

UNIVERSITY OF PENNSYLVANIA
The Wharton School
The Finance of Buyouts and Acquisitions: FNCE 751
Fall 2020
Part I: Professor Burcu Esmer
Part II: Professor Karin Thorburn

Course Objective

The aim of the course is to provide an understanding of key concepts and institutions involved in corporate buyouts and public company takeovers. Students will develop skills necessary to structure a deal or form an opinion about a proposed transaction. The course is most suitable for finance majors who are considering careers in corporate finance, investment banking, private equity, or consulting.

Reading Materials

The course materials include a number of cases and readings. You should focus on the case analyses and use the readings as background and reference material.

- 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:
 - 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.
 - Gaughan, Patrick A., *Mergers, Acquisitions and Corporate Restructurings* 7th ed., Wiley, 2017 (below referred to as Gaughan).

Format

This course will be taught synchronously online via Zoom. Some content may be pre-recorded and made available on Canvas. When appropriate, pre-recordings may replace some of the class time. All lectures and case discussions will be recorded and available to view until the following Monday, 9am (EST). Slides will be posted ahead of time to allow students sufficient time to print them before class.

The structure of the course includes lectures, case discussions, and guest speakers. The lectures provide the relevant institutional facts, empirical evidence and analytical methods that will be needed for case discussions. The case discussions will take place in real time. A 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 analysis as the "correct solution" defeats the purpose of the case and contributes to the silly notion that there is a single correct recipe to follow in the real world.

Because so much learning occurs in the classroom, it is important that you attend every class in real time with video on. A goal of the course is to provide students with the opportunity to learn how to best contribute to discussions about complex financial issues. Moreover, many students have relevant experience that benefits other students when brought into the classroom. For these reasons, participation in the classroom discussion is a central part of the course.

Study Groups

The two term projects will be group-work. Students should organize themselves into groups of four or five. All teams should self-register on Canvas by no later than *Friday, September 11*. You may use the discussion board on Canvas to post that you are looking for a team member or a group. If a student does not self-register by the deadline, s/he will be randomly assigned to a group. It is the student's responsibility to contact the other team members and arrange meetings. Since group work is a cooperative undertaking, students should ensure that they form groups that are able to work effectively. Diverse background within the group is beneficial.

Code of Ethics

Assignments submitted for grading should be your 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 a failing grade for the course.

Student responsibilities and assessment

Class attendance and participation

Starting on September 9, attendance will be recorded within five minutes of the start of each lecture. Recorded attendance requires that you have your web camera on at all times. If you are in a location with poor-quality internet, you need to apply for an individual exception to this rule in advance no later than September 11 by filling out the course survey on Canvas. You need to make sure that your zoom log in name matches your name on your academic record, otherwise we may not be able to track your attendance. Missing up to two classes for any reason (illnesses, interviews, religious holidays, case competitions etc.) in the semester would not affect your attendance score. Any absences beyond two will lower your attendance grade. Attendance will not be recorded for sessions held outside the regular class time.

Students are expected to engage and participate actively. You may use the "raise hand" function to show that you would like to contribute. We encourage voluntary class participation, but will also cold call to ensure that the class enjoys the benefit of every student's contribution. Class participation is individual effort and rated in each session on a scale from 1 (minimal participation) to 3 (active and contributing to the flow). We consider quality of your comments as well as quantity. The overall class participation grade is based on each student's total participation score over the term. Inadequate class participation combined with several absences can lead to a failing grade.

PART I (Q1): (50% of the course grade)

Class attendance and participation: (8% of the course grade)

For the first part of the course, an (extra) individual case submission option will be given to students who are unable to participate in the class discussion throughout the first part of the course. Students who would like to take this option must notify us by September 11 via the course survey. Please note that you may receive a maximum of 2/3 for class participation score for Part I if you choose this option. Therefore, it is not a perfect substitute to participating in the class discussions. We will not return this report to you.

Each student will anonymously evaluate their team members for each case and project submission, these evaluations will contribute to your participation score.

Post- Class Quizzes: (10 % of the course grade)

Each week, a quiz will be posted on Canvas related to that week's material. The weekly quiz will be published Wednesday evening and will be due 9am EST the following Monday. There is no make-up for missed quizzes. If you experience any technical issues, you must notify me as soon as possible so that we can fix the issue in a timely manner.

Case Submission (7% of the course grade)

Each group is expected to **submit** a soft-copy of their conclusions on HCA case in a 2-3 page long executive summary. Supporting computations and tables can be included in an appendix. Groups must submit the .xls file along with their executive summary. All of the assumptions and mathematical formulas used should be provided (preferably as a footnote). Raw data from the case exhibits in .xls format, and sometimes hints to help guide the analysis, are available on Canvas.

The write-up is submitted via Canvas and is due at 9:00am (EST) on September 28. Submission via email and late submissions will not be accepted.

LBO Proposal: (25% of the course grade)

Each group is asked to identify a target firm as a financial buyer and prepare a deal proposal. The deal proposal is an active learning tool and allows you to apply many concepts that you have learned at the Wharton School. You may use firm specific or market data that are publicly available for your analysis. However, you cannot use materials prepared by professionals for a deal. Furthermore, any existing deal that is used in a teaching material, e.g., a case study, cannot be chosen as the topic of your proposal.

A written report and a power point presentation are due at 11:59pm (EST) on Monday, October 19. Three or four selected groups will present their term projects on October 21 in front of a panel of industry professionals. The remaining groups should record and submit their presentation by October 22. Additional details are in the LBO Proposal Guidelines on Canvas.

PART II (Q2) (50% of the course grade)

Class attendance and participation: (15% of the course grade)

In this part, if you feel disadvantaged in the class discussion, you may individually submit a case write-up of 3-4 pages addressing the assigned questions. Upload the report on Canvas no later than 10 minutes prior to class. Each write-up substitutes for class participation and gives a maximum score of 2 (to receive a 3, you need to speak up in class). However, a missed class cannot be replaced by a write-up. We do not return the reports to you.

Pre- Class Quizzes: (10% of the course grade).

For each case, there is a quiz in Canvas. The quiz has five simple questions on case facts that are useful for the analysis of the case. The purpose is to encourage preparation before class and help identify relevant facts. The quizzes are an individual assignment. Students have 30 minutes to take the quiz. It opens a week in advance and closes 10 minutes prior to class.

Merger project for part II: (25% of the course grade)

Each group should 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 part II, 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 pre-built models that you have used in the past or materials otherwise prepared by professionals. Exchange of analysis and calculations across groups is not allowed.

A written report and a power point presentation are due at 11:59pm (EST) on Monday, December 7. Three to four selected groups will present their term projects on the last day of class (December 9). The remaining groups should record and submit their presentation by December 10. Students will evaluate their team members after submitting the project. Additional details are in the Merger Project Guidelines on Canvas.

Office hours and contact information

Professor Burcu Esmer

Office Hours: Wednesdays 3:30pm-4:30pm (EST) on <https://upenn.zoom.us/j/94687308942>

Email: besmer@wharton.upenn.edu

Professor Karin Thorburn

Office hours: Tuesdays 9am-10am (EST) on <https://nhh.zoom.us/j/2871805420>

Email: karinsi@wharton.upenn.edu

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 class size, we may not be able to do so promptly—especially the night before a deadline.

Teaching Assistants

The teaching assistants (TAs) are responsible for taking attendance and recording class participation, as well as answering questions about case analyses, holding weekly office hours, and grading cases, and projects. TAs for the course are:

Aditi Kamat, aditik@wharton.upenn.edu (Section 1)

TBA (Section 2)

Enrico Venerus, evenerus@wharton.upenn.edu (Section 3)

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. Note that guest lectures may be scheduled outside of the regular class slots due to our guests' work schedules. Conditional on our guests' permission, these sessions will be recorded and made available on Canvas.

PART I (Q1): BUYOUTS

Session 1: September 2 (Wed)

Introduction and Organization

Session 2: September 9 (Wed)

Review: Basic Valuation Concepts

Session 3: September 14 (Mon)

PE Process

Reading:

- Gaughan Ch. 8 and 9.

Session 4: September 16 (Wed)

PE Trends

Session 5: September 21 (Mon)

Reduced Form Valuation / Multiples

Session 6: September 23 (Wed)

LBO Model

Session 7: September 28 (Mon)

*Case 1: HCA**

Session 8: September 30 (Wed)

Guest Speaker TBA

Session 9: October 5 (Mon)

Case 2: Realogy

Session 10: October 7 (Wed)

Restructuring: Comparative Analysis

Session 11: October 12 (Mon)

Case 3: Middle Market

Session 12: October 14 (Wed)

Guest Speaker TBA

Session 13: October 19 (Mon)

Incentives and Private Equity Fund Structure

Reading:

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

Session 14: October 21 (Wed)

LBO Deal Proposal Presentations

PART II (Q2): PUBLIC COMPANY TAKEOVERS

Session 15: October 26 (Mon)

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

Reading:

- Gaughan Ch. 1 and 2.
- Eckbo, B. Espen, 2009, “Bidding strategies and takeover premiums: A review”, *Journal of Corporate Finance* 15, 149-178.
- Eckbo, B. Espen, 2014, “Corporate takeovers and economic efficiency”, *Annual Review of Financial Economics* 6, 51-74.

Session 16: October 28 (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: November 2 (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: November 4 (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. Sirower, 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 9 (Mon)

Minority buyouts and tender offers

CASE 6: Roche's acquisition of Genentech, HBS 9-210-040.

Reading:

- Gaughan Ch. 6.

Session 20: November 11 (Wed) at 10:30am or watch the recording

Inside Roche's acquisition of Genentech

Guest speaker: Stephen Krognes, CFO of Denali Therapeutics.

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

Session 21: November 16 (Mon)

Price protection and risk sharing.

CASE 7: 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, 1997, Price protection in stock-swap transactions, *Merger & Acquisitions* 32, 22-28.
- Technical note on consideration: floors, caps, and collars, HBS 9-902-056.
- Note on basic option properties, HBS 9-205-105.
- Note on option valuation, HBS 9-205-106.

Session 22: November 18 (Wed)

Expected deal probability, merger arbitrage, and empty voting

CASE 8: 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 23: November 23 (Mon) at 9am and 10:30am, or watch the recording

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 24: November 30 (Mon)

Hostility, defensive tactics, and antitrust.

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

Reading:

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

Session 25: December 2 (Wed) at 9am or watch the recording

Structuring the deal.

Guest speaker: Stephen Munger, Managing Director and Chairman, Global M&A Morgan Stanley Investment Banking Division

Session 26: December 7 (Mon)

Course review

Session 27: December 9 (Wed)

Merger project presentations