Analyst Sentiment around Takeover Announcements

Abstract

This paper studies the sentiment among financial analysts around announcements of mergers and acquisitions (M&As). Analyst sentiment is defined as the optimism or pessimism demonstrated by financial analysts in their earnings forecasts or their buy-hold-sell recommendations. We calculate financial analysts' revisions of earnings forecasts to capture analyst sentiment. We find that bidders are more likely to offer stock rather than cash in their takeovers when forecast revisions on their earnings are more favorable prior to their takeover announcements. We also find that the favorable earnings forecasts on stock bidders experience a downward swing subsequent to takeover announcements. Similarly, the industry peers of stock bidders also face more favorable pre-announcement earnings forecasts than the industry peers of cash bidders. However, the industry-wide pattern of forecast revisions persists even after bidders announce their takeovers. Finally, we find that stock bidders and their industries face more favorable forecast revisions compared to targets and their industries prior to takeover announcements. Our evidence suggests that a firm facing more positive analyst sentiment is more likely to offer stock as the means of payment in its takeover and that a firm facing more negative analyst sentiment is more likely to offer cash. This evidence is consistent with the market timing theory in Shleifer and Vishny (2003). However, our evidence cannot be fully explained by efficient market theories such as the asymmetric information explanation in Hansen (1987) and Fishman (1989).