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A Deal Too Far – The Case of the Killer Acquisition

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A Deal Too Far – The Case of the Killer Acquisition

Abstract

Merger and acquisition transactions are often explained and justified by reference to their potential capacity to generate value – for example through the achievement of operational synergies, critical scale or optimal scope. In contrast, a significant and growing literature questions the worth of acquisition transactions as value generating devices, and the motivations of managers who initiate them. This literature sheds light on the impact of corporate acquisitions by pointing to evidence of the consistent failure of significant numbers of such transactions to generate improved shareholder value, and, concomitant with this, the loss of shareholder value which often results. In some transactions however, the loss of value attributable to acquisitions is of such a magnitude that it threatens the continued existence of the firm initiating the purchase – a phenomenon which has to date attracted comparatively little attention. This paper provides insights into the "killer acquisition" phenomenon by means of a detailed review of one such transaction, the acquisition of Australian bulk wine producer Cranswick Premium Wines by Australian boutique producer Evans & Tate Limited. The analysis demonstrates how factors such as failed governance arrangements, lack of due diligence, pursuit of an inappropriately sized target and failure to appreciate the impact of a shifting strategic environment can transform the adverse value consequences of an acquisition transaction from regrettable but manageable to existence threatening within a short timeframe.

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Introduction

Mergers and acquisitions have long been and seem likely to remain objects of fascination within the world of finance. Whilst scholars puzzle over the theoretical motivations and value impacts of such transactions, practitioners devote their efforts towards the end of fuelling what has again become a burgeoning juggernaut[1]. The result of these twin streams of effort has been the creation of an unresolved though clearly important paradox.

Many researchers interested in mergers and acquisitions have expressed deep scepticism as to the fundamental rationale for undertaking acquisition transactions (Roll's "hubris hypothesis" being perhaps the best known exemplar of this trend), arguing that there would be far fewer such events if shareholder value creation was their true aim. They have also gathered large quantities of empirical evidence which at very least raises serious doubts as to the likelihood that acquisitions generate value for the buying party (Sudarsanam, 2003).

This is not to say that the literature on acquisitions does not throw up examples of acquisitions which have been apparently well motivated or which, irrespective of motivation appear nonetheless to have resulted in the generation of net increments to economic wealth for acquiring parties. Indeed, some recent analysis suggests that there are three key reasons why the results of empirical studies into the performance effects of acquisition transactions have shed such a consistently dim light on them. First, the wrong transactions were being studied – with many small transactions being excluded from the datasets being used by researchers. Second, the wrong measures of performance were being used and third, the wrong measurement timeframes were being adopted (Harding & Rovit, 2004).

Despite the foregoing, it is not to an examination of the preconditions for value creation in acquisition transactions that this paper turns. Instead, the focus lies on transactions which lead not just to value dissipation for acquiring parties, but which result in such a profoundly negative outcome that the fact of the consummation of the transaction actually results in the onset of financial distress and potential liquidation for the newly enlarged firm. We refer to this as the killer acquisition problem.

Of course, pre-existing literature has hinted at this problem. Sirower's (1997) elegant analysis of the so called synergy trap in acquisition transactions certainly points to the issue. He conceptualises acquisitions as a special case of the capital budgeting problem, in which the question of value creation or destruction resulting from each transaction is most forcefully explained by balancing the present value of any premiums paid to effect change of control against the present value of any synergies resulting from the combination.

Viewed through this lens, were the value of the premium paid to effect an acquisition sufficiently large in the context of the financial resource base of the acquiring firm, and the synergies (if any) sufficient delayed[2], it is possible to conceive of financial

distress as one outcome for the acquiring firm. But beyond reference to excessive premium for control and lack of timely synergy realisation, this approach fails to yield a more clinical set of factors upon which to found a reasonable expectation of financial failure of the type examined here.

Similarly, though previous literature has cited a range of factors which appear to be significant in differentiating the characteristics of those acquisition transactions which fail (that is, destroy value) from those which succeed, including; relative size of target and acquirer, strategic relatedness, acquirer track record, combined entity market power, whether domestic or international and form of consideration (to produce a non exhaustive list), little attempt has been made to study factors which are likely to be associated with catastrophic outcomes for acquirers. (Agrawal et al, 1992; Franks et al, 1991; Healy et al, 1997; Jensen & Ruback, 1983).

Therefore, this paper contributes to the literature by focusing on a specific under researched phenomenon, the catastrophic or killer acquisition, and the factors which are associated with such events in particular as opposed to value dissipating transactions in general. Given the lack of a substantial extant literature, a case methodology is employed as a means of yielding insights with a capacity to contribute to the development of a more theorised approach to the understanding of the phenomenon at hand (Yin, 1989).

The remainder of the paper is organised as follows. Section two provides an overview of and background to the focal case organisation, Australian wine producer Evans & Tate Limited. Section three explores a sequence of acquisition transactions undertaken by this company, their strategic context and impact on Evans & Tate. Section four focuses in specific detail on one of these acquisitions, the company's 2003 purchase of Cranswick Premium Wines. This section of the paper outlines suggested explanations both for why the transaction itself was so dangerous and also of the particular traits of the acquiring entity which led it to pursue and consummate the deal notwithstanding its obvious risks. Section five contains a synthesis of the research and offers some conclusions in relation to the incidence of the killer acquisition phenomenon.

Overview of the Focal Company

Evans & Tate is an Australian based wine producer. The business was established by John Evans, Jan Evans, John Tate and Toni Tate[3] in 1971 with a small land holding in the Perth Hills. Within a short period of time the winegrowing potential of the then nascent Margaret River region[4] was recognised by the founders and by 1974 the company had expanded to include operations at Redbrook, situated within the Margaret River district[5]. In the years that followed, the company successfully established a number of key brands which still remain an important element of the business[6].

Though the Evans name precedes the Tate name in the company's title, the destiny of the company has for the greater part of its lifespan rested with the Tate family, the Evans interests exiting the business in 1983[7]. This dominance was cemented firmly into place in 1987 when Franklin Tate, son of founders John and Toni, joined the

company[8]. At that point, the business was a minnow, with annual sales of just $700,000[9]. By 1992, with the business growing rapidly, Franklin Tate was elevated to the role of Managing Director. By 1995, annual sales had reached $5 million then doubled again to $10 million by 1998[10].

Though the years to 1998 had seen the transformation of the company from minnow to substantial commercial enterprise, the following year represented a watershed in the organisation's history. By 1999 the company had swallowed Margaret River rival Selwyn Wines, owned 260 hectares of prime Margaret River vineyards[11], two fully equipped wineries[12] and was achieving annual sales of $12 million. Most significantly, Chief Executive and Chairman Franklin Tate determined that the time was ripe to transform the family business into a listed public company.

This was achieved through the execution of a successful, fully subscribed initial public offering which closed in late December 1999, pursuant to which the Tate family sold 42% of their holdings and the company raised a total of $26 million. At the close of the first day of trading, IPO participants had achieved stagging profits in the order of 20%, and the freshly listed company enjoyed a market capitalisation of slightly more than $50 million.

Though the business had experienced rapid growth during the 1990s, that had come off a very low base. Even at the time Evans & Tate made the leap from family to public company, it could still be best thought of as a parochial niche producer. More than 90% of its sales at that stage were restricted to the State of Western Australia[13]. Yet only half a decade later, the firm's asset base would have ballooned approximately tenfold, from $26 million to $272 million[14] and its revenue flows would have increased by a similar factor, from $12 million to $104 million.

In that same period, the company would be transformed from an organisation filled with brash optimism to one so ridden with financial disease as to be a heart beat away from death. The broad brushstrokes of Evans & Tate's trajectory in its post listing era are encapsulated in Tables 1 and 2 below. The first sets out details of the company's revenue and earnings history as a listed vehicle, while the second provides insight into the size of the firm's asset portfolio and financing strategy.

Table 1 – Evans & Tate – Post Listing Revenue and After Tax Earnings History

Year	Revenue $	Year on Year Growth %	After Tax Earnings $	Year on Year Growth %
1999	$12,335,000	24%	$701,000	n/c
2000	$19,718,000	60%	$2,376,000	238%
2001	$29,269,000	49%	$2,682,000	13%
2002	$30,200,000	3%	$2,925,000	9%
2003	$63,143,000	109%	$4,431,000	51%
2004	$101,643,000	61%	$7,624,000	72%
2005	$104,123,000	3%	($49,800,000)	-750%

Table 2 – Evans & Tate – Post Listing Asset and Liability History

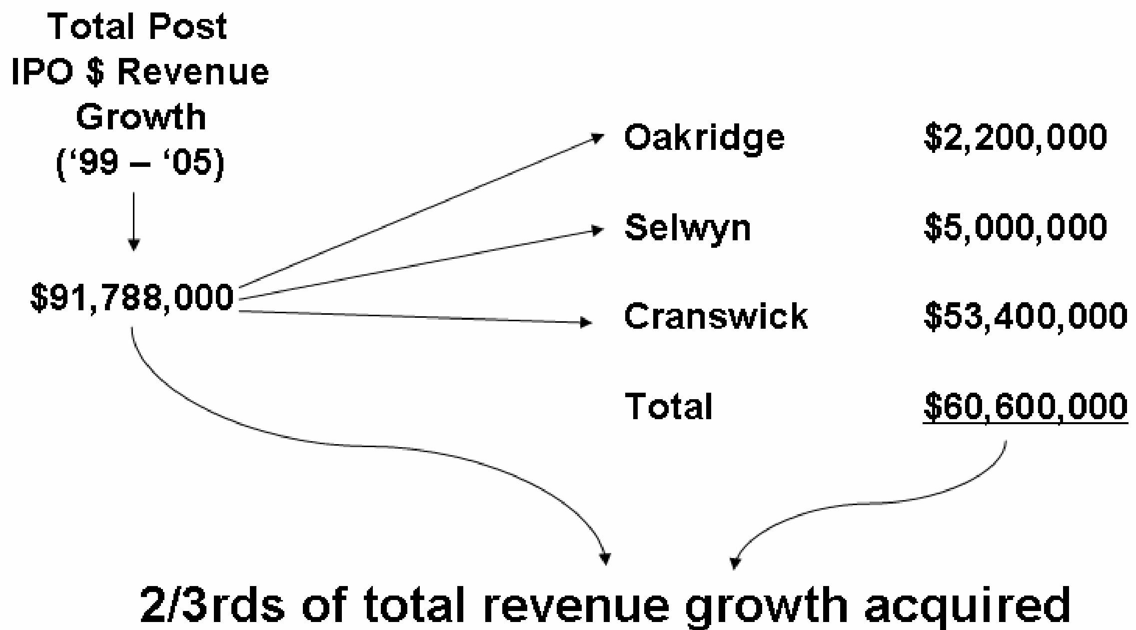
Year	Total Assets $	Year on Year Growth %	Total Liabilities $	Year on Year Growth %
1999	$26,124,000	n/c	$16,581,000	n/c
2000	$44,545,000	71%	$18,826,000	14%
2001	$53,929,000	21%	$36,144,000	92%
2002	$80,353,000	49%	$48,237,000	33%
2003	$201,796,000	60%	$148,203,000	207%
2004	$215,408,000	7%	$138,881,000	(6%)
2005	$272,401,000	26%	$164,363,000	18%

A number of trends become quickly evident even after a brief review of this data. First, the firm's revenue grew by a cumulative total of approximately 750% between 1999 and 2005. Over the same period, the firm's asset base grew by approximately 940% while liabilities expanded by 890%. Put simply, between 1999 and 2005, the firm massively increased gearing in order to fund a substantially enlarged though obviously underperforming asset portfolio. The result was a loss in 2005[15] of $49.8 million, or $2.50 for every dollar in post tax profits earned by the company in sum between 1999 and 2004 (inclusive).

Clearly, the story of Evans & Tate between 1999 and 2005 was of rapid and ultimately deeply unhealthy growth. But the firm's growth was of a particular character. As Figure 1 shows, though part of the firm's expansion was organic, the dominant portion of it stemmed from the firm's acquisitiveness.

Specifically, during the period under review, the firm made three acquisitions. First, Selwyn wines, another Margaret River producer, second, Oakridge Estate, a tiny Yarra Valley concern[16], and finally Cranswick Premium Wines. Figure 1 shows the revenue of each of these acquired firms at the time they were purchased by Evans & Tate, juxtaposed against that firm's total revenue growth between 1999 and 2005.

Figure 1 – Source of Growth



As will be evident from the data above, the firm's post IPO story was dominated by its involvement with a string of acquisitions. However, those acquisitions were not of a consistent character, and one in particular, the 2003 purchase of Cranswick Premium Wines, was of such a magnitude - both in an operational and financial context, that it had the capacity not only to transform Evans & Tate – but also to sow the seeds of that firm's downfall were all not to go to plan. It is to this possibility and the reasons for it that the next section of the paper turns.

A String of Acquisitions

Prior to the initial public offering and acquisition of the Selwyn wine business, Evans & Tate could be best characterised as a vertically integrated[17] boutique producer of premium, super premium and ultra premium branded bottled wine (with greatest emphasis on super premium products)[18]. However, over the course of the next four years, the company metastised into an organism vastly different in scale and emphasis to that which had been profiled to investors in the 1999 IPO.

This change began with the Selwyn acquisition, which Evans & Tate rationalised as a key plank of its strategy to develop a meaningful non branded wine operation[19]. This business differed somewhat to that which the company had previously developed, in that its central economic tenet revolved around volume, not margin.

The Selwyn acquisition also resulted in a vineyard management business being bolted onto the pre existing wine making business, creating a service revenue stream to accompany the company's product based revenue streams[20]. However, on balance, the acquisition was not of a character or of a size which would result either in a

fundamental transformation of the Evans & Tate business or result in a significant threat to it.

The total value of the Selwyn transaction, at approximately $6 million was small in comparison to the level of resources available to Evans & Tate. Further, the physical assets acquired (principally vineyards and wineries) were similar in character an physically closely proximate to Evans & Tate's existing operations[21].

Some further change to the business mix came with the company's subsequent decision to acquire the entities which undertook the distribution of much of its production in key markets. Thus Evans & Tate acquired U.S distributor Scott St. Portfolio[22], European distributor Australian Wineries UK[23] and finally Australian distributor WineSource[24]. No data published by the company provides insight into the contribution of this group of businesses as a standalone segment to the overall profit or loss of the Evans & Tate group. However, since these businesses are essentially predicated on assisting the company to sell its own product, it can be assumed that they play a useful, though auxiliary role in the context of the group overall.

After digesting Selwyn, Evans & Tate engaged in two further acquisitions of wine production businesses. The first involved the acquisition of Oakridge Vineyards Limited in 2001. This deal gave Evans & Tate access to a small winemaking facility[25] and vineyard located within the premium Yarra Valley district of Victoria (and thus a degree of geographic diversification), but was otherwise unremarkable[26]. Oakridge was a tiny operation and the total consideration paid to effect its acquisition was in the order of $2 million – a relatively immaterial sum in the context of Evans & Tate's operations at that time.

This lay in stark contrast to the company's acquisition of Cranswick Premium Wines, via a scheme of arrangement completed on 17 March 2003[27]. Cranswick was a volume giant compared to Evans & Tate (even after the incorporation of Selwyn and Oakridge). In the year ending June 30 2002, Cranswick produced over 1.9 million case equivalents and crushed 41,500 tonnes of grapes at its two wineries[28]. Cranswick owned 390 hectares of fully developed vineyards located across sites located mainly in NSW and Victoria[29] - a transcontinental distance from Evans & Tate's key operations. Evans & Tate, by comparison, crushed approximately 7,500 tonnes of grapes and produced approximately 500,000 cases of wine in the same period, and owned developed vineyards less than a quarter of the total size of Cranswick's holdings.

Scale though, was not the chief difference between the two businesses. Indeed, aside from the fact that both organisations produced wine, there were very few points of similarity. Whereas the pre Cranswick Evans & Tate business had defined itself as a dominant player in the very small (though lucrative), highly brand driven Margaret River niche, Cranswick produced downmarket product which appealed to consumers more on price than on any other dimension[30]. Evans & Tate had been a domestic sales success, achieving almost 90% of its sales in Australia[31], while Cranswick was highly export focused and had built up a viable distribution structure in the United Kingdom and Europe[32].

Vast distance, differences in scale, production techniques and brand propositions between the Evans & Tate business and Cranswick are all factors which in all likelihood would have conspired to reduce the size of potential synergies arising upon combination of the businesses. However, as troubling as these issues may have been in and of themselves, it was the financial dimensions of the Cranswick acquisition which most strongly signalled the potential for dangerous after effects.

The first announcement that Evans & Tate and Cranswick were in merger negotiations came in early June 2002. By August, Evans & Tate reported that the purchase due diligence process was proceeding well, and that the putative value which would be placed on Cranswick for the purposes of the acquisition would be approximately $57 million.

However, by September, Cranswick had been forced to make a range of embarrassing confessions about its financial position – including that it would make a full year loss of $23 million, having suffered declining revenues, the after effects of the liquidation of its distribution arm and a range of impairments to key asset categories, including inventories and intangibles.

Despite this, and extensive press speculation that Evans & Tate would walk away from the proposed deal in light of these revelations, the fact of Cranswick's wounded position only seems to have hardened the resolve of Evans & Tate to consummate the transaction – albeit at a lower price than had originally been contemplated – the value of the proposed deal being reset to approximately $45 million by late September. Ultimately, it was for this price that Evans & Tate acquired Cranswick the following March – and it is to the detail and context of this transaction that the next section of the paper turns.

Exploring a Killer Deal

Though Evans & Tate attempted to cast its acquisition of Cranswick in a positive light, the truth of the matter, ultimately revealed two years after the consummation of the deal was that it had in fact acquired a business so flawed in a transaction of such scale that its own financial existence was subject to question[33]. Cranswick's business model was to produce and sell high volumes of relatively low margin product, primarily into export markets. While achieving the first of these objectives, the margins it had generated on this business were so thin as to place the long term financial viability of the business in jeopardy.

Thus, in purchasing Cranswick, Evans & Tate had extended itself financially to purchase a firm which controlled impaired brands and was generating negative cashflows by reason of poor working capital management. Prior to its acquisition of Cranswick, Evans & Tate had reported small though consistently positive net cash inflows from operating activities. After the transaction, the firm's cashflow position rapidly haemorrhaged, as margins fell and stock turn remained unacceptably low. The substantial alteration to the Evans & Tate's financial affairs post Cranswick (2003 and after) compared to the pre Cranswick (2002 and before) position is well captured in the data set out in Table 3 below, which includes information pertaining to revenues and margins on a per case sold basis, as well as the over all stock turn position of the firm.

Table 3 – Evans & Tate – Key Financial Indicators

Year	Revenue Per Case	COGS Per Case	Interest Per Case	Gross Margin Less Finance Costs Per Case	Inventory Days
2000	$144	$73	$5.82	$65.18	486
2001	$99	$53	$3.67	$42.33	577
2002	$96	$51	$4.73	$40.27	602
2003	$70	$43	$4.04	$22.96	687
2004	$61	$35	$5.34	$20.66	698
2005	$58	$40	$5.53	$12.47	657

The disjuncture between the firm's position pre and post Cranswick is stark. Not only did margins fall dramatically, but the average holding interval for stock widened by an appreciable margin – despite Cranswick being in the business of producing wines not requiring extensive maturation or cellaring prior to sale.

Whatever else might be said about the transaction, it certainly cannot be argued that Evans & Tate could only have been in a position to learn of the poor state of Cranswick's finances until the post completion period. As discussed previously, Cranswick actively signalled its situation soon after Evans & Tate began merger talks, by reporting a very substantial operating loss, negative cashflows from operations and material inventory and intangible asset impairments.

These were unlikely to have been transient events – on the contrary, they were anchored firmly in a series of industry trends whose momentum and import ought to have been obvious to all who chose to contemplate them. Data published by the Australian Bureau of Statistics (set out in Table 4, below) tells an eloquent tale of an industry gripped by increasing competition on one side while dogged by sustained overproduction on the other. This, combined with a fundamental reshaping of the liquor retailing in scene in Australia, such that market power was dramatically transferred from producers to two key retail groups which had grown their share of the trade tenfold over the space of less than a decade spelt a period of substantial turmoil even for well financially balanced operators.

Table 4 – Key Industry Trends

Year	Wine Producers	Cases Produced	Domestic Case Sales	Export Case Sales	Inventory Estimate Cases
1999	1,104	94,571,444	38,816,556	24,016,556	121,064,778
2000	1,197	95,462,889	41,030,111	31,659,444	132,421,222
2001	1,318	119,615,333	42,760,778	37,587,667	152,987,111
2002	1,465	135,596,889	42,914,667	46,488,111	174,504,000
2003	1,624	120,665,000	44,719,889	57,626,889	175,760,333
2004	1,798	163,469,778	46,375,333	64,933,000	206,056,222

Thus, all other things being equal, the better view of the transaction must be that Evans & Tate pursued the matter with its eyes wide open. This raises serious questions about the strength of the control and governance systems and processes in place at Evans & Tate in its post IPO period, and whether these had changed sufficiently substantially to measure up to the challenges associated with the firm's 1999 metamorphosis from family owned to public corporation. Arguably, the lack of a strong capacity to rationalise the Cranswick acquisition on either operational or financial grounds suggests that an alternate explanation for the deal lies in the phenomenon of governance failure.

Of course, the quality of a firm's governance is inherently more difficult to judge, especially only with the benefit of publicly available information, than dimensions of an organisation's performance such as the financial outcomes it generates. Yet enough circumstantial evidence in relation to quality of Evans & Tate's governance does exist to facilitate contemplation of the impact of this matter on the decision trajectory exhibited by the firm.

Review of the available evidence suggests several areas for concern. The first of these is the apparently unchallenged position of Evans & Tate's cornerstone shareholder, chief executive officer and board chair, Franklin Tate. Having assumed the role of CEO in 1992, Tate also took on the task of chairing the company's board from 1999 onwards.

The board he assembled was small in size (fluctuating between just four or five members in total) and poorly balanced. Tate was the only executive director, and to ensure the continuity of his capacity to control the board, his wife Heather acted as an alternate non executive director. Further, the skill mix brought to the table by the board's members was constrained – dominated by those with a legal background, but devoid of strong financial, industry and marketing experience.

This weakness at the board level seems also to have been replicated in critical areas of the firm's internal management. For example, between November 2003 and January 2006, the firm had four different CFOs, an unusual degree of turnover in such a critical role. Further, the lack of strong board financial experience coupled with a lack of continuity in the CFO role may have rendered Evans & Tate less capable of independently assessing the nature of advice tendered to it by key outside stakeholders, such as its primary creditor, ANZ bank, which was directly and indirectly involved in all of the acquisition transactions undertaken by the firm in its post IPO guise.

In particular, it seems relevant to note that ANZ had been a creditor to the financially weak Australian Premium Wines when in 1999 it assisted Cranswick to purchase that company, and was a creditor to both financially weakened Cranswick and Evans & Tate when the latter acquired the former in 2003. ANZ's investment banking arm had also played a key role in Evans & Tate's 1999 IPO, the acquisition of Selwyn wines and of Oakridge estate.

This dominant lending and advisory role serves at very least to raise questions about the possibility that there existed asymmetries between the motivations of ANZ and Evans & Tate in entering into the string of transactions which both were mutually involved in, and, given the apparent weaknesses in latter's internal financial functions, the capacity of Evans & Tate to conserve its own interests in the face of the advice tendered to it.

Overall then, the available evidence seems to suggest that the dominant motivation for the transaction undertaken was the pursuit of growth. Evans & Tate chairman and chief executive Franklin Tate appears to have become intent on rapidly expanding the ambit of the firm's operations on a range of key dimensions (product portfolio, geographic scope, market reach) within a highly constrained time span. This desire led to the creation of a deep chasm between ambition and the resources available within the organisation to fuel the fulfilment of that ambition. It was a void which would, by necessity, be filled by debt propelled acquisition activity.

Elementary analysis suggests that during the three year period spanning the Cranswick acquisition (2002 – 2004), Evans & Tate's sustainable growth rate averaged 3.23% per annum, while over the same period, the firm's actual rate of expansion lay close to 50% per annum. Debt financing, almost exclusively provided and facilitated by ANZ provided the means of bridging the resulting financial void – yet, as has been demonstrated above, this significant increase in appetite for financial and operational risk came at a time when the market for Evans & Tate's products was being buffeted by an almost perfect storm.

The dangers associated with driving growth at rates substantially in excess of sustainable limits, rapid increases in leverage and the distractions associated with the need to manage large one off transactions such as acquisitions would normally be expected to place internal governance mechanisms on notice and elicit a counterbalancing response.

Yet in the case of Evans & Tate, it appears that this simply was not a meaningful possibility. The firm suffered from poor management systems and controls –

particularly in the key area of financial management. Meanwhile at board level, the range of skills required to effectively critique the quality of outside advice (e.g from principal creditors) and understand its ramifications was severely limited. There was no functioning counterweight to the influence of Franklin Tate – architect of the firm's strategy, cornerstone shareholder, chief executive officer and board chair. The rest, as they say, is history.

Conclusions

It is well known that acquisition transactions can represent a moment of considerable danger for those firms which use them as a method of embarking on a high growth trajectory. Largely however, the literature which has contemplated the propensity of acquisition transactions to result in value destruction for acquiring parties has not extended to a contemplation of value destruction so profound that it has the effect of threatening the ongoing financial viability of the acquiring party.

In distinction to most pre-existing literature, this paper has focused on this possibility in particular, and some of the phenomena which might prove responsible for its existence, of which three in particular emerge from the case analysis above. First, the financial condition of the target firm at the time the acquisition takes place. Second, industry conditions and trends contemporaneous with the acquisition, and third, the quality of the internal governance processes which act as a check and balance on deal proposals brought to the acquiring firm's board both by interested internal and external stakeholders.

Of these, we propose the third as the most important, since effective governance review would arguably result either in deal avoidance or appropriate price protection in relation to deals proposed where either or both of our first two nominated phenomena presented.

In the case of Evans & Tate however, it appears that there was little opportunity for effective checks and balances being brought to bear on deal proposals. In that firm, a dominant chief executive and board chair bent on growth found an ally in a financial services provider no doubt content to generate growing fee streams while assisting the fulfilment of that desire in conditions where neither other directors or internal finance executives appear to have been in a position to offer an effective counterbalance.

It may well have been the case that neither the Selwyn nor Oakridge acquisitions which pre-dated the Cranswick deal the subject of this analysis represented transactions motivated by a cogent investment thesis. Individually however, this would have been of relatively little importance in terms of the survival prospects for the acquiring firm, since both transactions were very small in scale.

The Cranswick deal was of a markedly different character. As a target, it was large in size compared to Evans & Tate. It had a highly geared balance sheet, poor cashflows and a portfolio of chronically underperforming assets. Its key operations were geographically remote from those of the acquiring business. Its customers were profoundly different in terms of their location, their product and pricing preferences. Being a primarily export oriented business, Cranswick was exposed to a plethora of

risks (for example currency risk) which would not have impacted the almost wholly domestically focused Evans & Tate business to any meaningful degree prior to the acquisition. And of course, the key competitors of the Cranswick business were not only far larger than the key competitors to the more boutique Evans & Tate operation – but also to be found all over the new world.

That so many obvious risk factors existed and would have been evident to a dispassionate observer contemporaneously with the consummation of the transaction raises serious questions about how such a deal could have been executed – for their exists an enormous gulf between a dangerous deal proposal, and a dangerous deal actually done. Our analysis has led us to the conclusion that the primary explanation for the fact of this deal was Evans & Tate's lack of, for want of a better term, a functioning immune system.

Where swarms of directors armed with pertinent questions about the strategy underpinning the transaction, its risk characteristics, financial simulations showing base case, worse case and best case scenarios for the impact of the transaction and the like should normally have surrounded the chief executive and his coterie of bankers and prevented their forward motion until satisfactory answers had been provided – there were none. There was nothing, in other words, to prevent the ingestion of pathogens into the body corporate. Once that state of affairs came into being, it was only a matter of time until opportunistic parasites happened upon and exploited a compromised host.

In this paper, we have scrutinised just one case in detail. However, this detailed contemplation has led us towards the development of propositions amenable for empirical testing aimed at the end of more comprehensively understanding the killer acquisition phenomenon.

In particular, we posit that firms with higher levels of turnover in key financial management positions – particularly the position of Chief Financial Officer, with unbalanced boards, with high reliance on a single financial services provider and with high CEO power concentration are more likely to be susceptible to this form of risk phenomenon than firms which do not share these characteristics. In consequence, it would be to these factors that we would suggest future researchers turn their attention as they seek to expand the boundaries of knowledge on the subject.

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Endnotes

[1] According to data produced by Thomson Financial Securities, the global value of completed M&A transactions totalled approximately US $3 Trillion, having increased at an annualised growth rate of 33% over the decade of the 1990s. The value of acquisition transactions completed fell sharply to US $1.2 trillion in 2002. However, Thomson Financial Securities estimates that the annualised growth rate in global acquisition deal total value since that time has been 46%.
[2] This assumes that positive synergies result from the deal. However, as some commentators note, it is also entirely possible that negative synergies flow from a business combination – for example loss of a key customer as a result of becoming the owner of a competitor firm. (Wasserstein, 2000).
[3] Evans & Tate Prospectus, 1999, p.1.
[4] The Margaret River region is located approximately 300 kilometres south of Perth, the capital city of Western Australia. Benefiting from a Mediterranean climate and excellent terroir, it is widely recognised as one of the premier wine growing districts in Australia. Wine produced in the Margaret River region is exported globally and commands premium prices.
[5] Presentation by Phillip Osborne, Evans & Tate Chief Operating Officer to Evans & Tate Annual General Meeting, 30 November 2004.
[6] These included: "Redbrook", "Gnangara" and the "Evans & Tate Margaret River" range.
[7] Evans & Tate Prospectus, 1999, p.1.
[8] His initial appointment as was sales and marketing manager.
[9] Evans & Tate Annual Report 2001, p.4.
[10] Presentation by Franklin Tate, Evans & Tate Chairman and Chief Executive Officer to Evans & Tate Annual General Meeting, 6 November 2003.
[11] Approximately 80 Hectares of this total was under vine by the conclusion of 1999.
[12] These were: The Selwyn Winery – acquired in 1999 and a new purpose built winery built on the Lionel's vineyard site in 1999. The two facilities were located approximately 1 km from each other.
[13] Considering that Perth, the capital of Western Australia is by far that state's largest population centre, but also holds the distinction of being the most isolated capital city on earth, the narrow niche filled by Evans & Tate at the time in question should be graphically evident.
[14] The actual reported value of total assets in the firm's 2005 financial statements was $215.8 million. However, this figure was derived after allowing for asset write downs to a total value of $56.6 million in the year ended 30 June 2005. Therefore, to facilitate consistent analysis, this sum has been written back to the balance sheet.
[15] The loss was triggered by substantial asset write downs.
[16] The Yarra Valley is one of Australia's premiere cool climate wine growing regions, with a particular reputation for excellent Pinot Noir. It lies very close to Melbourne, located to the very south of Australia's eastern seaboard. Flying time between Perth – the capital city nearest Margaret River and Melbourne, the capital city nearest the Yarra Valley is approximately 4.5 hours.
[17] That is, the company owned its own vineyards and winery and had on site access to bottling and packaging. Further, the company had developed a reasonable distribution and sales capability.
[18] These were, the ultra premium ($30 - $50 per bottle) Redbrook range, the super premium ($15 - $30 per bottle) Evans & Tate Margaret River range and the premium ($10 - $15 per bottle) Gnangara range.
[19] No cogent rationalisation for this "strategy" was ever stated within the prospectus.
[20] The viticultural services business represented approximately 3% of revenue in 2001, 8.5% of revenue in 2002, 5% of revenue in 2003, 5.5% of revenue in 2004 and approximately 5% of revenue in 2005 (all dates referring to financial year ends, not calendar year ends). Overall, this business does not represent a material element of the overall activity portfolio of the Evans & Tate group, and nor is the success or failure of the group (as configured) likely to turn on the performance of this element of the enterprise.
[21] The distance between them was approximately 1 Kilometre.
[22] L Gettler, (2002), "Wine Group Buys Taste of U.S Market", *The Age*, 14 March 2002, p. 3. The consideration paid was approximately AUD $625,000 in a mix of Evans & Tate shares and cash.
[23] A 49% share of the equity of this company was acquired when Evans & Tate took control of Cranswick Premium Wines in 2003. Subsequently, in 2004, Evans & Tate arranged to acquire the remaining equity in this business for reported consideration of AUD $2 million. See – L Gettler, (2004), "Evans & Tate Tightens Grip on UK Distribution", *The Age*, 27 March 2004, p.2.
[24] This transaction also took place in 2004, costing initial cash consideration of AUD $11 million with the possibility of additional payments to the vendors totalling no more than AUD $3.34 million contingent on the financial performance of the business in the years ending 30 June 2005 and 30 June

2006. As at the time of writing, a further $1.2 million dollars was payable to the vendors of the business under this variable consideration arrangement – see; Evans & Tate Limited, Running Sheet for AGM, 30 November 2005.

[25] Approximately 18 hectares in total of vineyards.

[26] The key assets of Oakridge were an 18 Hectare Vineyard, a modern purpose built winery capable of crushing 1100 tonnes of grapes per annum and the Oakridge Estate brand name. In the year of the acquisition, Oakridge produced approximately 54,000 cases of wine. By way of contrast, Evans & Tate produced more than 500,000 case equivalents in the same period. At the time of the acquisition, Evans & Tate's market capitalisation stood at approximately AUD $50 million, while the total value of consideration payable in respect of the Oakridge acquisition was in the range of $AUD 4 million. See – Scheme Booklet for the Scheme of Arrangement between Oakridge Vineyards Limited and Evans & Tate Limited, August 2001.

[27] See – Evans & Tate Media Release: Completion of Schemes of Arrangement, 20 March 2003.

[28] One winery was located in Mildura, the other in Griffith.

[29] See; Explanatory Statement for Schemes of Arrangement between Cranswick Premium Wines Limited in relation to the Proposed Merger with Evans & Tate Limited, December 2002, p. 44.

[30] Its most successful product, the "Barramundi" range – principally an export brand, was selling more than one million cases per annum by the time of the acquisition. This range was priced in the sub AUD $10 per bottle segment of the market. See; S Evans, (2002), "Cash Lubricates Tate, Cranswick Wine Merger", *Australian Financial Review*, 27 September 2002, p. 54.

[31] L Gettler, (2002), "Evans & Tate Merger Fails to Excite", *The Age*, 15 June 2002, p.3.

[32] J McCulloch, (2002), "Evans & Tate Chairman is a Family Man", *Perth Sunday Times*, 23 June 2002, p. 47.

[33] Indeed, post July 2005, Evans & Tate has survived principally for one reason – the fact that it has been propped up by its chief creditor, ANZ bank, without whose support the firm would undoubtedly be insolvent.