Analyst following during mergers and acquisitions

Master Thesis

in

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Executive Summary

Hypothesis

A M&A transaction clearly changes a company's operations, but it will also impact the information environment of the acquirer and the target. Thus, analysts face the decision whether to continue, initiate or drop coverage after the M&A. The following master thesis studies security analysts' behaviour during M&A. It thereby investigates analyst following on aggregate level as well as on individual level. *Four* different group of analysts are distinguished, namely *acquirer analysts*, *target analysts*, *cross-cover analysts* and *new analysts*. Additionally, for each analyst group different coverage decision models are hypothesised and later empirically tested.

Methodology

A sample of US M&A transactions from 1994 to 2007 is used to empirically study analyst behaviour around M&A. Four models are employed to investigate analyst behaviour. First, a *level regression model* is adopted to check for pattern changes in aggregate analyst following in the years around the M&A announcement. In order to account for the well-documented phenomena of inertia in analyst following, the level regression model is further improved by including the *lagged dependent variable*. A *change model* is applied to explain the observed changes in aggregate analyst following after the M&A. Finally, four different *choice models* - one for each analyst group - are employed to study the decision making process on individual level. Furthermore, this study considers the decision making process on *analyst* and on *broker house level*.

Results

Analyst following of the acquirer - on average - increases in the years after M&A. Although, the change can be partly explained by the increase in the market value of the acquirer. Moreover, analysts seem to consider the *quality* of the target measured by previous recommendation levels. In line with theory, ownership stability is negatively associated with analyst following and low priced equities are generally prefered by analysts. Cross-cover analysts are significantly more likely to retain coverage after the M&A than acquirer analysts, especially in cases of conglomerate mergers as they can take advantage of their cross-cover knowledge. Target analysts are more likely to initiate coverage on the acquirer when the acquirer operates in the same industry or when the target will constitute a considerable part of the new entity. Furthermore, target and new analysts take into account the number of analyst already following the acquirer when making their coverage decision.

Conclusion

The coverage decision for each analyst group do indeed differ significantly. In particular, target analysts and new analysts seem to *herd*, which could be contributed to a *signaling effect* (lucrative business) or to a *peer pressure effect* (must-covers). Furthermore, these findings suggest that new analysts are attracted by acquirers, which possess a favourable assessment by other analysts. This supports the *self-selection theory* in the context of M&A. In line with previous research, the prevalent intertia in analyst following does indeed alter inference results. Thus, it remains important to account for the autoregressive nature of analyst following, even in the presence of corporate events such as M&A.