Companies Rewarded for All-Cash Deals

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U.S. corporations are learning that it's impossible to hide $1 trillion in cash on their balance sheets. Both investors and bankers alike are clamoring to get their hands on it.

Today, Jim Woolery, North American co-head of M&A at J.P. Morgan, makes his pitch for why companies are well served using some of that cash to make acquisitions. His argument: right now, markets are rewarding those that do. (Woolery's research can be found here at the Harvard Law School Forum on Corporate Governance and Financial Regulation blog.)

Woolery, of course, has a vested interest in pushing this line of thought, but the data he presents seems to bear out the basic thesis.

All-cash deals represented 62% of all M&A done in the first three months of the year. Among those, the median acquirer saw its stock rise around 16% in the 30 days following the announcement of the deal, Woolery notes. The median was a share price drop of 1.5% in all stock deals and a drop of 1.4% in stock and cash deals among acquirers.

The reason for the positive reaction to all-cash deals, according to one hedge fund investor, is straightforward.

"In a world where cash is yielding 0%, every cash deal is massively accretive," he said. "Today, if there's an all-cash deal that's not 10% accretive, you have to raise your eyebrows and wonder what is wrong."

Stock deals, on the other hand, are generally dilutive for shareholders, making them leery of such deals.

But Woolery says that isn't the whole story.

"Accretion isn't the overall governor [of market reaction]," he said in an interview. "It's about strategic logic." As an example, Woolery points to this biggest deal for J.P. Morgan so far, AT&T's proposed $39 billion acquisition of T-Mobile. That deal was for both cash and stock, and AT&T doesn't expect it to become accretive to earnings until the third year after the deal closes. Yet, 30 days after announcement, AT&T's stock has risen more than 7%.

Of course, not every all-cash deal is met with enthusiasm. Take Microsoft, for example. Although the company used cash trapped overseas to make its $8.5 billion acquisition of Skype, its shares have fallen about 5% since the deal was announced last week. Financing does not appear to be at issue. Instead, investors have complained about Microsoft's relatively sparse M&A track record, the fact it is moving outside its traditional areas of expertise, and the high price it paid.

Cash, while king, can't cure all.