The Purchase Price in M&A Deals

- Question that came in the other day…
- "In an M&A deal, does the buyer pay the **Equity Value** or the **Enterprise Value** to acquire the seller?"
- "What does it mean in press releases when they say the purchase consideration 'includes the assumption of debt'? Does that mean the price is the Enterprise Value?"

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TE Connectivity to Acquire Measurement Specialties, Inc.

June 18, 2014

Transaction Establishes TE as a Leader in the High-Growth Sensor Market; Further Expands TE's Leadership Position in Harsh Environment Applications

Expected to be Accretive to 2015 Adjusted EPS

SCHAFFHAUSEN, Switzerland, June 18, 2014 /PRNewswire/ -- TE Connectivity Ltd. (NYSE: TEL), a world leader in connectivity, announced today that it has entered into a definitive agreement to acquire Measurement Specialties, Inc. (NASDAQ: MEAS) for $86 cash per share or a total transaction value of approximately $1.7 billion (including assumption of net debt).

Measurement Specialties, a leading global designer and manufacturer of sensors and sensor-based systems with expected revenue of $540 million in its current fiscal year, offers a broad portfolio of sensor technologies including pressure, vibration, force, temperature, humidity, ultrasonics, position and fluid, for a wide range of applications and industries.

"The acquisition of Measurement Specialties is a key part of our strategy to be a leader in the very attractive, high-growth sensor industry and adds nearly $40 billion to our addressable market," said Tom Lynch, TE Connectivity Chairman and CEO. "We are excited about this acquisition as it enables TE to provide customers with an

Equity Value and Enterprise Value

- **Equity Value:** Value of ALL the company’s assets, but only to common equity investors (shareholders)

- **Enterprise Value:** Value of ONLY the core business operations, but to ALL investors (equity, debt, etc.)

Implications of This Definition:

- So when you calculate Enterprise Value, starting with Equity Value…

- **Add Items When:** They represent *other* investors (Debt investors, Preferred Stock investors, etc.) or *long-term funding sources* (Capital Leases, Unfunded Pensions)

- **Subtract Items When:** They are not related to the company’s core business operations (side activities, cash or excess cash, investments, real estate, etc.)

Equity Value and Enterprise Value

- **Intuition:** Many sources say Enterprise Value is what it "really costs to acquire a company"… but…
- That is **NOT** exactly true – yes, sometimes Enterprise Value is closer, but it depends on the deal and the items in Enterprise Value
- What **can** we say about the Purchase Price in an M&A deal?

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- **Certainty:** If you acquire 100% of a company, you must pay for 100% of its common shares

- **Floor:** So the Purchase Equity Value *is* sort of a “floor” for the purchase price in an M&A deal

- **But:** Should we really add the seller’s Debt, Preferred Stock, and other funding sources, and subtract 100% of the seller’s cash balance?

Does Debt Increase the Purchase Price?

- **PROBLEM #1:** Does Debt really increase the purchase price?

- **Depends:** Debt can be either “assumed” (kept) or “refinanced” (replaced with new debt, or paid off)

- **Treatment:** Depends on the terms of the debt and what the buyer/seller want to do – it *usually* has to be refinanced in a “change of control”

Does Debt Increase the Purchase Price?

- **Debt is Assumed:** Does **not** increase the amount the buyer “really pays” for the seller

- **Debt is Repaid with the Buyer’s Cash:** Does increase the amount the buyer “really pays”

- **Existing Debt is Replaced with New Debt:** *Sort of* increases the amount the buyer “really pays”… but the buyer still isn’t paying more cash

Does Cash Reduce the Purchase Price?

- **PROBLEM #2:** Does Cash really reduce the purchase price?

- **What Happens After A Deal:** Can the buyer just “take” all the seller’s cash for itself? That’s what the Enterprise Value definition implies

- **No!** Of course not… it’s not that easy, and even when calculating Enterprise Value outside of deals, cash doesn’t work like this

Does Cash Reduce the Purchase Price?

- **All Companies:** Need a certain “minimum cash balance” to keep operating, paying the bills, etc. – so THAT cash is actually a core business asset

- **Enterprise Value:** As a simplification, we ignore the minimum cash and subtract all cash

- **M&A Deals:** So a buyer can’t just walk in and take all the seller’s cash for itself – might not even be able to “take” all the excess cash

Other Complications

- **Transaction Fees:** These always exist, and will always increase the price the buyer pays (lawyers, accountants, bankers, etc.)

- **Unfunded Pensions, Capital Leases, etc.:** These don’t necessarily have to be “paid” or “repaid” upon change of control… so they may not even affect price

- **Extra Cash:** What if the buyer’s cash + seller’s cash are used to fund the deal?

The Bottom Line

- Have to distinguish between **valuation** of a company or deal and **actual price paid**
- **Valuation:** Equity Value & Enterprise Value are useful
- **Actual Price Paid:** Not so much; the real price paid is often <u>between</u> these metrics, or much different
- **Why:** Debt assumed vs. refinanced, minimum cash, fees, liabilities that don't increase the cash cost…

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The Bottom Line

- "Including assumption of net debt" = Approximate **Purchase Enterprise Value** for the deal, because they are calculating Purchase Equity Value + Debt – Cash

- **BUT:** This still isn't what the buyer actually pays!

- It's just a way to **value** the deal and get multiples like EV / EBITDA