CHAPTER 2 ANSWERS

1) D. Transaction comps tend to be higher for two reasons. Buyers generally pay a control premium when purchasing another company, and in return the acquirer receives the right to control decisions regarding the target's business and its underlying cash flows. Strategic buyers often take the opportunity to realize synergies, which supports the ability to pay a premium.

2) B. The correct order for a precedent transactions analysis is: Select the universe of comparable acquisitions; Locate the necessary deal-related and financial information; Spread key statistics, ratios, and transaction multiples; Benchmark the comparable acquisitions; and finally, Determine valuation.

3) A. The overall motivation and sale process matter. When a corporation in need of cash is selling a non-core business, it may prioritize speed of execution, certainty of completion, and other structural considerations, which may result in a lower valuation than a pure value-maximization strategy.

4) D. Depending on the nature of the transaction, a "going private" deal may require enhanced disclosure. For example, in an LBO of a public company where an affiliate (such as a senior company executive or significant shareholder) is part of the buyout group, the SEC requires broader disclosure of information used in the decision-making process on a Schedule 13E-3. Disclosure items on Schedule 13E-3 include materials such as presentations to the target's board of directors by its financial advisor(s) in support of the actual fairness opinion(s).

5) B. When performing a precedent transactions analysis, equity value is calculated by multiplying the total of fully diluted shares outstanding by the acquirer's offer price ($100.00mm x $40.00mm).

6) C. In an M&A transaction where the target is private, the equity value is calculated as enterprise value less assumed/refinanced net debt.

7) A. The offer price per share is calculated by dividing the cash offer price by the number of shares outstanding ($300.0mm / $5.0mm).

8) D. Purchase consideration refers to the mix of cash, stock, and/or other securities that the acquirer offers to the target's shareholders. The three primary types of consideration are all-cash, stock-for-stock, and cash/stock mix.

9) A. An all-cash transaction represents the cleanest form of currency and certainty of value for all shareholders; however, receipt of such consideration typically triggers a taxable event. In contrast, the exchange or receipt of shares of stock, if structured properly, is not taxable until the shares are eventually

sold.

10) A. A fixed exchange ratio defines the number of shares of the acquirer's stock to be exchanged for each share of the target's stock.

11) B. The fixed exchange ratio can be determined by dividing the number of shares the acquirer is exchanging of its stock (1) by the number of shares the seller must tender to receive the acquirer's shares (4), so (1/4 = 0.25).

12) A. The offer price per share is calculated as the exchange ratio multiplied by the acquirer's share price. The exchange ratio is calculated by dividing the number of shares the acquirer is exchanging of its stock (1) by the number of shares the seller must tender to receive the acquirer's shares (4), so (1/4 = .25). The equity value is calculated as follows.

$$\text{Equity Value} = \left(\text{Exchange Ratio} \times \text{Acquirer's Share Price}\right) \times \text{Target's Fully Diluted Shares Outstanding}$$

$$\$125.0\text{mm} = \left(.25 \times \$20.00\right) \times 25.0 \text{ million}$$

13) C. This is an example of a floating exchange ratio. A floating exchange ratio represents the set dollar amount per share that the acquirer has agreed to pay for each share of the target's stock in the form of shares of the acquirer's stock.

14) A. In a fixed exchange ratio, the target's shareholders assume the risk, as they will get the same number of shares regardless of the acquirer's share price. With a floating exchange ratio, the acquirer assumes the risk, because even if its share price goes down, the target's shareholders will get the same value.

15) D. In a cash-and-stock transaction, the offer price per share is calculated as follows. The exchange ratio is .50; it is calculated by dividing 1 (AcquirerCo is exchanging one share of its stock) by 2 (the number of shares the stockholders must tender to receive a share of AcquirerCo common stock).

$$\text{Offer Price per Share} = \text{Cash Offer per Share} + \left(\text{Exchange Ratio} \times \text{Acquirer's Share Price}\right)$$

$$\$20.00 = \$5.00 + \left(.50 \times \$30.00\right)$$

16) D. The premium paid in an M&A deal is calculated by dividing the offer price per a share by the *unaffected* share price. In this scenario, news of the acquisition broke the previous day, causing TargetCo shares to rise. When leaks occur, it is appropriate to examine the premiums paid relative to the target's share price at various intervals prior to such an announcement or leak in addition to the actual transaction announcement.

17) D. Synergies refer to expected cost savings, growth opportunities, and other financial benefits that occur as a result of the combination of two businesses. To account for synergies in an EBITDA multiple, add the total amount of synergies to the LTM EBITDA. EBITDA is calculated by adding depreciation and amortization to EBIT. The calculation for the EBITDA multiple that includes synergies is shown here.

$$\frac{\text{Enterprise Value}}{\text{LTM EBITDA + Synergies}} = \frac{\$3{,}500 \text{ million}}{\$450 \text{ million} + 50 \text{ million}} = 7\text{x}$$

18) C. A precedent transactions analysis looks at previous transactions and therefore avoids making assumptions about future performance.

19) A. The premium paid in a transaction is calculated by dividing the offer price by the unaffected share price of the target and subtracting 1: (35 / 20) – 1.

20) B. Traditionally, strategic buyers have been able to pay higher purchase prices than financial sponsors due to their potential ability to realize synergies from the transaction, among other factors, including lower cost of capital and return thresholds.

21) C. Hostile situations, whereby the target actively seeks alternatives to a proposed takeover by a particular buyer, may produce higher purchase prices.

22) B. The use of stock as a meaningful portion of a transaction leads to lower valuations, when the target's shareholders receive stock and expect to share in the upside.

23) D. Private acquirer/private target transactions (including LBOs) involving nonpublic financing are the most difficult transactions for which to obtain information, because there are no SEC disclosure requirements.

24) A. In a fixed exchange ratio structure, the number of shares always remains constant.

25) A. In a floating ratio structure, the number of shares exchanged fluctuates in accordance with the movement of the acquirer's share price.

26) C. In cases where the acquirer purchases less than 100% of the target's outstanding shares, equity value must be grossed up to calculate the implied equity value for the entire company.

27) B. For LBOs of private targets, the availability of necessary information depends on whether public debt securities (typically high yield bonds) are issued as part of the financing. In this case, the S-4 contains the relevant data on purchase price and target financials to spread the precedent transaction.

28) D. A Schedule 14D-9 contains the recommendation from the target's board of directors on how shareholders should respond to a tender offer.