

PEPPERDINE UNIVERSITY
THE GEORGE L. GRAZIADIO
SCHOOL OF BUSINESS AND MANAGEMENT

JOHN K. PAGLIA, Ph.D.

MERGERS AND ACQUISITIONS (MBAM 624)

MALIBU CAMPUS

MONDAY: 1:00 P.M. – 5:00 P.M.

FALL 2008 (Session B)

SYLLABUS

Mergers and Acquisitions
Fall 2008: Malibu Graduate Campus
Monday: 1 p.m. – 5 p.m.

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Introduction

Welcome to Mergers and Acquisitions! This course is designed to acquaint students with the fundamental issues surrounding corporate control transactions. Topics include value creation in mergers; choice of payment method; ethical and social considerations, valuation of contingent payments; deal protection; incentive effects of deal financing; defensive tactics; and leveraged buyouts. We discuss bidding strategies and takeover tactics. Students get to practice merger negotiations in a team exercise. We also cover the legal and regulatory framework for takeovers, such as filing requirements, fiduciary duties of the target board of directors, and antitrust regulation. The course uses a mix of case analysis, providing ample opportunity to practice the application of standard corporate valuation methods and lectures.

Course Description (2008-2009 GSBM Catalog)

The purpose of this course is to study the motives for control transactions and the process by which economic resources are reallocated. Among the transactions studied are mergers, acquisitions, hostile takeovers, going-private transactions (LBOs and MBOs), asset restructuring, and voluntary and involuntary liquidation. Methods for developing takeover defenses also are examined. The influences of the legal and regulatory environment as well as competition in input and product markets are considered in developing a framework for understanding merger waves and industry consolidations.

Prerequisites: MBAM 623: Business Valuation and MBAM 614: Finance.

Texts and Course Materials

1) Patrick A. Gaughan, Mergers, Acquisitions, and Corporate Restructurings, 4th edition, Wiley Finance 2007. ISBN: 978-0-471-70564-2

2) Case Study Packet

The case study packet contains the following:

Case: Pinkerton (A), HBS 9-291-051.

Case: Chase Manhattan Corporation: The making of America's largest bank, HBS 9-298-016.

Case: Cooper Industries, Inc. HBS 9-274-116.

Case: General Mills' acquisition of Pillsbury from Diageo Plc., UVA-F-1326.

Case: AXA MONY, HBS 9-208-062.

Technical note on considerations: floors, caps, and collars, HBS 9-902-056.

Case: Brazos Partners: The CoMark LBO, HBS 9-202-090

Case: Time Inc.'s entry into the entertainment industry, HBS 9-293-117 **and** B-case, HBS 9-293-133

Technical note on structuring and valuing incentive payments in M&A: Earnouts and other contingent payments to the seller, UVA-F-1322.

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.

Case: The Acquisition of Consolidated Rail Corporation (A), HBS 9-298-006, **and** (B), HBS 9-298-095

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

Case: The Hilton-ITT Wars, UVA-F-1217

Bruner, Robert, "Hostile takeovers: A primer for the decision maker", UVA-F-1362.

Case: American Telephone & Telegraph (AT&T): The AT&T/McCaw merger negotiation, UVA-F-1142, or

McCaw Cellular Communications: The AT&T/McCaw merger negotiation, UVA-F-1143

Grading

The grade description and weighting method are given as follows:

<u>Grade distribution</u>	<u>Assignment weights</u>
A = 93% - 100%	Class participation 20%
A - = 90% - 93%	Case presentation(s) 40%
B+ = 87% - 90%	Merger Negotiation 10%
B = 83% - 87%	Takeover Research Paper <u>30%</u>
B- = 80% - 83%	
C+ = 77% - 80%	Total: <u>100%</u>
C = 73% - 77%	
C- = 70% - 73%	
F = Below 70%	

The course grade is based on individual class participation and team assignments. You may not use notes or other material from any previous offering of this or a similar course, or discuss the material with students who have already taken the course. This restriction extends to case-related information obtained from other sources.

A brief description of each of the grade components is given below:

I. Class participation

Students are expected to attend every class. Class participation is individual effort and is graded after each session. The class participation grade is a function of attendance, submission of case summaries (see “Cases”), and value-added class discussion.

II. Cases

Each case after the first class meeting will be presented to the class by a group of students. The presentations, which should not exceed 45 minutes, must address all of the case study guiding questions in addition to a brief overview and summary of actual events that transpired. (I recommend researching the actual events after you prepare your case so as to not let the actual events influence your conclusions.) Those students who are not members of the presenting group are expected to read the case, turn in a 1-2 page high-level analysis of the issues in the case (at the beginning of each class), and contribute to the class discussion. Students may form teams and submit them by email to me by midnight after the first class meeting. All students who are not organized in groups (i.e. that have not emailed me) by this deadline will be assigned to a team and notified by noon of the following day.

III. Merger negotiations

The AT&T/McCaw case is a negotiation exercise that takes place during class #6. You will be assigned to a two-person team representing one side of the negotiations between AT&T and McCaw. Your team will negotiate the merger with a team from the counterparty. Prior to the negotiations your team should hand in a confidential report outlining your opening price, walk away price and negotiation strategy. After the negotiations you should hand in a report explaining and justifying the outcome of the negotiations. This final paper is due within three days of the date on which the negotiation took place.

IV. Takeover Research Paper

Students will make a thorough analysis of a potential takeover transaction. You should pick a possible bidder and target, justifying why this target is an attractive acquisition for the bidder. The write-up should provide an analysis of a range of different aspects of the transaction, including the strategic and economic benefits, bid range, type of consideration, bidding strategy, legal and tax aspects, anticipated management reaction, and potential competition. This assignment should be completed with your case study presentation group. The paper is due at the beginning of the final class and each group will give a brief presentation on their analysis and findings.

Attendance Policy

Attendance for the first class is mandatory. It is during the first meeting that groups are formed and direction for the class is given. Missing the first class meeting will result in your being dropped from the class.

For other class meetings, it is expected that students will only miss class under extenuating circumstances (working out of town, attending weddings/funerals, etc.); however missed classes may have an adverse contribution on your participation grade. Prior written notice of expected absences is highly encouraged.

Laptop Use

One benefits most from this class by having an undiluted focus during class meetings; therefore, laptops should be closed during class activities that do not require computer use. If someone's use of a computer is not for class purposes or is disruptive to anyone in the class or to me, it will negatively impact the participation grade.

Office Hours and How to Contact Me

In general, I will be available before and after each class but I will be happy to arrange meetings outside of these times on request. The best way to contact me personally is through e-mail at my University e-mail address (see above). I check my e-mail regularly and will respond to messages as quickly as possible.

Conduct

This course may require electronic submission of essays, papers, or other written projects through the plagiarism detection service Turnitin (<http://www.turnitin.com>). Turnitin is an online plagiarism detection service that conducts textual similarity reviews of submitted papers. When papers are submitted to Turnitin, the service will retain a copy of the submitted work in the Turnitin database for the sole purpose of detecting plagiarism in future submitted works. Students retain copyright on their original course work. The use of Turnitin is subject to the Terms of Use agreement posted on the Turnitin.com website. You may request, in writing, to not have your papers submitted through Turnitin. If you choose to opt-out of the Turnitin submission process, you will need to provide additional research documentation and attach additional materials (to be clarified by the instructor) to help the instructor assess the originality of your work.

The University expects from all of its students and employees the highest standard of moral and ethical behavior in harmony with its Christian philosophy and purposes. Engaging in or promoting conduct or lifestyles inconsistent with traditional Christian values is not acceptable.

The following regulations apply to any person, graduate or undergraduate, who is enrolled as a Pepperdine University student. These rules are not to be interpreted as all-inclusive as to situations in which discipline will be invoked. They are illustrative, and the University reserves the right to take disciplinary action in appropriate circumstances not set out in this catalog. It is understood that each student who enrolls at Pepperdine University will assume the responsibilities involved by adhering to the regulations of the University. Students are expected to respect order, morality, personal honor, and the rights and property of others at all times. Examples of improper conduct for which students are subject to discipline are as follows:

- *Dishonesty in any form, including plagiarism, illegal copying of software, and knowingly furnishing false information to the University.*
- *Forgery, alteration, or misuse of University documents, records, or identification.*
- *Failure to comply with written or verbal directives of duly authorized University officials who are acting in the performance of assigned duties.*
- *Interference with the academic or administrative process of the University or any of the approved activities.*
- *Otherwise unprotected behavior that disrupts the classroom environment.*
- *Theft or damage to property.*
- *Violation of civil or criminal codes of local, state, or federal governments.*
- *Unauthorized use of or entry into University facilities.*
- *Violation of any stated policies or regulations governing student relationships to the University.*

Disciplinary action may involve, but is not limited to, one or a combination of the alternatives listed below:

Dismissal – *separation of the student from the University on a permanent basis.*

Suspension – *separation of the student from the University for a specified length of time.*

Probation – *status of the student indicating that the relationship with the University is*

tenuous and that the student's records will be reviewed periodically to

determine suitability to remain enrolled. Specific limitations to and

restrictions of the student's privileges may accompany probation.”

Policy on Disabilities

Assistance for Students with Disabilities

The Disability Services Office (DSO) offers a variety of services and accommodations to students with disabilities based on appropriate documentation, nature of disability, and academic need. In order to initiate services, students should meet with the Director of the DSO at the beginning of the semester to discuss reasonable accommodation. If a student does not request accommodation or provide documentation, the faculty member is under no obligation to provide accommodations. You may contact the Director of Disability Services at (310) 506-6500. For further information, visit the DSO Web site at: <http://www.pepperdine.edu/disabilityservices/>.

**MBAM 624: Mergers and Acquisitions
Schedule of Classes**

Class	Topics	Book Chapters	Other Readings <i>Note: Journal and HBR Readings are accessible using Pepperdine Library's Electronic Database</i>	Case Studies
1	Introduction; The Takeover Process; Corporate Governance; Social and Ethical Considerations, Target valuation, and financing the acquisition.	Ch. 1,2		Pinkerton
2	Motives for mergers and acquisitions; Exchange ratios; Antitrust regulation and enforcement; Synergy valuation; accretion and dilution analysis; acquisition premiums.	Pages 100-115; Ch. 4, 14 and 15.	<p>Eckbo, B. Espen, and Karin S. Thorburn, 2000, "<i>Gains to Bidder Firms Revisited: Domestic and Foreign Acquisitions in Canada</i>," Journal of Financial and Quantitative Analysis 35, 1-25.</p> <p>Rappaport, Alfred, and Mark L. Sirower, 1999, <i>Stock or cash? The trade-offs for buyers and sellers in mergers and acquisitions</i>, Harvard Business Review (Nov-Dec), reprint 99611.</p>	<p>Chase Manhattan Corporation;</p> <p>Cooper Industries</p>
3	Valuing contingent payments: CVRs and earnouts; Price protection: floors, caps, and collars; Control compensation payments; Convertible bonds; Voting and trading incentive effects.	Ch. 8	<p>Caselli, Stefano, Stefano Gatti, and Marco Visconti, <i>Managing M&A risk with collars, earn-outs and CVRs</i>, Journal of Applied Corporate Finance 18 (4), 91-104.</p> <p><i>Technical note on considerations: floors, caps, and collars</i>, HBS 9-902-056.</p> <p>Amobi, Tuna N., 1997, <i>Price protection in stock-swap transactions</i>, Merger & Acquisitions 32, 22-28.</p>	<p>General Mills' Acquisition of Pillsbury;</p> <p>AXA MONY</p>
4	The merger agreement; Board fiduciary duties; Parachutes and executive compensation; Value creation in leveraged buyouts; asset vs. stock purchase; evaluating a takeover offer; management responses.	Ch. 3, 12, 7	<p><i>Technical note on structuring and valuing incentive payments in M&A: Earnouts and other contingent payments to the seller</i>, UVA-F-1322.</p> <p>Bower, Joseph L., 2001, <i>Not all M&As are alike and that matters</i>, Harvard Business Review (March), reprint R0103F.</p> <p><i>M&A legal context: Basic framework for corporate governance</i>, HBS 9-803-200, and <i>Standards related to the sale or purchase of a company</i>, HBS 9-904-004.</p>	<p>Brazos Partners: The CoMark LBO;</p> <p>Time Inc.'s Entry into the Entertainment Industry</p>

5	Preventative and reactive defensive strategies; Takeover tactics: toeholds, tender offers, and proxy fights.	Ch. 5, 6	<p><i>M&A legal context: Hostile takeovers</i>, HBS 9-904-005.</p> <p>Bruner, Robert, “<i>Hostile takeovers: A primer for the decision maker</i>”, UVA-F-1362.</p>	<p>The Acquisition of Consolidated Rail Corporation;</p> <p>The Hilton-ITT Wars</p>
6	<p>Negotiation exercise: negotiating a merger agreement. Students will be assigned to represent either AT&T or McCaw. Class time will be used for negotiations in small teams. Each team should hand in confidential pre-negotiation and post-negotiation reports. We will then do a merger negotiation debriefing and discuss effective negotiation strategies.</p>		<p>Aiello, Robert J., and Michael D. Watkins, 2000, <i>The fine art of friendly acquisition</i>, Harvard Business Review (Nov-Dec), reprint R00602.</p> <p><i>Giving great advice: An interview with Bruce Wasserstein</i>, 2008, Harvard Business Review (jan), reprint R0801G.</p>	<p>The AT&T/McCaw merger negotiation, or McCaw Cellular</p>
7	<p>Student presentations of takeover research papers. All term papers are due at the beginning of class.</p>			

Case Study Questions

Class 1

Pinkerton (A), HBS 9-291-051.

1. How much is Pinkerton worth to Wathen? Value Pinkerton using DCF and multiples.
2. What are the different synergies in this deal and what are they worth?
3. What is the value of Pinkerton under American Brands?
How much could other bidders pay for Pinkerton?
4. Are any of the synergies unique to Wathen?
5. Should Wathen finance the \$100 million bid with debt or equity?
6. What debt ratio will the merged firm have if the bid is financed with 75% debt and 100% debt, respectively? Will there be sufficient cash flow to cover the debt payments?
7. What do you think of the proposed terms for the \$25 million equity contribution from the investment firm? Which financing alternative would you recommend to Wathen?

Class 2

Chase Manhattan Corporation: The making of America's largest bank, HBS 9-298-016.

1. Chemical and Chase are attempting to reduce their costs by merging. This approach ("bigger is better") represents a sharp contrast to the refocusing and downsizing which has characterized much of US restructuring in recent years. Do you think the interest of the banks' shareholders and other constituencies would be better served by another form of restructuring that instead emphasizes increased corporate focus?
2. What are the strategic benefits, if any, of combining Chase and Chemical? What is the most significant benefit that the banks will realize from this merger?
3. What incentives are there for the two management teams to support this merger?
4. Should Chemical reconsider any of its other prospective merger partners?
5. Assuming that all the anticipated benefits from the merger are realized, what is the likely dollar impact of the merger on the combined wealth of Chase and Chemical common stockholders?

6. How will the merger affect the banks' financial performance (e.g. as measured by return on equity)? How would you measure the success of this transaction? Use an equity beta for bank common stock of 1.25 and a 10-year US Treasury Bond rate of 6.4%.

7. How would you determine the share exchange rate? If you were Chemical management, what exchange ratio would you seek for the merger? What if you were Chase management?

8. Is the exchange rate a deal breaker or are there other features of the transaction that you might adjust?

Cooper Industries, Inc. HBS 9-274-116.

1. If you were Mr. Cizik of Cooper Industries, would you try to gain control of Nicholson File Company in May 1972?

2. What makes the target an attractive candidate for Cooper? Is it a good strategic fit?

3. What is the maximum price that Cooper can afford to pay for Nicholson? Do a DCF valuation of Nicholson using a WACC of 10%.

4. What are the potential synergies worth? What do you make of Nicholson's inventory?

5. What exchange ratio can Cooper offer before the acquisition has a dilutive effect on Cooper's earnings per share (EPS)? Is it important to consider the impact of an acquisition on EPS? How can decisions based on EPS go wrong?

6. Is it feasible for Cooper to pay with cash or debt finance a cash bid? How does cash consideration impact EPS?

7. Assume that on March 2, the day before Porter's offer, Cooper stock closed at \$22 and Nicholson stock at \$30. Moreover, assume that Cooper on the evening of May 3 offers Nicholson shareholders an exchange ratio of 2.0, i.e. 2 Cooper shares per Nicholson share. If the acquisition goes through, what percentage of the new company will be owned by Cooper's former shareholders? What acquisition premium is Cooper offering? What are the minimum synergies required for this offer to make sense for Cooper's shareholders?

8. What are the concerns and what is the bargaining position of each group of Nicholson stockholders? What must Cooper offer different shareholders in order to acquire their shares?

Class 3

General Mills' acquisition of Pillsbury from Diageo Plc., UVA-F-1326.

1. What are General Mills' motives for this deal?
2. Estimate the present value of the expected cost savings.
3. Why was the contingent value right (CVR) included in this transaction? How does the claw-back affect the attractiveness of the deal from the standpoints of General Mills and Diageo? How is an earnout different from a CVR, and in what situation should one or the other be used?
4. How does the contingent payment work? Draw a payoff diagram (a hockey stick diagram) of the claw-back feature. What option positions should you take to create the same payoff?
5. What is the contingent payment worth when the deal is negotiated in July 2000? What is it worth when shareholders vote on the deal in early December 2000? Use a Black-Scholes analysis.
6. Is this deal economically attractive to General Mills' shareholders? Would you recommend that shareholders approve or reject the deal?
7. What can the bidder do to protect its shareholders from stock price fluctuations before the deal is closed? How can the target protect its shareholders?

AXA MONY, HBS 9-208-062.

1. Why is AXA bidding for MONY? Does the deal make sense for AXA; for MONY shareholders; and for management? As a MONY shareholder, what concerns would you have about the deal?
2. How did AXA finance the takeover bid? Explain the structure that AXA used. Why did AXA use this structure? What effects, if any, do you think this method of financing has on the likelihood of the deal succeeding?
3. How would you price the ORAN at issue? Is it fairly priced? What does the price of the ORAN on February 9, 2003, imply for the probability of the deal succeeding? What is the fair price of MONY stock?
4. Suppose that you hold a position in the ORAN on February 9. Would you want to buy or sell MONY stock (a) at the "fair" price calculated in the question above or (b) at the market price of \$31.55? How do you explain the price of MONY stock on February 9?

5. Suppose that you manage a \$2bn hedge fund with a significant stake in MONY and that on February 10 you receive a phone call asking to buy your stock at above the market price if you sign over the voting rights with the shares. What considerations would enter into your decision about whether to sell you MONY stock at \$31.55 on February 9?

Class 4

Brazos Partners: The CoMark LBO, HBS 9-202-090

1. What is Brazos' strategy? How is it differentiated from that of other buyout funds?
2. What is the GTT (Generation Transfer Transaction)?
3. Why would CoMark be a good candidate for a leveraged buyout? What do you think of this opportunity?
4. How did Brazos make itself comfortable with the transaction while other funds passed? What does the planned financial structure look like?
5. Why does CoMark's management need Brazos? Why don't they simply make a leveraged recap?
6. What do you think of the \$40 million price for CoMark? Value CoMark using multiples and the APV method.
7. What are the issues with asset purchase vs. stock purchase? Analyze the tradeoff between the two methods.

Time Inc.'s entry into the entertainment industry, HBS 9-293-117. B-case, HBS 9-293-133.

1. How attractive is the merger of Time with Warner? What are the value enhancement opportunities?
2. What do you think of the proposed exchange ratio of 0.465 per Warner share? How much synergy is needed to make the merger attractive?
3. What are the motivations of the two management teams to support the merger? What prompted Paramount's interest in Time?

4. Why are the investment bankers' valuations so much higher than the market values?
5. What legal, financial, and restructuring options does Time have to combat the Paramount bid? To ensure that it is not a target in the future?
6. What would you do as Mr. Munro? How would you explain a decision to reject the Paramount offer at the annual shareholders' meeting?

Class 5

The Acquisition of Consolidated Rail Corporation (A), HBS 9-298-006, and (B), HBS 9-298-095

1. Why does CSX want to buy Conrail? How much should CSX be willing to pay for it?
2. Why did CSX make a two-tiered offer? What effect does this structure have on the transaction?
3. As a shareholder in Conrail, would you tender your share to CSX at \$92.50 in the first stage tender offer? Explain why or why not?
4. What are the economic rationales for and the takeover implications of the various provisions in the merger agreement, e.g. no-talk clause, lock-up options, break-up fee and poison pill shareholder rights plan?
5. Why did Norfolk Southern make a hostile bid for Conrail?
6. How much is Conrail worth? In a bidding war, who should be willing to pay more, Norfolk Southern or CSX?
7. Why does CSX refer to Norfolk Southern's bid as a "non-bid"? What should Norfolk Southern do as of mid-January 1997?
8. As a shareholder, would you vote to opt-out of the Pennsylvania antitakeover statute?
9. What do the capital markets expect will happen?
10. What are the costs and benefits of regulating the market for corporate control through statutes such as Pennsylvania's antitakeover law?

The Hilton-ITT Wars, UVA-F-1217

1. What is the stand-alone value of ITT? Why is it relevant to look at the break-up value when valuing ITT? How does the stand-alone value compare to ITT's historical market value? What was ITT's value to Hilton?
2. Why did Bollenbach open his bidding for ITT at \$55 per share? What was his likely strategy? What were his tradeoffs in deciding on this bid? Why did Bollenbach not raise the bid between January and July?
3. What do you expect the price of ITT's equity would be if Hilton's bid fails? Would it collapse to its pre-tender offer trading value of around \$44; would it remain stable at its existing level of around \$60; or would it rise to meet ITT's share repurchase price of \$70?
4. At what bid would risk arbitrageurs be inclined to tender their shares to Hilton? How much do they expect to earn from waiting for a new bid? What other underlying assumptions are you making in drawing this conclusion?
5. How should Bollenbach react to ITT's trivestiture defense? Should he change the bid or walk away?