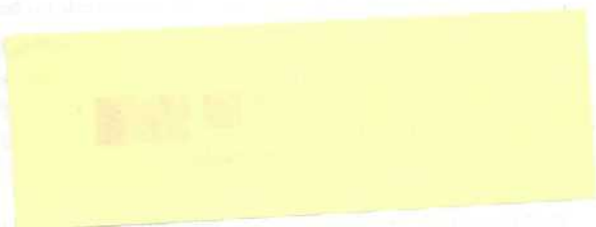


Applied International Corporate Finance

von
Prof. Dr. Dr. Dietmar Ernst
und
Prof. Dr. Dr. Joachim Häcker



Verlag Franz Vahlen München

Content

Preface	V
Testimonials	VII
Acknowledgements	IX

Part 1: Mergers & Acquisitions (M&A)

Chapter 1: Why Mergers&Acquisitions?

1.1 The Term "Mergers & Acquisitions"	1
1.1.1 Mergers	2
1.1.2 Acquisitions	6
1.1.3 M&A and Business Alliances	6
1.1.3.1 Forms of business alliances	6
1.1.3.2 M&A versus business alliances	9
1.2 Reasons for and success factors of M&A	10
1.3 The process of M&A	13

Chapter 2: Initial Phase (Phase 1)

2.1 Pitch	15
2.2 Choice of process	17
2.2.1 The discrete approach	17
2.2.2 Simultaneous bilateral negotiations	17
2.2.3 Controlled competitive auction	17
2.2.4 Full public auction	17
2.3 Candidate screening and selection	19
2.3.1 MBO or MBI	20
2.3.2 Financial investors	21
2.3.3 Strategic investors	22
2.4 Advisers	24
2.4.1 Investment banks	24
2.4.2 Accountants and tax advisers	25
2.4.3 Lawyers	26
2.4.4 Other advisers	26
2.5 Mandate letter	28
2.6 Confidentiality agreement	34

Chapter 3: Contacting Interested Parties (Phase 2)

3.1 Documentation	38
3.1.1 Anonymous short profile	38
3.1.2 Information memorandum	38
3.2 Letter of Intent	39

Chapter 4: Financial Aspects in an M&A Sales Process (Phase 3)

4.1	Due Diligence	45
4.2	Valuation	45
4.3	Structuring	45

Chapter 5: Legal Aspects in an M&A Sales Process (Phase 4)

5.1	Negotiations	49
5.2	Binding offer	52
5.3	Purchase agreement and closing	52
5.3.1	Purchase Agreement	52
5.3.2	Closing	54

Part 2: Private Equity**Chapter 1: What is Private Equity all about?**

1.1	Definitions	57
1.2	Types of investment financing	62
1.2.1	Early stage financings (venture capital financings)	63
1.2.1.1	Seed financing	63
1.2.1.2	Start-up financing	63
1.2.1.3	First-stage financing	63
1.2.2	Later-stage financings (Private equity financings)	64
1.2.2.1	Second-stage financing	64
1.2.2.2	Third-stage financing	65
1.2.2.3	Fourth-stage financing	65
1.3	Occasions for private equity financing	67
1.3.1	Expansion (development capital)	67
1.3.2	Bridge financing	67
1.3.3	Public-to-private (Going private)	68
1.3.4	Succession planning and displacement of existing shareholders	68
1.3.5	Spin-off	69
1.3.6	Private placement	70
1.3.7	Turnaround	70
1.3.8	Platform strategy or buy and build strategy	70
1.4	Types of investments	72
1.4.1	Open investments	72
1.4.2	Indirect investments	73

Chapter 2: Who drives Private Equity?

2.1	Bidder groups for equity capital	75
2.1.1	Captive funds	75
2.1.2	Public funds	75
2.1.3	Independent funds	75
2.2	The role of banks in the private equity business	76

2.3	Investors in private equity capital	78
2.3.1	New funds raised according to capital sources	78
2.3.2	Geographical distribution in Germany	79
2.3.3	New funds raised according to financing phases	80
2.3.4	Sectoral distribution of investment	80

Chapter 3: How are Private Equity firms organized?

3.1	Organisational aspects	82
3.1.1	Structure of Private Equity Companies	82
3.1.1.1	Separation of fund and management	82
3.1.1.2	Subsidiaries	83
3.1.2	Management-, control- and advisory organs	83
3.1.3	Inner organisation	84
3.2	The investment contract	86
3.2.1	Basic types and significant parts of the contract	86
3.2.2	Adoption of existing contracts, important side contracts and covenants	88
3.2.3	Combined investment contracts	89
3.2.4	Participation in advisory and control organs	90
3.3	Taxation of capital gains according to German law	92
3.3.1	Sale of investments by a corporation / limited liability company	92
3.3.2	Sale of investments by a partnership	92
3.3.3	Sale of investments by a private person	92
3.4	Valuation of private equity investments	93
3.4.1	Measuring performance: the Internal Rate of Return (IRR)	93
3.4.1.1	Derivation of the IRR	94
3.4.1.2	Calculating the IRR using standard spreadsheet software	95
3.4.1.3	Three levels of IRR advocated by EVCA	96
3.4.2	Valuation principles and methodologies	98
3.4.2.1	Valuation principles	98
3.4.2.2	Valuation methodologies	100

Chapter 4: How is Private Equity Business done?

4.1	The working approach of private equity companies	107
4.1.1	Organisational milestones	107
4.1.1.1	Recruiting	107
4.1.1.2	Fund raising	108
4.1.2	Project-oriented milestones	109
4.1.2.1	Deal-flow	109
4.1.2.2	Due diligence	110
4.1.2.3	Business plan	111
4.1.2.4	Investment negotiations	112
4.1.2.5	Investment support	113
4.1.2.6	Exit	114
4.2	Acquisition policy and risk management	120
4.2.1	Quality controls in the project examination area	120

4.2.2	Setting of competences and decision levels	121
4.2.3	Selection of projects according to the criteria of company size	121
4.2.4	Risk limitation through syndication	122
4.2.5	Risk limitation through specialisation	122
4.3	Investment purchase abroad	124

Part 3: Acquisition Financing

Chapter 1: What makes acquisition financing special?

1.1	Definition and challenges	127
1.2	The challenges of acquisition financing	128
1.3	Acquisition financing vs. buy-out/buy-in financing	130
1.3.1	Management Buy-Out (MBO)	130
1.3.2	Management Buy In (MBI)	131
1.3.3	Leveraged Buy-Out (LBO)	131

Chapter 2: Who drives acquisition financing?

2.1	Acquisition financing – parties involved and their various motives	133
2.1.1	Senior partners	133
2.1.2	Strategic investors	134
2.1.3	Financial investors (private equity investors)	134
2.1.4	Management	134
2.1.5	Financial institutions	135
2.1.6	Advisors	136
2.2	Main goals of debt capital investors	136
2.2.1	Low debt capital ratio	136
2.2.2	Collateral	137
2.2.3	Marketability – loan syndication	137
2.2.4	Return on debt	138
2.3	Main goals of equity capital investors	139
2.3.1	Return on equity	139
2.3.2	Limited liability	139
2.3.3	Contract flexibility	140
2.3.4	Minimum expenses	140

Chapter 3: How does acquisition financing work?

3.1	Functionality of Leveraged Buy-Outs	141
3.2	Exploiting the leverage-effect	142
3.3	Improvement of cash-flows	143
3.3.1	Fixed assets and working capital optimisation	143
3.3.2	Strategic reorientation of the enterprise	143
3.3.3	Efficient capital allocation	144
3.3.4	Know-how transfer by financial investors	144

3.3.5	Elimination of underperformance in the enterprise	144
3.3.6	Asset Stripping	144
3.4	Improvement of company valuation	145
3.4.1	Increase purchase price-multiple due to improved returns and profits	145
3.4.2	Increase purchase price-multiple due to an optimised firm size	145
3.5	Integral parts of successful Leveraged Buy-Outs	146
3.5.1	Attractive LBO market environment	146
3.5.2	LBO proficient company	146
3.5.3	Exit possibilities and increase in company value	147
3.5.4	Management	147
3.5.5	Track record and firm ethics of financial investor	148
3.5.6	Fair price	148
3.5.7	Fiscal-optimisation	150
3.5.8	Feasible and sustainable financing structure	150

Chapter 4: How to structure an acquisition

4.1	Acquisition financing – structuring the project under company law	154
4.1.1	Three step takeover approach	154
4.1.2	Respective interests of equity capital investors	156
4.1.3	Respective interests of debt capital investors	156
4.1.4	Legal restrictions	156
4.2	Asset deal vs. share deal	157
4.3	Acquisition financing – structuring the financing tools	158

Chapter 5: How to determine the financial structure of an acquisition financing

5.1	Determination of the debt service ability	162
5.2	Acquisition financing – role of equity capital	165
5.2.1	Share capital	165
5.2.2	Shareholder loans	165
5.3	Acquisition financing – role of outside capital	167
5.3.1	Senior term debt	167
5.3.2	Working capital facilities	170
5.4	Mezzanine capital	173
5.4.1	Particular characteristics of mezzanine capital	173
5.4.2	Mezzanine capital in the context of acquisition financings	174
5.4.2.1	Mezzanine capital – bridging the gap	174
5.4.2.2	Mezzanine capital – payment structure and yield expectations	175
5.4.2.3	Mezzanine capital – contractual structuring	175
5.4.3	Different forms of mezzanine capital	177
5.4.3.1	Equity mezzanine instruments	178
5.4.3.2	Debt mezzanine instruments	179
5.5	Capital structure and key figures	183

Chapter 6: What kind of contracts are used in acquisition financing?

6.1	Credit agreement	186
6.1.1	Precedent conditions	187
6.1.2	Representations and warranties	187
6.1.3	Covenants	188
6.2	Collateral agreement	191
6.3	Consortium agreement	191
6.4	Intercreditor agreement	191
6.5	Purchase agreement	192

Chapter 7: How is acquisition financing done?

7.1	Pre-deal screening	194
7.1.1	Business plan	194
7.1.2	Due diligence	195
7.1.3	Financing case	197
7.1.4	Financing structure and term sheet	197
7.1.5	Commitment letter	198
7.1.6	Contract documentation	198
7.1.7	Syndication	198
7.1.8	Deal signing and closing	200
7.2	Post-deal monitoring	200

Part 4: Initial Public Offering**Chapter 1: Why Initial Public Offering?**

1.1	Definition and reasons for IPO	203
1.2	Pros and Cons	206
1.2.1	Benefits and Opportunities	207
1.2.2	Drawbacks and Continuing Obligations	208
1.3	Pre-IPO Strategy	211

Chapter 2: How do the Stock Exchanges in Frankfurt, London and New York work?

2.1	Listing at the Frankfurt Stock Exchange	215
2.1.1	Frankfurt Stock Exchange – the Company	215
2.1.1.1	History and Development	215
2.1.1.2	Legal Framework	216
2.1.1.3	Organisation and Indices	217
2.1.2	Listing Requirements	221
2.1.2.1	Requirements before IPO	221
2.1.2.2	Continuing Listing Requirements	223
2.2	Listing at the London Stock Exchange	225
2.2.1	London Stock Exchange – the Company	225
2.2.1.1	History and Development	225
2.2.1.2	Legal Framework	225

2.2.1.3	Organisation and Functions	226
2.2.2	Listing Requirements	228
2.2.2.1	Requirements before IPO	228
2.2.2.2	Continuing Listing Requirements	232
2.3	Listing at the New York Stock Exchange	235
2.3.1	New York Stock Exchange – the Company	235
2.3.1.1	History and Development	235
2.3.1.2	Legal Framework	235
2.3.1.3	Organisation and Functions	236
2.3.2	Listing Requirements	238
2.3.2.1	Listing Requirements before IPO	239
2.3.2.2	Continuing Listing Requirements	241

Chapter 3: What is the difference between an IPO in Germany, UK and the US?

3.1	The IPO process in Germany	243
3.2	The IPO process in UK (LSE)	244
3.2.1	Countdown to flotation	244
3.2.2	The flotation timetable	244
3.2.2.1	The timetable: 12 to 24 weeks before admission	244
3.2.2.2	The timetable: 6 to 12 weeks before admission	245
3.2.2.3	The timetable: 1 to 6 weeks before admission	245
3.2.2.4	The timetable: 1 week before admission week	246
3.2.2.5	The timetable: Admission week	246
3.3	The IPO Process in the US	247
3.3.1	Overview of the IPO Process	247
3.3.2	Securities regulation in the USA	247
3.3.3	Securities Act of 1933	247
3.3.4	Securities Exchange Act of 1934	248
3.3.5	Private placements vs. public offerings	248
3.3.5.1	Private placements	249
3.3.5.2	Rule 144a	249
3.3.5.3	Buyers of Rule 144a offerings	249
3.3.5.4	Regulation S	249
3.3.6	Documents	250
3.3.7	Resale restrictions	250
3.3.8	Ongoing disclosures	250
3.3.9	The offering process	251
3.3.10	Timetable	252
3.3.11	Documentation and disclosure	253
3.3.12	Financial statement requirements	253
3.3.13	Liability and due diligence	254

Chapter 4: What is the roadmap for a successful IPO?

4.1	Phase One: Planning and preparation	256
4.1.1	Checking the pre-requisites for Going Public	256

4.1.1.1	Stock Corporation	256
4.1.1.2	Financial Reporting	258
4.1.1.3	Business Plan	259
4.1.2	Equity Story	259
4.1.3	Issue Concept	262
4.2	Phase two: Structuring	264
4.2.1	Recruiting syndicate banks	264
4.2.1.1	Co-ordinators	264
4.2.1.2	Syndicate Structure	265
4.2.1.3	Designations	268
4.2.1.4	Beauty Contest and Selection Criteria	269
4.2.1.5	Agreements with Co-ordinators	271
4.2.1.6	Underwriting Commissions	272
4.2.2	IPO Consultants	273
4.2.3	Legal Advisers	274
4.2.4	Auditors and Tax Advisers	276
4.2.5	IR/PR Agencies	276
4.2.6	Due Diligence	277
4.2.7	Valuation	279
4.2.8	Prospectus	281
4.2.9	Corporate Governance	284
4.3	Phase three: Marketing: Investor Relations, Pre-marketing, and Road Show	285
4.3.1	Investor Relations	285
4.3.2	Pre-marketing	286
4.3.2.1	Analyst Meetings	286
4.3.2.2	Research	286
4.3.3	Road Show	289
4.4	Phase four: Pricing, Allocation and Stabilisation	290
4.4.1	Pricing	290
4.4.1.1	Pricing Methods	290
4.4.1.1.1	Fixed-Price Method	290
4.4.1.1.2	Bookbuilding	290
4.4.1.2	Pricing Structure	291
4.4.1.3	Pricing Mechanism	291
4.4.2	Allocation	294
4.4.2.1	Allocation to Institutional Investors	294
4.4.2.2	Allocation to Retail Investors	295
4.4.2.3	Employee equity compensation programmes	296
4.4.2.4	Friends & Family Programme	296
4.4.3	Stabilisation	297
4.4.3.1	Greenshoe (Over-Allotment Option)	297
4.4.3.2	Naked Short	298
4.4.3.3	Naked Long	298
4.5	Phase five: Life as a Public Company	299
4.5.1	Ad-hoc Disclosures	299

4.5.2	Insider Information and Compliance	300
4.5.3	Transparency for Capital Markets	301
4.5.4	Annual Financial Statements and Quarterly Reports	302
4.5.5	Analyst Conferences and Research	304
4.5.6	Corporation Action Timetable	304
4.5.7	Investor Relations	305

Part 5: Going Private

Chapter 1: Why go private?

1.1	Definition of going private	309
1.2	Going private and going dark	310
1.2.1	Going dark	310
1.2.2	Similarities and differences between going private and going dark ...	312
1.3	Motives and success factors for going private	313
1.3.1	Reasons for going private	313
1.3.2	Benefits of going private	314
1.3.3	Risk of going private	315
1.4	Candidates for going private transactions	316
1.5	Recent transactions in the U.S., U.K. and Germany	317

Chapter 2: Going private in the U.S. and U.K.

2.1	Delisting Procedure at New York Stock Exchange and London Stock Exchange	319
2.1.1	Delisting at the New York Stock Exchange	319
2.1.2	Delisting at the London Stock Exchange	319
2.2	Legal Framework	321
2.2.1	The Sarbanes Oxley Act affecting the U.S. going private activity	321
2.2.2	Corporate Governance Guidelines in the U.K.	323
2.3	Protection of shareholders	324
2.3.1	Protection of shareholders in the U.S.	324
2.3.1.1	Rules against false and misleading information	324
2.3.1.2	Disclosure issues	325
2.3.2	Protection of shareholders in the U.K.	326

Chapter 3: Going private in Germany

3.1	What is the legal framework of going private transactions in Germany?	331
3.2	How can delisting be done?	332
3.2.1	Ex officio delisting	332
3.2.2	Hot delisting	332
3.2.3	Cold delisting	333
3.2.3.1	Squeeze-out	333
3.2.3.2	Integration	335

3.2.3.3	Conversion, merger and corporate division	336
3.2.3.4	Liquidation and sale of all assets	337

Part 6: Due Diligence

Chapter 1: Why Due Diligence?

1.1	Definition of the term due diligence	339
1.2	Motives for conducting a due diligence	340
1.3	Objectives of the due diligence process	341
1.3.1	Reducing the information asymmetry	341
1.3.2	Identifying and examining the synergy potential	341
1.3.3	Linking the strategic preparation with the integration period	342
1.3.4	Providing reps and warranties	342
1.4	Participants in the due diligence process	342
1.5	Information sources for conducting due diligence	343
1.5.1	Internal sources of information	343
1.5.1.1	The Data room	343
1.5.1.2	Interviewing the management	343
1.5.1.3	Site visits	344
1.5.2	External sources of information	344

Chapter 2: What is a data room?

2.1	The data room	345
2.2	Data room checklist	347
2.2.1	Corporate organisation	347
2.2.2	Employees	348
2.2.3	Litigation	348
2.2.4	Pensions	348
2.2.5	Taxation	348
2.2.6	Agreements	349
2.2.7	Insurances	349
2.2.8	Financial documents	349
2.2.9	Intellectual property	349
2.2.10	Property	349
2.2.11	Products/services/technology	350

Chapter 3: What is done in a due diligence?

3.1	The strategic audit	351
3.1.1	Assessing the target company's forecasting process	351
3.1.2	Steps for formulating a business plan	351
3.1.3	What happens with the business plan?	352
3.1.4	Challenging the business plan	352
3.2	The financial audit	357
3.2.1	Assessing internal controls	357

3.2.2	Assessing annual reports	357
3.3	The legal audit	361
3.3.1	The legal foundation	361
3.3.2	The legal risk factors	361
3.3.3	The internal legal structure	362
3.3.4	The external legal structure	362
3.4	Conducting a tax due diligence	363
3.4.1	The scope of the tax due diligence	363
3.4.2	Past periods that were not covered by tax audits	363

Part 7: An Overview of Corporate Valuation

Chapter 1: Why Valuation?

1.1	Valuation methods at a glance	367
1.2	Occasions and Purposes of Valuation	369
1.3	General framework	372
1.3.1	Valuation: Art or Science?	372
1.3.2	Value versus price	372

Chapter 2: How to carry out a valuation

2.1	Valuation techniques	374
2.2	Methods of individual valuation	374
2.2.1	Net asset value based on reproduction values	375
2.2.2	Net asset value based on liquidation values	375
2.3	Multiple methods	377
2.3.1	Multiples valuation procedure	377
2.3.2	Comparable Companies Approach (Trading Multiples)	378
2.3.2.1	Enterprise-value multiples versus equity-value multiples	378
2.3.2.2	Enterprise-value multiples	379
2.3.2.3	Equity-value multiples	380
2.3.2.4	Example	380
2.3.2.5	Applicability of the Comparable Companies Approach	381
2.3.3	Comparable Transactions Approach	382
2.3.3.1	Procedure	382
2.3.3.2	Example	382
2.3.3.3	Applicability of the Comparable Transactions Approach	383
2.3.4	Summary	384
2.4	Discounted Cash Flow Method	385
2.4.1	Introduction	385
2.4.2	The entity approach or WACC method	386
2.4.2.1	Introduction	386
2.4.2.2	Cash flows and terminal value	387
2.4.2.3	Cost of Capital	390
2.4.3	Applicability of the Discounted Cash Flow Method	394

2.5	The Book value	396
2.6	The Trade Buyer's Approach	396
2.6.1	The procedure	396
2.6.2	Applicability	397
2.7	Real Options Approach	399
2.7.1	Advantages and classification of the Real Options Approach	399
2.7.2	Basic overview on the real options approach models	400
2.7.2.1	Analytical models	400
2.7.2.2	Numerical models	400
2.7.3	Advantages of the binomial model	400