

UNIVERSITY OF PENNSYLVANIA
The Wharton School
The Finance of Buyouts and Acquisitions: FNCE 751
Part I: Professor Vinay Nair
Part II: Professor Karin Thorburn
Fall 2018

Course Objective

The aim of the course is to provide an understanding of key concepts and institutions involved in corporate buyouts and takeovers. This course is most suitable for finance majors who are considering careers in corporate finance, investment banking, and buyout funds.

Reading Materials

- Course Reader (cases and articles)
- Materials and lecture notes on the course webpage in Canvas
- Articles distributed electronically through Lippincott library
- Recommended (but not required) for background reading:
 - i. Robert Bruner, *Applied Mergers and Acquisitions*, Wiley Finance, 2004
 - ii. Thomas Meyer and Pierre-Yves Mathonet, *Beyond the J Curve: Managing a Portfolio of Venture Capital and Private Equity Funds*, the Wiley Finance Series, 2009.
 - iii. Gaughan, Patrick A., *Mergers, Acquisitions and Corporate Restructurings* 7th ed., Wiley, 2017 (below referred to as Gaughan).

Format

The course structure includes lectures, case discussions, and guest speakers. The major objective of the case method in finance is to use the logic of financial theory to arrive at sensible conclusions when faced with real-world problems. However, one should keep in mind that different assumptions can lead to different solutions and there is not one right answer to a case. Through case discussions, this course will help students distinguish sensible/good arguments and senseless/bad arguments. Considering the professor's analyses as the correct solution defeats the purpose of the course and contributes to the silly notion that there is a single correct recipe to follow in the real world.

Student Responsibilities and Assessment

- Case Study Assignments: (Approximately 20% of the course grade). Students should organize themselves into groups of five members to work on case assignments. Groups must be fixed throughout the semester. Diverse background within the group is beneficial. Since group work is a cooperative undertaking, students are encouraged to form groups that can work effectively as a team. Although brief discussions across different groups are allowed, exchange of analysis and calculations is not.

Each group is required to submit a total of **five case write-ups**. Case 1 and case 2, marked with a (*) in the detailed course outline below, are required. In addition, each group should submit write-ups for three of the six cases marked with (**), i.e., case 4 through 9.

Case write-ups must be submitted through Canvas before 9am on the day of the class. The write-up should be 2-3 pages long, with supporting computations and tables in an appendix. Provide all assumptions and formulas that you use—preferably as footnotes. The questions that should be addressed will be posted on the course webpage. The raw data for cases are also available in Excel format on Canvas.

- **Class Participation and Attendance:** (Approximately 30% of the course grade)
A goal of this course is to provide students with the opportunity to learn how to best contribute to discussions about complex financial issues. Therefore, participation in the classroom discussion is an important and essential part of the course. Because so much learning occurs in the classroom, it is important that you attend every class. Students are expected to prepare for each case and participate actively in class. We encourage voluntary class participation, but will also cold call to ensure that the class enjoys the benefit of every student's contribution. Performance will be judged based on the quality of comments/answers. Inadequate class participation combined with several absences can lead to a failing grade. To facilitate recording of class participation, please keep the same sitting arrangement throughout the semester.

Since class participation is an integral component of the course, we want you to focus on the discussion while in class. Therefore, laptops and reading pads connected to the internet are not allowed in the classroom. Please print out and bring any case material or solutions that you may want to refer to in class.

- **Mid-term Examination for Part I:** (Approximately 25% of the course grade)
You will be tested on both the concepts and the methods studied in this course. You will have access to a calculator and limited amount of information.
- **Merger Project for Part II:** (Approximately 25% of the course grade)
Each group must propose a potential takeover transaction, taking the role of an investment bank pitching the deal to the bidder or the target. Using the analytical tools learned during the course, you should select a bidder and a target, and structure the transaction. The analysis should cover different aspects of the deal, such as the strategic and economic benefits, target and synergy valuation, method of payment, bidding strategy, target management reaction, and corporate governance issues. You should rely on firm and market data that are publicly available for your analysis. However, you cannot use materials prepared by professionals.

Each group is required to give a 10-minute presentation in class on December 3 (Mon) or 5 (Wed). A **written report and power point presentation is due at 5pm on Sunday, December 2, 2018.** Additional details are in the Merger Project Guidelines on Canvas.

Code of Ethics

Assignments submitted for grading should be your own or your team's own work only. Most cases in this course involve actual companies. You may use firm specific or market data that are publicly available for your analysis. However, you cannot use old notes, handouts, or solutions to the cases from previous or other sections of this course or similar courses elsewhere for your written reports and class discussions. Failure to observe this rule may result in an automatic failing grade for the course.

Office Hours and Contact Information

Vinay Nair

Office Hours: Mondays 3-4pm.

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Karin Thorburn

Office Hours: Tuesdays 10am-11am, SHDH 2426

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If you have questions about the material, the best place is the Canvas discussion board. We will try to answer all questions. However, considering the size of the classes we teach, we may not be able to do so promptly—especially the night before an exam.

Teaching Assistants

The teaching assistants (TAs) are responsible for taking attendance and answering questions about the grading of case hand-ins, exams, and the term project. TAs for the course are:

Michael Alexander, malexa03@wharton.upenn.edu (9am-10:20am section)

Tom Belatti, tbelatti@wharton.upenn.edu

Minwoo Choi, minwooc@wharton.upenn.edu (10:30am-11:50am section)

John Curry, minwooc@wharton.upenn.edu (1:30pm-2:50pm section)

TENTATIVE COURSE OUTLINE

This outline is a preliminary guide as to when material will be covered. There may be changes, with advance notice given in class and/or on Canvas. Most **guest lectures will be held outside regular class time and location, and may be rescheduled due to our guests' busy schedule.**

PART I (Q1): BUYOUTS

Session 1: August 29

Introduction and Organization

Session 2: September 3

Basic Valuation Concepts, Adjusted Present Value, Costs and Benefits of Debt Financing, Reduced-Form Valuation Methods

Reading:

- “Chapter 2: Using Financial Reporting Information”: “Chapter 10: Valuation by Multiples” by Simon Beninga and Oded Sarig.
- Berk and DeMarzo: Chapters 15, 18 and 19.
- Bruner: Chapter 9 and Chapter 13.

Session 3: September 10

Overview of the Buyouts Model.

Session 4: September 12

CASE 1: Sungard & LBO Method (*)

Session 5: September 17

Incentives and Private Equity Fund Structure

Reading:

- “Note on Private Equity Partnership Agreements” by Josh Lerner.
- Meyer and Mathonet: Chapters 2 and 3.

Session 6: September 19

Deal Design under Adverse Selection.

Session 7: September 24

Non-institutional PE, Family Offices, and Deals outside the fund structure

Session 8: September 26

CASE 2: Fojtasek (*)

Session 9: October 1

CASE 3: Domino's

Session 10: October 3

Trends in PE and Outline of Practitioner Sessions.

Session 11: October 8

Guest Speaker on Value Creation.

Session 12: October 10

Mid-Term

Session 13: October 15

The Growth Equity Model & Speaker.

Session 14: October 17

The Sector Lens, Some less-crowded sectors, and Speaker.

PART II (Q2): TAKEOVERS

Session 15: October 22 (Mon)

Introduction to M&A: value creation and the merger process.

Reading:

- Gaughan Ch. 1 and 2.
- Eckbo, B. Espen, 2014, “Corporate takeovers and economic efficiency”, *Annual Review of Financial Economics* 6, 51-74.
- McConnell, John J., and Valeriy Sibilkov, 2016, “Do investment banks have incentives to help clients make value-creating acquisitions”, *Journal of Applied Corporate Finance* 28, 103-117.

Session 16: October 24 (Wed)

Consideration, distribution of synergy gains, and corporate governance issues in M&A.

CASE 4: Stanley, Black & Decker, HBS 9-211-067 (**)

Reading:

- Gaughan Ch. 4 and 13.
- M&A legal context: Basic framework for corporate governance, HBS 9-803-200.
- Standards related to the sale or purchase of a company, HBS 9-904-004.

Session 17: October 29 (Mon)

Synergy valuation and target stand-alone value.

CASE 5: Monmouth, HBS 4226.

Reading:

- Gaughan Ch. 15.
- Corporate Valuation and Market Multiples, HBS 9-206-039.

Session 18: October 31 (Wed)

Accretion/dilution, method of payment, and exchange ratio.

CASE 5: Monmouth, HBS 4226. (**)

Reading:

- Evaluating M&A Deals: Accretion vs. Dilution of Earnings-per-share, HBS 9-208-059.
- Evaluating M&A Deals—Equity Consideration, HBS 9-208-077.

- Rappaport, Alfred, and Mark L. Siower, 1999, Stock or cash? The Trade-Offs for Buyers and Sellers in Mergers and Acquisitions, *Harvard Business Review* (Nov-Dec), reprint 99611.

Session 19: November 5 (Mon)

Price protection and risk sharing.

CASE 6: General Mills' acquisition of Pillsbury from Diageo Plc., UV0089. (**)

Reading:

- Caselli, Stefano, Stefano Gatti, and Marco Visconti, 2006, Managing M&A risk with collars, earn-outs and CVRs, *Journal of Applied Corporate Finance* 18 (4), 91-104.
- Amobi, Tuna N., 1997, Price protection in stock-swap transactions, *Merger & Acquisitions* 32, 22-28.
- Technical note on consideration: floors, caps, and collars, HBS 9-902-056.

Session 20: November 7 (Wed)

Expected deal probability, merger arbitrage, and empty voting.

CASE 7: Mylan Labs' proposed merger with King Pharmaceutical, HBS 9-214-078. (**)

Reading:

- Gaughan Ch. 7.
- Wyser-Pratte Guy P., Merger Arbitrage, *Merger & Acquisition Handbook*, 2nd ed. by Rock-Rock-Sikora, 1987.
- Gillan, Stuart L. and Laura T. Starks, 2007, "The Evolution of Shareholder Activism in the United States", *Journal of Applied Corporate Finance* 19, 55-73.

Session 21: November 12 (Mon)

Hostility, defensive tactics, and antitrust.

CASE 8: Canadian Pacific's bid for Norfolk Southern, HBS 9-216-057. (**)

- Gaughan Ch. 5
- M&A legal context: Hostile takeovers, HBS 9-904-005.

Session 22: November 13 (Tue) at 4:30pm (Note day and time)

Interactive role-play focusing on the legal and regulatory issues in M&A transactions.

Guest Speaker: Stuart Cable, Partner Goodwin Procter LLP.

Reading: Gaughan Ch. 3.

Session 23: November 14 (Wed)

Minority buyouts and tender offers.

CASE 9: Roche's acquisition of Genentech, HBS 9-210-040. (**)

Reading:

- Gaughan Ch. 6.

Session 24: November 14 (Wed) at 4:30pm (Note the time!)

Roche's acquisition of Genentech

Guest speaker (by skype): Stephen Krognos, CFO of Denali Therapeutics.

Head of Roche's global M&A team, 2004-2009. CFO of Genentech, 2009-2015.

November 19: NO CLASS (Thanksgiving week)

Session 25: November 26 (Mon) at 4:30pm (Note the time!)

Structuring the deal: Selling Guidant.

Guest speaker: Stephen Munger, Managing Director and Chairman, Global M&A

Morgan Stanley Investment Banking Division

Session 26: November 28 (Wed)

Course review and bidding tactics

Reading:

- Eckbo, B. Espen, 2009, "Bidding strategies and takeover premiums: A review", *Journal of Corporate Finance* 15, 149-178.

Session 27: December 3 (Mon)

Term project presentations.

Session 28: December 5 (Wed)

Term project presentations.

December 10: NO CLASS