Mergers and Acquisitions: What Investors Need to Know

Mergers and acquisitions, or M and A, refers to the consolidation of companies through various types of financial transactions. Although they're often used interchangeably, they mean slightly different things. A merger occurs when two companies combine to create one organization. For example, Exxon and Mobil merged in 1999 to form a new company, ExxonMobil.

An acquisition, on the other hand, refers to the purchase of one company by another where the purchasing company obtains majority ownership in the target company. For example, Amazon acquired Whole Foods in June of 2017. But both companies preserved their names and organizational structures after the deal was finalized.

Over the last century, there have been multiple waves of M&A activity in the U.S. The recipe for M&A usually involves **cash-heavy companies** and **low interest rates**, allowing companies to more easily pay for deals. Also, when demand for their goods and services slow, companies might look to grow through M&A, rather than organically. Conversely, **high interest rates** and an **unfriendly regulatory environment** have the potential to slow down M&A activity.

Companies do M&As for a number of reasons: to increase performance, decrease costs, diversify their business, or **to grow market share** by buying a competitor. Do all mergers and acquisitions work out for the best? Not quite. In 2001, America Online combined with Time Warner in a massive 165-billion-dollar merger. The new company, AOL Time Warner, **sought to capitalize** on the convergence of mass media and the internet. Shortly after the merger, **the dot-com bubble burst**, causing the company's AOL division to lose significant value. In 2002, the company reported a massive loss of 99 billion dollars.

In an acquisition, once plans are made public, the acquiring **company's stock price** typically declines, while the target company's stock price often rises near the expected deal price. But this isn't always the case. When Amazon agreed to buy Whole Foods for $42 per share, Whole Foods jumped from $33 to $42, gaining more than $9. Amazon stock also gained, opening $32 higher. As a **shareholder**, the decision to hold or sell stock before a deal is final can be tricky. It's always possible that the deal may fall through, likely erasing any gains. However, other companies may **jump in and bid a higher price** for the target company. This may result in a **"bidding war"** and drive the stock's price even higher. So, what happens if you own stock in a company being acquired? You could receive cash for your stock, a combination of cash and stock, or another form of compensation.

It's important to note that every deal is different. Be sure to check the investor relations page of both companies and contact your broker with any questions. With any trade, there are always **inherent risks**. Trading companies involved in mergers and acquisitions could result in a substantial profit, or a substantial loss, in a short time frame. Make sure to do your research and assess risk before making a decision.