

NICE WORK IF YOU CAN GET IT

BY VIPAL MONGA AND SUZANNE STEVENS

“It was the best question I’ve ever been asked,” says Ken Moelis, the founder of boutique investment bank Moelis & Co LLC. It was December 2005 and Moelis was standing in a London elevator with longtime client Steve Bollenbach. Then the CEO of Los Angeles-based Hilton Hotels Corp., Bollenbach, after months of negotiations, was finally about to close a £3.3 billion (\$5.4 billion) deal for U.K.-based Hilton Group plc’s lodging assets.

Recalls Moelis: “We had pushed the elevator button, and [Bollenbach] looked at me, and asked, ‘Should I do this deal?’ Moelis answered yes.

It is the idealized vision of the relationship between investment banker and client. The CEO, alone with his most trusted adviser, forgets for the moment all the financial analysis laid out in acres of spreadsheets and leaves behind the army of bankers and corporate associates that have analyzed, from every angle, the financial and strategic rationale for the transaction.

At the moment of truth, there are only the banker and his client, and that one simple question.

But that vision no longer seems to apply. When most CEOs turn to their advisers these days, they will most likely not be met by an investment banker, but by a dealmaker from their own corporation who is as well versed on the ins and outs of a transaction as any banker.

Conversely, when bankers pitch ideas or get called in on a deal, they won’t arrive alone, but often with entire teams from their firms pitching myriad products and services from every area of their banks.

Today, when a CEO asks his banker, “Should I do the deal?” even the simple answer -- “yes” or “no” -- is loaded with a complex set of motivations. The push and pull between those motivations, between the banks and their clients, has been a defining characteristic of the last decade of dealmaking. And it seems likely to set the tone for years to come.



Indeed, a succession of dramatic events has marked the past decade in dealmaking. Markets lived through the tech and telecom bubble and bust, Sept. 11, the Enron and WorldCom accounting scandals, the explosion of private equity and the global financial meltdown. But through it all, M&A volume continued to rise. In 1999, worldwide M&A volume surged to \$3.2 trillion, a quantum leap from \$851 billion in 1995. Despite the ebb and flow of crises, booms and busts, it has never again fallen below \$1 trillion.

Meanwhile, macroeconomic and social changes have changed how deals get done.

For instance, technological innovations, led by the Internet, have made it easier for companies to gather market intelligence for themselves and conduct financial modeling and due diligence.

“Some number of years ago, providing stock price information and analysis was one of the ways we brought value to our clients,” says Tim Ingrassia, head of Americas M&A for Goldman, Sachs & Co. “But that’s all info you can pull up on Yahoo Finance today.”

Macroeconomic forces such as globalization also created a competitive environment that forced corporations to adapt quickly, often through acquisitions, adds Gene Sykes, co-chairman of Goldman Sachs’ M&A group. “If you look back some 20 years or so, M&A was a bit of an extraordinary and unusual activity for corporations,” he says. “But since then, transaction-based activity has become central to the business strategy of most companies. The merger business is no longer an arcane field.”

As a result, the personal relationship Moelis romanticizes has been replaced by an institutional model that has fundamentally changed the nature of the banks’ relationships to their clients. The corporations that are at the center of M&A have become increasingly sophisticated over the years. Large acquisitive firms such as General Electric Co. and Johnson & Johnson have long had dedicated M&A teams. But an explosion in M&A over the past decade, coupled with the reality that companies must live with the results of their

acquisitions, caused more corporations to build in-house deal teams -- many staffed with former investment bankers, strategy consultants and M&A lawyers.

Consider Siemens Corp., the holding company for the U.S. operations of German industrial giant Siemens AG. The company has a four-person corporate M&A team and deep deal expertise throughout the organization, developed by churning through an average of 10 acquisitions a year since 1985.

“Naturally, as M&A becomes more a tool to accomplish corporate objectives you want to internalize the professional capabilities in that area,” says Ken Meyers, vice president of M&A. “We’re at least a generation beyond where we were 10 years ago. You don’t want to rely on outsiders every time you want to do a deal.”

Another example is LexisNexis, a division of publisher Reed Elsevier Inc. LexisNexis has executed more than 35 acquisitions since 2001, transforming from a legal records database firm into a provider of technology workflow and risk management services to clients in a range of industries.

By the time LexisNexis completed its largest acquisition, the \$4.1 billion purchase of data and analytics provider ChoicePoint Inc. in September 2008, it had developed a talented bench of experienced dealmakers.

Michael Frankel, a former vice president of business development at GE Consumer Finance-Americas and a Merrill Lynch & Co. vice president, was hired a few months earlier as senior vice president of business development and M&A. Today LexisNexis has “at least 10 fully competent deal execution people,” Frankel says.

The company still uses investment bankers. UBS Investment Bank and Morgan Stanley advised on the ChoicePoint deal. And it relies on bankers -- often middle-market and boutique shops -- to keep it informed about the small and often far-flung content providers and technology companies it typically acquires. But on plain-vanilla transactions, LexisNexis often goes solo. The same is true for an increasing number of acquisitive firms.

In 1999, there were 856 deals valued at more than \$500 million transacted worldwide. Of those, 305 -- or 35.6% -- featured at least one party in the deal without an adviser. The percentage hovered in the 34% to 35% range between 2003 and 2005. By 2006, however, 42.9% of large transactions included at least one party with no banking adviser. The number rose to 50.7% in 2008, according to research firm Dealogic.

“Bankers are being asked to demonstrate value more often,” says Frankel. “They have to go beyond, ‘I know how to do deals.’”

Most of the bankers interviewed for this article were careful to emphasize the still-personal nature of the banker-client relationship. “The relationship is the most important thing,” says J.P. Morgan’s global head of M&A, Jimmy Elliott. “Once a relationship is established, we can deliver everything else.”

Still, several note that the old-school model of the trusted consigliere -- à la Felix Rohatyn -- no longer serves as most M&A bankers’ archetype.

“It’s fair to say there’s a lesser ability to use the old-line model of the pure consigliere where you could just show up and get that strategic business, irrespective of whatever other relationships you had, [services you offered]” says Mark Shafir, global head of M&A at Citigroup Inc.

Or as Doug Braunstein, head of J.P. Morgan’s investment banking operations, puts it: “An adviser’s role needs to be much broader. There is a juxtaposition of traditional trust and confidence in an advisory relationship, and the need to have expertise across a very broad range of products and geographies. It used to be much simpler.”

It’s telling that these views come from senior bankers at firms that epitomize the idea of the one-stop-shop or universal bank. That model took root over the 1980s and 1990s but fully flowered in 1999, after Congress repealed the Depression-era Glass-Steagall Act, which had separated commercial from investment banking. Over the succeeding years, the growth of the so-called full-service banks, such as Citigroup, J.P. Morgan Chase & Co. and Bank of America Corp., added competition to an M&A business that formerly was the exclusive purview of pure-play investment banks such as Goldman, Morgan Stanley and Lehman Brothers Inc.

Dealogic’s league tables show that in 1999, Goldman Sachs, Merrill Lynch and Morgan Stanley dominated U.S. M&A activity. By 2008, only Goldman, in first place, was still in the top three. J.P. Morgan and Citigroup held the next two spots.

Initially, the commercial banks’ ability to provide other services such as lending gave them an advantage over the traditional advisory firms, but soon even the investment banks were anteing up their balance sheets to get business.

Coupled with the corporations’ increasing dealmaking sophistication, this changed everybody’s expectations, and forced banks to offer an ever-expanding menu of services to entice clients.

For example, Citi advised Warner Chilcott plc when the Irish drugmaker announced Aug. 25 that it would buy Procter & Gamble Co.’s prescription drug business, and received M&A credit. However, the bank also put up a sizable amount of money as part of the \$4 billion Warner Chilcott borrowed to complete the deal.

Citi’s group on the Warner Chilcott deal was led by Chris Hite, global co-head of healthcare investment banking, and included Shafir. As Hite puts it, going to a client such as Warner Chilcott is no longer just a matter of showing up with some ideas on how to close a deal. “It’s my responsibility to make sure that we’re bringing the services of the firm,” he says. “When you’re thinking about a \$2 billion or a \$15 billion deal, I’m not only delivering the M&A advice, but I’m delivering the firm to ensure clients have the capital required to do the transaction.”

It is worth noting that many acquirers, IBM among them, don't need financing to complete a transaction. Even so, Elias Mendoza, vice president of corporate development at IBM and a former Morgan Stanley investment banker, says bundling services has become increasingly important to banks at a time when clients need M&A advice less. "If there was a broader revenue opportunity, there was always a push to maximize revenue, to lead with some of the difficult products that were more sticky and add M&A on top of that. So the M&A isn't the big money maker for the firms. It's the financing piece."

Some corporate clients even suggest having a full slate of services is necessary to gain business. "Ten years ago, if a banker didn't bring a balance sheet it didn't matter. Now, the financing and M&A are more integrated at a shop like ours," says one corporate dealmaker at a Fortune 500 company. "Yes, the personal relationship matters, but the institutional relationship is becoming increasingly important. If there's a party that can bring everything to the table, then they bring everything to the table."

For all that, the past 10 years have also been marked by an interesting countertrend to the growth of the universal banks: the flourishing of the boutique model of investment banking. That model emphasizes smaller firms with few business lines other than advisory services, and, in some cases, small capital markets units.

In the 1990s, the boutiques were epitomized by firms such as Lazard (whose CEO, Bruce Wasserstein, is chairman of The Deal LLC), Evercore Partners Inc. and Greenhill & Co. The latter two firms were founded in 1996 by M&A bankers -- Roger Altman and Robert Greenhill, respectively -- who matured during the height of the banker-as-consigliere days. As testament to the viability of their business models, all three of those firms have successfully gone public. In the past few years, the banker-led boutiques' ranks have grown with the addition of Perella Weinberg Partners LP, co-founded by former Morgan Stanley M&A impresario Joseph Perella, and Moelis & Co.

The boutiques all argue that the nature of the full-service banks leaves room for a breed of unconflicted banker, whose only interest is in providing useful advice to the client, not selling them a menu of other services. Indeed, Greenhill touts its conflict-free status on its Web site, while Evercore notes it was founded on the belief that there are clients that want advisers who are "free of the potential conflicts of interest created within large, multi-product financial institutions."

Even without balance sheets to use to attract M&A business, the boutiques have been able to convert their relationships into substantial mandates. Evercore and Lazard, in fact, worked on three of the largest deals of the first part of 2009, Wyeth's \$68.1 billion acquisition by Pfizer Inc. (Evercore advised Wyeth), BHP

Billiton's acquisition by Rio Tinto Ltd. (Lazard advised Rio Tinto) and Xstrata plc's \$48.3 billion hostile bid for Anglo American plc (Lazard advised Anglo American).

Potential conflicts take many forms, but all center around a banker's motivation, conditioned by a bank's need to make profits.

For example: Is a banker pushing a client to structure a deal a certain way not just because it makes sense for the deal but because it will bring in larger fees for the bank? Is there more incentive for a banker to remain loyal to his client or to his colleagues, whose own fee performance could determine how they rate the relationship managers when it comes time for the bank to dole out bonuses?

But the idea of conflict-free advice only goes so far, argues Rob Kindler, head of global M&A at Morgan Stanley. "There are virtually no [large] transactions where a boutique firm is the sole adviser," he says. "Boutiques are unable to provide a client the most important advice, and that is capital market advice."

And while the pitch about conflicts is essential to the boutiques' success, some corporate dealmakers don't see conflicts as a huge issue. "There's been an increasing level of maturity about handling conflicts of interest," says Siemens' Meyers. "As you always must with any adviser, you have to think critically and very analytically about the advice you're getting and whether you want to act inconsistently with the recommendation of your most trusted adviser."

The value corporations place on bankers' expertise seems as cyclical as deal activity in general, says Jim Woolery, an M&A partner with Cravath, Swaine & Moore LLP. "In a boom, people tend to view the adviser role as more commoditized. Then we run into a crisis -- and hopefully this is the mother of all crises -- and there is a flight to quality."

He adds that many boards and executives were burned by deals that blew up in the aftermath of the credit crisis, which has made companies more interested in what could go wrong than in closing a deal at all costs. This requires advisers and boards that can work together, even as they protect their own interests. "Good advisers can explain anything no matter how complicated it is," he says. "And good board members won't go forward with something unless it can be explained to them in a way they can understand."

And, in a global environment in which innovation and growth are paramount, even some corporations that have most often relied solely on their in-house transaction expertise seem to be more open to turning to the traditional M&A gatekeepers for advice.

"While we haven't had a pattern of using banks, I think the nature of the environment, the ways things are evolving competitively in M&A in our spaces, we'll be open to using banks more than we have before," says IBM's Mendoza. "I think we could certainly go out and get a lot more insight and a lot more help from these guys than we have in the past in a way that doesn't detract at all from the internal capabilities but supplements them."

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