

December 8, 2014

NYU Stern School of Business  
Spring 2015 (31 March to 5 May)  
6-9pm, Room T-UC21  
B40.3196.30

## ***Mergers & Acquisitions***

Professor Eduardo Mestre

### Course Description

This is a “thematic” short course in Mergers and Acquisitions that focuses on a wide variety of issues that companies and their advisors often encounter in the marketplace. The issues selected for analysis and discussion are practical and real world based, but they also provide a bridge to concepts and questions which are debatable and almost always multi-dimensional. The course is designed to make the point that inventiveness and creativity are integral to being a successful M&A professional.

The course requires an understanding of the basics of corporate finance and accounting. It is a hybrid of lectures and analysis and discussion of specific cases, with appearances by guest lecturers.

The broad themes that will be covered are:

- The evolving context of M&A – three broad drivers of merger and acquisition activity
- The role of governance in mergers and acquisitions
- Valuation (two sessions)
- Structuring a transaction
- The role of the balance sheet in M&A and post merger integration

Instructor: Eduardo G. Mestre

By way of background, I am a new Adjunct Professor at Stern. I have been an investment banker for 37 years. After practicing law for four years, I joined Salomon Brothers in 1977 (as part of my transition I took four finance courses at Stern), where I ran the M&A department for five years. I was then appointed to run all of corporate finance and M&A, which I continued to do for seven years through Salomon’s merger with Smith Barney and Salomon Smith Barney’s merger with Citibank. I left Citigroup in 2004 for Evercore, a “boutique” investment bank, where I ran the U.S. merger advisory practice for eight years. I am now a Senior Advisor at the firm and I serve on the Boards of two acquisitive public companies (Comcast and Avis Budget).

This is the first time I have taught this course at Stern. I hope many of you will join in what will be an intense discussion of mergers and acquisitions in today’s marketplace.

## Readings

Assigned readings will be a combination of articles, memos prepared by professional advisors, public deal related documents (including SEC filings), statistical data, spread sheets, and analyses presented to managements and boards in real M&A transactions. There will also be supplementary optional readings.

No textbook is required, but I suggest “Mergers, Acquisitions and Other Restructuring Activities”, Seventh Edition, by Donald M. DePamphilis for those students who would like a general reference text on M&A and related topics.

Assigned readings will be posted on the course website or available on identified websites. Four readings were purchased from Harvard School Publications and to access them students need to purchase a “keycode” from the bookstore.

## Class Participation and Student Deliverables

1. Class participation is required and critical to the success of the course, as students will be encouraged to engage in active classroom discussions. Class participation will account for 20 % of your grade.
2. Two papers, 3-5 pages in length each, on assigned cases. These papers can be prepared individually or in cooperation with up to two additional students, i.e. a maximum of three authors per paper. The papers will be due at the beginning of the second session and the fifth session. These papers will account for 30% of your grade.
3. Final exam taken online during a prescribed two hour window after the course is over.

## Course Outline

### **Session 1 March 31**

#### Big Three Drivers of M&A

1. Consolidation and the Quest for Scale and Scope

Review of consolidation in the telecommunications, banking and aerospace and defense industries and current activity in internet and social media.

2. The Role of Private Equity

3. The Debate Over Focus vs. Diversification

a. The rise and fall of the conglomerate

b. The latest rage – spins (Trian white paper to be discussed in class)

4. Case Study – the creation of Citigroup through the merger of Citibank and Travelers (guest speaker)

#### Readings

Slides from lecture to be given in class (to be posted)

Trian letter and white paper to PepsiCo Board – The Case for Separating Global Snacks and Beverages (Trianwhitepapers.com)

Spin-Off Precedents Analysis (to be posted)

What Happened at Citigroup – Harvard Business School Publications 9-310-004

Optional: Spin-Off Guide – Wachtell Lipton Pages 1-16 (Google: Wachtell, Lipton, Rosen & Katz Spin-Off Guide 2014)

## Session 2 April 7

1. The Role of the CEO vs. the Board
2. The role of M&A management and culture in determining the success/failure of M&A
3. The Importance of Governance in Determining Price
  - a. Supervoting stock
  - b. Merger of equals
4. The Role of Shareholders in M&A
  - a. The rise of shareholder activism

### Readings

The M&A Paradox: Factors of Success and Failure in Mergers and Acquisitions By Yackov Weber, Christine Oberg, Shlomo Tarba, January 16, 2014

<http://www.tpress.com/articles/printerfriendly/2164982>

Mergers of Equals – 3 pages (on class website) to be covered in lecture

Dual-Class Share Structure Considerations – to be covered in lecture (on class website)

AOL-Starboard Case Study (Go to SEC Edgar and under “AOL” look up filings for the December 2011-June 2012 period). Required readings include: letters from Starboard to AOL dated December 21, 2011 and February 24, March 30, April 10, 2012; AOL Investor Presentations dated May 24, May 29, June 4, 2012; June 14, 2014 Form 8-K; and ISS June 2, 2012 AOL report (hard copies of the ISS report to be distributed in March 31 class)

### Assignment

Write a 3-5 page report addressing the following:

Why did Starboard take a position in AOL and wage a proxy contest?

What was AOL’s main defense?

What were the main issues in the debate?

How would you have voted and why?

### **Session 3 – April 14 – Valuation Part I**

1. Standard Valuation Techniques
  - a. Comparables
    - i) revenue, EBITDA, earnings and free cash flow multiples; peg ratios
    - ii) operating performance
  - b. DCF's
    - i) cost of capital, terminal value, forecast period
  - c. Present value of future value of equity
  - d. Deal precedents
  - e. Premium analysis
  - f. Break-up value
  
2. Use of Forward Looking Numbers
  - a. Budget
  - b. Management
  - c. Research
  - d. Third parties

#### Readings:

Methods of Valuation for Mergers and Acquisitions; Darden Business Publishing, February 24, 2009  
UV0112

Overview of Trading Comps and Fairness Opinions – Evercore Training Materials – to be posted on class website

Delaware Court of Chancery Provides Guidance Regarding Preparation and Use of Discounted Cash Flow Analysis – Simpson Thatcher Memorandum June 8, 2010 (available on line – Google)

International Paper/Temple Inland Valuation Case – Evercore – to be posted on class website (much of the class will be devoted to discussing this case in detail)

## Session 4 April 21 – Valuation Part II

1. The Widespread Use of Adjusted EBITDA, EPS and Cash Flows
  - a. Stock based compensation
  - b. Restructurings
  - c. Write offs
  - d. One-time tax breaks
  - e. Non-recurring events
2. Accretion/Dilution
  - a. GAAP EPS/Cash EPS
  - b. Status Quo Case compared to what target company capital structure, expected leverage ratio embedded in management forecasts, alternative use of cash (e.g. stock buy backs).
3. Role of synergies in valuation
4. Five key valuation challenges
5. Merger Analysis – Frontier/Embarq and Century Link/Qwest (guest speaker)

### Readings

The 5 Types of Earnings Per Share by Rick Wagman

(<http://www.investopedia.com/articles/analyst/091901.asp>)

Chart of the Day: Here's How You Should Think About "Adjusted" Earnings (<http://www.Businessinsurer.com/gaap-us-non-gaap-earnings-eps-2013-12>)

Why Stock-Based Compensation is a Cash Expense, Dane Mott Research LLC 5/1/2013

(<http://www.danemott.com/it-is-not-double-counting-to-expense-stock-based-compensation>)

Matthews International Adjusted EPS Alternatives, July 2014 – Evercore (to be posted on class website)

Valuation Overview – 5 Key valuation Challenges – Evercore (to be posted on class website)

Valuation and Merger Analysis of Proposed Merger between Frontier and Embarq and between Century Link and Qwest (to be posted on class website)

(these two cases will be discussed extensively in class)

## Session 5 April 28 -- Structuring a Transaction

This class will be a lecture on the topics below and a homework assignment and class discussion on the sale of Dell to Michael Dell and Silver Lake. There may be a guest speaker.

1. Managing risk, negotiations, price, maximizing certainty
2. Stock and stock/cash transactions – fixed price vs. fixed ratio; taxable vs. tax free
3. Cash transactions – source of financing, financing outs
4. Stock vs assets
5. Bridging value gaps – earnouts, CVR's
6. Maximizing certainty of closing – reverse break-up fees, regulatory risks, material adverse clauses
7. Acquisitions of less than 100%
8. Indemnification and escrows
9. Tenders vs. shareholder votes
10. “Locking up” a transaction – go shops, break-up fees, voting agreements, role of confidentiality agreements, expense reimbursements for competing bidders

### Readings

Top Ten Issues in M&A Transactions

<http://www.mbbp.com/resources/business/top-10-merger-issues.html>

Taking Stock-Value Protection in Stock and Mixed Consideration Deals – Kirkland M&A Update – June 10, 2014 (Google)

Transaction Case Study with Evercore-Dell LBO (to be posted on class website)

Southeastern Asset Management Challenges Buyout at Dell - Harvard Business School Publications 9-114-015

Optional – Dell Proxy Statement, May 31, 2013

- Background of the Merger – pages 20-50 (Edgar SEC Filing)

### Assignment

Write a 3-5 page report addressing the following:

What is the difference between taking a company “private” and “selling a company”?

Why was a special committee of the board formed? What was the role of the special committee vs. the full board?

Why did the independent committee choose to sell the company instead of installing new management?

In view of JP Morgan's role as advisor the special committee, what was Goldman's role as advisor to the Company?

Why was Evercore added as a second advisor to the Committee?

Why was BCG brought in to develop financial projections?

Why was a go shop process introduced in this case?

Why was the transaction subject to a “majority of the minority” vote requirement? Why did the special committee agree to a last minute change in defining majority as a majority of all shares outstanding vs. a majority of shares voting?

Would you have done anything different if you had been on the Special Committee?

## Session 6 May 5

### Role of Balance Sheet in M&A; Culture and Post Merger Integration

#### Acquisition Financing

1. Acquisition Financing – Introduction
2. Role of Bridge Financing
  - a. Buyers require certainty
  - b. Structuring of a bridge loan
3. Hidden costs of impediments in outstanding debt
  - a. Change of control provisions
  - b. Make whole
  - c. Substantially all tests
  - d. Covenants
  - e. Restricted vs. unrestricted subsidiaries

#### Post Merger Integration

1. Do's and Don'ts in Post Merger Integration

#### Readings

Financing Provisions in Acquisition Agreements by Linda Curtis and Melissa Barrhup, Summer 2011 (Google)

Fundamentals of Middle-Market Acquisition Financing, Chapman and Cutter, October 9, 2014 (Google)

Acquisition Financing Teach-In – October 2, 2013, Evercore (to be posted on class website)

T-W Telecom – Capital Structure Considerations, April 16, 2014 – Evercore (to be posted on class website)

Level 3 Redemption Press Release

<http://investors.level3.com/investor-relations/press-releases/press-release-details/2014/Level-3-Announces-Notices-of-Redemption-of-tw-telecom-Holdings-5375-Senior-Notes-Due-2022-and-6375-Senior-Notes-Due-2023/default.aspx>

Note on Postmerger Integration - Darden Business Publishing, February 19, 2009 UV1024