Kellogg School of Management
Northwestern University

FINC 448: M&As, LBOs and Corporate Restructuring
Section 80
Spring 2018

José María Liberti

COURSE SYLLABUS
[Old Draft – To Be Updated]

A. Aims and Objectives
The course involves analysis of corporate restructuring strategies including mergers, acquisitions, and takeovers, financial re-capitalization, leveraged buyouts, management buyouts, going private, and reorganization under bankruptcy. The course integrates the corporate governance and agency dimensions, financial and strategic management aspects, and legal and accounting considerations into a unified framework for investigating issues such as, pre-merger planning, fact-finding, accounting and tax implications, anti-trust problems, post-merger integration, and short-term and long-term shareholder wealth consequences of financial and organizational restructuring transactions. The course combines applied theoretical approach with the case study method through detailed analysis of domestic and global restructuring cases. The focus will be on fundamental concepts of valuation and analytical tools of corporate finance related to restructuring.

The aim of the course is for the students to understand the motivations, decision processes, transaction execution, and valuation consequences of financial, business, and organizational restructuring by corporate units. The course facilitates developing ability among students to plan, evaluate, and execute corporate restructuring strategies using financial modeling and quantitative techniques. In addition, objective of this course is to enable students to appreciate the fundamental issues involved in the structure and functioning of market for corporate control within the framework of finance theory. The course is designed so as to create an interface or link between the academic and the practitioner perspectives of various dimensions of corporate restructuring process.

Who Should Take This Course? The course is aimed at students planning to work for investment banks and corporate advisory firms involved in business restructuring and turnarounds, mergers and acquisitions, and financial reorganization transactions. The course offers a comprehensive strategic perspective, a framework of conceptual and theoretical paradigms, and applied tools for deal design and corporate valuations that may facilitate students establishing their own consulting and advisory services.

At the completion of the course the students will have developed a capability to accomplish the following:

- Master the language and processes of M&A. Basic knowledge about the field of M&A is the
foundation for effective work in a wide range of fields including corporate development, investment banking, consulting, and advising senior management. Class case discussions, the books and articles, the lecture slides and the practical experience of the instructor will help you master the basics.

- **Identify M&A issues worth of attention.** For example, in today’s environment Corporate Restructuring, Corporate Reorganization, Private Equity and Leveraged Buyouts seem to be the most relevant. The next stage of professional competency is to develop an instinct for the problems and opportunities in an M&A situation. This course highlights elements in the structure and process of every M&A transaction that deserve professional scrutiny.

- **Analyze both M&As and LBOs transactions rigorously.** Valuation analysis is the core skill in M&A and is supplemented by analyses of strategy, dilution, financing, and risk management. The course will exercise analytics in these areas.

- **Develop a concept and design deals.** All transactions begin with the spark of an idea. Translating that idea into a concrete proposal takes hard work. Doing so teaches a lot about the drivers of M&A success, where value will be coming from (the asset side or liability side of the balance sheet) and the elements of deal design. Designing a transaction requires skills of analysis and negotiation. We will survey a number of analytic tools, and then exercise them. Solving and modeling each case will teach you a great deal about the design process. We will survey some strategic frameworks useful in M&A, and the steps necessary to translate a concept into a solid proposal.

- **Form an opinion about a proposed deal.** The key aim of the course is to create an ability to think critically, rather than becoming specialists of one particular area of M&A and Private Equity. Training in M&A should settle for nothing less. We will review a framework about deal design, and apply it to several cases.

The subject is complex, competition in M&A and Private Equity is intense, and the consequences of error are large. If you tackle this course earnestly, you will learn a great deal. At the same time, your learning will be deeper and more effective if you engage the course in the spirit of invention and curiosity rather than for the sake of a “grade.” The course will argue that deal design is fundamentally a creative effort. The best creativity happens in an environment that is both demanding and fun. I will intend and do my best to promote this; you should too.

**B. Learning Outcomes**
The learning goals of the course are given by the following:

- **Develop an all-inclusive analytical framework for planning corporate restructuring transactions:**
  - Explain the structure and functioning of market for corporate control.
  - Identify major market forces generated and corporate specific opportunities for creating value through corporate restructuring transactions.
  - Evaluate the objectives and motivations of various stakeholders: shareholders, managers, bondholders and employees among others behind restructuring activities.
  - To be able to utilize forecasting tools to quantify future cash flows and capital needs.
To be able to identify and estimate value of operational, financial, and managerial synergies and incorporate those into the deal value calculations.

Demonstrate knowledge of deal negotiation process and deal documentation.

From an investor perspective, be able to negotiate with other players pre- and post-deal structuring.

Identify and resolve conflicting issues in the target/acquirer relationship.

Understand how corporate restructuring creates value; when it makes sense for a company to restructure; and what kind of most restructuring is most appropriate for dealing with a given problem.

To be able to identify what issues and challenges managers have to deal with when implementing a restructuring and to ensure the goals of the restructuring strategies are achieved.

- Explain various legal and regulatory provisions as they impact the choice and performance implication of various restructuring transactions.
  - Evaluate available alternatives- deal structures and terms- for various corporate combinations to achieve positive value consequences given the US and global regulatory parameters.
  - Analyze implications of tax, fair trade practices, and securities laws for deal design and implementation.
  - Be able to design a “Win-Win” deal for both the parties involved in a corporate combination transaction.

- Be able to conduct valuation of the mergers, acquisitions, and corporate divestitures.
  - Use due diligence process to identify and strategically evaluate a target or an acquisition offer.
  - Apply various valuation methodologies to quantify the financial impact of restructuring transactions.
  - As an acquirer, conduct comparative valuation of various targets to arrive at different offer price scenarios.
  - From a target perspective, apply well accepted finance concepts like risk-return trade-off, cost of capital, capital structure, equity risk premium, and CAPM framework to evaluate acquisition proposals.
  - Quantify value implications of various financing alternatives and payment methods.

- Analyze various corporate governance structures and agency conflicts and their implications for corporate investors and hence market value of the firm in question.
  - Identify variety of exit modes for incumbent managements and boards of target firms.
  - As an acquirer, design various takeover tactics in a manner so as to minimize value loss to either the target, or the acquirer or the combined post-merger entity. Be able to minimize adverse impact of takeover defense provision in the target firm.
  - As a target, evaluate and redesign existing takeover defense mechanisms to maximize positive value consequences of a particular deal.

- Design and implement going private/ leveraged buyout transactions including being able to identify alternative sources of capital and planning post LBO reorganization plan.
  - Learn how to calculate IRR to sponsors.
Using the LBO model as a backward induction tool, determine the maximum amount of equity that a Private Equity firm may be willing to offer in an LBO transaction.

- Explain various factors leading to financial distress and be able to evaluate alternatives available to restore to financial health.
  - Evaluate pros and cons of Chapter 11 (Reorganization) and Chapter 7 (Liquidation) restructuring options and their wealth consequences for various stakeholders in the firm.
  - Analyze the advantages and disadvantages of “363 sales” in fraud-driven bankruptcies.
  - Explore the role of controlling and minority shareholders in closely-held firms and the extraction of private benefits of control.

- Be able to analyze financial and legal aspects unique to cross-border restructuring transactions and incorporate those aspects into deal design and implementation.

C. Focus of Study: Scope of Ideas and Topics
M&A will draw on cases and examples with the following leanings:

- The large publicly held corporation headquartered in the U.S. and abroad.
- Mainly oriented to finance, though the course will draw in contributions from accounting, law, business strategy, organizational behavior, and the role of incentives of each of the players involved in the transaction.
- Primary attention will be given to U.S. laws and regulations.
- Mainly oriented to transaction design, rather than the development of long-term policies.

Success in M&A is defined first and foremost in the creation of economic value or unlocking value. This value may come from different sources, such as, enhanced financial stability, improved competitive position, strengthened organization, enhanced reputation, and observance of the letter and spirit of laws and ethics, among many others.

These kinds of outcomes are the fruits of two important influences:

- Structure of the Environment in Which the Deal Takes Shape. This includes the nature of the economic opportunity, the strategic setting of the buyer and target, the nature of the organizations of the buyer and target, the reputation and incentive of the players, and the matrix of laws and ethical norms surrounding the firms.
- Conduct of the Players. Given the constraints and opportunities in the environment, how you play the M&A game significantly shapes outcomes. We will explore the influence of conduct in areas such as acquisition search, due diligence, negotiation and bidding, dealing with laws, regulations, and the judicial system, deal design, post-merger integration, communication, and management of the deal development process.

In short, the course presents a considerably richer view of M&A than you will have seen in previous courses and newspaper or magazine articles.
We will use the case method to motivate our discussion to close the gap between rigorous finance theory and its application to practical problems in corporate finance, and the thought-process required when faced with this gap. The course is roughly divided into 5 core topics.

**Part A:** Valuation Methods Review. Where Is Enterprise Value Coming From?

Valuation Methods and Techniques
- Weighted Average Cost of Capital (WACC)
- Unlevering and Relevering Betas
- Discounted Cash Flows Modelling
  - Free Cash Flows or Unlevered Cash Flows
  - Capital Cash Flows or Levered Cash Flows
  - Equity Cash Flows or Residual Cash Flows
- Adjusted Present Value (APV)
  - The Relation Between APV and CCF
- Relative Valuation Analysis: Transaction and Trading Multiples
- Developing Break-Up Analysis
- Sensitivity Tables

**Part B:** Traditional M&A Topics and Transactions

Hostile Takeovers and Friendly Acquisitions. Strategic and Financial Aspects
- Tender Offers: Hostile vs. Friendly Takeovers
- Defense Tactics: Pre-Emptive Defenses vs. Post-Offer Defenses
  - Deal Agreements and Deal Protections
  - Structural Defenses vs. Non-Structural Defenses
  - “The White Knight”
  - Poison Pills: Flip-In vs. Flip-Over
  - “Vote” vs. “Value” vs. “Board” Related Defenses
- Why Perform Accretion/Dilution Analysis?
- Why Perform Contribution Analysis?
- Acquisition Currency: Cash vs. Stock
- One vs. Two-Tier Offers
- Merger of Equals: How to Split the Firm?
- The Diversification Discount. Is it a Myth?
- The Market for Corporate Control
  - Delaware vs. Pennsylvania Courts
  - Fiduciary Duties of Board of Directors

**Part C:** The Role of Corporate Raiders and Activists in Disciplinary Takeovers
- Shareholders activism as a corporate governance mechanism.
  - Are Corporate Raiders “good” or “bad”? For whom?
- Are Corporate Raiders or Activist Shareholders necessary?
- Corporate Raiders as a disciplinary takeover mechanism.
  - Why are disciplinary takeover the most successful?
- The Role of Proxy fights
- Staggered boards as defense mechanism to hostile takeovers.
Part D: Creating Value through Corporate Restructuring
  o Corporate Reorganization Strategies
    ▪ Spin-Offs, Carve-Outs, Target Stock and Divestures
  o Financial Distress & Bankruptcy
    ▪ Chapter 11 (Reorganization)
    ▪ Chapter 7 (Liquidation)
    ▪ Out-of-Court Restructuring vs. On-Going Concern
  o Net Operating Losses (NOLs and Capital Losses)
  o The Role of Private Equities in Value Creation

Part E: Private Equity and Leveraged Buyouts (LBOs)
  o The Role of Private Equity Firms: Screening for Candidates
    ▪ Strategic and Financial Sponsors
    ▪ Pros and Cons of Different Sponsors
  o Financial Modeling of LBOs
    ▪ The Problem of Changing Capital Structure
    ▪ Capital Cash Flows vs. Equity Cash Flows
    ▪ The Method of Backward Induction
    ▪ The Role of a Target IRR
    ▪ Maximum Equity vs. Debt Capacity

Part F: The Role of Risk “Arbs”
Managing M&A Risk: Collars, Earn-Outs and Contingent Value Rights
  o The Role of Arbitrageurs in the M&A scenario.
    ▪ Interpreting arbitrage spreads.
    ▪ Calculating the probability of success of a transaction from the arbitrage spread.
  o Managing M&A Risk with Collars, Earn-Outs and CVRs
  o Two classes of M&A risk:
    ▪ Pre-Closing: Fluctuations in bidder’s and target’s stock prices.
    ▪ Post-Closing: Failure of target to perform to expectations.
  o Pros and Cons for bidder and target shareholders of using Fixed Collar Offers vs. Floating Collar Offers.

Part A acts as reference material. We will go back and forth to the material in Part A throughout the course. In addition to analyzing the specific financing problems or issues, we will consider how those issues relate to the strategic and business objectives of the firm. It will be important to examine the “big picture” assumptions that are used in the numerical calculations. This course also places emphasis on presentation and discussion skills. It will be important to explain your positions to each other and to argue convincingly for your recommendations.

Part D, E and F are very important in today’s economic environment. I teach the course from the perspective that corporate restructurings —far from being a rare or episodic event that happens to
“someone else”— is a common and important event in the professional lives of many managers. The reach of Corporate Restructuring, Private Equity and LBOs is far greater than any statistic may show. The course also emphasizes that the scope of corporate restructuring has become increasingly global, as heightened competition in international product, capital and labor markets puts tremendous pressure on companies worldwide to increase, their competitiveness and maximize their market value.

D. Course Material
The reading material for the course is contained in:

- A digital case and article packet which is available at Study.Net (www.Study.Net). The digital package contains all the cases and copyrighted material you will need to purchase for the class during the quarter. All the other necessary material including slides, lecture notes and articles will be uploaded in Dropbox. I will not distribute this material in class, so you should therefore print this material or just read the material on-line before class and for each assignment. I will only distribute in class the case solution(s) for the case(s) we are discussing and solving in that specific session.


I highly recommend a small, practical and inexpensive but surprisingly comprehensive dictionary defining over 5,000 terms:


As reference material for basic corporate finance topics you may want to use any of the usual graduate textbooks:


- Brealey, R., Stewart Myers and Franklin Allen (BMA), “Principles of Corporate Finance,” 9th Edition, McGraw-Hill/Irwin, 2007. This is another textbook you may find useful in case you want to review core topics that were taught in your corporate finance classes.

In addition (most of) the material will also uploaded in Dropbox during the term (subject to copyright regulations). I will also hand out during the course teaching slides and additional reading material as well as case solutions. In some cases I will e-mail my valuation model, so you can follow in class how my solution looks like relative to the one your group produced. All material I distribute in class will also be uploaded in Dropbox, except for the solutions of the cases. If you are missing any material, you should contact me via e-mail. I will be happy to provide it.

There are several other books on the market covering Mergers & Acquisitions, The Market for Corporate Control and the Role of Private Equity to various degrees of depth. We will not use these books in this course, but if you nevertheless wish to consult other books occasionally, here are some good useful books. In some cases I will upload in Dropbox some of the chapters of these books according to the topics we cover each week. You should also feel free to ask me for book recommendations in other topics if you are interested.


perspectives and special insights for small businesses, manufacturers, and service companies, this primer is essential for everyone involved in M&As.


- Schweiger, D., “M&A Integration: A Framework for Executives and Managers,” First Edition, McGraw-Hill, 2002. Studies of Fortune 500 executives found that post-merger integration issues such as culture clashes, style, ego, and management changes are the most common pitfalls that can derail otherwise successful mergers or acquisitions. The book provides a practical framework for integrating acquisitions while helping managers direct each step in the volatile and uncertain post-merger integration process.

For valuation purposes four good references are:


They are generally pretty expensive books, so feel free to consult me before buying any of them. I can lend them to you so you can browse through them and check whether you feel they may be useful for your future careers or current jobs. I highly recommend the two valuation books since they are unique source of reference when dealing with particular topics in valuation.

The following list of books is those which I have found interesting as well as informative. They are more like bed-time reading. If after my class you are interested in additional reading, please,
let me know. This list is meant to be my suggestions of where you can start looking.


- Schwager, J.D., The New Market Wizards: Conversations with America’s Top Traders, Harper, 1994. This book is a series of interviews with very successful traders. These are people who have beaten their respective markets.

### E. Course Procedures: Group Case Write-Ups

Deadlines for the class are non-negotiable. If you have a question about a deadline, you should resolve it prior to the deadline. Under special circumstances, you may arrange to turn in your work *early*. Submissions will not be accepted after the due date and exams may not be taken late. Late submissions or taking an exam later than your scheduled time may provide a student with unfair advantage over other students. In the interest of fairness, all students must face the same set of deadlines.

There will be **12/13** group case write-ups/assignments depending on the availability and feasibility of time as the course progresses. Case write-ups must be submitted on time before the beginning of each lecture. No credit will be given for late cases. I will grade the cases on a scale of 0 to 5 (including decimals places) and give you as much feedback as possible in the corrections. I have a very particular way of grading, it is tough but it is very detailed and, most important, you will learn from the mistakes. The Case-Study Questions for each of the 13 cases will be available on Dropbox a week in advance. Note that the Mini-Cases in the Course Outline are not graded. These cases and material will be covered in class.

You are allowed and encouraged to meet in groups outside of class to discuss and analyze the
cases. In the past, students have found that these groups complement the class discussion well. I encourage you to collaborate on cases. Groups should be composed by exactly 5 students. If you have any problems in finding someone to work with, please e-mail me and let me know. I will be happy to assist you in finding a group.

Diversity in group composition will be rewarded (strong and weak finance students, men and women, single and married…) and you can describe on the cover page along which dimension your group is diverse. You are allowed to change groups during the term (although I do not prefer this situation). Also, bear in mind that it may be helpful to choose groups according to the specific home addresses of the group members since most likely you will be meeting during the week-ends to solve and discuss the cases.

Regarding the cases, each group will submit a three-page (and NOT a single page more) memorandum of analysis and recommendations covering the case study questions plus any accompanying tables, models, graphs and exhibits you wish to include as appendices. Tables should be well organized and labeled. Include whatever exhibits you deem necessary, but I suggest not to waste the reader’s time with exhibits that do not add significant value to the analysis. For example, do not use two similar exhibits that do not add much to the analysis and understanding of the case, or do not repeat what is written on the case. Be sure to indicate how you arrived at your conclusions. I care about the thinking process and the logic behind the cases rather than the correct or incorrect answer. I will accept one memorandum from the group and count it for all students in the group. Write these as if you were writing a recommendation for the CEO or major decision maker in the case. Be sure to address in each paragraph of the memorandum the questions you are being asked in the case-study questions. I urge you to start each paragraph with a number referring to the question you are answering. For your convenience, I will also post some of the relevant data for each case in a worksheet on Dropbox

Each group should also submit (via e-mail) the excel file that contains the (professional, neat, complete, and clear) analysis. This way is easier for me to grade your quantitative analysis. The excel file should be named FirstName_LastName_CASENAME.xls. The first and last name can correspond to any member of the group.

For your convenience, I will also post some of the relevant data from each case in an Excel worksheet on the corresponding week in Dropbox.

The main point of the cases is to help you learn by ensuring that you prepare for class and think about the material to cover each week. Reading the material assigned for each week is crucial and preparing for the cases is the best way to enjoy and learn from this course. My advice about the cases is: do your best in working through them, but recognize that they are hard and you will not always get it right. They will get harder and harder as the course progresses.

Brevity is a virtue for case write-ups. Do not repeat the facts of the case. You should turn in your memo at the beginning of the class on the due date. You are expected to have read the case and prepared your answers. Keep a copy of your answers as you will be expected to contribute to the class discussion based on your written answers. I expect the answers to be well-reasoned. The cases are your opportunity to apply the concepts you have learned thus far to messy, not-so-clear,
and complex real-world problems. Understanding the ideas is important and being able to explain them to your boss and co-workers is equally important. Thus, your case write-ups will be graded both on your answers as well as how well you defend your proposed solution.

The readings and articles, which I have assigned and will hand out as the course progresses or post in Dropbox, are largely non-technical in nature and summarize the findings of academic and business research in corporate finance in the recent past. These articles are meant to be background material, which will help you to analyze the cases. The readings should not necessarily be cited in the case discussion; I do not want a summary of my reference material! You should try to argue as if you were in a corporate boardroom rather than in a doctoral seminar. The goal is to have an open and interactive class-case discussion, where the process of arriving at the answer is as important as getting the answer.

Because of the nature of this course (and its grading criteria), it is extremely important that you attend every class, arrive on time, and are prepared to participate. To help me remember who said what, it is important that you always sit in the same places. Also, if your picture is not in the Kellogg directory/roaster face book, I recommend that you come and introduce yourself to me on the first day of class.

F. Grading
The weighting for the final grade is given by:

- Class Participation: 25%
- Group Case Write-Ups: 55%
- Peer Review Evaluation: 20%

As a strict rule, there is no make-up days for material due. It is your responsibility to schedule the rest of your activities such that you are able to attend comply with the rules of the class.

**Class Participation:** By design, this is a case-based course. Given the format, class participation is an indispensable part of the learning experience. I will judge your performance based both on the quality and the number of your comments. Because so much of the learning in this course occurs in the classroom, it is very important that you attend every class. Low class participation combined with several absences can lead to a lower grade. If you are uncomfortable with such a heavy weight on class participation, this class may not be for you. I will grade for each case your class participation using a discrete scale of 1, 2 and 3. For the best (or bests) student(s) in terms of class participation for each session, I will assign only one numerical value of 5 per class. I will post in Dropbox each night (after class) the class participation grades for that day so you can check the performance for that particular session.

**Group Case Write-Ups:** As mentioned in Section E, this grade will be based on the 12/13 group case write-ups. Grading is very seriously done and I expect from all the groups high-quality write-ups.
Peer-Review Evaluation: During Week X, I will distribute and post a peer-review evaluation which you will have to complete individually evaluating each member of the group. In addition you may submit an attached hard-copy letter to the peer-review evaluation describing each team members’ performance and contribution to the group, and an assessment of “how the process went.” Please, remember to put your name on the letter. I recommend you hand me in the peer-review evaluation and your letter in a sealed signed envelop in class on the last class of the quarter.

G. Access to Dropbox
The class webpage on Dropbox is intended as the main information dissemination mechanism. When you have a question, you should consult Dropbox first, as in most cases; you will find the answer there. If it is not the case, then contact me. In particular: lecture notes, teaching slides, handouts, announcements, frequently asked questions (and their answers) and supporting material will all be posted on Dropbox.

From Dropbox you will be able to download excel spreadsheets and case questions for the 12/13 graded cases. Each workspace, in turn, contains one or more of the exhibits in the case. This will make it easier for you to spend time on the analysis, rather than punching in numbers. From the portal you will also be able to download most of the handouts I supply throughout the course as well as teaching material and slides. Anything I hand out in class will also be put on the home page (unless it is copyright material).

H. Office Hours and Contact Information
The best way to get in touch with me is via email: j-liberti@kellogg.northwestern.edu. I follow an open door policy. You can also call, come to my office, or put a note in my mailbox. You can call at my office number. My office is located at the Finance Department, Global Hub 4371. I will also be available for individual meetings by appointment at times that are mutually convenient. Please e-mail me to make appointments. If you come, I will stay until student exhaustion or midnight whichever comes first.

As a rule to follow, I will NOT discuss any question related to the cases before they are solved in class. After they are solved I will be more than happy to discuss them with you. I am happy to discuss anything you want regarding the course material, job offers, projects, careers, etc.

I. Finance Review and Reference Material
One of the challenges of Corporate Restructuring, LBOs and Private Equity is that students’ background is generally very different, specifically coming from different programs and careers and having taken different courses at different times in their MBAs careers. For some of you some of the finance material will be fresh, but for some others it will be rusty (or even very rusty since the last time you took a finance course was at College). For those of you who feel you need to review some of the “old” material I am providing you with some of material from core corporate finance courses (FINC 430/440/441). I have been writing these notes during the last 5 years now. I am still updating them. Feel free to let me know about typos or things that are
unclear. I will be more than happy to correct them. You will NOT need the 15 chapters for this
class. I will let you know which the relevant chapters are for each session. You should check the
Reading Material for that particular week.

Feel free to browse the specific issues and chapters for each of the relevant cases as indicated in
the assigned Weekly Readings. I will assume that you are acquainted with this material; I will
NOT lecture this material during the course. Use these slides as a reference material in case you
need so, and obviously feel free to download them as reference material for upcoming courses.

J. First Week Class Assignment
In Week I, Tuesday, April 3 we will go over some basic valuation review concepts including
different types of cash flows (Free Cash Flow, Capital Cash Flow, and Equity Cash Flows),
WACC, Adjusted Present Value (APV), the concept of the optionality of equity and understanding Where is Enterprise Value Coming From? Show up in class, happy, rested and ready to work! You may want to read/skim the material under Week 0: Introduction: Does M&A Pay? and Why Do We Follow M&A Transactions? This is mostly “chit-chat” material.

K. Workshops
There will be two Workshops according to the Course Outline. Workshop A will take place on
Saturday, April 7 in Global Hub 2130 and will cover Valuation Techniques (mid-morning) and
Affordability Analysis (afternoon). Workshop B will take place on Wednesday, May 23 in
Global Hub L070 and will cover Valuation of Leveraged Buyouts and Financial Modelling of
LBOs.

L. Review Sessions/Tutorials/Workshops
I will conduct an open class Q&A Session every Wednesday between 1:30P and 4:30PM,
respectively. Please check the course outline for the topics of each Q&A Session.

M. Tips On How To Engage The Course
Diversify. The course offers a number of learning modes. Engage them all! The plan for the
course shows that regular case studies will be the focus of 11 of the class meetings.

Follow Your Interest. This is a “self-tailoring” course in that it leaves much of the technical
reading to the discretion of the student. The two books, articles and slides will give you the
framework of terminology and tools in M&A. Consider reading carefully where you find
interesting topics.

Join a Learning Team to Prepare For Class. The ideas in the cases and readings for class are
deep; the analysis can get complex. You will learn more from the course, and perform better in
class participation by discussing these cases together in a learning team. I will serve as a
clearinghouse for those students who have been unable to join a learning team.
Commit to Your Write-Ups and Learning Teams. Team-based work makes a large contribution to the course. The Group work accounts for 40% of the final grade. High performance teams show a number of common attributes:

- Members commit to the success of the team.
- The team plans ahead, leaving time for contingencies.
- The team meets regularly.
- Team members show up for meetings and are prepared to contribute.
- There may or may not be a formal

N. Academic Integrity Policy
As a condition of their enrollment in this course, all students enrolled in a course offered by the Kellogg School of Management agree to abide by the Kellogg Honor Code as outlined in http://www.kellogg.northwestern.edu/stu_aff/policies/honorcode.htm. A violation of the Honor Code will result in sanctions, including a failing grade for the course.

O. Course Reading List and Course Outline
The course reading list is divided by Weeks and classified in Required Readings, Business Readings and Supplementary Readings. You do not need to read the Supplementary Readings. This supplementary material is provided to expand your knowledge in the particular topic we are covering. It is more to suffice your curiosity in the specific topic we are covering that day. If you want any additional information please do not doubt to let me know. I will be happy to provide you with any additional material or readings.
Introduction: Does M&A Pay?

The M&A Environment: 1990-2017

Recommended Readings


- University of Rochester Roundtable on Corporate M&A and Shareholder Value, Journal of Applied Corporate Finance, Volume 17, Number 4, Fall 2005

Supplementary Readings on the Current Status of the M&A Market

Given the chaos in the financial economy, it should come as no surprise that M&A activity fell sharply in the fourth quarter of 2008. Since 1980, US recessions have led to steep declines in the value of global M&A activity—typically, of around 50% during the first year. That fall-off results from factors we see in the current downturn as well, including lower deal values in sinking equity markets; difficulties with financing, particularly for very large transactions; and a general fear about the economic outlook, which forces acquirers to put plans on hold. Moreover, in December 2008 stock markets were down 40 to 50 percent from their January levels.


Business Reading
• “In a Record Year for Deals, Success and a Few Missteps,” Dealbook New York Times, December 22, 2015.


• “M&A Deals Lift Wall Street Shares Nearer a Record High,” Reuters, February 19, 2013.


Week I/Workshop A  
[April 3/April 7]

Valuation Methods Review  
Where Is Enterprise Value Coming From?  
Reconciliation of Valuation Methods

Recommended Readings

Required Readings on Valuation

- CA, “The Practitioner’s Guide To Investment Banking, Mergers & Acquisitions, Corporate Finance,” Part II: Valuation, Chapters 8 (The Role of Valuation) and 11 (Discounted Cash Flow Analysis).


  
  [Concentrate on the 2 basic Cash Flows: FCF and CCF. This chapter is already in the set of slides I distributed in class!]


Required Readings on Reconciliation Methods


Required Readings on Capital Structure


Required Readings on Transaction and Trading Multiples

- CA, “The Practitioner’s Guide To Investment Banking, Mergers & Acquisitions, Corporate Finance,” Part II: Valuation, Chapters 9 (Comparable Company Analysis) and 10 (Comparable Transaction Analysis).


Supplementary Readings on Valuation


- BMA, “Principles of Corporate Finance,” Chapter 17, 18 and 19 (Financing and Valuation).


**Supplementary Readings on Transaction and Trading Multiples**


**Supplementary Readings on Capital Structure**


**Supplementary Readings on Sensitivity Tables**

Workshop A
[April 7]

Merger Consequences Analysis:
Affordability Analysis
M&A Analysis

In the first lecture and workshop you will learn how to perform the mechanics of merger consequences analysis, which are often called affordability analysis. This includes using accretion/dilution analysis to determine how the proposed transaction will affect the acquirer’s earnings per share (or EPS), and using credit analysis to determine how the proposed transaction will affect the acquirer’s credit rating. We will also discuss the fundamentals of purchase accounting, the concept and creation of goodwill and asset-write ups and how to determine fixed exchange ratios using relative contribution analysis.

Using Hershey Foods Corporation's (HFC) 10-Q financial reports from March 31 2002, we value HFC as a potential target for an acquirer. Why is it a potential target? Using financial and qualitative information available in the 10Qs we compute the Intrinsic Enterprise and Equity Value and comparing them to the market stock price. Is HFC undervalued? Overvalued? Does it have a fair price? In doing so we use WACC, Transaction & Trading multiples. We will finally go over the merger consequences analysis for Wrigley’s acquisition of Hershey.

Recommended Readings

- CA, “The Practitioner’s Guide To Investment Banking, Mergers & Acquisitions, Corporate Finance,” Part I: The Basics, Chapter 4 (Strategic Transactions) and Chapter 5 (Introduction to M&A), Chapter 6 (Analyzing Strategic Transactions) and Chapter 7 (Screening for M&A Transactions).


- Hershey Foods Corporation, Management’s Discussion and Analysis.

Week II  
[April 10]  

Mergers and Acquisitions:  
Valuation of Hard and Soft Synergies  
Multiples in Practice  

Break-Up Analysis:  
The Diversification Discount: Is It a Myth?  
Take-Over Defenses and Bidding Strategies  
Implementing Structural Defenses  
Structuring Acquisition Offers  

Recommended Readings  

Required Readings on M&As, Takeover Attempts, Tactics and Battles  
- BMA, “Principles of Corporate Finance,” Chapters 32 and 34.  
  [Concentrate especially on Section 32.5: Takeover Battles and Tactics]  

Required Readings on Synergies  


**Required Readings on the Diversification-Conglomerate Discount**


**Supplementary Readings on M&As, Structuring Acquisition Offers and Synergies**


**Supplementary Readings the Diversification-Conglomerate Discount**


Week III
[April 17]

The Market for Corporate Control:
Delaware vs. Pennsylvania

Structuring Offers: Two-Tier Offers
Avoiding the Free-Rider Problem in M&A Contexts

Takeover Battles and Corporate Defense Tactics
Merger of Equals (MEO)

Recommended Readings

Required Readings on Takeover Defenses, Battles, Tactics and Merger of Equals


  [Read all Chapter 5. For Chapter 6 only read pages 247-249 devoted to Two-Tier Offers.]


Supplementary Readings on Strategic Acquisitions and Takeover Defenses


*Business Readings*


• Free-Rider Problem Takes Toll on Restructurings, *Financial Times*.

• M&A Losers in $10 Trillion Deal Binge Led by McClatchy, Sprint (*Bloomberg*; August 19, 2011)

• Live-Nation Ticketmaster in $2.5B Merger Deal (*MarketWatch*; February 10, 2009)
Week IV-A
[April 24]

Hostile Takeovers: Agency Issues
The Use of EVA™

The Role of Corporate Raiders: Hostile Takeovers
How Effective is Corporate Governance?

Recommended Readings

Required Readings on Agency Costs and Benefits of Debt


Required Readings on EVA™ and the Role of Governance

- CA, “The Practitioner’s Guide To Investment Banking, Mergers & Acquisitions, Corporate

- Kim, K.A. and John R. Nosfinger and Derek J. Mohr, “Corporate Governance,” Chapter 7
  (Shareholders and Shareholder Activism), and Chapter 8 (Corporate Takeovers: A

- Liberti, J., “Economic Value Added (EVA™) - Executive Compensation,” Class Lecture
  Slides, Kellogg School of Management, 2018.

- O’Connell, S., Michael Park and Jannick Thomsen, “Divestitures: How to Invest for

Required Readings on Corporate Raiders and Hostile Takeovers

- Davidoff, Steven M., “Gods at War: Shotgun Takeovers, Government By Deal, and The
  Private Equity Implosion,” Chapter 8 (Microsoft, InBev, and the Return of the Hostile

Supplementary Readings on Corporate Governance

  Number 1, Winter 1988.


**Supplementary Readings on EVA™**


**Business Readings**


Week IV-B  
[April 24]  

Dynamics of Takeover Attempts: Tactics  
Strategic vs. Financial Buyers  
The Role of Hedge Funds as Activist Shareholders  
The Role of Excess Cash in Valuation

Recommended Readings

Required Readings on Takeover Attempts and Defenses


Required Readings on Excess Cash and Valuing Control Premium


Business Readings

Week V-A
[May 1]

Hostile Takeovers: Dynamics
Defense Strategies
The Logic of Investors and Risk Arbitrageurs

Recommended Readings

Required Readings on Hostile Takeover and the Role of Arbitrageurs

  [Concentrate on the concept of takeovers as games and EVNT analysis. The Chapter is intended to support this case and others in the area of takeovers.]

  [Concentrate on Sub-Section: Risk Arbitrage [Pages 347-354].]


Supplementary Readings on Hostile Takeover and the Role of Arbitrageurs


Week V-B
[May 1]

Agency Issues:
Conflict of Interests between Stake-Holders
Fiduciary Duties of Board of Directors
Event Studies
Corporate Restructuring Strategies:
Spin-Offs, Split-Ups, Carve-Outs, Tracking Stock and Divestures

Recommended Readings

Required Readings on Fiduciary Duties and the Role of Board of Directors


Required Readings on Corporate Restructuring


  [Very nice article on how restructuring through spin-offs, equity carve-outs, and tracking stocks can create shareholder value.]


Supplementary Readings on Corporate Restructuring and Corporate Control

- Anslinger, P.L., Sheila Bonini and Michael Patsalos-Fox, “Doing The Spin-Out,” The
Mckinsey Quarterly, 2000, Number 1.


Week VI
[May 8]

Bankruptcy, Corporate Restructuring and Financial Distress
Chapter 11, Chapter 7, On-Going Concern vs. Private Workouts

Incentives Issues in Corporate Bankruptcy

Recommended Readings

Please refer to the Reference Material on Week I in case you are having doubts on the Capital Cash Flow Method in order to value Marvel Entertainment Group. In case you are having doubts you can review (again!):


Required Readings on Bankruptcy and Financial Distress

- Ayer, J.D., Michael Bernstein and Jonathan Friedland, American Bankruptcy Institute Journal, “What Every Unsecured Creditor Should Know About Chapter 11.”


  [Concentrate on Financial Restructuring [Pages 530-535]].


  [This is a must read article!].


  [Concentrate on Section II: Corporate Restructuring, Section I was covered during Week III (Paramount)].

[Concentrate on Summary of the Chapter 11 Process [Pages1-7]].


Supplementary Readings on Capital Cash Flow


Supplementary Readings on Bankruptcy and Financial Distress


Sprayregen, J.H.M., Jonathan P. Friedland and Evan Gartenlaub, “First Things First – A


**Business Readings**


**Supplementary Readings on Corporate Governance**


Week VII
[May 19-23]

Bankruptcy, Corporate Restructuring and Financial Distress
Chapter 11, Chapter 7, On-Going Concern vs. Private Workouts

Founding Families and Public Shareholders
Exit Modes: “363 Sale”

Recommended Readings

Required Readings on Distressed Investment

  [Concentrate on the Corporate Restructuring Section and the Prisoner’s Dilemma problem [Slides 16-26]].


Required Readings on “363 Sale”


Required Readings on Structural Subordination


Supplementary Readings on Structural Subordination


Supplementary Readings on Distressed Mergers and Acquisitions

Week VIII
[May 22]

Valuation of Leverage Buyouts (LBOs)

Private Equity
Strategic vs. Financial

Dealing With Time-Varying Capital Structure
Using Cash Flow Available for Debt Service (CADS)

Recommended Readings

Required Readings on Private Equity & LBOs


- BMA, “Principles of Corporate Finance”, Chapters 33.
  [Concentrate on Section 33.1: Leveraged Buyouts and Section 33.2: Fusion and Fission In Corporate Finance]

  [This is a fantastic article to understand the role of Leveraged Buyouts and other transactions such as takeovers, corporate break-ups and spin-offs in shaping a new organization during the late 1980s.]


Supplementary Readings on LBOs and the Market for Corporate Control


- Cornell, B. and Kevin Green, “The Investment Performance of Low-grade Bond Funds,” *The


Supplementary Readings on Limited Arbitrage


Business Readings


[Recommended Pages: Definitely read this article. Fantastic!]
Workshop B
[May 23]

LBO Modeling
CCF and Cash Flow Available to Service Debt (CADS)
Equity Cash Flows and IRRs to Sponsors
The LBO Valuation Model
Target IRR Model

Recommended Readings

Required Readings on Private Equity and LBOs


Week IX-A/IX-B
[May 29]

Strategic vs. Financial Sponsors

Sources of Value in LBOs

Value Creation in Private Equity

The LBO Valuation Model

CCF, CADS, ECF and IRRs to Sponsors

Required Readings on Private Equity and LBOs


[This is a must read article! The Section: Is Private Equity a Superior Organizational Form? [Pages 130-136] describes in detail the changes private equity firms apply to the firms in which they are investing in.]


*Business Readings*


• Schneider, K., “How Do You Solve a Problem Like Sharia?” *Real Deals*, November 27, 2008.

[As Islamic financial products become increasingly popular, Kai Schneider of Latham & Watkins explains how to make a fund Sharia-compliant.]


*Supplementary Readings on Private Equity and LBOs*

• Acharya, V., Julian Franks and Henri Servaes, “Private Equity: Boom or Bust?,” *Journal of Applied Corporate Finance*, Volume 19, Number 4, Fall 2007.


Week X
[June 5]

Sources of Value in LBOs
Value Creation in Private Equity
Corporate Restructuring and Asset Backed Securities
Securitization

Recommended Readings

Required Readings on the Financial Crisis and LBO Market


Required Readings on Asset Backed Securities


Supplementary Readings on Asset Backed Securities

- Kotecha, M.K., “The Role of Insurance In Asset-Backed Securities,” International Securitization (Chapter 9), 193-207

- Leixner, T.C., “Securitization of Financial Assets,” Holland & Knight LLP, September 1999

Week XI
[June 12]

The Role and Economic Logic of Risk Arbitrageurs ("Arbs")

Key Value Drivers for Arbs

Sensitivity of Arbs to Returns, Time and Outcomes

Calculating the Value of Offers and Probabilities of Events

Recommended Readings

Required Readings on the Role of Arbs

  [Concentrate on Sub-Section: Risk Arbitrage [Pages 347-354].]


Required Readings on Fashion and Handbags


Supplementary Readings on Understanding and Pricing Options

- BdeM, “Corporate Finance,” Part VII: Options, Chapter 20 (Financial Options) and Chapter 21 (Option Valuation).

- BMA, “Principles of Corporate Finance,” Part Six, Chapter 21 (Understanding Options) and Chapter 22 (Valuing Options).

SUMMARY OF COURSE OUTLINE
[Old Draft – To Be Updated]

This is a summary of the course outline. This outline is a tentative schedule and may be subject to changes as the Quarter progresses. I reserve the right to alter one or more cases at a later date according to your performance in the cases. Lectures are basic guidelines for the following case. A (*) indicates if time permits. If we do not have the time to cover this in class, it will be your responsibility to read the required material and apply it to the following case. All cases will be graded.

INTRODUCTION

WEEK 0
This is background material to capture your interest in the subject.

PART A: VALUATION METHODS REVIEW
WHERE IS ENTERPRISE VALUE COMING FROM?

WEEK I (4/3)
Valuation: Understanding Where Value Is Coming From?
Reconciliation of Valuation Methods: WACC, APV and CCF
Review on Valuation Modelling

Lecture: Valuation Methods and Techniques
- Weighted Average Cost of Capital (WACC)
- Discounted Cash Flows:
  - Free Cash Flow or Unlevered Cash Flows (FCF)
  - Capital Cash Flow or Levered Cash Flows (CCF)
  - Equity Cash Flows or Residual Cash Flows (ECF)
- Adjusted Present Value (APV)
  - The Relation Between APV and CCF
- Unlevering and Relevering Betas
- Trading and Transaction Multiples: Relative Valuation Analysis
- Developing Break-Up Analysis
- Sensitivity Tables

Application: Valuation Techniques: Summary of Formulae and Concepts
Application: Excel Modelling and Applications: Full Valuation Model

**WORKSHOP A (4/7) Merger Consequence Analysis**

**[Saturday]**

**Lecture:** Affordability Analysis:
- Balance Sheet Impact
- Income Statement Impact
  - EPS Accretion/Dilution Analysis
  - Capital Structure
  - Debt Capacity Analysis

M&A Analysis:
- Implied Exchange Ratios
  - Stock-for-Stock Acquisitions
  - Cash-for-Stock Acquisitions
  - Relative Contribution Analysis
- Purchase Accounting and Goodwill Creation
  - Net Tangible Assets
  - Fair Market Value
  - “Write-Up” of Net Assets
  - Goodwill Creation
- Tax Implications
  - Asset Purchase vs. Stock Purchase
  - Election 338

Application: Sample M&A Analysis

*Corporate Valuation: Exercises*

Application: Hershey Foods Corporation: Using Forms 10-Q

**PART B: TRADITIONAL M&A TOPICS**

**HOSTILE TAKEOVERS AND FRIENDLY ACQUISITIONS**

**STRATEGIC AND FINANCIAL ASPECTS**

**WEEK II (4/10) Mergers & Acquisitions: Valuation of Hard and Soft Synergies**

*Take-Over Defenses and Bidding Strategies*

*Break-Up Analysis: The Diversification Discount*

*Structuring Acquisition Offers: Cash vs. Stock*

*Termination Fees and Lock-Up Options*

**Case:** Paramount Communications, Inc. – 1993

**Lecture (*):**

Stock of Cash? The Trade-offs for Buyers & Sellers in Mergers and Acquisitions

**TUTORIAL (4/11) Q&A Session: Paramount’s Affordability Analysis**
**WEEK III (4/17)**  
*The Market for Corporate Control: Delaware vs. Pennsylvania Supreme Court*
*Structuring Offers: Two-Tier Offers – Avoiding The Free-Rider Problem*
*Takeover Battles and Corporate Defense Tactics*
*Merger of Equals*

**Case:** The Acquisition of Consolidated Rail Corporation (A) & (B)

**Lecture (*):** The Market for Corporate Control: Corporate Defenses

**TUTORIAL (4/18)**  
*Q&A Session: Takeover Defenses. Conrail’s Calculations*

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**PART C: THE ROLE OF CORPORATE RAIDERS**

**DYNAMICS OF TAKEOVER ATTACKS AND DEFENSES**

**THE ROLE OF ‘ARBS’ IN TAKEOVER BATTLES**

**WEEK IV-A (4/24)**  
*Hostile Takeovers: The Role of Corporate Raiders*
*Agency Costs of Debt: The Free Cash Problem*
*How Effective Is Corporate Governance? The Role of Proxy Fights and Staggered Boards*
*The Use of EVA™ In M&A*

**Case:** Gulf Oil Corporation – Takeover

**Lecture (*):** Economic Value Added (EVA™) – Executive Compensation

**WEEK IV-B (4/24)**  
*Dynamics of Takeover Attempts and Tactics*
*The Role of Excess-Cash in Valuation*

**Case:** The Chrysler Takeover Attempt

**Lecture (*):** Excess Cash in Valuation. How Does Excess Cash Affect the Risk Profile of a Company?

**TUTORIAL (4/25)**  
*Q&A Session*
*Valuation Handout “The Chrysler Takeover Attempt”*

**WEEK V-A (5/1)**  
*Dynamics of Takeover Attacks*
*Corporate Restructuring as Non-Structural Defenses*
*Bidding Strategies*
*Estimating the Value of Not Tendering*

**Case:** The Hilton-ITT Wars
WEEK V-B (5/1)  Conflicts between Equity and Debt-Holders
Fiduciary Duties of Board of Directors
Event Studies
Corporate Restructuring: Spin-Offs vs. Carve-Outs
Alternative Methods of Restructuring

Case: Marriott Corporation (A)-(B)
Mini-Case: Texaco-Pennzoil Battle for Getty Oil

Lecture (*): Corporate Restructuring: Strategic Divestures
Lecture (*): Fiduciary Duties: Board of Directors and Corporate Officers

TUTORIAL (5/2)  Q&A Session
Fiduciary Duties: Board of Directors and Corporate Officers
The Hilton-ITT Wars Case Discussion

PART D: BANKRUPTCY AND FINANCIAL DISTRESS

WEEK VI (5/8)  Bankruptcy, Corporate Restructuring and Financial Distress
Chapter 11 (Bankruptcy), Chapter 7 (Liquidation), On-Going Concern and Private Workouts
The Capital Cash Flow Method

Case: Bankruptcy and Restructuring at Marvel Entertainment Group
Lecture (*): Bankruptcy: Codes and Practices
Corporate Restructuring in Financial Distress: Private Workouts and Bankruptcy

TUTORIAL (5/9)  Q&A Session: Marvel Calculations

WEEK VII (5/19-23)  Conflicts of Interest: Founding Families and Public Shareholders
Bankruptcy Exit Mode: “363 Sale” vs. Stand-Alone Chapter 11 Reorganization

Case: Adelphia Communications Corp.’s Bankruptcy
Lecture (*): Distressed Debt Investment

TUTORIAL (5/19-23)  Q&A Session: Limits to Structural Subordination
[Saturday-Wednesday]
PART E: PRIVATE EQUITY AND LEVERAGED BUYOUTS (LBOs)

WEEK VIII (5/22)  
**Valuation of Leverage Buyouts (LBOs)**  
Private Equity & LBOs  
Dealing With Time-Varying Capital Structure

Case:  
Seagate Technology Buyout

Lecture (*):  
Private Equity and LBOs

Lecture:  
LBO Valuation Modelling: Practitioners’ Chapter 12  
Capital Cash Flow and Cash Flow Available to Service Debt (CADS)  
Equity Cash Flows and IRRs to Sponsors  
The LBO Valuation Model and the Target IRR Model

WORKSHOP B (5/23)  
**Workshop on Valuation of Leveraged Buyouts**  
LBO Modelling  
The LBO Valuation Model: Target IRR and Backward Induction

WEEK IX-A (5/29)  
**Strategic vs. Financial Sponsors**  
Sources of Value in LBOs and Value Creation in Private Equity  
Capital Structure and Valuation of LBOs  
CCF, CADS, Equity Cash Flow and IRRs to Sponsors

Case:  
Berkshire Partners: Bidding for Carter’s

WEEK IX-B (5/29)  
**Leveraged Buyout Transaction Structures**  
The Private Equity Model Outside U.S.: Strategies and Development  
Timing and Exit of Investments

Case:  
The Exxel Group: March 2001

TUTORIAL (5/30)  
**Q&A Session: Berkshire Partners Calculations**

WEEK X (6/5)  
**Sources of Value in LBOs. Equity Cash Flow Valuation**  
Calculating IRR to Private Equity Firms  
Corporate Restructuring and Asset Backed Securities

Case:  
Hertz Corporation (A)-(B)

Lecture (*):  
Asset Backed Securities

Lecture:  
Course Wrap-Up  
Teaching Course Evaluations (In Class)  
Peer-Review/Letter Evaluations Due
PART F: MANAGING M&A RISKS COLLARS, EARN-OUTS, AND CVRS
DEBT AS A SOURCE OF VALUE FOR PRIVATE EQUITY

WEEK XI-A (6/12)  The Role and Economic Logic of Arbs. Key Value Drivers for Arbs
Sensitivity of Arbs to Returns, Time and Outcomes
Calculating the Value of Offers and Probabilities of Events

Case:  “War of the Handbags” The Takeover Battle for Gucci Group N.V.

OR

WEEK XI-B (6/12)  Debt as a Source of Value for Private Equity
Investing in Distressed Debt
Loan-to-Loan Investment Strategies

Case:  Oaktree and the Restructuring of CIT Group (A)-(B)