

NEW YORK UNIVERSITY
STERN SCHOOL OF BUSINESS

Mergers and Acquisitions
B40.3196, Spring 1999



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Office Hours: Monday, 2PM-3:30PM; Tuesday, 2:30PM-5PM

Course Description

The main objectives of this course are: (1) to apply the principles of corporate finance to analyze corporate change-of-control transactions, and (2) to gain a good, basic understanding of the actual nuts and bolts of mergers and acquisitions, including relevant legal and regulatory issues. While the course will focus primarily on the U.S. market, we will devote a significant amount of attention to the special issues that arise in cross-border transactions. Students are expected to stay abreast of major transactions reported in the financial press and be prepared to contribute to discussions of them in class.

Readings, Cases, and Other Assignments

The basic reading material for this course is the series of handouts to be distributed in class. After the first session, students should have read the relevant handout **before** each class. A packet containing the Brown-Forman and Cooper Industries cases can be purchased at the bookstore. The bookstore also has copies of Mergers, Acquisitions, and Corporate Restructurings, by Patrick A. Gaughan (New York: John Wiley & Sons, Inc., 1996), which can be a useful supplement to class handouts and discussions, particularly regarding tender offers, proxy contests, and the legal background of transactions involving public companies. However, it is **not** required for the course, and is **not** a helpful reference for valuation, tax, or accounting issues; indeed, it contains a number of errors in these areas.

Apart from the Cooper case--**to be handed in at the start of class on March 8**--students will be required to submit a mock takeover proposal to a "client" of their choice, including a discussion of valuation, strategic, and due-diligence considerations. **This assignment is due at the start of class on April 26.** Detailed instructions for both of these assignments are attached, and for both of them, students should work in groups of 3-to-5 that they organize among themselves. Ideally, at least one member of each group should have already completed a corporate finance course at the level of B40.2302 and have a good working knowledge of discounted-cash-flow valuation techniques. **Once you have formed your groups, please have someone in each group e-mail me a list of all of the team members, along with their preferred e-mail addresses.**

Grading

The course grade will be determined as follows: Cooper case, 10%; takeover analysis, 30%; final exam, 60%. In case of any “close calls”, I will give some (positive) consideration to class participation.

Course Outline

1. January 25 & February 1--Mergers and Acquisitions in the Context of Shareholder Value

Readings--Handouts #1 and #2.

Alternative ways to increase shareholder value; historical perspective on M&A activity; some major recent trends; importance of planning for implementation; principal participants in M&A transactions and their roles/interests; taxonomy of transaction types.

2. February 8 & February 22--Some Alternative Approaches to Valuation

Readings--Handout #3.

Prepare the Brown-Forman case; this will not be turned in, but groups will be called on to present various aspects of this valuation starting on February 8.

Why value may differ for different participants in a transaction; review of DCF techniques (e.g., how to project cash flows; how to estimate the WACC); comparables analysis--trading multiples vs. transaction multiples; the need for due diligence.

3. March 1 & March 8--Some Key Accounting and Tax Considerations

Readings--Handout #4.

Prepare the Cooper case to be turned in as well as discussed in class March 8.

Purchase vs. pooling accounting, including rules governing which approach to use and the possible impact, if any, on value; taxable vs. “tax-free” transactions and the choice of consideration; relationships between tax and accounting issues and sources of confusion; presentation and discussion of the Cooper case.

4. March 22--LBO Analysis

Readings--Handout #5.

The logic of LBOs; the potential downside; bondholders vs. shareholders; recent LBO activity in contrast to that of the 1980s.

5. March 29, April 5, & April 12--Hostile Public Deals: Acquisition Strategies and Defensive Techniques

Readings--Handouts #6 & #7.

Introduction to public deals, with an emphasis on hostile ones; mechanics of and regulations governing tender offers and proxy fights; any-and-all offers, two-tier offers, and partial offers; forward and reverse triangular structures; Delaware vs. Pennsylvania law; poison pills, blank-check preferred, staggered boards, etc.; deal-protection techniques; analysis of the Conrail saga.

6. April 19--Duties of Directors and Anti-Trust Issues

Readings--Handout #8.

The business judgment rule and the duties of loyalty and care; Revlon, Unocal, and more recent cases; evolving anti-trust attitudes and standards.

7. April 26 & May 3--Friendly Deals: Selling a Company or a Division

Readings--Handouts #9 & #10.

Prepare takeover project to be handed in on April 26.

Strategic issues in selling vs. spinning; tactical considerations in the approach to a sale (private sale, controlled auction, public sale); engagement letters and confidentiality agreements; due diligence and the preparation of the "book"; principal elements of a sales/purchase agreement; fairness opinions.

8. **May 10—Final Exam**

Instructions for Cooper Case

It is May 1972, and you are an aspiring young AVP at Cooper Industries. Robert Cizik has asked for a short presentation on the possible purchase of the Nicholson File Company. Specifically, he wants your analysis on the value that could be reasonably assigned to Nicholson. You know from past experience that he likes to see several approaches to valuation, but that he will devote most of his attention to your detailed cash-flow analysis. You plan to supplement that with an analysis based on trading multiples of comparable companies and with a liquidation analysis (which will be limited by the data that you have from Nicholson's balance sheet) to gauge the deal's downside.

You plan to work up detailed projections of the free cash flow to the firm for five years, to which you will append an appropriate terminal value analysis. The cash flows will incorporate the cost reductions that Cooper expects to be able to make, phasing them in over two years. You are aware that the beta of Cooper is 1.19 and of Nicholson, 0.54. The risk free rate is 6% and the market risk premium, 7%.

You know that Mr. Cizik hates to read irrelevant material, so you will be concise in your write-up, keeping the text to two double-spaced pages in which you summarize your key assumptions and your principal conclusions. To these two pages you will attach at most five pages of summary data--cash flows, sensitivity analyses, details of your alternative valuation methods, etc. You will include just enough information that Mr. Cizik can clearly understand your assumptions and your methodology.

Mr. Cizik expects your report on March 8.

Instructions for Takeover Assignment

For this assignment, you are to put yourself in the position of an investment banker making a recommendation to a client on a potential acquisition. Your client for this purpose may be any U.S. company, including a U.S. subsidiary of a foreign company, but it must be one for which an acquisition makes strategic sense from a shareholder-value perspective. Similarly, you are totally free to propose any U.S. entity as the designated target as long as you can make a convincing case for it in the presentation to your client. (I am willing to entertain requests to drop the restriction of only U.S. firms, but the easy availability of consistent accounting data makes domestic companies preferable for this exercise. Please do not choose a non-U.S. company without first discussing it with me.)

Your presentation must be in the form of a traditional banker's "pitch book", i.e., pages printed in "landscape" format, each with a heading in which you make your main point followed by five-or-six "bullet points" in which you develop your argument. Graphs or tables can be used as you see fit. Each book should conform to the following structure:

(1) The strategic situation of your client (competitive position, etc.) and why an acquisition is a plausible way to increase shareholder value.

(2) Why the proposed target makes sense in light of the above; specific ways in which its acquisition would make strategic sense to your client.

(3) Why the target might be available, e.g., a large block of stock in the hands of someone who might want to sell, an aging founder of a private firm with no family member in line to succeed, etc.

(4) Preliminary valuation of the target as a stand-alone entity, plus an assessment of possible synergy.

(5) List of key due-diligence questions which will need to be answered before a final agreement on value is reached.

(6) Proposed approach to the target and proposed structure of the offer, e.g., a friendly meeting to discuss a merger or a formal tender offer for the shares, an all-cash offer or a stock-swap or some combination, etc. You should include both the initial amount that you propose to offer as well as the upper end of what you feel the appropriate range is for your client to ultimately pay.

(7) Potential legal-regulatory-antitrust hurdles that need to be considered.

(8) Principal issues in a successful integration of the target into your client's operations.

Most of these topics should occupy one page of the presentation each, although you may need a second page in some cases, perhaps for graphical material. One exception is the valuation section, where you should have one page clearly summarizing the assumptions that you made followed by a page with valuation results from a DCF and from a comparable trading multiples analysis. If you are able to find some recent comparable transactions as well, fine, but that is not a requirement. You should relegate the details of the valuations to an appendix, which should also include a summary of the target's financials over the past five years, i.e., enough data for me to make a reasonable appraisal of your DCF work. In doing the DCF, please use 5% as the risk-free rate and 7% as the market risk-premium.

While the valuation is clearly a critical part of this assignment, it is only one portion of it. My suggestion would be to spend a good deal of time choosing your client and the proposed target--making sure that you can argue persuasively why this deal would make sense--before you begin working on the valuation and the tactics of the transaction.

Your presentation is due at the start of class on April 26. If your Cooper team functioned reasonably well, I would strongly suggest that you keep it intact rather than trying to regroup.

Please do not hesitate to ask for clarification of these instructions.