Contents

Preface		X
Dedication and Acknowledgments		XV
PART I	Introduction	1
CHAPTER 1	Winning through Mergers and Acquisitions	3
	Critical Values Shareholders Overlook	5
	Stand-Alone Fair Market Value	6
	Investment Value to Strategic Buyers Win–Win Benefits of Merger and Acquisition Computation of Cavendish's Stand-Alone, Fair	10
	Market Value Investment Value to Strategic Buyer	11 12
PART II	Building Value	15
CHAPTER 2	Building Value and Measuring Return on Investment in a Private Company	17
	Public Company Value Creation Model Computing Private Company Value Creation and ROI	17 19
	Analyzing Value Creation Strategies	35
CHAPTER 3	Market and Competitive Analysis	41
	Linking Strategic Planning to Building Value Assessing Specific Company Risk Competitive Factors Frequently Encountered in	43 48
	Nonpublic Entities	53
	Financial Analysis Conclusion	54 59
CHAPTER 4	Merger and Acquisition Market and Planning Process	61
	Common Seller and Buyer Motivations Why Mergers and Acquisitions Fail	64 65

<u>vi</u> Contents

Sales Strategy and Process Acquisition Strategy and Process Due Diligence Preparation	67 78 86
CHAPTER 5 Measuring Synergies	91
Synergy Measurement Process	92
Key Variables in Assessing Synergies	95
Synergy and Advance Planning	96
PART III Measuring Value	99
CHAPTER 6 Valuation Approaches and Fundamentals	101
Business Valuation Approaches	101
Using the Invested Capital Model to Define the	
Investment Being Appraised	103
Why Net Cash Flow Measures Value Most Accurately	104
Frequent Need to Negotiate from Earnings	104
Measures	106
Financial Statement Adjustments	109
Managing Investment Risk in Merger and	
Acquisition	112
Conclusion	117
CHAPTER 7 Income Approach: Using Expected Future Returns	
to Establish Value	119
Why Values for Merger and Acquisition Should Be	
Driven by the Income Approach	119
Two Methods within the Income Approach	121
Three-Stage DCF Model Establishing Defendable Long-Term Growth Rates	128
and Terminal Values	131
DCF Challenges and Applications	133
CHAPTER 8 Cost of Capital Essentials	135
Cost of Debt Capital	136
Cost of Preferred Stock	138
Cost of Common Stock	138
Fundamentals and Limitations of the Capital Asset Pricing Model	139
Modified Capital Asset Pricing Model	142
Build-Up Model	143

Contents vii

	Summary of Rate of Return Data	151
	Private Cost of Capital	153
	International Cost of Capital How to Develop an Equity Cost for a Target	156
	Company	157
	Reconciling Discount Rates and P/E Multiples	159
	Conclusion	161
	Appendix 8A Using Specific Company Risk Strategically	162
CHAPTER 9	Weighted Average Cost of Capital	169
	Iterative Weighted Average Cost of Capital Process	170
	Shortcut Weighted Average Cost of Capital Formula	174
	Common Errors in Computing Cost of Capital	176
CHAPTER 10	Market Approach: Using Guideline Public	101
	Companies and M&A Transactions	181
	Transaction Multiple Method	182
	Guideline Public Company Method	186
	Selection of Valuation Multiples Commonly Used Market Multiples	190 191
CHAPTER 11	Asset Approach	199
OIM ILK II		
	Book Value versus Market Value Premises of Value	200 201
	Use of the Asset Approach to Value Noncontrolling	201
	Interests	201
	Adjusted Book Value Method	202
	Specific Steps in Computing Adjusted Book Value	207
CHAPTER 12	Adjusting Value through Premiums and Discounts	209
	Applicability of Premiums and Discounts	210
	Application and Derivation of Premiums and	
	Discounts	211
	Apply Discretion in the Size of the Adjustment Control versus Lack of Control in Income-Driven	213
	Methods	215
	Fair Market Value versus Investment Value	215
CHAPTER 13	Reconciling Initial Value Estimates and	
	Determining Value Conclusion	217
	Essential Need for Broad Perspective	217
	Income Approach Review	220

viii Contents

	Market Approach Review Asset Approach Review Value Reconciliation and Conclusion Checks to Value Candidly Assess Valuation Capabilities Valuation Scenarios – Platform for M&A Appendix 13A Disciplined and Thorough Valuation Analysis Key to Avoiding Failed M&A Deals Analysis of a Hypothetical Synergistic Deal Establishing the Value of an Acquisition Target Establishing Value for the Acquirer Considerations of Other Impacts on Value	225 226 228 231 232 232 235 235 236 238 239
PART IV	Specialty Issues	241
CHAPTER 14	Exit Planning	243
	Why Is Exit Planning So Difficult? What Makes Planning for Your Private Company	244
	Investment Unique? Why Should Exit Planning for Your Private	247
	Company Begin Now?	249
	Exit Planning Process	250
	Step 1: Setting Exit Goals	252
	Step 2: Owner Readiness	254
	Step 3: Type of Exiting Owner	256
	Step 4: Exit Options	258
	Step 5: Range of Values Step 6: Execution of Exit Plan	263 265
	Step 0. Execution of Exit Hair	
CHAPTER 15	Art of the Deal	269
	Unique Negotiation Challenges	269
	Deal Structure: Stock versus Assets	271
	Asset Transaction	276
	Terms of Sale: Cash versus Stock	279
	Personal Goodwill	282
	Bridging the Gap	283
	See the Deal from the Other Side	286
CHAPTER 16	Fairness Opinions	289
	Why Are Fairness Opinions Obtained? The Use of Fairness Opinions by Private	291
	Companies	294

<u>Contents</u> ix

	Parties Who Prepare Fairness Opinions Components of a Fairness Opinion	295 297
	What Fairness Opinions Are Not	301
	Conclusion	302
	Appendix 16A Sample Fairness Opinion Letter	303
CHAPTER 17	M&A and Financial Reporting	309
	U.S. GAAP and IFRS	310
	Relevant FASB and IFRS Statements	311
	Reviews by the Audit Firm	312
	ASC 820: Fair Value Measurements	313
	ASC 805: Business Combinations ASC 350: Goodwill and Other Intangible Assets	315 325
	Incorporating ASC 805 into the Due Diligence	34)
	Process	326
	References	329
CHAPTER 18	Intangible Asset Valuation	331
	Approaches to Valuing Intangible Assets	332
	Key Components to Intangible Asset Valuation	334
	Intangible Asset Valuation Methods	343
	Conclusion	352
CHAPTER 19	Measuring and Managing Value in High-Tech Start-Ups	353
	Why Appraisals of High-Tech Start-Ups Are	
	Essential	353
	Key Differences in High-Tech Start-Ups	355
	Value Management Begins with Competitive	25/
	Analysis Stages of Development	356 358
	Stages of Development Risk and Discount Rates	360
	Start-Ups and Traditional Valuation Methods	361
	QED Survey of Valuation Methods Used by Venture	301
	Capitalists	367
	A Probability-Weighted Scenario Method to Value	
	Start-Ups	372
	Equity Allocation Methods	377
	Conclusion	380
CHAPTER 20	Cross-Border M&A	381
	Strategic Buy-Side Considerations	381
	Due Diligence	390
	Sell-Side Considerations	395

X Contents

PART V	Case Studies	397
CHAPTER 21	Merger and Acquisition Valuation Case Study – Distribution Company	399
	History and Competitive Conditions	400
	Potential Buyers	401
	General Economic Conditions	402
	Specific Industry Conditions	403
	Growth	404
	Computation of the Stand-Alone Fair Market Value	404
	Risk and Value Drivers	409
	Summary and Conclusion of Stand-Alone Fair	
	Market Value	418
	Computation of Investment Value	420
	Suggested Considerations to Case Conclusion	427
CHAPTER 22	Merger and Acquisition Valuation Case Study – Professional Services Firm	429
	Characteristics	429
	Valuation Methods	433
	Case Study Introduction	435
	Potential Buyer	435
	Historic Financial Performance	436
	Future Expectations	439
	Risk and Value Drivers	443
	Discounted Cash Flow Method	445
	Other Valuation Methods to Consider	445
	Suggested Considerations to Case Conclusion	451
About the Au	thors	453
Glossary		455
Index		465