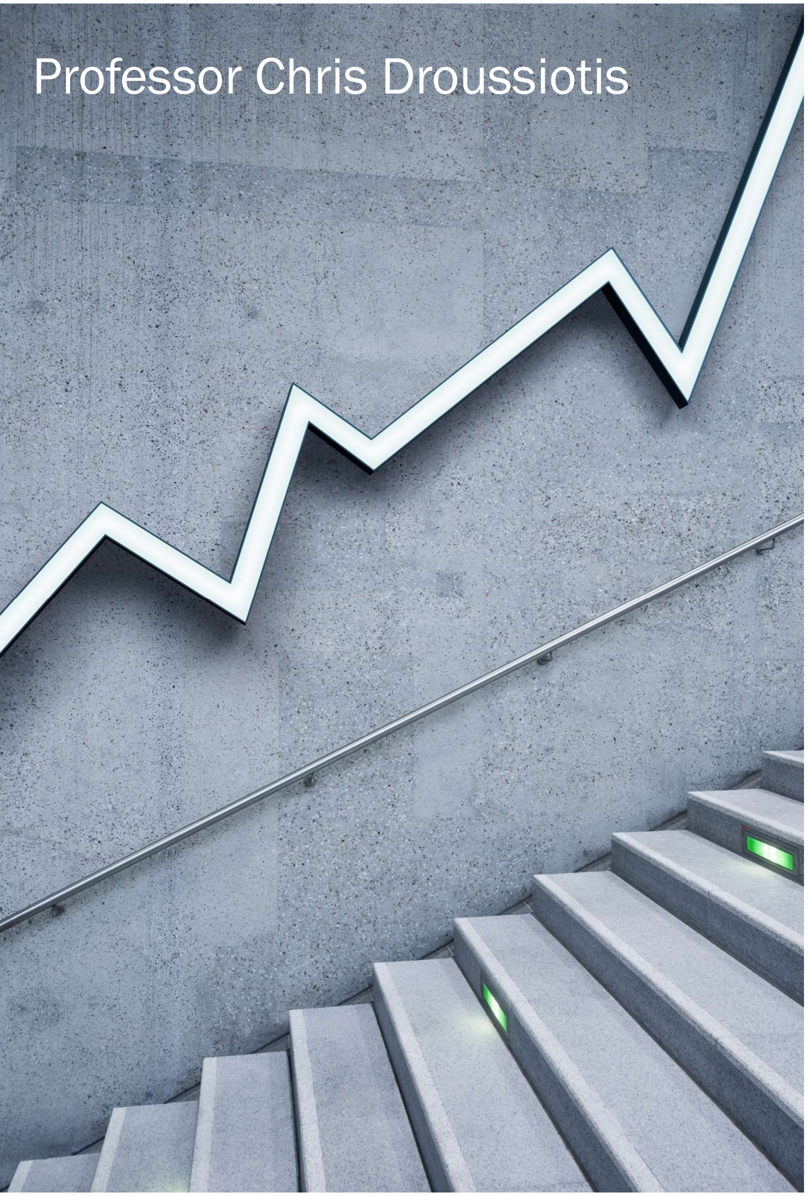


Mergers & Acquisitions

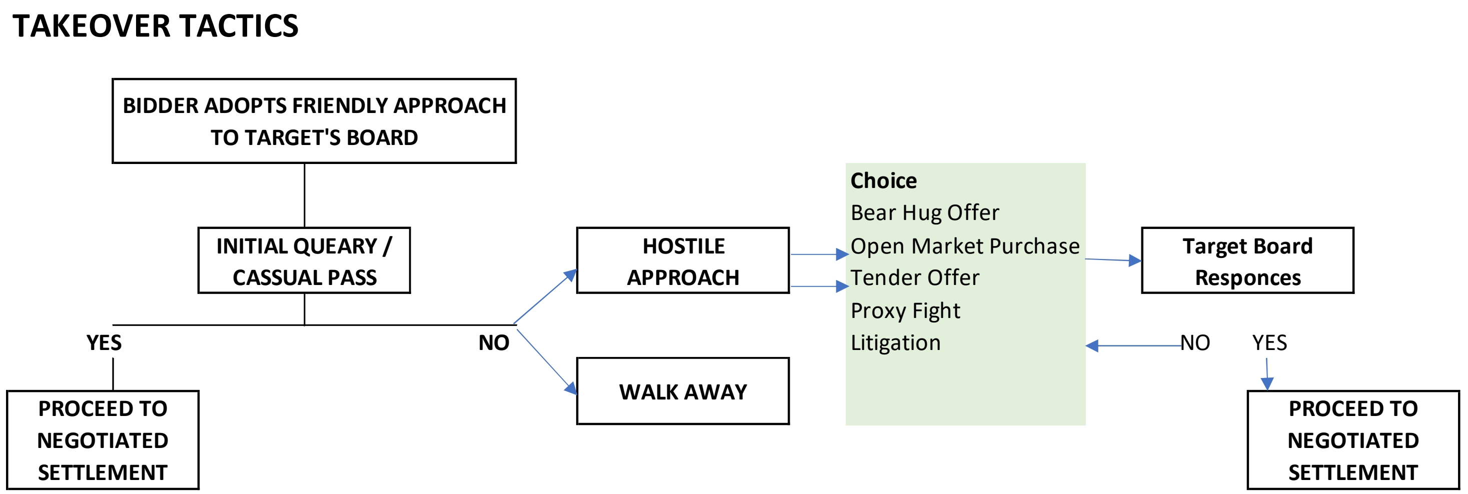
LECTURE 3: CORPORATE TAKEOVER MARKET

CASE STUDY 2: FACEBOOK ACQUISITION OF WHATSAPP

Understanding Takeover Tactics

- Friendly Takeovers
- Hostile Takeovers
- Reverse Takeovers
- Backflip Takeover

Understanding Takeover Tactics



Friendly Takeover

- Target company agrees to the acquisition offer in a peaceful manner subject to approvals by:
  - Shareholders
  - Regulators (check if the deal complies with the antitrust laws)
- Both the acquirer and target company takes part in designing the structure of the deal to their mutual satisfaction.
- Better price per share is another advantage of a friendly takeover.

$19 Billion

Friendly Takeover
Facebook acquiring WhatsApp

- Facebook purchased WhatsApp in February 2014 for an approximate total of $16 billion, broken down into:
- $4 billion in cash and about $12 billion in Facebook shares.
- As part of the deal, WhatsApp's founders and employees with an additional $3 billion in restricted stock units.
- The acquisition price was staggering for an app that made little money and was largely popular outside the United States.

Friendly Takeover

Facebook acquiring WhatsApp

BENEFITS FOR FACEBOOK SHAREHOLDERS	BENEFITS FOR WHATSAPP SHAREHOLDERS
BUYING THE TREND AND MARKET PENETRATION: WhatsApp was heavily outpacing Facebook Messenger on mobile in certain areas	PREMIUM PRICE: $19 Billion represent 950 x 2013 Revenue ($20 million) Sequa Cap invested: $58mm – taking a 3.5billion (60x) Founder: Takes $3 billion Tax Free
DEFENSIVE ACQUISITION: WhatsApp's rise came at a crucial moment — just as Facebook was fully realizing its ambitions as a mobile-first company and making messaging a core service. WhatsApp was quickly demonstrating that it could compete with Facebook on its most important battleground	GROWTH OPPORTUNITY: WhatsApp — which lacked the market reach of Facebook — was drawing from the same pool of limited attention. And with the rise of other messaging apps like WeChat, Kik, Line, and Viber, which all showed promising signs of growth (especially in markets like Asia), Facebook saw both vulnerability and opportunity in WhatsApp.

Facebook Acquiring WhatsApp

COMPANY VALUE VIEW - Quick & Dirty Approach

Target Cost of Acquisition (AC)	19,000	million	
Risk Free Rate:	3.0%	2014	
Equity Risk Premium	5.0%		
Total Expected Return	8.0%		
Income Earnings (NI) with 0% growth(EPS Method)	1,520	million	(Exp. Ret. X AC)
Tax Rate	30.0%		
Pre-tax Earnings	2,171	million	NI/(1-t)

Break-Even Analysis - Business Model

Pathway 1: $1 per subscriber - need 2.5 billion subs)

Pathway 2: $5 per year on existing 450 million subs

Patheway 3: Advertising revenue

IP VALUE VIEW - Quick & Dirty Approach

	Market Cap	EV	Rev	EBITDA	Net Income	Number of Users
Market Cap	1					
Enterprise Value	0.9998	1				
Revebues	0.8933	0.8966	1			
EBITDA	0.9709	0.9701	0.8869	1		
Net Income	0.8978	0.8971	0.8466	0.9716	1	
Number of Users	0.9812	0.9789	0.8053	0.9354	0.8453	1

2014

FACEBOOK Value	$	170,000	million
Number of Users		1,250	million users
Value per user	$	136.00	
WHATSAPP			
Number of Users		450	million users
Number of Users 1/3	$	150	million users
Applying FB per user Value	$	20,400	million

Hostile Takeover

- The target company doesn't want the acquirer to acquire it
- The takeover is without the consent of the board of directors of the target company.
- The acquirer will directly go to the shareholders of the company to acquire the shares of the target company without letting the management of the target company know about such actions.
- The target company can use several mechanisms to defend itself against a hostile takeover including:
  - Poison Pill
  - The crown jewel defense
  - Pac Man defense

Hostile Takeover
Kraft acquisition of Cadbury

- 2010 saw the most controversial takeover of British Cadbury by the American giant Kraft Foods.
- Kraft hopes to acquire Cadbury to expand its global influence, especially in the snack category from emerging markets such as India.
- Cadbury did not sell, posing a major challenge to Kraft’s search for Cadbury.
- UK’s takeover code, leading the UK to modify takeover rules on how foreign companies acquire British companies.
- Many people in the M&A field believe that it has become too easy for foreign companies to acquire British competitors, and the process has become a bit sketchy.
- The acquisition and merger team responsible for overseeing this area reviewed the law and revised the Takeover Code in September 2011 – the law was called “Cadbury Law”

Hostile Takeover

Kraft acquisition of Cadbury

$19.5 Billion

BENEFITS FOR KRAFT SHAREHOLDERS	NOT BENEFITIAL FOR CADBURY SHAREHOLDERS
<u>TIMING AND PRICE</u>: After recession, low price	<u>DISCOUNT PRICE:</u> Cadbury rejected the offer on the basis of undervalued Cadbury which was now of a lesser value. It was in fact even lower than the current Cadbury share price – £7.13 Net Value per share is lower than the 5-year average trading
<u>GLOBAL MARKET SHARE:</u> the biggest cross-border acquisition this year. Such a deal clearly pushed Kraft as number 1 dealer in confectionary. A merger allowed Kraft to gain a footing in the fast-growing chewing gum category.	<u>JOB LOSSES</u>: The unions are worried that the jobs of hundreds would be at stake (estimated 9000plus) as Kraft would try to reduce costs to operate efficiently and pay back its debts. The company has also not given any formal assurance that it would protect 4500 UK jobs. Also it is a known fact that when a company needs to cut costs, jobs and job conditions suffer.

Hostile Takeover

Kraft acquisition of Cadbury

$19.5 Billion

<table>
<tr><th>BENEFITS FOR KRAFT SHAREHOLDERS</th><th>BENEFITS FOR CADBURY SHAREHOLDERS</th></tr>
<tr><td>COST SAVINGS: A combination of Kraft products like Toblerone, Oreos and Ritz crackers with Trident gum and Dairy Milk chocolates from Cadbury would result in $625 million annual pretax cost savings on annual company costs of research and development, advertising, branding and procurement.</td><td rowspan="2">GLOBAL REACH: Cadbury would profit from Kraft’s extensive distribution network around the globe. Cadbury had been vulnerable to a takeover ever since it demerged its US soft drinks business. This high takeover bid was an attractive opportunity to do away with such a fear. A combined Kraft and Cadbury would significantly expand the global reach of both businesses and create synergies worth in the region of $625m. Since a stand-alone Cadbury “had limited opportunities for value creation,” agreement to the contract for takeover seemed like a wise decision.</td></tr>
<tr><td>REVENUE SYNERGIES: There would also be a significant level of revenue synergy ($50 billion annually) that would subsequently result in higher earnings per shar</td></tr>
</table>

Hostile Takeover

- An acquirer may proceed with the hostile takeover using any of the following strategies:
  - Tender Offer: In a tender offer, the acquirer company makes a public offer to purchase shares from the shareholders of the target company at a price more than the current market price.
  - Proxy Fight: In proxy fights, the acquirer company makes the shareholders of the target company agreed to use their proxy votes in a way that is in favor of the acquirer company so that they could make the desired changes in the target company or in its management.

Reverse Takeover

- A reverse takeover (RTO) is a process whereby private companies can become publicly traded companies without going through an initial public offering (IPO).
- A private company buys enough shares to control a publicly-traded company.
- An RTO is also sometimes referred to as a reverse merger or a reverse IPO.
- A reverse merger is an attractive strategic option for managers of private companies to gain public company status.
- It is a less time-consuming and less costly alternative to the conventional initial public offerings (IPOs).

Reverse Takeover
Burger King

- June 2012: The Miami-based company’s return to the stock market comes less than two years after it was taken private in a $3.26 billion sale to Brazilian investment fund 3G Capital Management LLC and at a time when restaurants are struggling to make gains against fast-food leader McDonald’s Corp.
- Burger King debuted at $14.50
- Burger King were taken private just 18 months before they decided to go public to initiate growth. They merged with Justice Holdings, an investment company based in London.

Backflip Merger

SBC Communications acquisition of AT&T

- In 2005, SBC Communications purchased AT&T for $16 billion and retained the AT&T name, while the SBC name was absorbed into the overall company. SBC did this because AT&T was and is one of the most popular brand names in the world and has one of the longest histories of a telephone company.
- SBC bought AT&T because the merger allowed SBC to grow significantly, accessing AT&T's large network and customer base, allowing other subsidiaries of SBC to expand beyond their regional areas of the business to become a truly national player.
- With this merger, SBC became the largest provider of data and phone services to corporate entities in America, and AT&T lived on through the merger in a business that it was otherwise struggling in.

Backflip Merger

- BA backflip takeover is a type of takeover that occurs when an acquirer becomes a subsidiary of the company it purchased.
- Upon completion of the deal, the two entities join forces and retain the name of the company that was bought.
- A backflip takeover is usually pursued by companies that want to expand and simultaneously revamp their image.
- The acquired company usually benefits from the vast financial resources of the acquiring company, helping it grow.

Antitakeover Defenses –
Poison Pills and Shark Repellent Concepts

- Shareholders' Rights Plans – Give existing shareholders the opportunity to buy additional stock at a discounted price – making the takeover more expensive (from increased shares) – Papa John's (PZZA) – MBO by ousted founder John Schnatter.
- Voting Rights Plans – a clause that the board of directors adds to its charter to regulate the voting rights of shareholders who own a predetermined percentage of the company's stock (i.e., 20%, or supermajority vote) – Avon Products
- Staggered Board if Directors and Proxy Fights– time consuming tactic to vote out the entire board of directors making the proxy fight a challenge for the prospective raider (staggered – directors elected at different times)
- White-Knight – A strategy that enables a company's management to thwart a hostile bidder by selling the company to a bidder they find more friendly. Walt Disney defended hostile bid by Saul Steinberg by Sid Bass and JPM and Bear Stearns
- Pac-Man Defense – Acquiring the Acquirer – Porsche / Volkswagen (Porsche accumulation of VW backfired)