



Università degli Studi di Firenze

Advanced Corporate Finance

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Introduction

Course structure

Course structure

3 credits – 24 h – 6 lessons

1. Corporate finance
2. Corporate valuation
3. M&A deals
4. M&A private equity
5. IPOs
6. Case discussions

Lesson 3 M&A Deals

Lesson 3 Summary

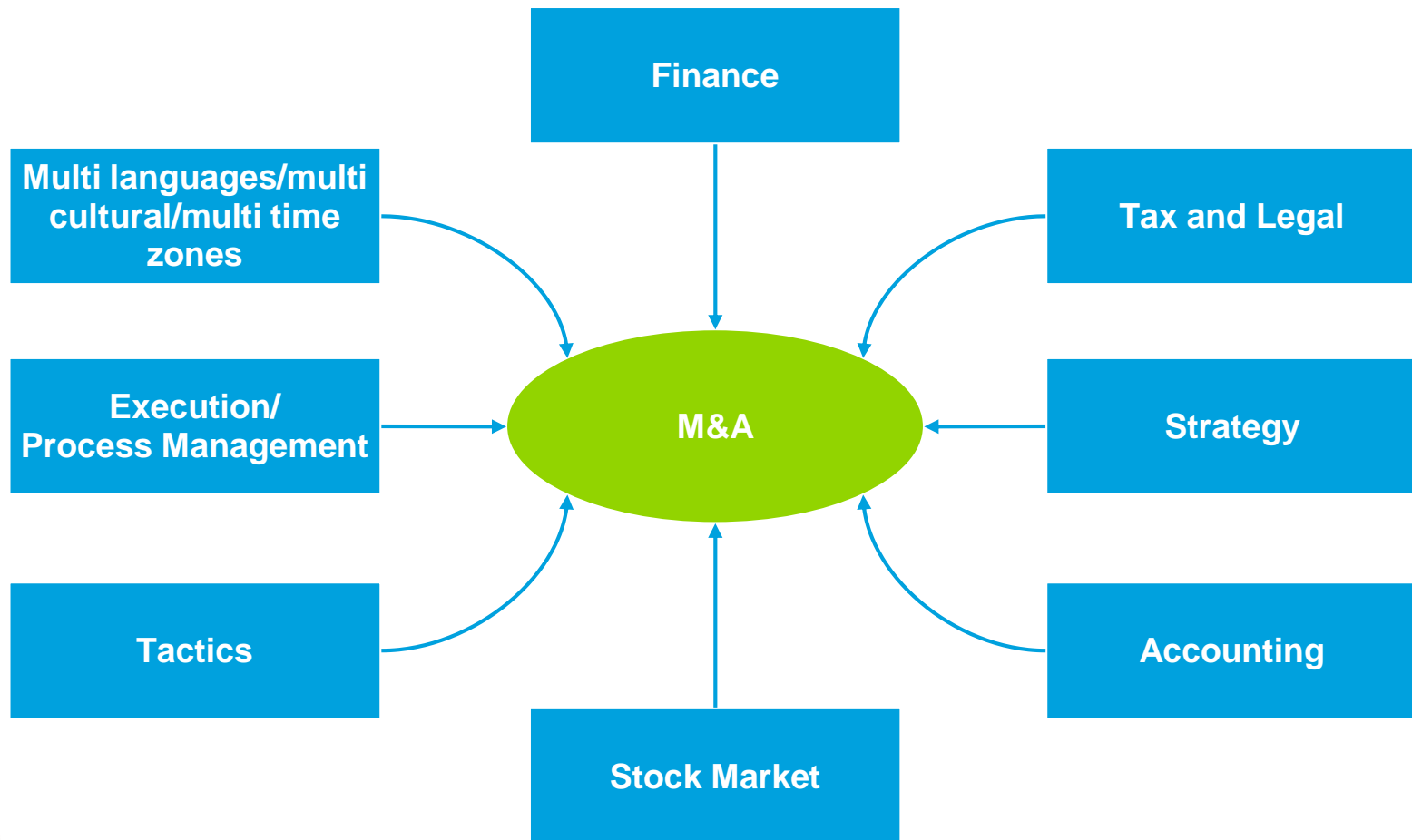
- 1 M&A Overview
 - Introduction
 - M&A scenario Global
 - M&A scenario in Italy
- 2 M&A Process
- 3 Negotiation
- 4 Closing
- 5 Post merger integration

M&A Overview

Introduction

An M&A transaction is usually a pooling of economic interests, often achieved by combining two companies

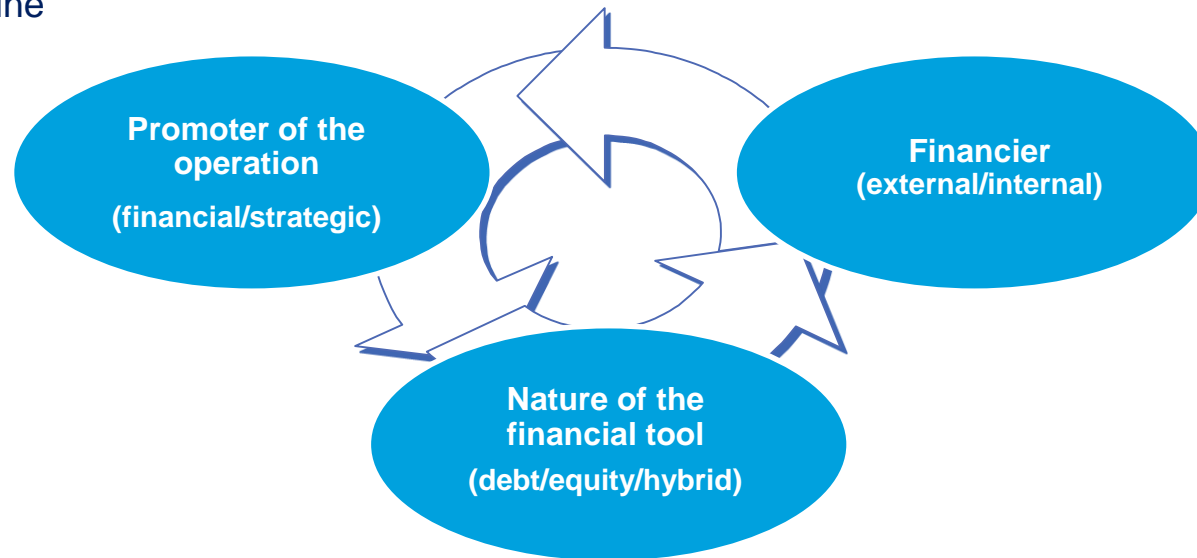
It's a complex and iterative process involving multiple skills set:



M&A Overview

Introduction

To correctly define extraordinary operations it's necessary first of all to analyze three aspects which can variously combine



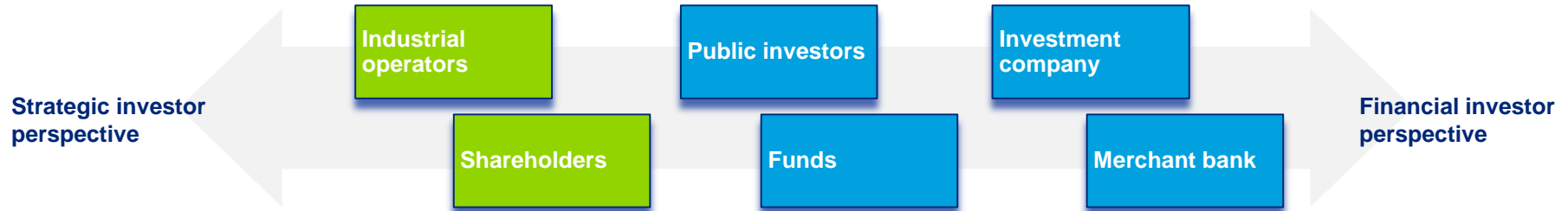
The term M&A is usually improperly used referring to all corporate finance operations. However it would be suitable to narrow down the term to:

- Acquisitions/divestitures
- Contributions
- Mergers/joint ventures that involve third parties
- Corporate reorganizations (mergers/spin off between group companies)
- Privatizations

M&A Overview

Introduction

Features of an M&A operation can be significantly influenced by the promoter of the operation



Strategic investor

- ✓ Usually a competitor or a company which operates in the same supply chain or commercial network



- ✓ Prevalence of motivations relative to business strategies

Market share/ Market leadership

Economies of scale

Horizontal/vertical integration

Commercial synergies (channel, sales mix, etc.)

Productive synergies or synergies related to complementary use of the resources

Structure efficiency

Financial investor

- ✓ Usually PE funds, investment company or financial holdings



- ✓ Prevalence of motivations related to value growth in the short period (3-5 years)

Financial source injection to finance the business development/restructuring

Optimization of the financial structure

Buy & Build

Cash generation

Exit opportunities

M&A Overview

Introduction

Financial sources used for financing company's activity can be classified by:

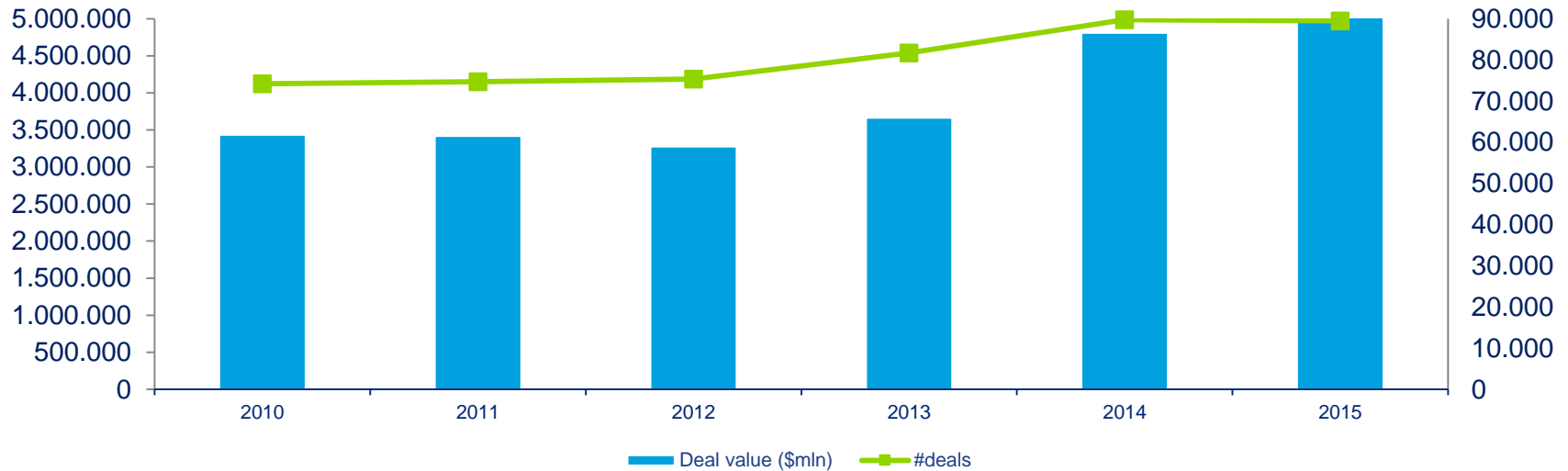
- ✓ financing tool nature;
- ✓ financier nature

| Nature of the Financing tool | | Nature of the Financier | | |
|------------------------------|--------|--|---|--|
| | | External | | Internal |
| | | bank side | market side | |
| Nature of the Financing tool | Debt | <u>Traditional bank debt</u> • short term • medium-long term <u>Structured finance</u> Project Financing | <u>Bond loan</u> <u>Mini bond</u> <u>Structured finance</u> Securitization | <u>Shareholders loan</u> |
| | Hybrid | <u>Mezzanine</u> | <u>Convertible B.L.</u> B.L with warrant <u>Participating financial tools</u> | <u>Participation financial tools</u> |
| | Equity | | <u>Ownership Equity</u> (Private Equity / Venture Capital/ IPO/ new strategic investors) <u>Warrant</u> | <u>Self financing</u> <u>Shares</u> (shareholder' s capital increase) <u>Warrant</u> |

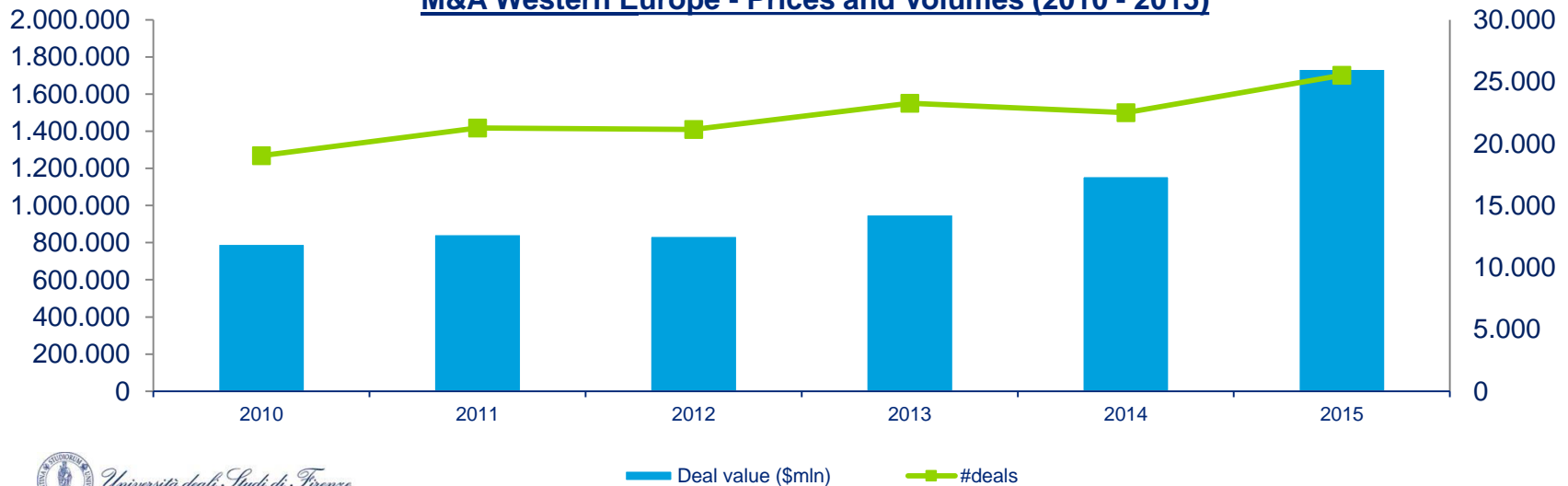
M&A Overview

M&A scenario Global

Global M&A - Prices and Volumes (2010 - 2015)



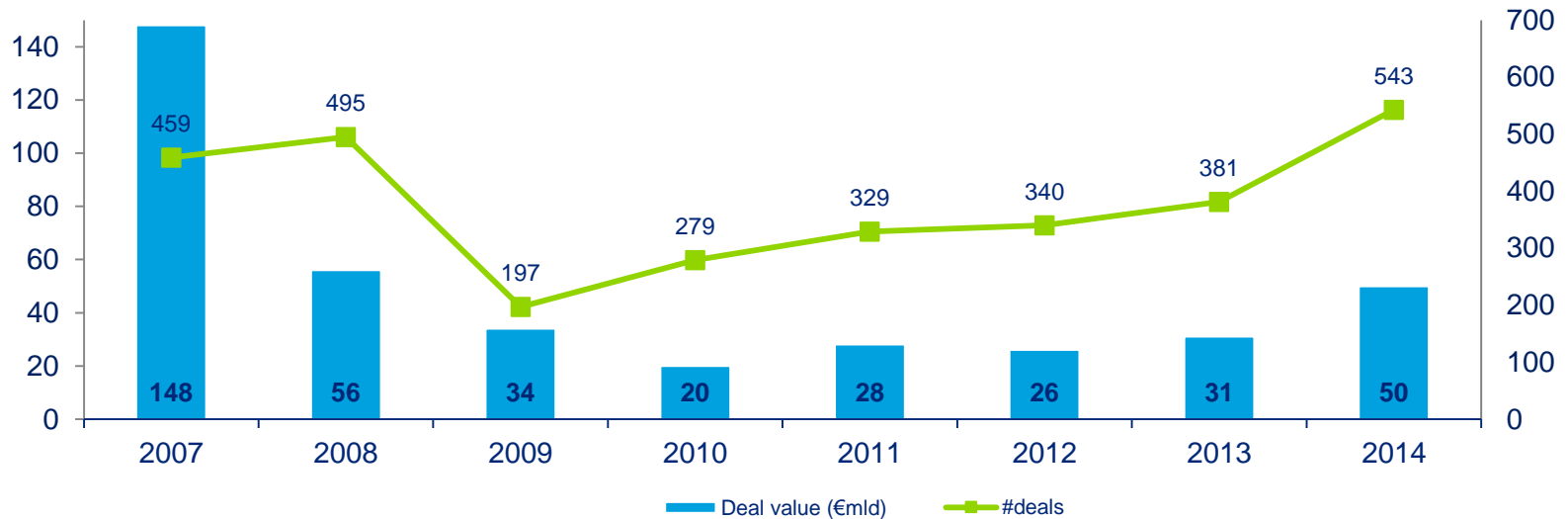
M&A Western Europe - Prices and Volumes (2010 - 2015)



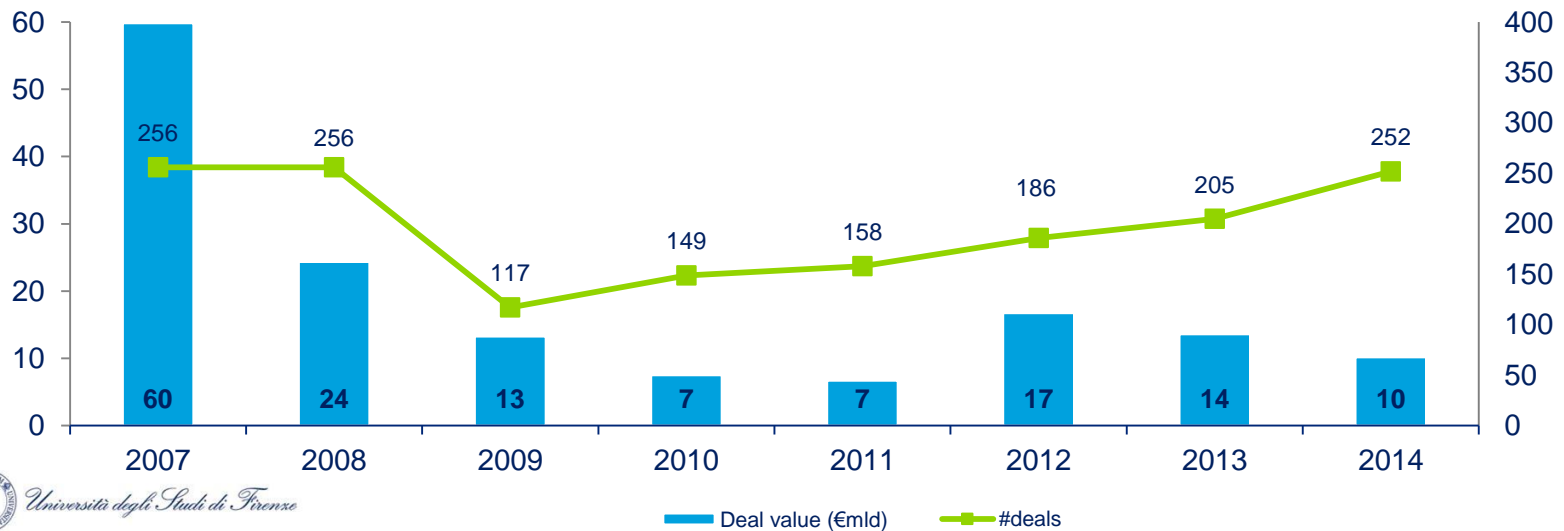
M&A Overview

M&A scenario in Italy (1/3)

M&A in Italy - Prices and Volumes (2007 - 2014)



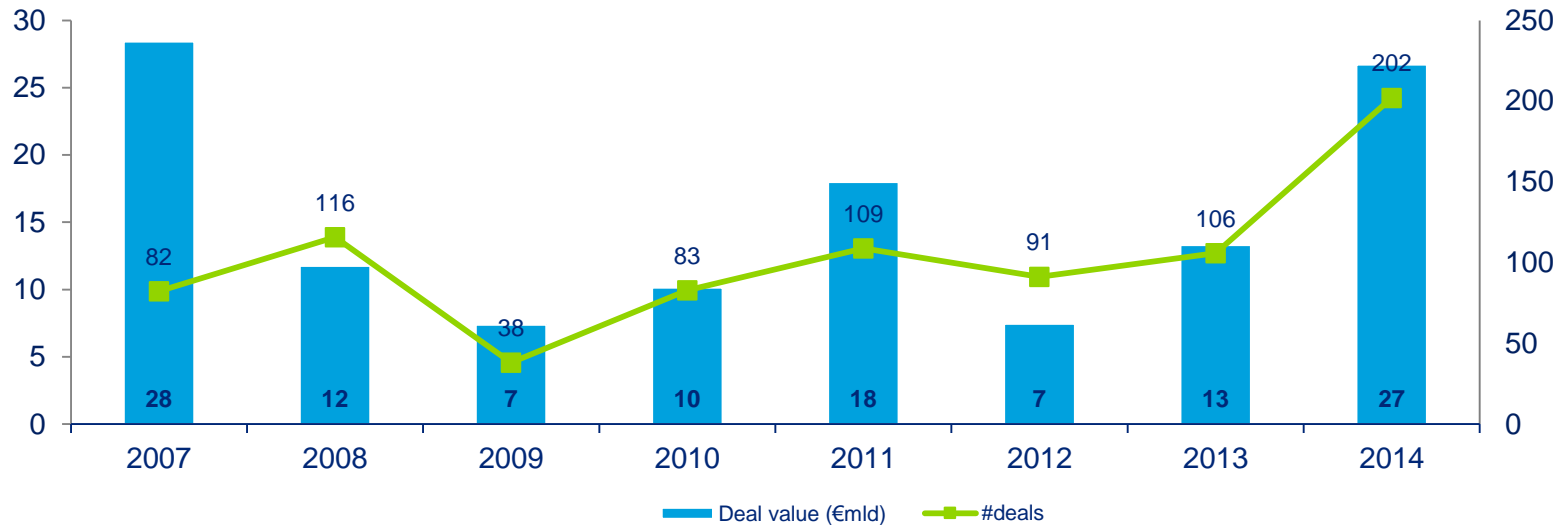
Domestic M&A - Prices and Volumes (2007 - 2014)



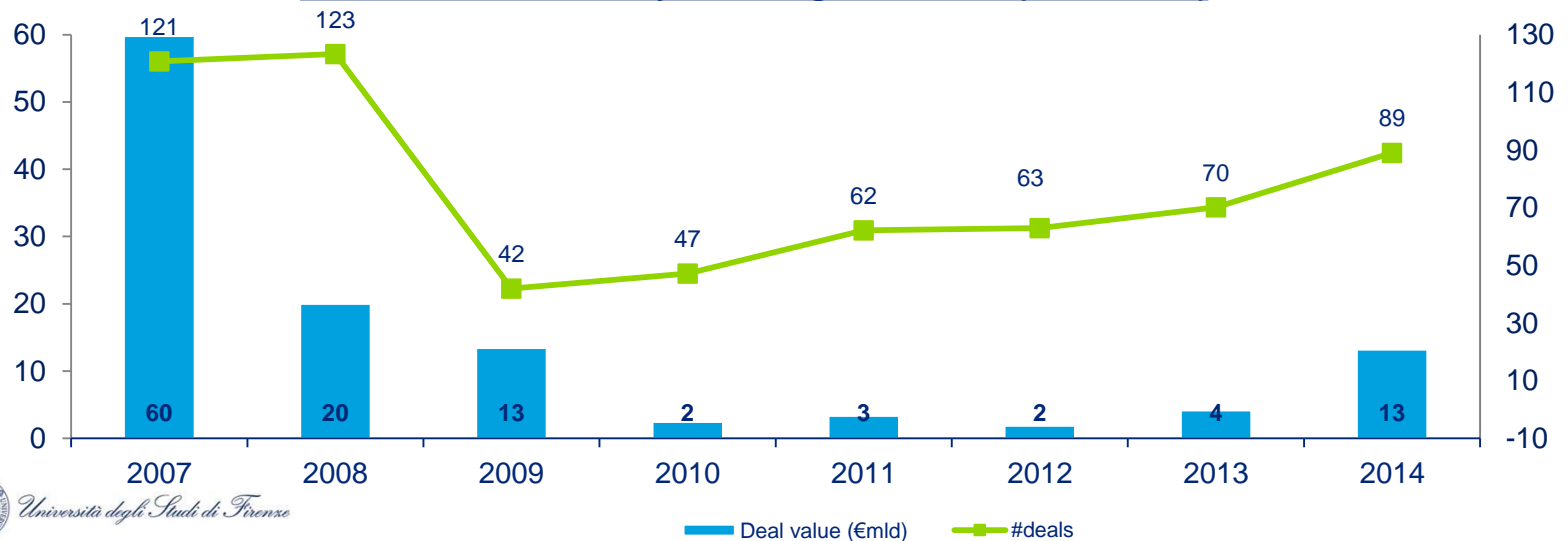
M&A Overview

M&A scenario in Italy (2/3)

M&A Cross border - Foreign countries on Italy (2007 - 2014)



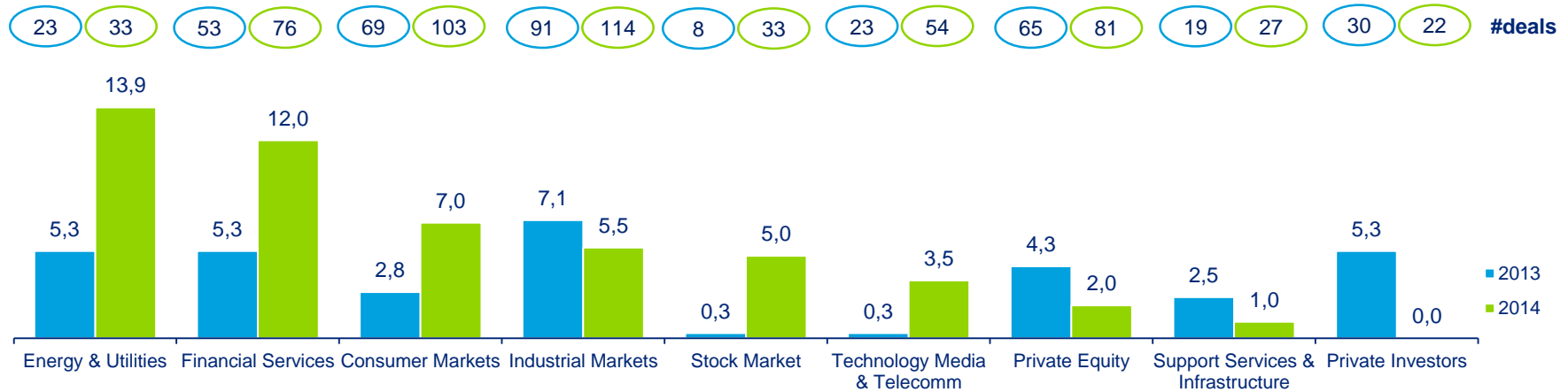
M&A Cross border - Italy on Foreign Countries (2007 - 2014)



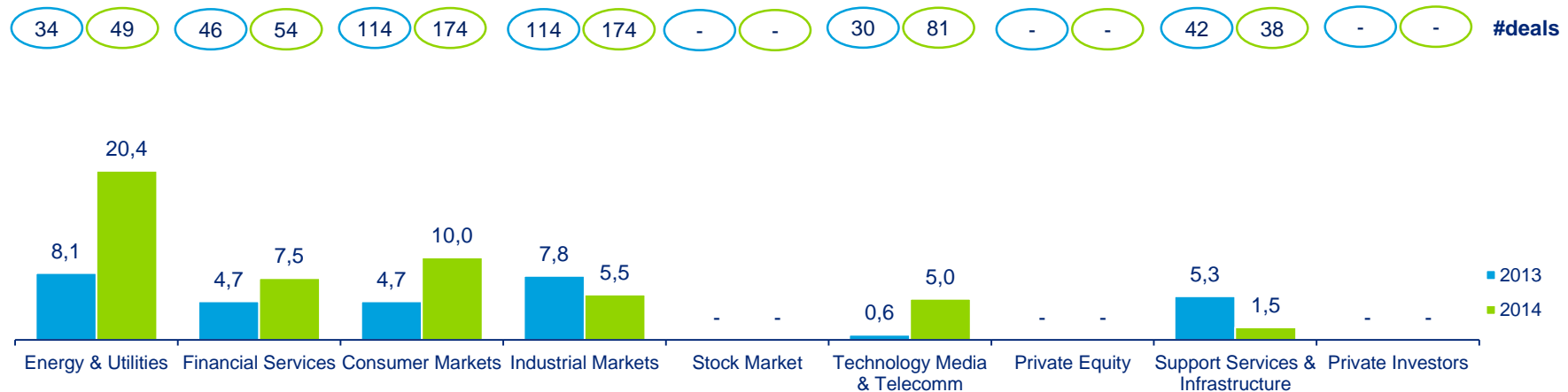
M&A Overview

M&A scenario in Italy (3/3)

M&A breakdown by sector of the Bidder (€ mln)



M&A breakdown by sector of the Target (€ mln)



Lesson 3 Summary

1 M&A Overview

2 M&A Process

- Phases of an M&A Deal
- M&A deals: Buy side - Sell side
- M&A documents
- Configuration of the sell process

3 Negotiation

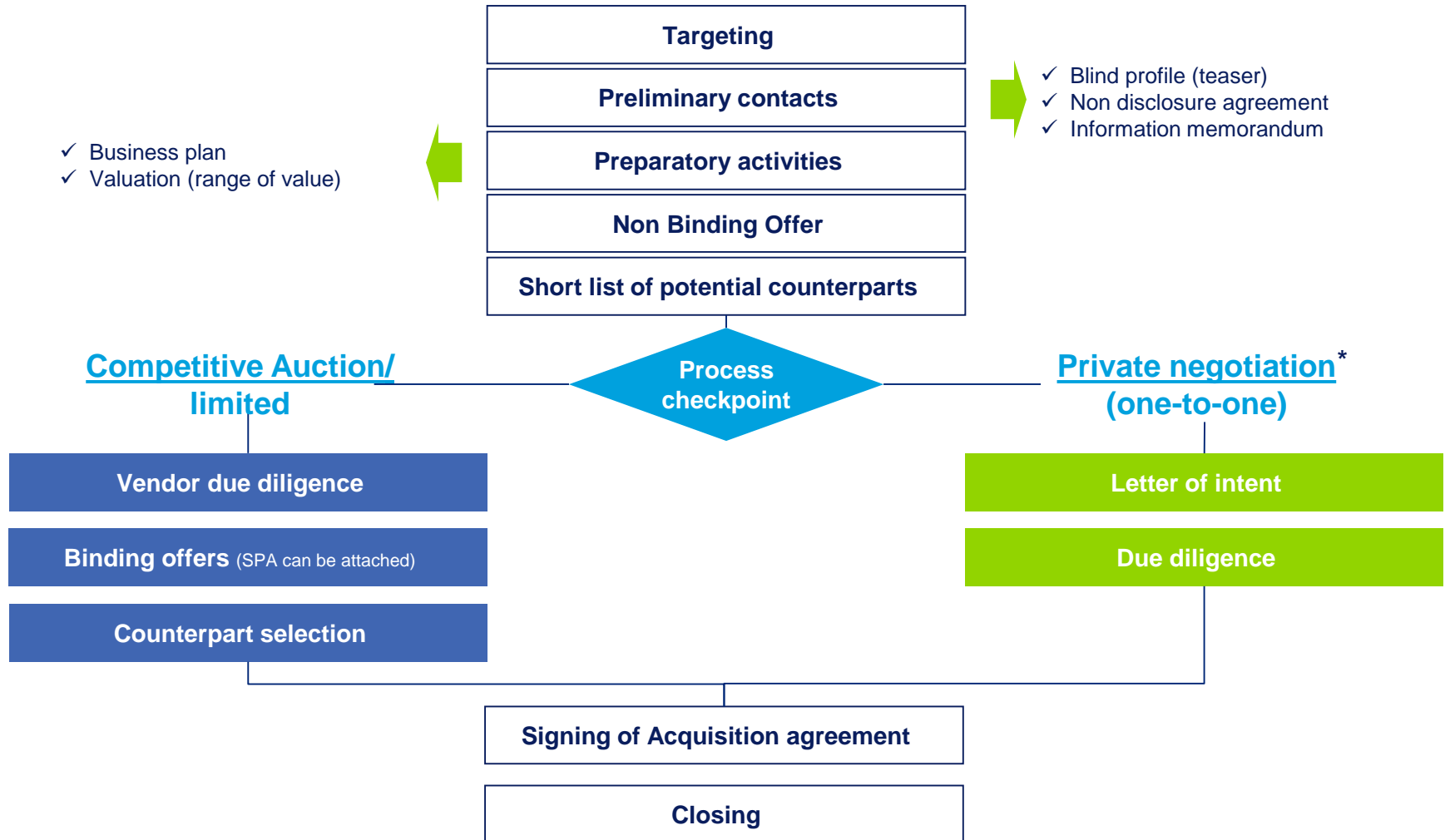
4 Closing

5 Post merger integration

M&A Process

Phases of an M&A deal

M&A process checkpoint:



Notes: It's more frequent in case of industrial investors, in particular in the circumstance that the seller(buyer) has since the beginning of the process a clear idea of the selected counterpart for specific strategic or personal reasons.

M&A deals: Buy side - Sell side

Buy side

Pre-Deal

- Strategic Direction
- Deal Origination
- Buying from Private Equity
- Auction process
- Managing Price
- Ownership structure
- External environment
- Financing

Deal Execution

- Speed of execution
- Competing against other bidders
- Governance and cost
- Identifying and evaluating risks and rewards
- Synergy benefits
- Competition clearance
- Organization structure
- Managing the SPA process

Post Deal

- Integration
- Customer retention
- Measuring value
- Optimizing value
- Key Learning

Sell side

Pre-Deal

- Deal origination
- Strategic positioning
- Auction process
- Carve out
- Confidentiality
- Transitional Service level Agreement
- Early issues identification
- Building a business case

Deal Execution

- Price maximisation
- Speed of execution
- Process control
- Minimising business disruption
- Governance and costs
- Pensions
- Rewarding management on exit
- Managing the SPA process

Post Deal

- Clean break
- Customer retention
- Measuring value
- Key Learnings

M&A documents

After the Targeting activities the Company's Advisor draws up some documents to start the first contacts with potential investors

Blind profile (Teaser)

A teaser is a blind profile of the target company that is sent to players that seem to be interested in the operation (or supposed to be on the basis of facts and information available)

- ✓ Reference market
- ✓ Activity
- ✓ Main financial data

Non disclosure Agreement

When a counterpart wants to proceed on the contact it's necessary to draw up a legal contract through which the parties agree not to disclose confidential information covered by the agreement

- ✓ Confidentiality of given information
- ✓ Ban of using information in someone personal interest
- ✓ Ban of submitting job proposal to management

Information Memorandum

Information memorandum contains more complete and specific information about the target Company, as well as personal data. It's useful to give:

- ✓ Detailed Company Profile
- ✓ Company's market position
- ✓ Company's economic and financial situation
- ✓ Company's potentialities

Teaser

At the beginning of an M&A process the target Company's Advisor draws up a **short anonymous description** of its business to test the market interest in the operation



The blind Profile (**Teaser**) is sent to companies that could potentially be interested in the operation to test the opportunity of carrying on the operation

Typical contents of a teaser are:

- ✓ Company headquarter ("Made in Italy")
- ✓ Ownership structure (anonymous)
- ✓ Products short overview
- ✓ Company activity
- ✓ Main financial highlights

Non Disclosure Agreement (Confidentiality Agreement)

In the common praxis the seller is likely to be required to provide some information about the business to prospective buyers/target companies before the beginning of detailed negotiations.



Unless and until a **binding sale and purchase agreement** has been entered into, **a seller will almost certainly want to keep confidential the fact that the business is “for sale”** and the fact that discussions/negotiations are taking place with one or more interested buyers.

- It may unsettle its employees
- It can impact on relationships with customers
- It can impact on relationships with suppliers

Confidentiality Agreement can be:

Unilateral: when only one part undertakes the non-disclosure duty.

Mutual: when the parties undertake the non-disclosure duty one to another and vice versa

Confidentiality Agreement Contents:

- **Parties** of the agreement
- Definition of what is **confidential**
- **Items excluded** from what must be kept confidential
- **Term** of the **confidentiality**
- **Term** the agreement is **binding**

Information Memorandum

When a formal auction process is undertaken, the seller needs to make sure that the same information is given to all prospective buyers



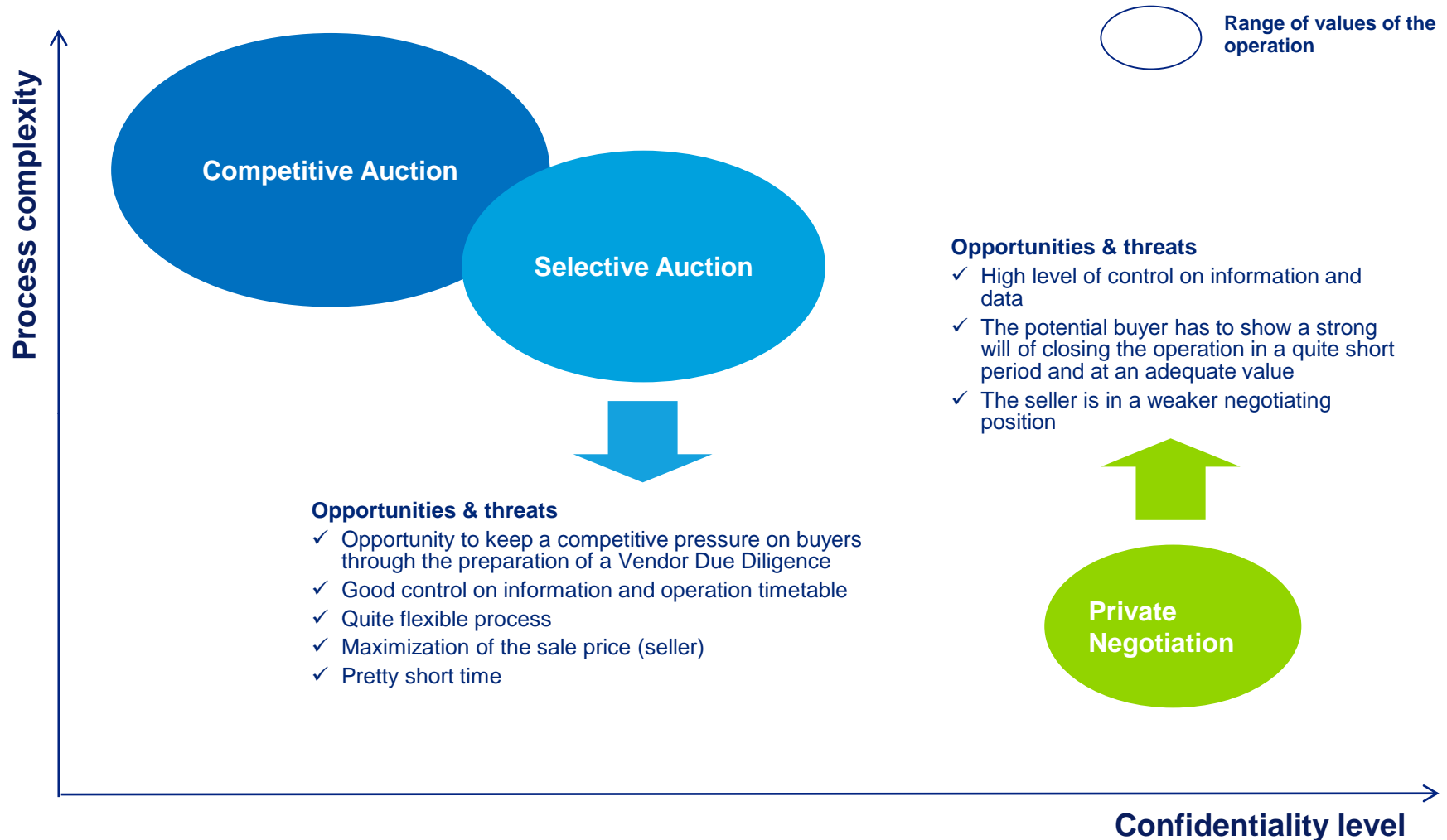
Information Memorandum

Normally prepared by seller's lead advisor on the basis of information provided by the seller

Typical sections of an Infomemo are:

- ✓ Investment Opportunities
- ✓ Company profile and Milestones
- ✓ Company structure
- ✓ Business model
- ✓ Market overview and competitive strategy
- ✓ Plants and logistics
- ✓ Products and commercial network
- ✓ Details about main relevant data (revenues breakdown by sector/product/area, ABC clients and suppliers, etc.)
- ✓ Corporate Governance and personnel
- ✓ Financial highlights (historical trend and forecast)

Configuration of the sell process



Lesson 3 Summary

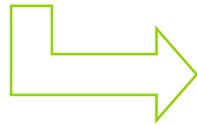
- 1 M&A Overview
- 2 M&A Process
- 3 **Negotiation**
 - Letter of Intent
 - Due Diligence
- 4 Closing
- 5 Post merger integration

Negotiation

Letter of Intent

It's a fundamental step of the M&A process, when the parties write down the terms of the transaction. It's a moral, more than legal, commitment for the parts to respect the agreement.

- ✓ **Innominate contract, not specifically regulated by the civil code**
- ✓ **Pre-contractual document that usually doesn't bind parties, except for:**



Obligation of confidential treatment of information (commitment sanctioned even by confidentiality agreement)

Contingent exclusive (Seller obligation to not carry on other negotiations for an established stretch of time, defined in the same letter)

Contingent *stand still* clauses (Seller obligation to not conduct any operation that go beyond company's ordinary activities)

Letter of Intent's contents are not peremptorily defined. Its aim, indeed, is to define the main aspects of the negotiation that will be refined with the Sell and Purchase agreement (SPA)



Contracting parties

Object of negotiation

Valuation methods for price determination

Purchase price (related to Due diligence outcome)

Way of payment (with other contingent kinds of reward)

Essential elements for the closing of the operation

- ✓ Seller's guarantees about company status
- ✓ Post- acquisition governance

Negotiation

Due Diligence



Verifying the presence of elements that don't allow to realize the investment or (more likely) that require reviews and revisions of one or more contractual conditions (price, guarantees, etc.)

“Light” Due diligence



It's the first phase of due diligence process. The investor directly collects information about the target company, through site visits, meetings with entrepreneur, management and experts

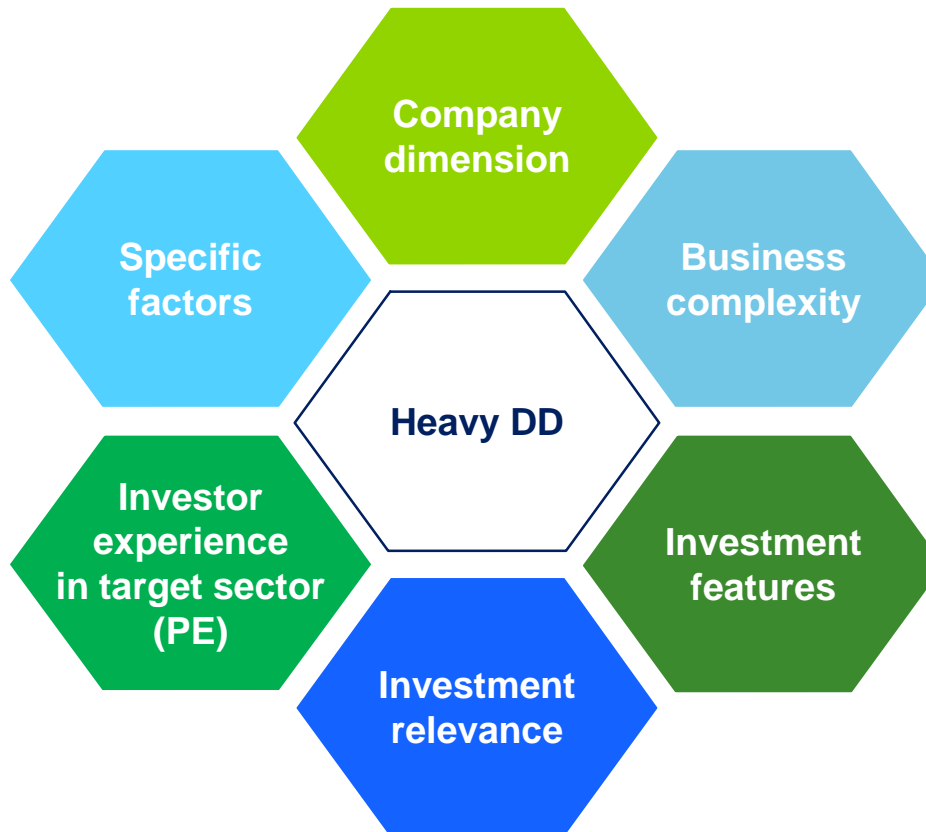
“Heavy” Due diligence



It's a subsequent phase, conducted by external advisors, which realize careful inspections on behalf of the investor, testing different aspects of the target Company

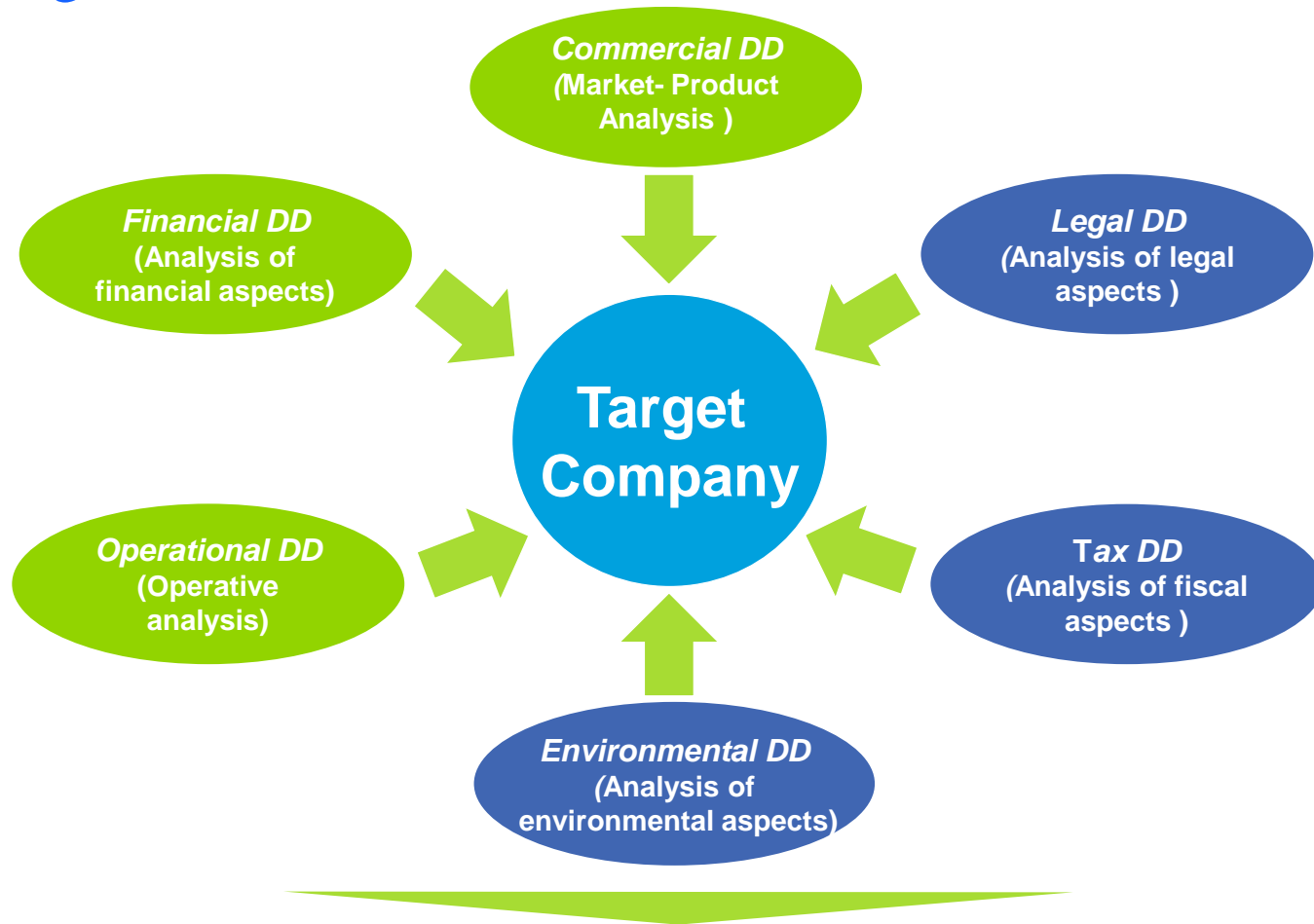
“Heavy” Due diligence

Accuracy and extension of “Heavy” Due Diligence depend on



Negotiation

Due Diligence

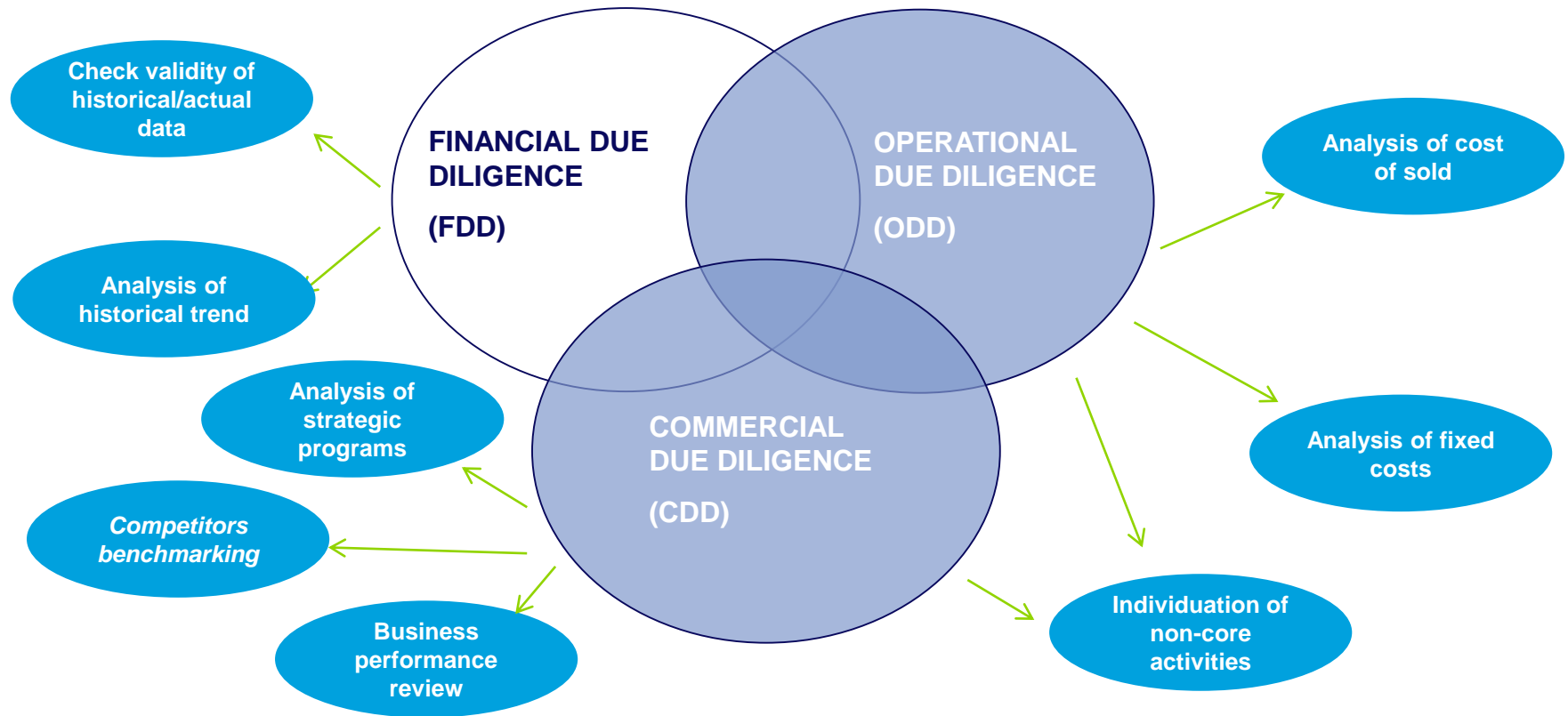


Due Diligence main objective is to verify historical results and to analyze the consistency and reliability of Business Plan development forecasts.

Negotiation

Due Diligence

Commercial, Operational e Financial Due Diligence are very integrated activities necessary for M&A transactions



- ▶ **Commercial DD:** External performance Analysis [Market] and control of the consistency of **BP commercial assumption**;
- ▶ **Operational DD:** Internal performance Analysis [Company] and control of the consistency of **BP operative assumption**;
- ▶ **Financial DD:** Historical performance Analysis and control of reported data.

Negotiation

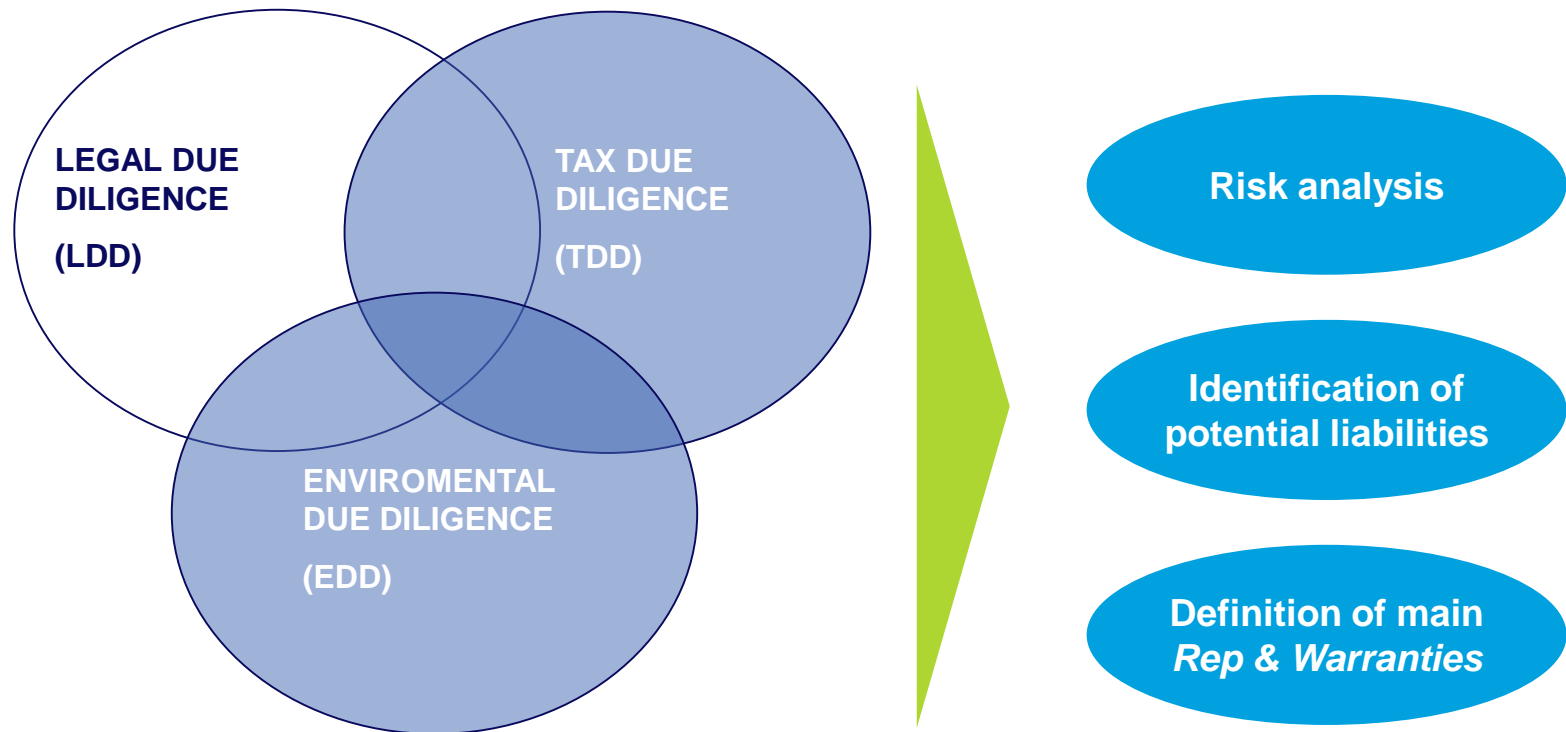
Due Diligence

| Area | Typical Questions | Aims and benefits |
|------|--|---|
| CDD | <ul style="list-style-type: none"> Is the strategy sustainable ? Is the market in a growth phase? What is competitors' behavior? Is the business well positioned in reference markets? Which threats could emerge? What's the reference regulatory context? Do new markets exist? Are margins sustainable? Is the <i>Business Plan</i> sustainable? | <p><u>Historical and forward analysis</u></p> <ul style="list-style-type: none"> Check of the consistency between expected results and market context; Check of business plan sustainability and reliability. |
| ODD | <ul style="list-style-type: none"> What has been company's historical operative performance? What's the cost structure related to this performance? Are the <i>assumptions</i> at the base of BP correct? How do improvement plans react to sensitivity analysis? Is there consistency between the timing of BP results and the assumptions? Have been some areas liable to improve efficiency ignored? Are there other opportunities to improve company performance? | <p><u>Historical and forward analysis</u></p> <ul style="list-style-type: none"> Identification of operative performance; Valuation of performance improvement plans Identification of additional improvement opportunities |
| FDD | <ul style="list-style-type: none"> Which are current economic and financial business performances? Is accounts' classification consistent with reference accounting standards? Are there non recurring items or normalized items? Are funds adequate? Are there overestimation elements of Equity? | <p><u>Historical analysis</u></p> <ul style="list-style-type: none"> Qualitative and quantitative analysis of assets, liabilities and incomes, for the purpose of verifying economic and financial results and potential liabilities |

Negotiation

Due Diligence

Legal, Tax and Environmental Due Diligence are ancillary activities that refine Due Diligence process to valuate every single aspect of M&A transactions



Negotiation

Due Diligence

| Area | Typical Questions | Aims and benefits |
|------|--|--|
| TDD | <ul style="list-style-type: none"> ▪ Have tax returns been correctly presented? ▪ Have been taxable incomes correctly determined? ▪ Is the company up to date with payments? ▪ Is the company in relationships with “<i>black list</i>” Countries? ▪ Are there current/potential tax litigations with financial authorities? | <p><u>Historical analysis</u></p> <ul style="list-style-type: none"> ▪ Check of company fiscal aspects, in particular it focuses on tax litigations, tax liabilities and contingent tax benefits (definition of <i>rep and warranties</i>). |
| LDD | <ul style="list-style-type: none"> ▪ Are there current/potential litigation risks? ▪ Does the Company respect current regulations? ▪ Does the Company respect intellectual property rights? ▪ Has the Company correctly edited/updated account books? ▪ Are company's relationships with employees/agents correctly regulated ? ▪ Has the Company lent financial guarantees? | <p><u>Historical and forward analysis</u></p> <ul style="list-style-type: none"> ▪ Check of any possible legal matter, that could impact on company's value and/or on the draft of the purchase agreement (definition <i>rep and warranties</i>) |
| EDD | <ul style="list-style-type: none"> ▪ Do factories and plants operate in accordance with current regulations? ▪ Does the Company respect regulation about health and work safety? ▪ Do environmental liabilities and/or related risks exist? ▪ Do dangerous materials and substances exist? ▪ Does the Company respect current regulation concerning waste management, water resources management, ground safeguard and air pollution? | <p><u>Historical and forward analysis</u></p> <ul style="list-style-type: none"> ▪ Check of company's compliance with current regulations and environmental impacts of company's activity. |

Negotiation

Due Diligence

Data Room

Data Rooms are part of the Due diligence procedure.

It represents the place where physically/virtually the due diligence documents are.

Its aim is to consent the proposed bidders to analyse the confidential documentation related to target Company.



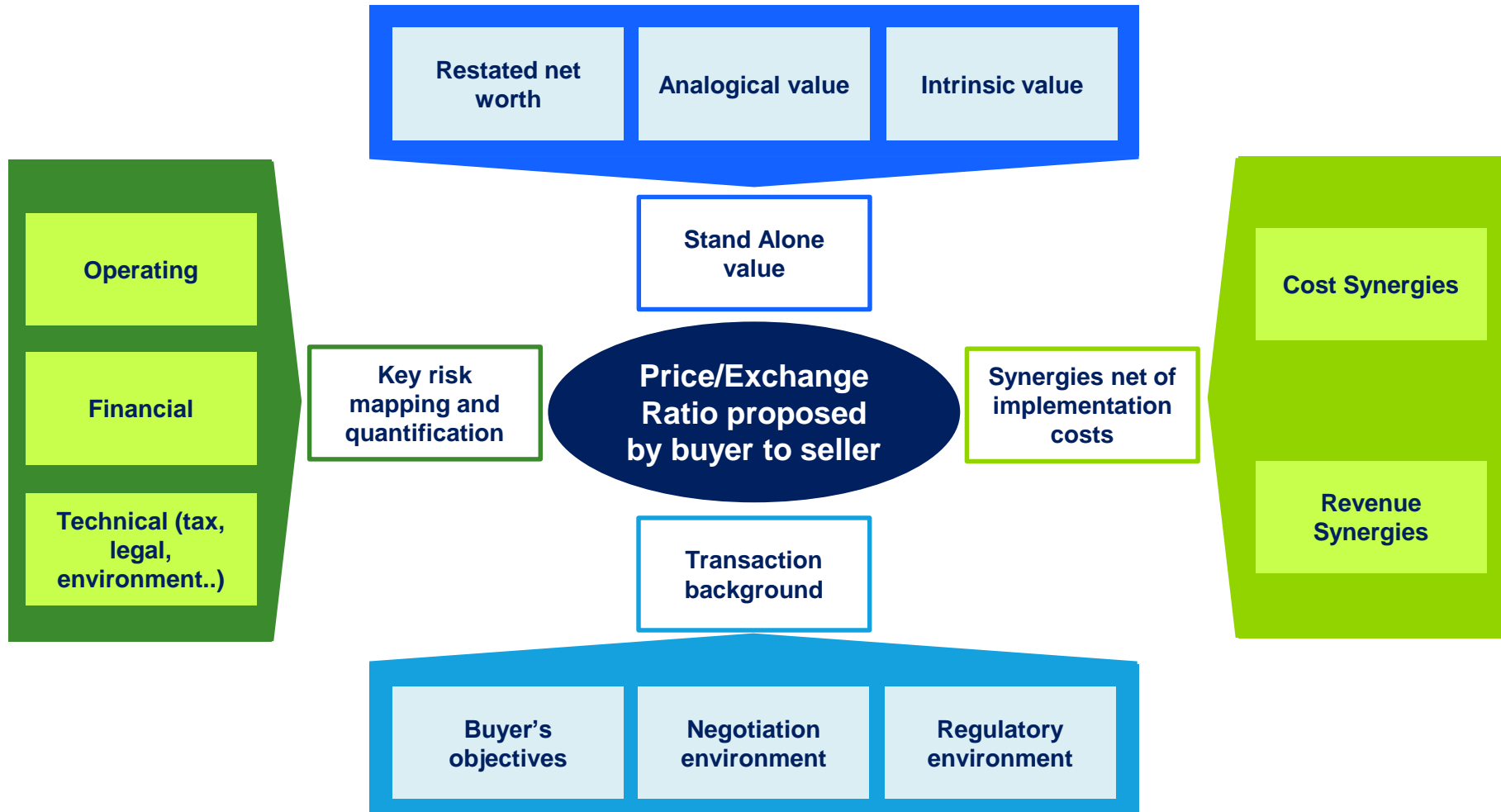
- ✓ **Virtual data rooms** are web-sites reserved to the players of the specific transaction, which through a password or an access key can display the documents.
- ✓ **Traditional data rooms** are a physically secure room, continually monitored, normally in the vendor's offices (or those of his lawyers), which the bidders and their advisers will visit in order to inspect and report on the various documents and other data made available.

Lesson 3 Summary

- 1 M&A Overview
- 2 M&A Process
- 3 Negotiation
- 4 Closing
 - From value to price
 - SPA
 - Closing
 - Different kinds of M&A deals
- 5 Post merger integration

Closing

From value to price



Contrasting objectives of buyers and sellers

Closing

SPA

M&A transaction ends with a Sale and Purchase Agreement (SPA) regulated by art 2556 and following of Italian Civil Code

On the basis of art. 2556 C.C., the Sale and Purchase Agreement:

- ✓ **must be proven in writing and draft in the form of public deed or private deed certified by a notary**
- ✓ **the notary must register the contract in the term of 30 days in the company registration list, and he must refer the agreed price and company's details to the commissioner contractor's personal data,**

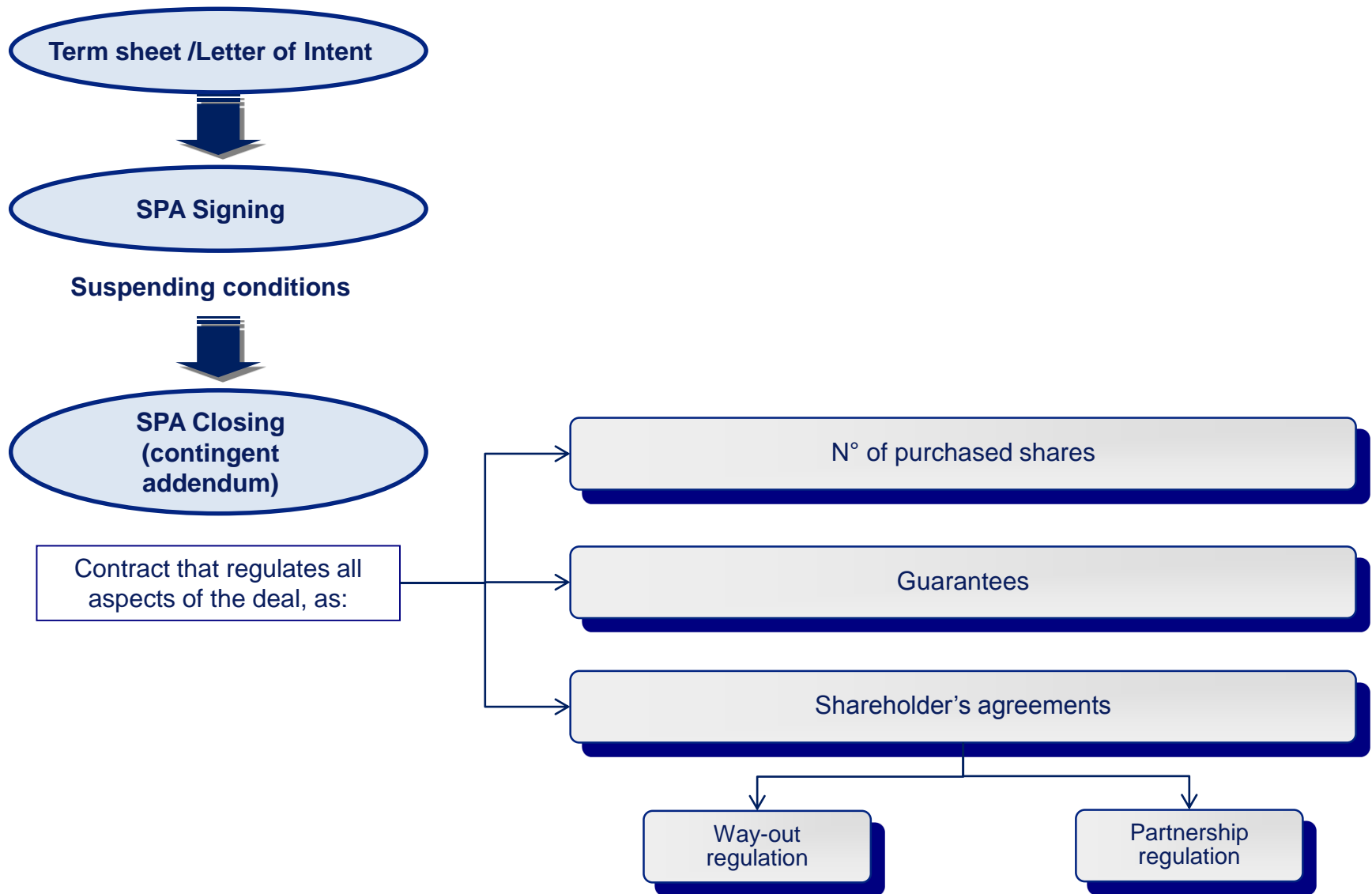
Even if it doesn't have a specific form, SPA usually contains following data:



| | |
|---|---|
| Contractor's personal data | Conditions related to contract's suspension/ resolution |
| Deal structure | Regulation of put&call options |
| Price settlement (conditions, timetable, earn out clauses) and payment methods | Ancillary and specific clauses |
| Assets and liabilities transferred | Declarations and guarantees |
| Seller obligation to not realize relevant changes at the transferred company before the closing | Shareholder's agreements (attached to contract) |
| Seller's competition ban (art. 2557 CC) | Ancillary contracts (properties rent, subordinate employment partnerships , etc.) |

Closing

Closing



Closing

Closing

Despite the SPA is drawn up after due diligence it's essential to protect the buyer from the risk of economic losses resulting from past management and occurred before the closing.

The seller includes in the agreement some declarations and guarantees

*In general in the agreement it's provided an **indemnification obligation** for the purchaser, related to company's previous liabilities and contingent liabilities that should occur, with regard to to the **situation of the company resulting from declarations and documents attached to the agreement.***

Nature of contingent liabilities can be:



Guarantees

(usually time and amount limited – allowance and ceiling)

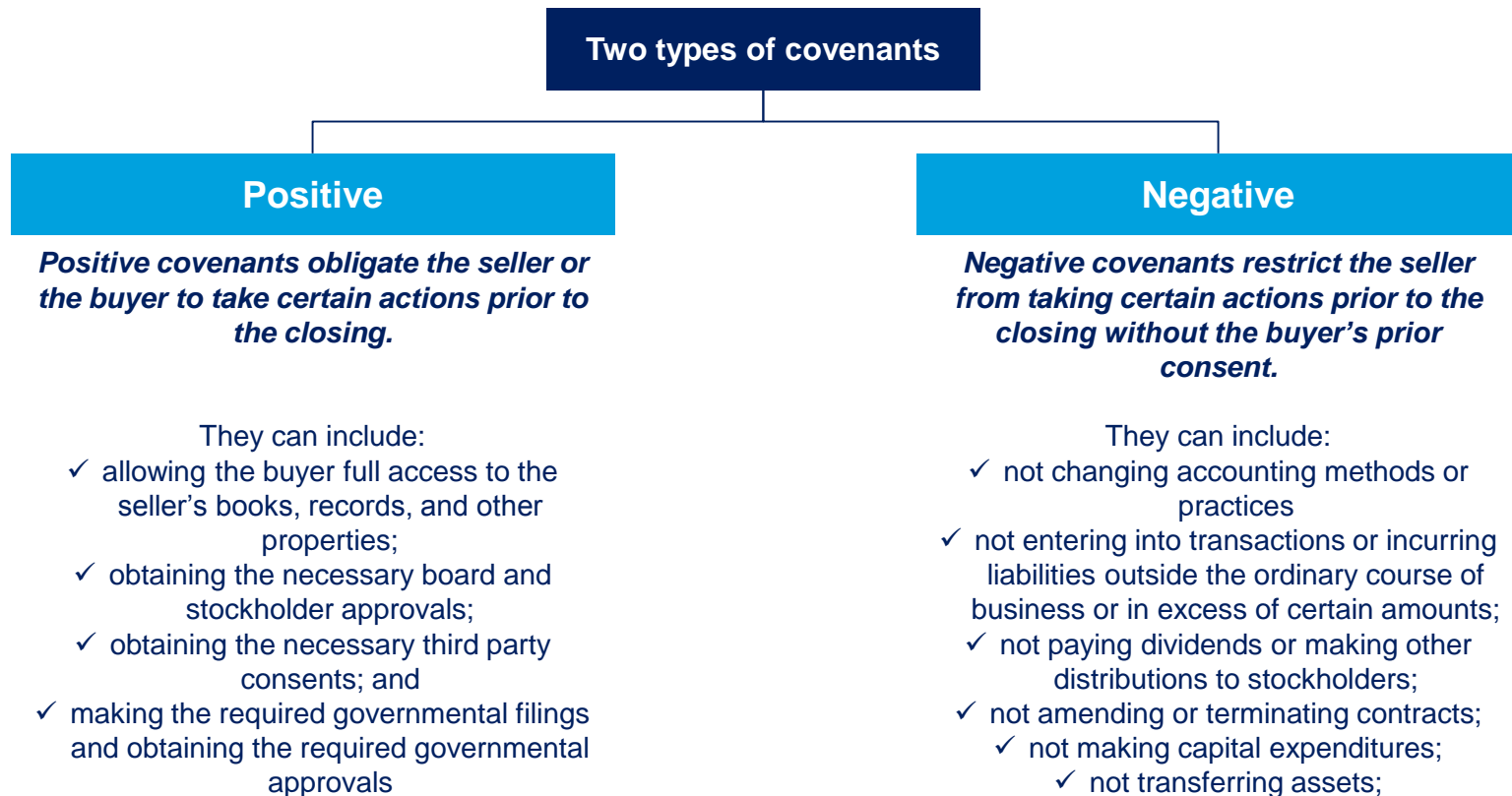
- ✓ Real: guarantee (usually at first request)
- ✓ Escrow account (part of the price paid is related to determined conditions)

Even the seller usually asks for guarantees for the amount yet to be collected (also contractual guarantees)

Closing

Closing

An important feature of SPA are pre-closing covenants, or promises to do/not do something during the period between the signing of the SPA and the closing



M&A deals usually contain also several conditions to closing: certain obligations that must be fulfilled in order to legally require the other party to close the transaction, such as corporate approvals, governmental filings.

Closing - Partnership discipline

Governance

- **Corporate Governance composition:**
 - Management Designation
 - Board of Directors Designation
 - Board of Statutory Auditors Designation
- Veto right and BoD exclusive topics regulation
- Decision deadlock regulation
- Bad leaver clause
- Non Competition agreement

Stock option plan

Regime of shares outstanding

Lock-up clause

Drag along clause

Tag along clause

Sell option(Minority shareholders)

First bid right

Closing

Different types of M&A deals

| | | Type of transaction | |
|---------|-------|---------------------------------|-------------------------------------|
| | | Asset purchase | Stock purchase |
| Payment | Cash | Acquisition (sale) of assets | Acquisition (sale) of shares |
| | Stock | Contribution of assets | Contribution of shares or merger |

Lesson 3 Summary

- 1 M&A Overview
- 2 M&A Process
- 3 Negotiation
- 4 Closing
- 5 Post merger integration
 - Types of integration
 - Problems of integration

Post merger integration

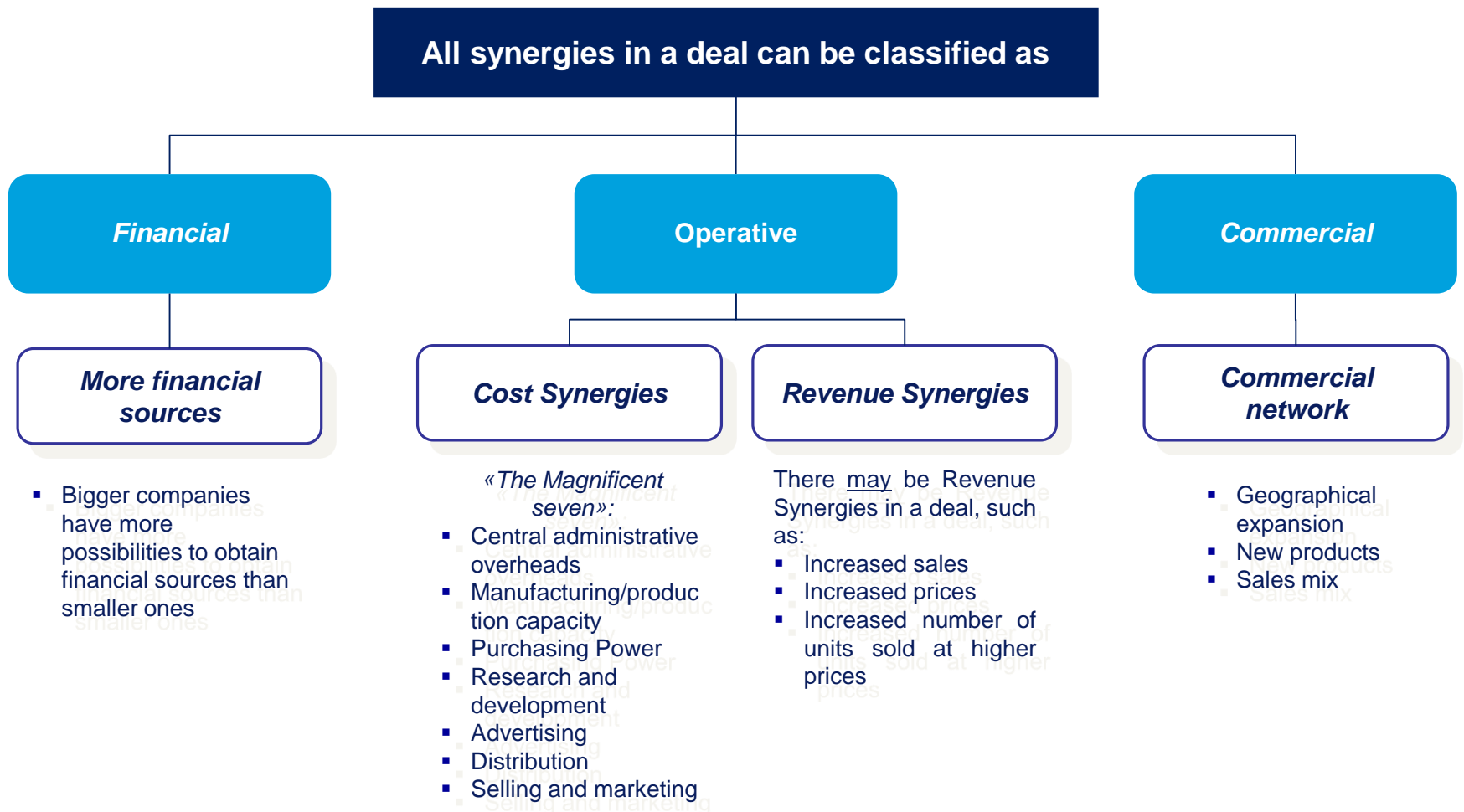
Types of integration

M&A deals can configure different kind of integration:

| | Horizontal | Vertical | Conglomerate |
|-----------|--|---|---|
| Target | <ul style="list-style-type: none">Has same products/servicesHas same margin of business | <ul style="list-style-type: none">Is a supplierIs a distributorIs a customer | <ul style="list-style-type: none">Has different products/servicesHas different customers |
| Rationale | <ul style="list-style-type: none">Sector knowledge | <ul style="list-style-type: none">Protection of the supply chainMargins that would be lost | <ul style="list-style-type: none">Spread risk |
| Notes | <ul style="list-style-type: none">Often deals are called horizontal even if they are not (same clients)More anti-trust issues | | <ul style="list-style-type: none">Conglomerates suffer the “diversification discount” 10-15% on average |

Post merger integration

Types of integration



Consequences: for same value different buyers may have different synergies, hence different prices

Post merger integration

Types of integration

In general through M&A operations companies hope to benefit from the following aspects:

“Staff reductions”

- Mergers usually mean reduction of staff members from accounting, marketing and other departments.
- Job cuts will also include the former CEO, who typically leaves with a compensation package.

“Economies of scale”

- Bigger company placing the orders can save more costs.
- Mergers also translate into improved purchasing power
- Placing larger orders, companies have a greater ability to negotiate prices with their suppliers.

“New Know-how”

- By buying an innovative smaller company with unique technologies, a large company can maintain or develop a competitive edge.

“New Market”

- Mergers allow companies to reach new markets and higher revenues
- Mergers may expand companies distribution offering new sales opportunities.
- Mergers can also improve a company's ability to raise capital than smaller ones

Post merger integration

Problems of integration

Problems with synergies

Prediction

- Human nature and buyers' nature
- Increase of predicted synergies as «deal crisis» approach
 - Sunk costs
 - Sunk management time
 - Buyer's ego
- Lack of reliable information

Achievement

- Target management often leaves
- Buyers often see the acquisition as the end of the transaction rather than the beginning
- Five of the seven operative costs synergies require job cuts, so there may be political, social and regulatory difficulties

Costs

- Synergies have a cost that is often underestimated/ignored:
 - Redundancy
 - Property
 - Environmental
- Costs come before savings
- There is often the possibility of negative synergies