

Buffett on High Premium Acquisitions

Regardless of the impact upon immediately reportable earnings, we would rather buy 10% of Wonderful Business T at X per share than 100% of T at 2X per share. Most corporate managers prefer just the reverse and have no shortage of stated rationales for their behavior.

However, we suspect three motivations - usually unspoken - to be, singly or in combination, the important ones in most high-premium takeovers:

1. Leaders, business or otherwise, seldom are deficient in animal spirits and often relish increase activity and challenge. At Berkshire, the corporate pulse never beats faster than when an acquisition is in prospect.
2. Most organizations, business or otherwise, measure themselves, are measured by others, and compensate their managers far more by the yardstick of size than by any other yardstick. (Ask a *Fortune 500* manager where his corporation stands on the famous list and, invariably, the number responded will be from the list ranked by size of sales; he may well not even know where his corporation places on the list *Fortune* just as faithfully compiles ranking the same 500 corporations by profitability.)
3. Many managements apparently were overexposed in impressionable childhood years to the story in which the imprisoned handsome prince is released from a toad's body by a kiss from a beautiful princess. Consequently, they are certain their managerial kiss will do wonders for the profitability of Company T (target).

Such optimism is essential. Absent that rosy view, why else should the shareholders of Company A (acquirer) want to own an interest in T at the 2X takeover cost rather than at the X market price they would pay if they made direct purchases on their own?

In other words, investors can always buy toads at the going price for toads. If investors instead bankroll princesses who wish to pay double for the right to kiss the toad, those kisses had better pack some real dynamite. We've observed many kisses but very few miracles. Nevertheless, many managerial princesses remain serenely confident about the future potency of their kisses - even after their corporate backyards are knee-deep in unresponsive toads.

Warren Buffett, Berkshire Hathaway, Inc. 1981 Annual Report