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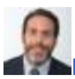
How to identify takeover targets for profits



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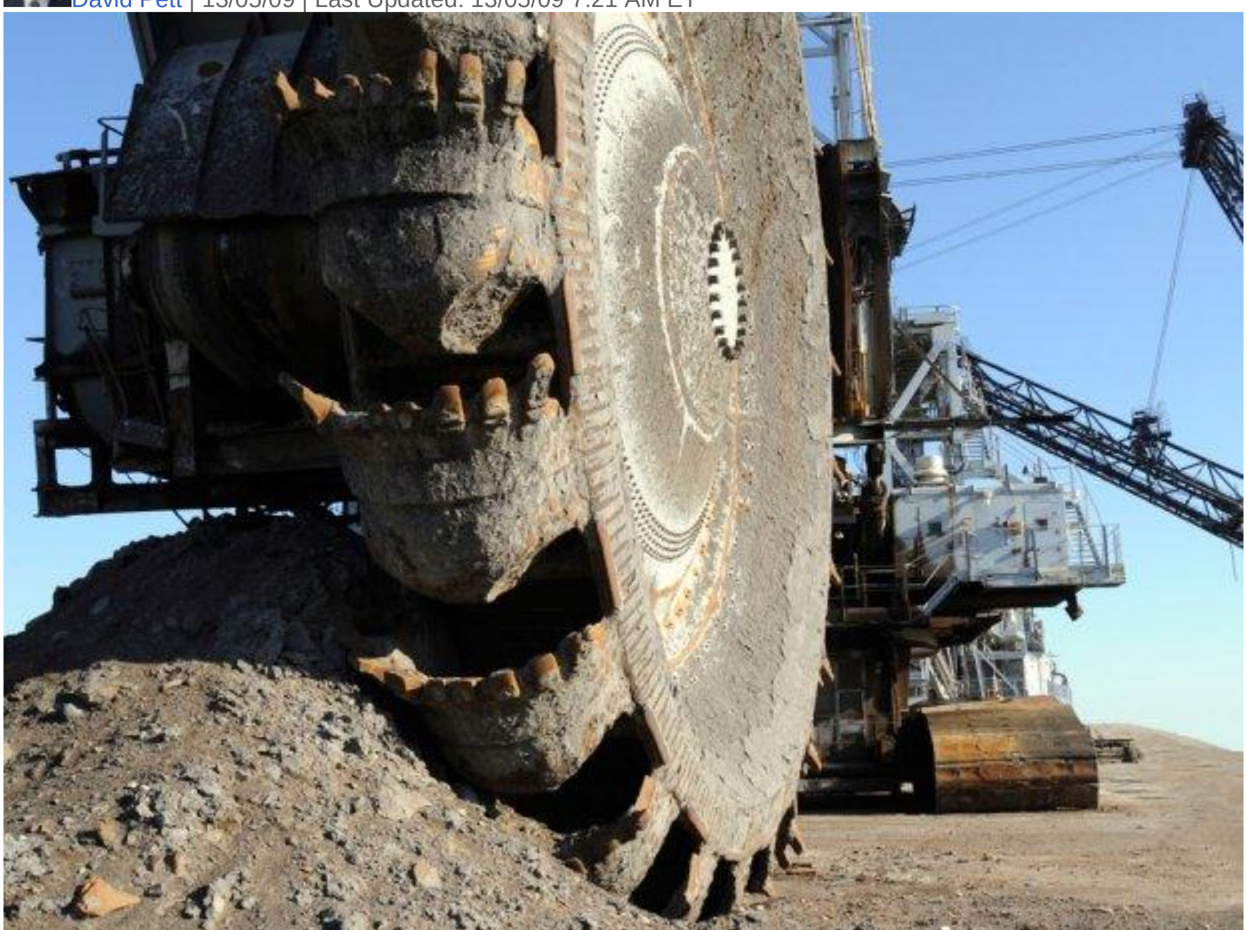

Despite the slowdown in Canadian mergers and acquisitions, there remains an opportunity for investors who take the time to evaluate potential takeover candidates, particularly within this country's junior mining sector.

The *Financial Post* takes a weekly look at tools that will help make your investment decisions. This week: How to identify takeover candidates.

Trying to identify potential takeover targets can seem like thankless work in a period of slower M&A activity, but getting it right just once can have a huge positive impact on portfolio returns.

“The advantage is that substantial profits can be made as takeovers tend to occur at a 38% to 54% premium to market,” said Peter Besler, an investment advisor at MGI Securities in Toronto.

“When buying undervalued securities, even if a takeover does not materialize, investors can still make a profit when the stock eventually starts to trade near its fair value.”

The number and value of mergers and acquisitions in Canada are down so far this year, said Mergermarket in a report late last month.

The research firm said 124 M&A deals worth US$14.4-billion happened during the first three months of the year, down from 140 deals worth US$35.5-billion a year ago.

Despite the slowdown, Mr. Besler said there remains an opportunity for investors who take the time to evaluate potential takeover candidates, particularly within this country’s junior mining sector.

“Oddly enough, this is an area that individual investors have an advantage,” he said. “They are much more nimble than institutional investors and can move in and out of a position a lot faster without affecting the market materially in most cases. And they have the luxury of being able to control the length of time they remain in an investment.”

Mr. Besler identifies targets in the mining space using several different criteria, including the credibility and potential of a company’s assets, as well as the uniqueness of its deposits.

Viable takeover candidates also tend to have favourable geographic and political backdrops, he said, whereby key infrastructure such as power lines, water, roads, or rail is nearby in order to reduce the acquirer’s costs and the risk of government appropriation is low.

Mr. Besler said it is also important to consider a company’s valuation. Comparing a company’s stock price against its enterprise value, reserve value and the discounted cash flow for producers or net present value for advanced projects can readily identify undervalued targets.

“Valuation of the target is No. 1 in importance,” he said. “It helps determine what upside may be available.”

Ultimately, Mr. Besler said it is necessary to know as much as possible about the takeover candidate, but investors should also research any of the potential acquirers as well.

“It’s like trying to play matchmaker between two single people,” he said. “You look at each person – in this case, the acquirer and the target – and see if each one has a need for each other.”