Mergers & Acquisitions

Prof. Ian Giddy

A mini-course dedicated to the valuation, structuring, financing and negotiating of M&A transactions

- Evaluating and pricing acquisitions
- Identifying and implementing operational and control synergies
- Creating shareholder value through rigorous pre-merger analysis
- Negotiating the terms of the deal
- Post-merger restructuring and divestitures
- Financing the acquisition

The Course

This course uses an analytical framework and real-world applications to introduce the key principles and techniques of successful mergers, acquisitions, divestitures and leveraged buyouts. It addresses crucial questions including: Why do mergers that looked great on paper fail in reality? How does one value companies acquiring, or being acquired? What is the best negotiation strategy? What does it take to make the "synergy" come to life? How can a merger be funded in such a way as to retain the merged entity's flexibility? When do leveraged buy-outs make sense, and how can they be financed?

One goal for students is to develop a critical appreciation of the key finance criteria in a proposed acquisition, so as to grasp the main strengths and risks of the company's strategic and financial alternatives.

Course Requirements

There is no course textbook, although several recommended books are listed at the bottom of this page. Students will be provided with an online package of materials useful for analysis and structuring of merger and LBO transactions, including case studies, pertinent articles, rating agency reports and sample documentation from actual deals done in North America, Europe and elsewhere. Each student will be given the opportunity to demonstrate their understanding of deals through individual and group work and plenary discussions. Grading will be based on your class contribution, written assignments and an online final exam.

Pre-course assignment: Read the case study Houston Exploration, and be prepared to discuss it in class.

Issues for Discussion

- How should a target company be valued? How does the method of valuation
affect the availability of funds from banks, institutional investors and private equity investors?

- How can one assess the potential gains from an acquisition? How dependable are these projections, from an investor’s viewpoint?
- What are the key features of due diligence?
- How much money is needed for the transaction, including fees and restructuring costs?
- When should a company divest? What are the alternative ways of divesting a business?
- What are the key terms and conditions, covenants and pricing, of different sources of acquisition finance, including subordinated notes, mezzanine finance and high yield bonds?
- What are the essential features of leveraged buyouts? How can one structure the financing of an LBO to raise the funds needed without losing control?

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### Course Outline

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<tr>
<th>Session</th>
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| **One** | Corporate Finance, Strategy and the Economics of M&A | **Presentations**
|         |        | Mergers & Acquisitions: The Economics |
|         |        | Acquisitions: Strategy and Due Diligence |
|         |        | **Case Studies**
|         |        | Houston Exploration |
|         |        | The SBC-AT&T Merger |
|         |        | The Acquisition of Allied Colloids: Episode 1 |
|         |        | The Acquisition of Allied Colloids: Episode 2 |
|         |        | New York Magazine |
|         |        | **Articles**
|         |        | Getting Better at M&A? |
|         |        | Glossary of M&A Terms |
|         |        | Technology Mergers |
|         |        | Types of Mergers and Acquisitions |
|         |        | Sample Due Diligence Checklist |
|         |        | **Spreadsheets**
|         |        | sbc-att.xls |
|         |        | valuedrivers.xls |
|         | **Evaluating Acquisitions, and Undertaking Due Diligence** | **Evaluating Acquisitions, and Undertaking Due Diligence**
|         |        | What are the target's value-drivers? |
|         |        | Required performance improvements embedded in acquisition premiums |
Competitive conditions that must drive valuations
What due diligence can reveal – and what it cannot
The winner's curse and morning-after woes
**Case study: The Acquisition of Allied Colloids.** We trace the sequence of events in this cross-border merger and develop a due diligence checklist.
Tailoring due diligence to the company and industry
**Case study: New York Magazine.** What are the key aspects of due diligence in the publishing world?

### Two Valuation for Mergers and Acquisitions
- Asset-based and balance-sheet approaches
- Market value approaches
- Multiples and comparables
- Enterprise value and EBITDA
- Establishing required rates of return
- Free cash flows to equity
- Free cash flows to firm
- Dividend- and cashflow-discount models
**Case study: Active Generation.** Teams value a private company for acquisition, using both comparables and cash flow methods and incorporating the results of potential synergies
- Real option approach
- Distress situations
- Blank-check acquisition companies
**Application: Jamba Juice.** Where's the value added?
- Break-up valuation
- Synergy analysis
- Sensitivity analysis
**Case study: MTC-Celtel.** How can one value the synergies resulting from a potential acquisition, adjusting for risk and cost-of-capital effects and employing sensitivity analysis on the hoped-for synergy gains?

### Three Negotiating the Terms of a Merger
- Role of investment bankers and

### Presentations
- **M&A: Tools of Valuation**
- **M&A: Valuation Applications**
- **Case Studies**
  - *Actavis Valuation*
  - *Active Generation*
  - *Jamba Juice*
  - *MTC-Celtel*
- **Articles**
  - *Calculating a Company's Cost of Capital*
  - *Methods of Valuing a Business*
- **Spreadsheets**
  - *actavis_ev.xls*
  - *actavis_tcf.xls*
  - *actavis_valuation.xls*
  - *schirnding.xls*
  - *mergerssynergy.xls*
  - *bofafleetupdate.xls*
  - *active_generation_valuation.xls*
  - *mtc-celtel.xls*
- Developing a negotiating stance
- Understanding sellers' goals and constraints
- Dealing with defensive strategies: poison pills and other devices
- **Mini case study: Goldfield's Anti-takeover Defenses**
- Dealing with rival bidders
- Dealing with private owners
- Structuring the deal: How much should we pay? How should we pay?
- The proposed basic Term Sheet
- Keep the romance alive during due diligence and while you secure financing
- Closing the deal
- **Case study: Ashanti-Bogoso.** Teams engage in a hands-on negotiating exercise including valuation, setting the price and payment terms of the merger, and negotiating control

### Four Divestitures

- Post-acquisition divestitures
- Measuring and managing break-up value
- **Application: John Deere - Breakup Value**
- Taxable and tax-free corporate breakups
- Before-and-after divestiture analysis
- **Case study: Pinault-Printemps-Redoute.** We learn how to perform a before-and-after divestiture valuation

### Five Acquisition Finance

- Finding the optimal capital structure: debt, equity or mezzanine?
- Capital structure considerations
- **Case study: Photronics.** Financing acquisitions at a technology company
- Senior secured bank financing
- Asset-based finance
- Bridge financing
- Second-lien and PIK notes
- **Application: Jefferson Smurfit acquisition finance**
- Subordinated seller notes
- Mezzanine debt
- Refinancing strategies
- High-yield bonds
- Private equity sources
- **Case study: Le Meridien.** Students evaluate a variety of creative financing techniques in the context of this challenging acquisition situation.

### Six Leveraged Buy-Outs

- The different approaches of financial vs strategic buyers
- The leverage effect
- How to structure and price the leverage for an acquisition or buyout
- **Exercise:** spreadsheet-based debt capacity analysis for leveraged finance
  - Focus: synthetic ratings and debt pricing
  - Focus: mezzanine and private equity finance
- **Case Study: The LBO of ISS**
  - Management vs outside equity
  - Valuation in LBOs: "The VC Method"
  - Paydown and exit analysis
- **Case study: Exit for Reykjavik Fleet Leasing**

- **Integrating Case Study: Flexics.**
  Rivals teams employ the tools and ideas of the course to a competitive situation featuring a leveraged buyout and sale to a strategic buyer. They negotiate key features, including:
  - Valuation of the target
  - Raising the funding
  - Terms of payment
  - Summary "term sheet" agreement

### Presentations

- **Leveraged Buy-Outs**

### Case Studies

- Nukem Security
- The LBO of ISS
- iss_financials.xls
- Reykjavik Fleet Leasing
- Flexics: Selling the Company

### Articles

- Introduction to Leveraged Finance
- A Note on LBOs
- Debt-to-EBITDA
- LBO Legal Checklist

### Spreadsheets

- ratings.xls
- lbocapacity2.xls
- financing_iss

### Additional Resources

#### Books

- Robert Bruner, *Applied Mergers and Acquisitions*
- Enrique Arzac, *Valuation for Acquisitions, Buyouts and Restructurings*
- Aswath Damodaran, *Damodaran on Valuation*
- McKinsey Quarterly (on-line subscription)

#### Background Articles

- Methods of Corporate Valuation
Notes on cost of capital and capital structure.
Critique of Valuation Methods
Private Equity Valuation Guidelines
A Company in One Page
The Fool’s Method
Warren’s World
Corporate Financial Restructuring
Real options valuation

Useful Links
dealbook (M&A and private equity deals)
biz.yahoo.com (summary data and financials)
morningstar.com (summary financials)
investinginbonds.com (treasury rates, corporate bond prices and ratings)
standardandpoors.com (bond ratings)
bondsonline.com (corporate bond spreads)
damodaran.com (industry ratios)
advfn.com (corporate financial ratios)

About the Instructor
Ian Giddy has taught finance at NYU, Columbia, Wharton, Chicago and in 40+
countries worldwide for the past two decades. He was Director of International Fixed
Income Research at Drexel Burnham Lambert from 1986 to 1989. The author of more
than fifty articles on international finance, he has served at the International Monetary
Fund and the U.S. Treasury and has been a consultant with numerous corporations
and financial institutions in the U.S. and abroad. As a banker and consultant he has
been involved in the growth of the structured finance market in the USA, Europe and
Asia. He is the author or co-author of The International Money Market, The Handbook
of International Finance, Cases in International Finance, Global Financial Markets,
Asset Securitization in Asia and The Hudson River Watertrail Guide. He and his wife
are the founders of Cloudbridge, a nature reserve in Costa Rica.

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