who have not taken into account the tactic utilized for acquisition, will in their analysis of wealth effects post the acquisition, not take into account the additional costs that arise when the acquisition is via a takeover. Their analysis of the wealth gains to target firm shareholders may exclude the costs of "poison pills" and will therefore not be a true reflection of potential gains and losses.

The research by Firth (1979), through the application of the efficient markets theory, analysed the profitability of takeovers in the United Kingdom (UK). Firth (1979) defined an efficient market as one where the share price is a true and accurate reflection of a particular stock because it includes and takes into account all available information on that particular stock, and new information is very quickly incorporated into the share price. The efficient markets theory therefore implies that the share price, at any point in time, is the best indicator of the economic value of a stock.

Firth (1979) compared market capitalisation (share price x number of shares in issue) of firms pre and post a takeover. The study found that there was no upside as a result of a takeover, and very few losses were observed possibly as a result of the costs associated with the takeover process. This no gain position was maintained for 2-years after the takeover, even after the release of financial results.

According to Black (1989), in the 1980's, takeovers produced higher returns for target company shareholders with average premiums of about 50%. Black (1989) argues that the Overpayment Hypothesis, though not a complete explanation, does provide a plausible explanation for shareholder gains in takeovers. Some of the reasons sighted for overpayment are differences or variations in management and shareholder interests, repeated over optimism in takeover processes, and ignoring the "winner's curse" theory.

The study by Mitchell (1991) provides evidence that takeovers create value by disciplining managers who do not work towards creating shareholder value and increase economic efficiency by re-allocating resources to areas of the business where they yield the greatest return.

Generally, one would assume that there is an obvious and strong relationship between growth and maximising shareholder value. Conversely, the study by Ramezani, Soenen and Jung (2002)

shows that rapid growth does not maximise profits and shareholder value. Ramezani, *et al.* (2002) argue that returns and shareholder value are maximised by moderate growth and not rapid growth in sales and earnings. The study cites rapidly growing companies such as Boston Chicken, Iomega Corporation, Credit Lyonnais, Enron Corporation, among others, which subsequent to the rapid growth, "lost their way".

The study by Ramezani, *et al.* (2002) is critical in the context of mergers and acquisitions, as it highlights the need for profitable growth as opposed to growth for mere increase in size and scale. Within this context, it is important that investment decisions such as acquisitions and, in particular, hostile takeovers, are made with a profitability and long run sustainability intent, rather than just as a growth and "bulking up" exercise.

Holl and Kyriazis (1997) differentiate between two types of takeovers:

- Disciplinary takeovers defined as the intent of the acquiring company. In these takeovers, the intent is to remove management whose performance is poor; and
- Synergy takeovers defined as the intent of the acquiring company. In these takeovers, the intent is to merge the two companies with the aim of achieving efficiencies and other synergistic benefits.

Holl and Kyriazis's (1997) assertion is that disciplinary takeovers are mostly resisted, particularly by target company management, whilst synergy takeovers are welcomed. Therefore, target companies' reaction and attitude to takeovers are, in the main, driven by acquiring companies' intentions.

Walker (2000) cites the reasons that increase wealth in the context of takeovers as efficiencies that accrue as a result of economies of scale and the disciplining of poor target firm management; taking advantage of the benefits of asymmetric information between acquiring firm management and target firm shareholders; reduction in agency problems in relation to the firm's free cash flow; increased market size and power, and tax credits.

Hanly (1992) detailed various defensive mechanisms implemented by target firms to stop takeovers as greenmail where the target firm buys back the acquiring firm's shares at a premium in order to stop a hostile takeover; golden parachutes which is a commitment given to existing management that they will receive pay-outs, over and above their current salaries, in the event of a takeover where job losses occur; and leveraged buyouts (LBOs) where the management of the target firm acquire shares of the target firm and hold these in their private capacity.

It should be noted that, generally, companies that are vulnerable to hostile takeovers are those with few shareholders, wherein each shareholder holds a substantial number of shares. It is easier for an acquiring company to negotiate with fewer shareholders and offer a premium for their shares. Where there are many small shareholders, the communication process is far more difficult and complex.

3.10 CONCLUSION

Overall, there is consensus in the literature reviewed that target company shareholder gains in an acquisition are greater that acquiring company shareholder gains. Whilst explicit with the regards to the drivers/motivations for mergers and acquisitions and the resultant wealth benefits realised for target and acquiring firm shareholders, the literature provides very little, if any, detail on whether the tactic utilised, in particular a hostile takeover tactic, impacts the wealth effect of the transaction. In all the research reviewed, only research by Schnitzer (1996), Firth (1979), Black (1989) explicitly site the costs and/or gains that result directly from a takeover. The gap in the literature in relation to hostile takeovers is very glaring. Majority of the research assumes the acquisition has been mutually agreed to by the target and acquiring firms and the resultant gains/losses are heavily influenced by this assumption.

CHAPTER 4: RESEARCH DESIGN

4.1 INTRODUCTION

The chosen research methodology will facilitate the assessment of mergers and acquisitions in the pharmaceutical industry with the aim of providing responses to the research questions. In order to provide responses to the research questions, a pre and post-acquisition analysis of Bidvest's, Adcock's and Aspen's financial performance will be reviewed. The period to be taken into account will be 4 years prior to the acquisition and 1 year post the acquisition. Ideally, a period longer than 1 year post the acquisition would be preferred but at the time of conducting the research, only 1 year post-acquisition data was available.

The research methodology is split into 3 sections: Section (4.2) covers all the quantitative analysis on Bidvest, Adcock and Aspen. Section (4.3) covers the comparison between the research findings from section (4.2) and other available data, with the key themes in the literature to see where the findings are either supported or not supported by the literature. Section (4.4) provides a quantitative view on the future turnaround strategies for Adcock.

4.2 QUANTITATIVE ANALYSIS: FINANCIAL REVIEW

The quantitative analysis is divided into the following 4 parts:

4.2.1 PART A

Part A presents the quantitative research on Bidvest that answers Part A of the Research Questions. A detailed pre and post-acquisition financial analysis on Bidvest will be conducted. The aim of the 4-year pre-acquisition analysis is to get a sense of operating performance, shareholders' returns and market perceptions on Bidvest prior its takeover of Adcock. This provides a good context and background on the company that can then be compared with the 1-year post-acquisition performance. The growth over the 4-year pre-acquisition is quantified and condensed using the Compound Annual Growth Rate. In both the pre and post-acquisition periods, the following performance determinants are analysed: Turnover, Gross profit, Operating profit, Net Profit, Gross profit margin, Operating profit margin, Net profit margin, Return on Equity (Net Worth), Return on Capital Employed, Return on Assets, Share Price, Earnings Per Share, Dividend Per Share, Price Earnings Ratio and Market Capitalisation.

4.2.2 PART B

Part B presents the quantitative research on Adcock that answers Part B of the Research Questions. A detailed pre and post-acquisition financial analysis on Adcock will be conducted. The aim of the 4-year pre-acquisition analysis is to get a sense of operating performance, shareholders' returns and market perceptions on Adcock before its takeover by Bidvest. This provides a good context and background on the company that can then be compared with the 1-year post-acquisition performance. The growth over the 4-year pre-acquisition period is quantified and condensed using the Compound Annual Growth Rate. In both the pre and post-acquisition periods, the following performance determinants are analysed: Turnover, Gross profit, Operating profit, Net Profit, Gross profit margin, Operating profit margin, Net profit margin, Return on Equity (Net Worth), Return on Capital Employed, Return on Assets, Share Price, Earnings Per Share, Dividend Per Share, Price Earnings Ratio and Market Capitalisation.

4.2.3 PART C:

Part C presents the quantitative research that compares the performance of the two pharmaceutical companies; Adcock and Aspen. This part of the analysis answers Part C of the research questions and focuses on the 1 year post-takeover period i.e. 2013 compared with 2014. The following performance determinants will be analysed: Turnover, Gross profit, Operating profit, Net Profit, Gross profit margin, Operating profit margin, Net profit margin, Return on Equity (Net Worth), Return on Capital Employed, Return on Assets, Share Price, Earnings Per Share, Dividend Per Share, Price Earnings Ratio and Market Capitalisation.

4.3 ANALYSIS IN RELATION TO EXISTING STUDIES:

The desk top study will take the form of a critique of the key acquisitions and valuation themes from the literature review in relation to how they compare to the Bidvest – Adcock hostile takeover process. It will be interesting to see to what extent the findings of the research support the literature reviewed. Disparities between the literature and the research findings will be highlighted and these will provide interesting alternative outcomes that can be taken into account in future research. The two key themes that will be analysed from the literature will be "Value and Wealth creation from acquisitions, in particular Hostile Takeovers" and "The role of Board of Directors in Hostile Takeovers".

4.4 QUALITATIVE ANALYSIS: INTERVIEWS

To enhance data on Adcock, whose performance post the acquisition is undesirable, interviews with the Chairperson of the Board, Chief Executive Officer and one non-executive director of the board were conducted. This selection of board members represents 25% of Adcock's board. A questionnaire was developed to focus on management's view on the turnaround strategy for Adcock. The questionnaire had 5 sections relating to:

- Introductory remarks regarding the takeover;
- Turnaround strategy plan to increase top line revenue;
- Turnaround strategy plans to improve operational efficiency (in relation to capital and asset allocation and utilisation);
- Plans to improve shareholder returns and market confidence;
- Closing remarks on the transaction.

This section will provide answers to Part 2, question 3 of the Research Questions.

4.5 CONCLUSION

The research analysis has been split in such a way that Part A, B and C of the analysis provides answers to Part A, B and C of the sub research questions as per Table 1.1. The interviews to be conducted in section 4.4 provide answers to Part B question 5 of the sub research questions as per table 1.1. The analysis in relation to existing studies enables us to examine to what extent the findings from the case study reflect outcomes of existing literature. Given the fact that the literature is in the main silent on whether the tactic used to make an acquisition impacts returns and wealth creation, it will be interesting to review whether there are in fact correlations between the outcomes of the case study and the literature reviewed.

We are therefore confident that the research methodology outlined will provide answers to all the sub research questions and therefore enables us to answer the main research question as to whether Bidvest or Adcock shareholders benefited the most from the transaction.

CHAPTER 5: RESEARCH ANALYSIS, FINDINGS AND RECOMMENDATIONS

5.1 INTRODUCTION

In line with the research methodology, the structure of the analysis is as follows: section (5.2), Quantitative analysis – financial review. This section deals with all the financial analysis on relevant data which enables us to reach some conclusion on the impact of the takeover on both Bidvest and Adcock's performance. This section is followed by section (5.3), the analysis in relation to existing studies. This section provides a detailed critique of the key acquisitions and hostile takeover themes from the literature review in relation to how they compare to the Bidvest – Adcock transaction. The final section of the analysis is (5.4) Qualitative analysis: interviews. This part of the analysis brings a qualitative aspect to the research, bringing in direct input from key Adcock decision makers, enabling us to include aspects of future prospects and profitability of Adcock. This is vital as the post-acquisition period under review of 1 year is too short.

Key findings from the analysis are highlighted in various sections. These will be brought together at the end of the analysis to assist in drawing conclusions that address the research questions.

5.2 QUANTITATIVE ANALYSIS – FINANCIAL REVIEW

The financial review portion of the analysis is divided as follows: sub-section (5.2.1) details the analysis and findings from the perspective of the acquiring company, Bidvest. This sub-section provides answers to Part A of the Research Questions. sub-section (5.2.2) details the analysis and findings from the perspective of the acquired/target company, Adcock. This sub-section provides answers to Part B of the Research Questions. sub-section (5.2.3) details the benchmarking analysis and findings between Adcock and Aspen. This sub-section provides answers to Part C of the Research Questions.

5.2.1 Financial Analysis - Bidvest

Part A of the research questions focused on the perspective of the Acquiring Company: The Bidvest Group, and the three questions were as follows:

- What was the impact of the acquisition on Bidvest's share price?
- What was the impact of the acquisition on Bidvest's operating performance?
- At an operational level, what synergy benefits and efficiencies did Bidvest realise post the acquisition?

In order to answer the above questions, a detailed analysis of Bidvest's pre and post-acquisition financial performance was conducted. Table 5.1 lists the chosen main financial indicators and shows the results and trends during the post-acquisition period (2010 – 2013), and pre-acquisition period (2013 vs. 2014).

Table 5.1: The Bidvest Group – pre & post acquisition performance, 2010 - 2014

Financial Performance Indicators	**Pre-Acquisition Compound Annual Growth Rate (2010 – 2013)**	**Post-Acquisition Comparison (2013 vs. 2014)**	**Post-Acquisition Period**	**Pre-Acquisition Period**			
			2014	**2013**	**2012**	**2011**	**2010**
Turnover (Rm)	8.72%	19.71%	183 645 179	153 404 532	133 533 633	118 482 736	109 789 207
Cost of Sales (Rm)	9.12%	0.98%	124 247 763	123 039 972	106 241 730	93 930 778	86 778 366
Gross Profit (Rm)	6.48%	9.21%	12 577 368	11 517 101	10 940 258	9 689 528	8 957 779
EBIT (Rm)	7.98%	6.38%	7 881 985	7 408 974	7 140 299	5 847 911	5 449 717
Net Profit (Rm)	10.05%	-4.27%	4 836 659	5 052 416	4 737 473	3 774 149	3 444 788

SOURCE: McGregor BFA, 2014; Bidvest, 2014

Prior to the acquisition, Bidvest's growth in turnover and operating profit (EBIT) was about 8% with net profit growth at 10%. It is very interesting to note that post the acquisition, whilst turnover growth was exceptionally higher at 19,7% and increases in cost of sales were well controlled increasing by just under 1%, at an operating and net profit level, there is a decline in the growth rates when comparing the 4-year compound growth rate pre the acquisition.

It was indicated in the introduction to the study that the 2014 results include an impairment value of R1 056 059 billion as a result of the Adcock investment. To see to what extent this acquisition negatively impacted Bidvest's results at an operating profit level, one could add back this value and the adjusted results would be as per Table 5.2 below:

Table 5.2: Bidvest results adjusted for the impairment value due to the Adcock acquisition

Financial Indicator	Pre-Acquisition Compounded Growth Rate (2010–2013)	Post-Acquisition **Including** Adcock Impairment (2013 vs. 2014)	Post-Acquisition **Excluding** Adcock Impairment (2013 vs. 2014)	2014 **Adjusted** Rand Value (Rm)	2014 Actual Rand Value (Rm)	2013 Actual Rand Value (Rm)
EBIT	7.98%	6.38%	20.63%	8 938 044	7 881 985	7 408 974
EAT	10.05%	-4.27%	13.84%	5 741 689	4 836 659	5 052 416

SOURCE: McGregor BFA, 2014; Bidvest Group, 2014

The above scenario with the impaired amount written back clearly shows that assuming a break-even (zero loss) investment return from the Adcock acquisition, Bidvest's operating profit would have increased by more than double its 2013 and 4-year compound growth at 20.6% and its net profit would not have declined year on year (-4.27% 2013 vs 2014) but would have even exceeded its 4-year compound growth at 13.84%.

Finding: from the above one can clearly conclude that at a financial performance level, the acquisition of Adcock had a negative impact on Bidvest's operating performance in the first year post the acquisition. This negative impact is to the value of R1 056 059 billion.

Bidvest's results from a ratio analysis perspective are as follows:

Table 5.3: The Bidvest Group – pre & post acquisition financial ratio analysis, 2010 – 2014

Profitability Ratios and Statistics	**Post-Acquisition Comparison (2013 vs. 2014)**	**Post-Acquisition Period**	**Pre-Acquisition Period**			
		2014	**2013**	**2012**	**2011**	**2010**
Gross Margin	-8.78%	6.85%	7.51%	8.19%	8.18%	8.16%
Operating Profit Margin (OPM)	-11.18%	4.29%	4.83%	5.35%	4.94%	4.96%
Net Profit Margin (NPM)	-19.29%	2.51%	3.11%	3.33%	2.99%	3.14%
Return on Equity (ROE)	-20.00%	14.48%	18.1%	20.54%	20.03%	19.99%
Return on Capital Employed (ROC)	-16.70%	10.97%	13.17%	15.88%	14.72%	15.2%
Return on Assets (ROA)	-10.58%	11.66%	13.04%	15.01%	14.33%	14.74%

SOURCE: McGregor BFA 2014; Bidvest Group, 2014

It is notable that the gross, operating and net profit margins have all declined substantially post the acquisition. Worse than this, the return on equity for shareholders in 2014 was at its lowest since 2010 and equally the return on assets and capital employed was also at all-time 5-year lows post the acquisition. Again, to see the impact of the acquisition, the adjusted figures below are shown in Table 5.4 when the impairment value is written back.

Table 5.4: The Bidvest Group – pre & post acquisition financial ratio analysis, 2014 adjusted for the loss on the Adcock investment

Profitability Ratios and Statistics	Post-Acquisition Period		Pre-Acquisition Period			
	2014 (Adjusted excluding Adcock loss)	2014 (Actuals including Adcock loss)	2013	2012	2011	2010
Gross Margin	6.85%	6.85%	7.51%	8.19%	8.18%	8.16%
Operating Profit Margin (OPM)	4.87%	4.29%	4.83%	5.35%	4.94%	4.96%
Net Profit Margin (NPM)	3.13%	2.51%	3.11%	3.33%	2.99%	3.14%
Return on Equity (ROE)	17.42%	14.48%	18.1%	20.54%	20.03%	19.99%
Return on Capital Employed (ROCE)	12.35%	10.97%	13.17%	15.88%	14.72%	15.2%
Return on Assets (ROA)	12.35%	11.66%	13.04%	15.01%	14.33%	14.74%

SOURCE: McGregor BFA, 2014; Bidvest Group, 2014

After writing back the impairment value, we note a slight increase in operating and net profit margins of 0.77% and 0.71% respectively. Though the percentage may be small, in rand terms this increase is R1.4 billion and R1.3 billion in operating and net profit margins (additional % turnover converted into operating and net profit when the impairment is written back.), which is quite significant. In terms of returns, once the impairment is written back, we see a 2.94%, 1.30% and 0.69% increase in ROE, ROCE and ROA respectively. In particular, the rand value increase with regards to ROE is significant, because if there were no loss on the Adcock transaction, the Bidvest shareholders would have enjoyed an additional return on their equity to the value of R169 million.

Finding. From the above one can conclude that the transaction has had a negative impact on Bidvest's performance at two levels: firstly, by reducing margins and therefore profitability before and after interest and tax by more than a billion and secondly, by reducing returns to shareholder (ROE) by R169 million.

Bidvest's share price performance is as follows:

Table 5.5: The Bidvest Group – pre & post acquisition share price analysis

Share Price Statistics	Post-Acquisition Comparison (2013 vs. 2014)	Pre-Acquisition Compound Annual Growth Rate (2010 – 2013)	Post-Acquisition Period	Pre-Acquisition Period			
			2014	2013	2012	2011	2010
Share Price (cents)	13.78%	15.60%	29800	26190	18614	16100	14664
Headline Earnings Per Share (cents)	11.10%	9.89%	1,733.9	1,560.6	1,474.2	1,157.4	1,070.0
Dividend Per Share (cents)	15.85%	13.62%	834.1	720	702	480	432
Price Earnings Ratio	8.30%	6.08%	16.44	15.18	12.3	12.8	11.99
Market Capitalisation (Rm)	17.33%	18.55%	90,119	76,805	56,775	46,508	38,884

SOURCE: McGregor BFA, 2014; Bidvest Group, 2014

When we look at the stock market, it is interesting to note from the analysis that whilst the year on year increase in share price is 1.82% lower than the annualised growth rate over the pre-acquisition period, the 13.78% increase in share price remains solid and significant. The growth in HEPS, Dividend per Share and P/E ratio all exceed annualised growth rate over the pre-acquisition, a good sign of returns to shareholders. The dividend per share indicator shows that post the acquisition, Bidvest shareholders received 2.23% more in profit distributions than what they received annually over the 4-year period prior the acquisition. Management kept the dividend per share year on year increase the same as it was in the 2013 financial year which was also 15.85%. The P/E ratio increased 2.22% more than the increase over the pre-acquisition period and was at a 5-year high of 16.44.

Finding: Whilst the Adcock investment decreased profits by a billion rand, wealth accruing to shareholders was still up year on year and in some cases higher than the 4-year compound annual growth rate. Bidvest management continues to be confident in the company's ability to grow and create shareholder wealth. One can conclude that notwithstanding the loss on the Adcock transaction, Bidvest shareholder wealth increased as seen in the increases in the share price, headline earnings per share and dividend per share. Overall, in terms of wealth accruing to them, Bidvest shareholders have not been worse off as a result of the transaction.

5.2.2 Financial Analysis - Adcock

Part B of the research questions focused on the perspective of the Target Company: Adcock Ingram, and the three questions were as follows:

- What was the impact of the acquisition on Adcock's share price?
- What was the impact of the acquisition on Adcock's operating performance?
- At an operational level, what synergy benefits and efficiencies did Adcock realise post the acquisition?

In order to answer the above questions, a detailed analysis of Adcock's pre and post-acquisition financial performance was conducted. Table 5.6 lists the chosen key financial indicators and shows the results and trends during the post-acquisition period (2010 – 2013), and pre acquisition period (2013 vs. 2014).

Table 5.6: Adcock Ingram – pre & post acquisition performance, 2010 - 2014

Financial Performance Indicators	**Pre-Acquisition Compound Annual Growth Rate (2010 – 2013)**	**Post-Acquisition Comparison (2013 vs. 2014)**	**Post-Acquisition Period**	**Pre-Acquisition Period**			
			2014 (9 months)	**2013**	**2012**	**2011**	**2010**
Turnover (Rm)	5,16%	-34%	3 615 287	5 445 639	4 599 249	4 453 567	4 440 654
Cost of Sales (Rm)	11,10%	-23%	2 475 723	3 208 798	2 505 167	2 336 871	2 105 827
Gross Profit (Rm)	-14.25%	-129%	-371 572	1 262 450	1 129 284	1 288 896	2 334 827
EBIT (Rm)	-7.18%	-209%	-974 735	890 805	868 821	1 068 638	1 200 302
Net Profit (Rm)	-1,67%	-260%	-962 156	601 230	719 076	792 952	643 228

SOURCE: McGregor BFA, 2014; Adcock Ingram, 2010; Adcock Ingram, 2014a

Adcock's 2014 results are for a nine month period because Adcock changed its year end from 30 September to 30 June. In order to accurately compare the data, the 2014 period is adjusted to 12 months as follows:

Table 5.7: Adcock Ingram – pre & post acquisition performance, 2010 – 2014. 2014 results adjusted from 9 months to 12 months

Financial Performance Indicators	Pre-Acquisition Compound Annual Growth Rate (2010 – 2013)	Post-Acquisition Comparison (2013 vs. 2014)	Post-Acquisition Period	Pre-Acquisition Period			
			2014	2013	2012	2011	2010
Turnover (Rm)	5,16%	-11.48%	4 820 383	5 445 639	4 599 249	4 453 567	4 440 654
Cost of Sales (Rm)	11,10%	2.87%	3 300 964	3 208 798	2 505 167	2 336 871	2 105 827
Gross Profit (Rm)	-14.25%	-139.24%	-495 429	1 262 450	1 129 284	1 288 896	2 334 827
EBIT (Rm)	-7.18%	-245.90%	-1 299 647	890 805	868 821	1 068 638	1 200 302
Net Profit (Rm)	-1,67%	-313.38%	-1 282 875	601 230	719 076	792 952	643 228

SOURCE: McGregor BFA, 2014; Adcock Ingram, 2010; Adcock Ingram, 2014a

5.2.2.1 Adcock pre-acquisition performance

Prior to the acquisition, Adcock was already producing negative shareholder returns. The 5.16% compound annual growth rate for the 4 years preceding the acquisition is extremely low, particularly in relation to an average inflation over the period 2013 – 2010 of 5.2% (Inflation.eu, 2015). This means that over the 4 years, Adcock has simply been realising inflationary growth and no real growth beyond inflation, a very worrying and unsatisfactory top line performance. To worsen the low turnover results, cost of sales has been increasing more than double the increase in turnover. Adcock's overheads are clearly too high and should be one of the first areas to look into when putting in place a turnaround strategy for this business. The low turnover and high cost of sales will obviously put a lot of pressure on margins, evident in the 14.25% decrease in gross profit. The negative spiral continues and results in negative returns with operating and net profit declining by 7.18% and 1.67% annually over this period.

This financial performance shows, that even though Adcock is rated the second largest pharmaceutical industry in SA, the company was losing market as it was no longer growing beyond inflation, overheads had increased to such a degree that there must be huge inefficiencies in Adcock's manufacturing and operating model, and the lower profitability was already translating into negative returns for shareholders. This situation must have already been untenable for shareholders and it is now obvious why Adcock would have had huge interest in

being acquired by another pharmaceutical company such as CFR Pharmaceuticals, as this could have been a possible life line for this company that was clearly losing its way.

5.2.2.2 Adcock post-acquisition performance

After the takeover by Bidvest, this situation worsens almost overnight at an alarming rate. The inflationary growth in turnover achieved prior to the acquisition is no longer even in reach as Adcock experiences an 11.48% (R625 million) decline in top line growth. One of the better decisions made post the acquisition was to curb the rising cost of sales from 11.10% (post acquisition) to a reduced 2.87% (R92 million) increase in cost of sales.

We see an even further disappointing picture as we move further along the income statement. The declining turnover and still high, even though reduced, cost sales totally eroded gross margins to such a degree that gross profit declined by an alarming 139.24% (R1.7billion). This domino effect continued, with the end picture a disastrous decline of 245.90% (R2.1billion) and 313.38% (R1,8billion) in operating and net profit respectively!

How is it possible for a company to make a R890 million operating profit in 2013 and then a R1.2 billion operating loss 12 months later? The question is to what extent, if any, did the takeover by Bidvest contribute to this poor performance? It is further interesting to note how this case study contradicts literature with regards to wealth creation for shareholders post an acquisition. Most of the research conducted found that post an acquisition, target company shareholders benefited more than acquiring company shareholders. In this instance, target company (Adcock) shareholders are far worse off and have lost huge value and wealth than before the takeover.

Finding: From the above one can conclude that the financial performance of Adcock declined dramatically post the acquisition. The returns to shareholders were declining prior to the acquisition, and post the acquisition; shareholders experienced negative returns on their investment in Adcock. What portion of the decline is directly as a result of the takeover and what portion is due to possible bad management decisions and running of the business is, at this stage, unknown.

Adcock’s results from a ratio analysis perspective are as follows:

Table 5.8: Adcock Ingram – pre & post acquisition financial ratio analysis, 2010 – 2014

Profitability Ratios and Statistics	Post-Acquisition Period	Pre-Acquisition Period			
	2014	2013	2012	2011	2010
Gross Margin	-10.28%	23.18%	24.55%	28.94%	52.58%
Operating Profit Margin (OPM)	-26.96%	16.36%	18.89%	24.00%	27.03%
Net Profit Margin (NPM)	-26.60%	10.79%	15.34%	16.93%	14.48%
Return on Equity (ROE)	-32.96%	14.92%	18.66%	20.51%	17.7%
Return on Capital Employed (ROCE)	-46.99%	16.17%	20.61%	24.44%	21.67%
Return on Assets (ROA)	-28.44%	16.55%	19.01%	24.46%	21.49%

SOURCE: McGregor BFA, 2014; Adcock Ingram, 2014a; Adcock Ingram, 2010

As indicated earlier, Adcock's 2014 results are for a nine month period due to the change of year end from 30 September to 30 June. Because the above data is presented as ratio's there is no need to adjust for the period difference as the ratios remain the same.

5.2.2.3 Adcock pre-acquisition performance

Without doubt, the inflationary growth in turnover and high cost of sales discussed earlier put pressure on margins and whilst they remain positive, we note the 29.48%, 10.67% and 3.69% decline in gross, operating and net profit margins respectively from 2010 to 2013. This decline exposes an erosion in profitability over time and as a result a decline in shareholder returns over time; in particular, return on equity over the period declined by 2.78%.

5.2.2.4 Adcock post-acquisition performance:

Post the acquisition, the negative earnings with regard to gross, operating and net profit discussed earlier is reflected in the negative margins we see in Table 5.8. The increased pressure on margins, particularly from an operating profit level onwards, tells us that the financial performance challenges experienced by Adcock were not limited to inadequate revenue and high overheads, but that expenses were also out of line, further eroding operating and net profit margins.

The returns post the acquisition unfortunately continue to tell a very disappointing story.

- Since ROE is a measure of the profitability generated from the use of shareholders capital/money, an ROE of -32.96% indicates that shareholders who could have invested their money elsewhere for a better return (even a bank return would be far higher), are seriously

prejudiced as their investment is losing value. This puts Adcock shareholders in an unenviable position as they are no longer creating wealth from this investment.

- ROCE which measures a company's efficiency gives one a sense of the return a company earns from the use of its capital. A ROCE of -46.99% reveals that Adcock's operations post the acquisition have become extremely inefficient.
- ROA, similar to ROCE, is a measure of how efficiently a company uses its assets to generate income. Again, a ROA of -28.44% reflects the extreme inefficient use and allocation of assets in Adcock.

Finding: The overall profitability of Adcock took a drastic turn for the worst post the acquisition. Gross profit margins were negative implying that the company had reached a point where the costs of production were greater than the total revenue generated. The negative operating and net margins also imply that expenses had reached a point where they were excessively high. Adcock's profitability was negatively impacted at multiple levels and there were a number of elements such as sales, costs, operational efficiencies, asset utilisation, and expense control that needed to be urgently re-aligned. A negative return on equity is a clear sign that shareholders should possibly be looking at other assets in which to invest their monies.

Adcock's share price performance is as follows:

Table 5.9: Adcock Ingram – pre & post acquisition share price analysis

Share Price Statistics	**Pre-Acquisition Compound Annual Growth Rate (2010 – 2013)**	**Post-Acquisition Comparison (2013 vs. 2014)**	**Post-Acquisition Period**	**Pre-Acquisition Period**			
			2014	**2013**	**2012**	**2011**	**2010**
Share Price (cents)	2.16%	-20%	5 433	6 779	5 971	6 133	6 223
Headline Earnings Per Share (cents)	-0.90%	-151%	-179.50	350.50	422.40	465.40	363.40
Dividend Per Share (cents)	-20.17%	#N/A	#N/A	73.1	170.85	#N/A	180
Price Earnings Ratio	3.10%	-217%	-22.70	19.34	14.14	13.18	17.12
Market Capitalisation (Rm)	4.54%	-31%	8 609 689	12 448 455	9 449 855	10 773 408	10 422 193

SOURCE: McGregor BFA, 2014; Adcock Ingram, 2014a

Adcock's share price took a steep fall of 20% post the acquisition. Whilst its previous share price annual growth rate of 2.16% was not outstanding, a 20% decline reflects the market's negative sentiment towards this stock. Due to the substantial negative returns post the acquisition, one would anticipate this would also be reflected in the headline earnings per share, and in the non-payment of dividends. The drop in the overall value of this company can be seen in the dramatic fall in its P/E ratio to -22.7% and a -31% year on year decline in market capitalisation, mainly due to the drop in share price. It must be noted that a market capitalisation of R8.6 billion is a 5-year low for Adcock, keeping in mind that Adcock only listed 2 years prior to the pre-acquisition period under review.

Finding: Post the acquisition we note the negative earnings, negative returns to shareholders, negative returns in terms of capital and asset utilisation and negative market sentiment reflected in the 20% drop in share price. Overall, the value of the company declined, reflected in the 31% decline in market capitalisation. It is quite clear that post the acquisition, Adcock shareholders were definitely worse off.

The decreasing revenue, declining margins, operational inefficiencies, inefficient capital and asset utilisation also contributed negatively to profitability and therefore to the value of the company. It is difficult to ascertain which portion of this value loss can be attributed to bad management decisions and the running of the business and which portion is as a result of the takeover.

5.2.3 Financial Analysis – Adcock vs. Aspen

Part C of the research questions introduced a benchmarking perspective, using Aspen as the industry benchmark. The two questions posed were as follows:

- How does the growth rate in Adcock's share price compare with growth rate of Aspen's share price post the acquisition?
- How does the growth in Adcock's operating performance compare to the growth in Aspen's operating performance post the acquisition?

5.2.3.1 Benchmarking Pre-Acquisition Performance:

For the benchmarking section of the analysis, Aspen's results are used as the industry benchmark. Before we review Adcock's post-acquisition performance in relation to Aspen's, we preface the analysis by providing some context. This context comprises Adcock and Aspen's

pre-acquisition compound annual growth rates, to give us an overview of performance prior the takeover of Adcock by Bidvest.

Table 5.10: Aspen and Adcock pre-acquisition comparative analysis

Performance Indicators	**Pre-Acquisition Compound Annual Growth Rate (2010 – 2013)**	
	Aspen	**Adcock**
Turnover (Rm)	17.29%	5,16%
Cost of Sales (Rm)	16.12%	11,10%
Gross Profit (Rm)	31.55%	-14.25%
EBIT (Rm)	17.63%	-7.18%
Net Profit (Rm)	18.15%	-1,67%
Financial Ratio's	**2013 Financial Year Actuals**	
	Aspen	**Adcock**
Gross Margin	47.81%	23.18%
Operating Profit Margin (OPM)	26.12%	16.36%
Net Profit Margin (NPM)	18.23%	10.79%
Return on Equity (ROE)	17.7%	14.92%
Return on Capital Employed (ROCE)	10.81%	16.17%
Return on Assets (ROA)	16.4%	16.55%
Share Price Statistics	**2013 Financial Year Actuals**	
	Aspen	**Adcock**
Share Price (cents)	22707	6779
Headline Earnings Per Share (cents)	788	350.50
Dividend Per Share (cents)	157	73.1
Price Earnings Ratio	27.1	19.34
Market Capitalisation (Rm)	103 484 600	12 448 455

SOURCE: McGregor BFA, 2014; Adcock Ingram, 2010; Aspen, 2013

From the above, we note that Aspen is far more aggressive than Adcock when it comes to top line growth and their number one position in the industry is probably as a result of an emphasis on growing market share annually. This aggressive turnover growth has sustained high operating and net profit of just under 20%, whilst Adcock's profitability has been declining. The high turnover growth of 17.29% has enabled Aspen to enjoy higher margins. In particular, Aspen's gross margin of 47.81% when compared to Adcock's of 23.18% reveals that Aspen's cost of sales growth is far better controlled and managed than Adcock's. The final net margin of 18.23% is really impressive. As would be expected, Aspen's ROE is higher at 17.7% compared to Adcock's 14.92%. It is interesting to note that Adcock's ROCE is higher than Aspen's and that the two companies' ROA is about the same.

Prior to the acquisition, Adcock's asset allocation and utilisation was in line with that of the industry and its capital utilisation was in fact better than the industry average. This means that prior to the acquisition, Adcock's main challenge in terms of operational performance was low

turnover growth, high growth in cost of sales (this in relation to growth in turnover) and high expense growth (2012 to 2013 increase was 9.9%) (Adcock Ingram, 2013). All of this reduced all margins considerably, resulting in an overall decline in profitability.

The share price statistics show us the relative difference in size between the two companies and it's interesting to note that whilst Adcock is ranked second in the industry after Aspen, Aspen is 8.5 times bigger than Adcock in terms of market capitalisation and Aspen share price is three times higher than Adcock's.

5.2.3.2 Benchmarking Post-Acquisition Performance:

The post-acquisition analysis of Aspen and Adcock is as follows:

Table 5.11: Aspen and Adcock post-acquisition comparative analysis

Performance Indicators	**Post-Acquisition Comparison (2013 vs. 2014)**	
	Aspen	**Adcock**
Turnover (Rm)	52.86%	-11.48%
Cost of Sales (Rm)	56.72%	2.87%
Gross Profit (Rm)	48.66%	-139.24%
EBIT (Rm)	47.22%	-245.90%
Net Profit (Rm)	42.44%	-313.38%
Financial Ratio's	**2014 Financial Year Actuals**	
	Aspen	**Adcock**
Gross Margin	29.01%	-10.28%
Operating Profit Margin (OPM)	25.16%	-26.96%
Net Profit Margin (NPM)	16.97%	-26.60%
Return on Equity (ROE)	17.34%	-32.96%
Return on Capital Employed (ROCE)	7.53%	-46.99%
Return on Assets (ROA)	18.47%	-28.44%
Share Price Statistics	**2014 Financial Year Actuals**	
	Aspen	**Adcock**
Share Price (cents)	29750	5 433
Headline Earnings Per Share (cents)	101 630	-179.50
Dividend Per Share (cents)	157	#N/A
Price Earnings Ratio	28,1	-22.70
Market Capitalisation (Rm)	136 395 800	8 609 689

SOURCE: McGregor BFA, 2014; Adcock Ingram, 2010; Aspen, 2013, Aspen, 2014.

The 2014 financial year for Aspen was a major year of growth and investment, represented by the more than 50% year on year increases in turnover and cost sales. Notably, Aspen (2014) details the following growth initiatives attributable to the substantial increases in turnover and costs of sales:

- Acquisition of the API manufacturing business in the Netherlands;
- Acquisition of 11 branded finished dose form molecules from the MSD business;
- Acquisition of the GSK thrombosis business; and
- Acquisition of the infant nutritional businesses in Latin American, South African and Australia.

These growth initiatives made a significant contribution to Aspen's profitability increasing operating and net profit by 47.22% and 42.44% respectively. Unfortunately, on the other hand, Adcock had no growth over the period, experiencing declines in turnover and negative earnings at gross, operating and net profit levels.

Aspen again produced a solid return on equity of 17.34% and improved its return on assets to 18.47% (2013: 16.4%). Adcock on the other hand produced negative returns margins and returns, meaning that in 2013, Adcock's main challenge was that operational performance was limited by low turnover growth, high growth in cost of sales and high expense growth; in 2014, this situation deteriorated and was exacerbated by inefficient capital and asset utilisation and allocation.

The deterioration in operating performance further translated into a reduction in the value of Adcock, evident in the reduction in Adcock's share price, P/E ratio and market capitalisation. The gap between Aspen and Adcock widened further with Aspen's share price 5.5 times higher than Adcock's (2013: 3 times higher) and Aspen's market capitalisation 15.8 times larger than Adcock's (2013: 8 times larger).

Finding: Overall, one can see that Adcock did not perform anywhere close to the industry benchmark. In fact, Adcock did not even produce the type of results it had been producing over the 4 years prior to the acquisition. At an operating performance level, Adcock's results were very far from the industry benchmark and to make matters worse, Adcock experienced negative returns which were obviously passed onto shareholders. In terms of the share price, we note a 19.9% deterioration in Adcock's share price from R67.79 before the acquisition (2013 financial year) to R54.33 post the acquisition (2014 financial year). On the other hand, Aspen's share price increased by 31% from R227.07 before the acquisition (2013 financial year) to R297.50 after the acquisition (2014 financial year). The market confidence in Aspen was solid and evident in this substantial growth in Aspen's share price, whilst on the other hand, the markets lack of confidence in Adcock was also evident in the steep decline in share price.

5.3 ANALYSIS IN RELATION TO EXISTING STUDIES

The aim of this section of the analysis is to analyse the literature that forms the basis of this research paper, and assess whether the key findings of the financial analysis and other aspects of this acquisition case study, are supported by the literature reviewed in Chapter 4. The main research question is "Which shareholders have benefited the most from the acquisition, Bidvest or Adcock shareholders?" The theme that is therefore analysed from the literature is "Value and wealth creation from acquisitions, in particular hostile takeovers".

The research has further found that the board of directors plays a very critical role in either supporting or attempting to stop a takeover. In this way we note that the actions of the board of directors can substantially influence shareholder value and wealth. The other theme that is therefore also analysed is "The role of board of directors in hostile takeovers". The key findings on these themes as discussed in the literature review is compared to the financial analysis findings of the Bidvest – Adcock case study and the similarities and differences are discussed in detail.

5.3.1 The role of the Board of Directors in Hostile Takeovers

One of the critical aspects in hostile takeovers is the role of the board of directors. According to Section 76(3) of the Companies Act (Republic of South Africa, 2008), directors must at all times act in good faith, act in the best interest of the company and act with care, skill and diligence. An extension of acting in the best interest of company is provided by Dewhirst and Wang (1992) who state that Board of Directors must act in the best interest of shareholders. In the Bidvest – Adcock transaction, it is interesting to note that the board of Adcock openly supported an alternative bid by a Chilean company called CFR Pharmaceuticals (CFR). Mokhele (2013) stated that the Adcock board believed that an Adcock-CFR combination would be in the best interest of shareholders. This statement was contrary to the positions of Adcock's major shareholder, the Public Investment Corporation (PIC) and Bidvest who at the time already owned approximately 4% of the issued ordinary shares in Adcock. Whilst the Adcock board was intent on their strategic support of the CFR bid, the PIC, a 20% shareholder in Adcock, vehemently disapproved of this decision and acted on their non-support of the CFR bid by supporting Bidvest in voting against the CFR offer. The board of Adcock effectively held a position (support of the acquisition by CFR) that was not supported by two shareholders who collectively owned 24% of the company. In this regard, a few questions come to mind:

- Was the board of Adcock wrong in supporting a view held by the balance of the shareholders who collectively owned a majority 76% of the company?
- How do we define acting in the "best interest" of shareholders?
- Is supporting the majority view of shareholders acting in their "best interest"?
- Could one argue that in acting in the "best interest" of shareholders, the view of the largest shareholder, in this case the PIC, has to have a significant influence on the board's decision-making? Or does acting in the "best interest" of shareholders simply mean maximising profitability and shareholder returns, regardless of varying preferences of the shareholders?

Adcock's 2013 Annual Integrated Report contains a detailed account for the support of CFR offer. In this report (Adcock, 2013), the board (excluding executive directors and management) states that it conducted an extensive evaluation of all bona fide proposals received and made a decision that the CFR offer was in the "best interest" of shareholders because of the following:

- Value – offer price of R73.51 per Adcock share to be settled in a combination of cash and CFR ordinary shares;
- Operational enhancements – as a result of complementary product portfolios, business structures, geographical presence and manufacturing footprints;
- Potential synergies – such as cost synergies through the consolidation of the manufacturing footprint, revenue synergies as a result of the combined enhanced and diversified portfolios, and efficiencies would be realised from sourcing synergies due to the combined procurement of products and services;
- Execution Risk – this risk was reduced due to the similarities between Adcock and CFR.

Whilst there were other reasons in support of the offer, the above four represent the key drivers behind the support of the CFR bid by the board. These reasons in support of the CFR bid are supported by the research by Alexandridis, Petmezas and Travlos (2010) that states that the goals behind mergers and acquisitions are growth of companies, boosting of profits, increase overall power in the market, and enhancing the wealth of shareholders. In particular, execution risk is supported by Cremers, *et al.* (2009) who found that the extraction of synergies and efficiencies between the target and acquiring firm was a key motivation for acquisitions.

One must admit that these reasons in support of the CFR bid in isolation are solid, and present a compelling argument for value creation post the acquisition. What is missing, however, for shareholders to have had complete information in making their decision on which offer to

support, is a similar detailed evaluation of the benefits, if any, which could have accrued to shareholders when considering Bidvest as the potential acquirer. This evaluation would have given shareholders the opportunity to interrogate both offers in a manner that does not initially favour one bid over the other, and then make the decision that would maximise shareholder wealth. If indeed, the reasons in support of the CFR bid were superior to the Bidvest bid, then transparency on the benefits and/or negatives of the Bidvest bid could have possibly swayed PIC's views. It is interesting to note that Coff's (2003) research found that bidding wars yield high returns for shareholders, but on the other hand, create huge uncertainty for management, particularly in relation to management's ability to retain control. Some managers attempt to ensure that bidding wars do not take place by giving a favoured bidder preferential status, with the aim of discouraging a competitive bidding process.

In conclusion, one must accede to the fact that the board did the necessary work in assessing the CFR bid, and their support for this transaction was well motivated and was underpinned by maximising shareholder returns post the acquisition. The board's intentions were therefore to act in the best interest of the company and shareholders. Criticism of the board is that there may have been a bias in the presentation of information to shareholders. On the basis of publically available information, it seems that the alternative offers were not evaluated in the way the CFR offer was and presented to shareholders for consideration. In doing this, the board may not have necessarily acted objectively and impartially. All offers should have been given equal level of focus and analysis, presented to shareholders and only thereafter, should have the board made a recommendation to shareholders of the bid they felt presented the best value proposition.

On another characteristic of the role of boards in hostile takeovers, Mallette and Fowler (1992) argue that directors of target firms usually do not retain their positions post the takeover. This high probability of job losses provides an incentive to target firm directors to attempt to stop takeovers, even though proceeding with the takeover would be in the best interest of shareholders. In the case of Bidvest and Adcock, the theory supports the outcome of the transaction because soon after the takeover (less than 4 months after the transaction), both the Chairman and CEO of Adcock resigned.

5.3.2 Value and Wealth Creation in Acquisitions, in particular Hostile Takeovers

The assertion by Alexandridis, Petmezas and Travlos (2010) that goals behind mergers and acquisitions are growth of companies, boosting of profits, increase overall power in the market, and enhancing the wealth of shareholders, implies that companies would pursue an acquisition

with the aim of increasing the value of the company and shareholder wealth. How one could best quantify the impact of an acquisition and assess whether indeed value and wealth has been created, needs some investigation. Whilst there are many financial models that can be applied, Holl and Kyriazis (1997) state that wealth creation is assessed by reviewing share prices pre and post the acquisition to see if there is an increase in value. Applying this principle, one can conclude for Bidvest, that, whilst the company and shareholders have lost some value due to the R1 billion impairment for the Adcock acquisition, the increase in the Bidvest share price from R261.90 pre the acquisition to R298 post the acquisition implies that Bidvest shareholder wealth has increased. Conversely, the decline in the Adcock share price from R67.79 pre the acquisition to R54.44 post the acquisition, implies that has been no wealth creation for Adcock shareholders.

The above finding that shareholder wealth has been created for the acquiring firm (Bidvest) shareholders post the acquisition whilst shareholders of the target firm Adcock are worse off post the acquisition contradicts all theory researched for this paper. The consensus amongst researchers such as Lubatkin (1983), Singh and Montgomery (1987), Black (1989), Datta, Pinches and Narayanan (1992), Holl and Kyriazis (1997), and Yook (2004), is that post an acquisition, target company shareholders experience wealth gains whilst acquiring company shareholders are worse off post the acquisition. The contradictory outcomes of the Adcock acquisition by Bidvest need investigation. Perhaps, Holl and Kyriazis's (1997) argument that wealth gains in related acquisition are linked to the coinsurance effect, and therefore acquisitions driven by market-relatedness will impact profitability, whilst an acquisition driven by production relatedness will impact growth, is valid. This theory is further supported by Singh and Montgomery (1987) who argue that acquired firms, where the acquiring firm is in a similar or related market, experience higher returns than firms acquired by companies in unrelated markets. According to Datta, Pinches and Narayanan (1992), synergy benefits between the acquiring and target firm which are both in related types of businesses should result in greater wealth creation than when the acquiring and target firm are in unrelated businesses or in a conglomerate transaction. This supports the argument by Singh and Montgomery (1987) and Holl and Kyriazis (1997). In the case of Adcock and Bidvest, there is no market relatedness or product relatedness. One can therefore conclude that the argument of Singh and Montgomery (1987) and Datta, *et al*. (1992) holds true in the case of Bidvest and Adcock and perhaps provides an answer as to why shareholders returns differ from the findings of the literature reviewed.

Finding: The preferences of board of directors heavily influence shareholders decisions when considering competing bids. In the case of the Bidvest-Adcock transaction, the board's support

of the CFR bid was well qualified and the board's intentions were to act in the best interest of the company and shareholders; however, the board did not provide the same transparency when it came to alternative bids (including the Bidvest bid) and was biased in the presentation of information. The board therefore did not necessarily act impartially in this case. Secondly, synergy benefits in the form of market and product relatedness, give rise to greater wealth creation, and in the absence of this, wealth maximisation can be compromised. In the case of the Adcock acquisition by Bidvest, the absence of market- and product-relatedness resulted in both companies not realising the increased growth and profitability benefits that could have accrued as a result of the "coinsurance effect".

5.4 QUALITATIVE ANALYSIS: INTERVIEWS

Thus far, all the conclusions made with respect to Adcock have been based on results of the financial analysis and a comparison of these results with the literature reviewed. In order to provide another view on Adcock's results and performance, interviews were conducted with the Chairperson of the Board of Adcock, Brian Joffe, the CEO of Adcock, Kevin Wakeford and Lindsay Ralphs, a non-executive director of Adcock. These interviews represent views from 25% of the board of directors of Adcock. The financial analysis and literature review analysis were both "backward" looking in nature, i.e. gave us a view of past performance. Because the post-acquisition period is limited to 1 year, the research is unfortunately unable to provide a longer term view. In order to address this weakness, the focus of the interviews was more "forward looking" and focused on plans that Adcock had to improve future shareholder returns.

The interview was structured in three sections as follows:

- Section 1: Introductory remarks regarding the takeover.
- Section 2: What turnaround strategies will be implemented to improve the profitability of Adcock?
- Section 3: Are there any strategies that will be implemented to improve the production/manufacturing efficiency of the Adcock operations?
- Section 4: Whilst we know that answers to Section 1 and 2 contribute to increasing the value of the company and in turn shareholders returns, are there any other initiatives to be implemented that will improve shareholder returns and market confidence?
- Section 5: Closing remarks on the transaction. The results of the interview are detailed below.

5.4.1 Section 1: Introductory Remarks regarding the Takeover

The usual expectation after a takeover is to deal with the operational matters and potential synergies between the acquirer and target companies. In the case of Adcock, the actual situation found both in terms of financial and operational performance differed greatly from what Bidvest anticipated. Bidvest's plans and aspirations for Adcock therefore needed to be altered in light of the unfavourable situation Adcock was in post the takeover. Some of this underperformance was attributed to the following historical events. Firstly, Adcock was initially a subsidiary of Tiger Brands. When Adcock was separated from Tiger Brands and listed independently on the Johannesburg Stock Exchange in 2008, the consumer products range in Adcock that was not subject to regulation was "stripped" from Adcock and kept by Tiger Brands. Secondly, Adcock management after the unbundling from Tiger Brands to the time of takeover by Bidvest was negatively impacted by the stripping of the good consumer products and the loss of support and leadership of its experienced parent company, Tiger Brands. Adcock therefore found itself independent and free from its holding company, unfortunately without the necessary experience to succeed. Therefore, strategic changes were implemented at high cost and the strategies implemented were in themselves flawed.

5.4.2 Section 2: Turnaround strategies to improve the profitability of Adcock

In the post-acquisition period, the first challenge was to identify the strengths and weaknesses of the company. The company identified its solid range of products and brands as a strength, particularly in comparison to their competitors. Two weaknesses were identified, firstly, the methodology and way in which the good products were managed and distributed. Secondly, infrastructure inefficiencies that existed in the business. Approximately R1.3 billion worth of losses were incurred in the post-acquisition period as a result of these inefficiencies. Geographically, Adcock's biggest market and contributor to profits is the South African market and it therefore made sense that the turnaround strategy was centred in Adcock's "anchor" market. The turnaround strategy aimed to make the business more agile and focused. This would be done by decentralising the business into accountable business units. The decentralisation would take the form of creating 4 divisions where the respective divisions would be defined on the basis of who or how the purchase decision was made.

First was the over-the-counter (OTC) Division, where the purchasing decision was driven in the main by recommendations by pharmacists. Many of the OTC products were believed to have huge potential and were previously neglected. The upside of the division was that it had good

products; the downside was that it would take a long time to reposition those products in the market. The products were there and they were leading brand names, therefore there was no doubt big future growth potential for this division.

Second was the Prescription Division, where the purchasing decision was driven by the medical physician who prescribed the preferred medication to be taken by a patient. Here, Adcock needed a strategic partner either in the form of equity or contractually in order to develop new products and keep up with global technological trends. The previous prescription drug distribution model was based on a pure commission structure, therefore the yield on these products was low. This division also included the manufacture of Ante Retroviral Virals (ARVs) for the South African government. The board took a decision to downscale Adcock's exposure in this space due to the low margin high cost of production.

The third was the Consumer Division, a division where the purchasing decision is made directly by the consumer. This division distributes products not subject to pharmaceutical regulation. The main objective of this division was, through Adcock's close relationships with retailers such as Clicks, to grow the size of this division.

Fourth was the Critical Care Division, which supplied intravenous fluids, renal equipment and blood bags where hospitals, other healthcare facilities or the South African National Blood Services (SANBS) made the purchase decision. Returns in this division were very low e.g. 1% return on assets, therefore the key focus of this division was improved profitability.

Each division would be headed by a Managing Director who would have the required support team consisting of a financial director, sales director, marketing director, and HR manager. Again, in an effort to further drive decentralisation and accountability in terms of production output and costs, each division would be allocated a factory which produced some of the products. Each division imported certain of its products as well. In addition, the divisions were incentivised on not only achieving trading profit targets but also on return-on-funds-employed targets which looks after asset management. Other than decentralisation, the focus was on simplifying the business and returning to business basics of removing any corporate clutter so as to focus on service, products and customers.

5.4.3 Section 3: Strategies to improve the production/manufacturing efficiency of the Adcock operations

The decentralisation of the factories by allocating each factory to a division was the first step towards improving production and manufacturing efficiencies. There were, however, different considerations that applied to each factory. The critical care factory was running at full capacity and thus needed to focus on improved efficiencies. On the other hand, the Clayville factory that produced over-the-counter (OTC) products was running well at current shifts but did have excess capacity which could be filled by growing market share, therefore the OTC division, in this case, would be looking at increasing volumes. The prescription factory at Wadeville factory produced small volume liquids together with creams and ointments but was predominantly set up as an ARVs (Ante-Retrovirals) factory and was running at below 50% capacity. In 2014, Adcock was not successful in being awarded any of the triple dose ARV tenders from the Department of Health which comprised the bulk of the tender. They retained the single dose allocation they already had but this was 5% of the total R14 billion tender value. Options for filling capacity at this facility were therefore being evaluated but the business would not be rushed into any decisions.

5.4.4 Section 4: Other initiatives to be implemented to improve shareholder returns and market confidence

Adcock performed its own distribution services via its own infrastructure. This Distribution Division would be measured on a stand-alone basis to determine whether it covers its costs after providing an arms' length service to the other divisions and can meet external service levels. There was no doubt that Adcock's distribution model needed to be strengthened. Most pharmaceutical companies outsourced distribution and Adcock management would also take this option into account when optimising its distribution model.

The important thing was that the company had embarked on a path that had been totally embraced by the people at Adcock and which focused on their customers, products and service. They were doing things differently. The half year results showed good cash generation and the business hoped to set a realistic base for the future in 2014. Each division had its core focus which was specific to itself and these were designed to improve returns-on-funds-employed. They were in a position to look at acquisitions particularly to bulk up their consumer division and the company would review these opportunities as and when they arose. They could also now turn to focusing on their investments outside of South Africa.

5.4.5 Section 4: Closing Remarks on the Transaction

In comparing Adcock and Aspen, it can be noted that whilst the two companies are in the same industry, the company's business models are not the same. Adcock has greater exposure to the higher end consumer OTC market, whilst Aspen focuses on the lower end OTC market and is expanding into other markets such as baby formula. Aspen has a strong alliance with GSK and through this alliance has expanded quickly outside the SA borders into Australia and Asia Pacific. Aspen's production units are also more efficient than Adcock's.

There is a long road ahead, but management and the board was confident that the company would turn, as evident in the half year results where, as per Adcock Ingram's Unaudited Financial Results for the six-month period ended 31 December 2014, the company posted a 39% year on year increase in operating profit of R200 million and a 38% year on year increase in Headline earnings per share of 83.8 cents per share (Adcock, 2014b).

Finding: The executive have quantified a turnaround plan for the company. The plan spans across enhanced operational structures within the company, increased accountability through decentralisation, improved efficiency both in terms of production and costs at all factories, and increased focus on revenue growth and profitability. The financial analysis conducted identified Adcock's greatest weaknesses as decreasing revenue, declining margins, operational inefficiencies, inefficient capital and asset utilisation. It is comforting to see that the turnaround strategy addresses each of these identified weaknesses.

5.5 CONCLUSION

From the qualitative financial analysis one can conclude that Adcock shareholders were worse off post the acquisition. On the other hand, Bidvest shareholders were better off, even after taking into account the R1billion impairment by Bidvest for the Adcock investment. Comparing Aspen and Adcock, we see that Aspen's results supersede those of Adcock's and Adcock performance was not close to the expected market performance.

From the analysis of the existing literature, we note the contradiction between the outcomes of the financial analysis and the findings from the literature reviewed. Whilst majority of the literature findings are that post an acquisition, target company shareholders benefit more that acquiring company shareholders, in the case of Bidvest and Adcock, the opposite is true. The literature that emphasizes the synergy benefits could provide a reason for this contradiction because Bidvest and Adcock are not in the same industry and there is also no product similarity

either. In terms of the board of director's role in hostile takeovers, we note that biases displayed by board's compromise the board's independence when considering competing bids can lead to subjective recommendations to shareholders.

From the interviews we note that whilst there may be no synergies between Bidvest and Adcock, through the appointment of the Bidvest CEO as Chairperson of the board of Adcock, Bidvest is taking a leadership role in steering to company out of the adverse situation it finds itself in. a clear turnaround plan has been put in place and this plan is beginning to yield positive results. This plan addresses every aspect of weaknesses and inefficiencies identified in the financial analysis and should therefore go a long way in improving the status of Adcock.

CHAPTER 6: CONCLUSION

6.1 CONCLUSION

The aim of the research paper is to review wealth effects from mergers and acquisitions, in particular hostile takeovers. The wealth effects considered are those of target and acquiring company shareholders post a hostile takeover. Research conducted in the field of mergers and acquisitions was taken into account and a case study of the Bidvest acquisition of Adcock was reviewed. The analysis conducted included a quantitative financial analysis, an analysis of existing literature and interviews with key Adcock board directors.

The main research question of the paper was "Which shareholders have benefited the most from the acquisition, Bidvest or Adcock shareholders?" From the analysis conducted we can conclude as follows:

Notwithstanding Bidvest's R1 056 059 billion impairment as a result of the Adcock acquisition, the continued market confidence in the Bidvest stock is reflected in the 13.78% increase in share price post the takeover. The growth in headline earnings per share, dividend per share and P/E ratio post the takeover exceeds the annualised compound growth rate over the pre-acquisition, a good sign of improved returns to shareholders. Bidvest shareholders received 2.23% more in profit distributions than they received annually over the 4-year period prior the acquisition. Whilst the Adcock investment decreased Bidvest's profits by a billion rand, shareholder returns in the post-acquisition period exceeded returns in the pre-acquisition period. Notwithstanding the loss on the Adcock investment, one can conclude that Bidvest shareholders continued to experience wealth gains from their investment and are better off post the acquisition.

Adcock experienced declining returns prior the acquisition and this worsened post the acquisition to negative returns. Some of the reasons for the negative returns were declining sales, increasing overhead costs, operational inefficiencies and asset underutilisation. The negative market sentiment due to the undesirable results was reflected in a 20% drop in share price, a 31% decline in market capitalisation and a zero dividend distribution post the acquisition. One can therefore concluded that post the acquisition, Adcock shareholders were worse off.

The above results contradict literature reviewed that finds that post an acquisition, target company (Adcock) shareholders experience wealth gains, whilst acquiring company (Bidvest) shareholders are worse off. Having analysed the possible reasons for this difference, we suggest

that the variations in findings are possibly as a result of firstly, the limited post acquisition period, and secondly, the lack of synergy between Bidvest and Adcock.

A post-acquisition analysis period of 1 year is too short to be able to see the long term effects of any acquisition. Unfortunately, due to the timing of when the research was conducted, only 1 years' worth of data was available. Most researchers advise a post-acquisition review period of 3-5 years. To expect an immediate return from any investment in a period of 1 year can be unrealistic and this is unfortunately a weakness of the research.

Secondly, research has shown that synergy benefits in the form of market and product relatedness, give rise to greater wealth creation, and in the absence of this, wealth maximisation can be compromised. The absence of market and product relatedness resulted in Adcock not realising the increased growth and profitability benefits that could have accrued as a result of the coinsurance effect.

Management has solid plans to improve the future profitability of Adcock. The Chairman of Adcock released a statement in February 2015 stating that half year profitability is expected to be 20% higher than the previous year. This improvement in results 18months post the takeover supports the assertion that the post-acquisition period under review of 1 year is too short.

It is worth noting that the new Chairman of Adcock is the current CEO of Bidvest. Whilst the synergy opportunities explained earlier may not exist, there is no doubt that the new Chairman's leadership will be invaluable. In taking on this position of Chairman, the CEO of Bidvest sends a strong message to the market that whilst the short term results of the acquisition are not favourable, he will personally lead the company out of the turmoil it found itself in post the takeover.

In conclusion, from the above it is clear that post the takeover, Bidvest shareholders benefited more than Adcock shareholders.

6.2 RECOMMENDATIONS FOR FURTHER RESEARCH

It is recommended that a further study be undertaken of the position of these two companies five years post-acquisition to evaluate the extent to which shareholder wealth has been created by the takeover. It is also recommended that a study be conducted into hostile takeovers and the resulting wealth effects. Most of the studies review mergers and acquisitions in general and there is limited large sample research in hostile takeover targets and the resulting wealth effects.

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