M&A and LBO Fundamentals

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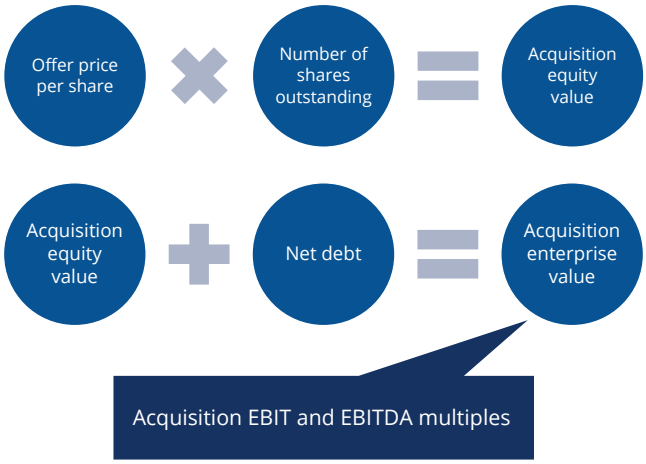
Equity Valuation in an M&A Context



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Financing a Transaction

Debt

- Depends on consolidated debt capacity
- Normally based on an EBITDA multiple
- Calculate proforma EBITDA
- Estimate maximum consolidated debt
- Compare with total pre deal debt
- Interest rate based on consolidated risk
- May impact credit ratings

Equity

- Normally more expensive than debt
- New shares issued means dilution
- May be impacted by volatile share prices
- May mean shares "flowback"
- Post deal ownership an issue for acquirer shareholders
- Exchange ratio calculated for offer document

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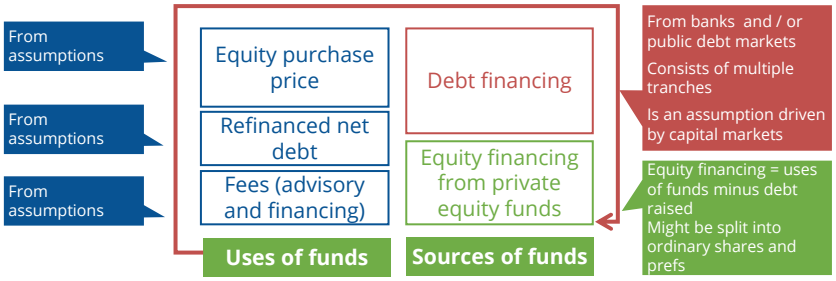
Sources and Uses of Funds



Sources and uses of funds						
Uses	$MM	Sources	$MM	x LTM EBITDA	Spread	Interest rate
Acquisition equity value	7,065.6	Revolver	0.0		2.0%	2.6%
Refinanced net debt	5,326.0	Term loan A	3,500.0	1.9 x	3.0%	3.6%
Debt financing fees	67.5	Term loan B	2,500.0	3.3 x	4.0%	4.6%
Advisory fees	70.7	Mezzanine loan (PIK)	750.0	3.7 x	8.0%	8.6%
		Senior unsecured notes	500.0	4.0 x	8.0%	10.3%
		Equity	5,279.8			
Total uses of funds	12,529.8	Total sources of funds	12,529.8			

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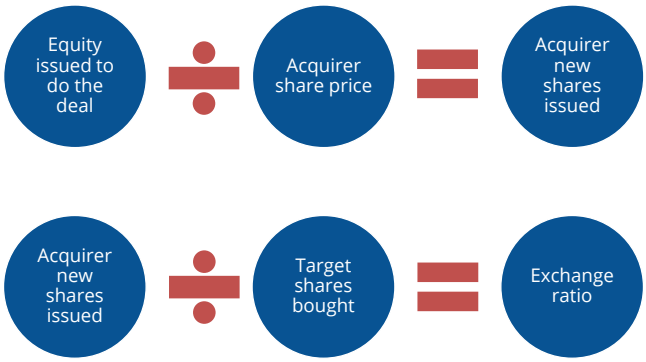
Equity Financing Exchange Ratio



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Output – EPS Accretion / Dilution

	Year 1	Year 2	Year 3	Comment
Target EPS	14.40	14.85	15.30	From research or management
Target shares outstanding	562.5	562.5	562.5	Todays: assume no changes
Target net income	8,100.0	8,353.1	8,606.3	Calculate = EPS * share count
Acquirer EPS	6.53	6.75	7.20	From research or management
Acquirer shares outstanding	1,522.1	1,522.1	1,522.1	Todays: assume no changes
Acquirer net income	9,939.3	10,274.2	10,959.1	Calculate = EPS * share count
Synergies	675.0	675.0	675.0	Estimate and benchmark
Synergies post tax @ 25.0%	506.3	506.3	506.3	Calculate = synergies * (1 – t)
Deal debt	6,415.2	6,415.2	6,415.2	From debt capacity analysis
Deal debt interest @ 6.0%	384.9	384.9	384.9	Deal debt * estimated interest rate
Deal debt interest post tax @ 25.0%	288.7	288.7	288.7	Calculate = deal debt interest * (1 – t)
Proforma net income	18,256.9	18,844.9	19,783.0	Target + acquirer + synergies - interest

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Output – EPS Accretion / Dilution

	Year 1	Year 2	Year 3	Comment
Consolidated shares				
Acquirer shares outstanding	1,522.1	1,522.1	1,522.1	Todays: assume no changes
New shares issued	1,472.6	1,472.6	1,472.6	Calculate = equity issued / acquirer share price
Proforma shares outstanding	2,994.7	2,994.7	2,994.7	Calculate = shares outstanding + issued
EPS accretion / (dilution)				
Proforma EPS	6.10	6.29	6.61	Calculate = Proforma net income / proforma shares outstanding
Acquirer EPS	6.53	6.75	7.20	Standalone
EPS accretion / (dilution)	(6.6%)	(6.8%)	(8.3%)	Calculate = (Proforma EPS / Acquirer EPS) -1

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Leveraged Buy Out – Definition

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IRR and Value Analysis

	Entry	Exit	Comment
EBITDA	36.3	62.7	Today and estimated for exit
EBITDA multiple	6.0 x	7.0 x	Assumption based on expected performance within industry
Enterprise value	217.8	438.9	Calculate = EBITDA * multiple
Debt	108.9	65.3	From debt capacity and forecast paydown
Equity	108.9	373.6	Calculate = EV – debt
IRR – exit year 4	36.1%		Calculate = (equity on exit / equity on entry) ^ (1 / 4) - 1
Value created	264.7		Calculate = equity on exit – equity on entry
Debt repayment	43.6		Calculate = debt on entry – debt on exit
EBITDA improvement	158.4		Calculate = (exit EBITDA – entry EBITDA) * entry multiple
Multiple expansion/(contraction)	62.7		Calculate = (exit multiple – entry multiple) * exit EBITDA
Value created	264.7		Debt repayment + EBITDA improvement + multiple expansion

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