Strategic Corporate Development

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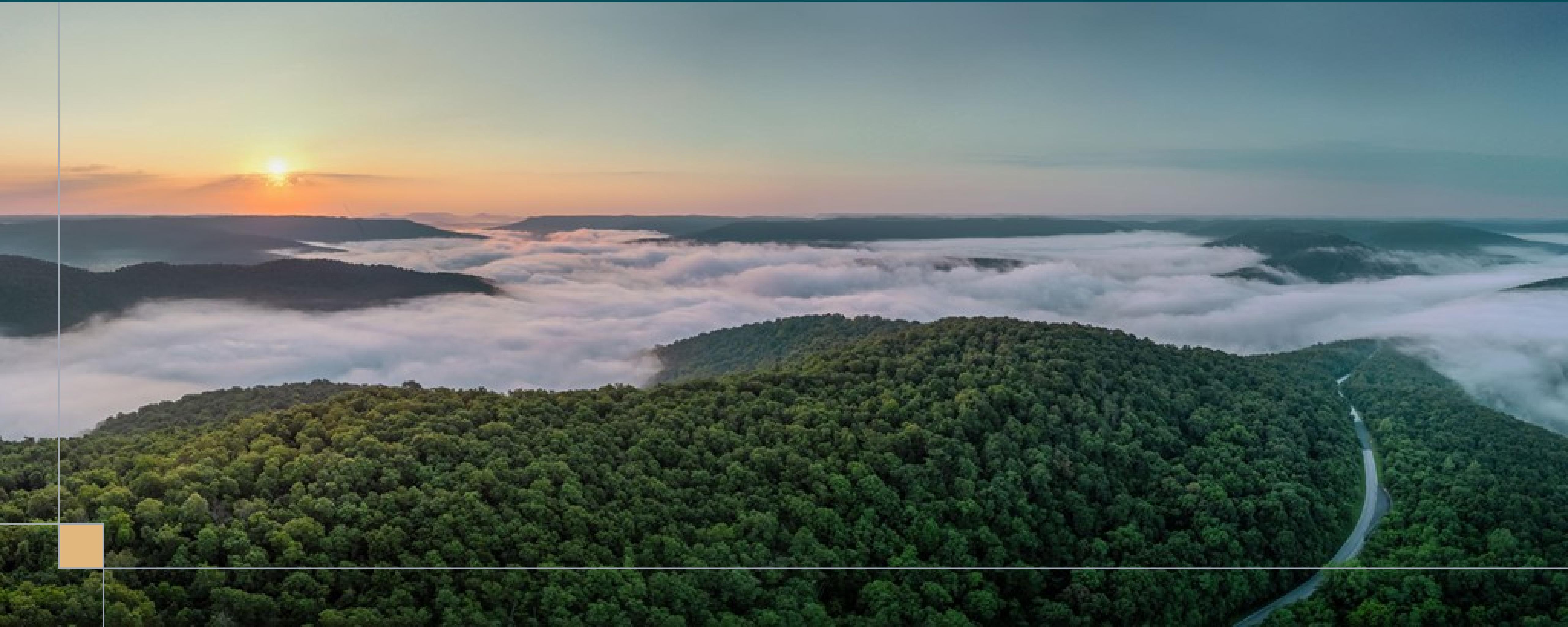


Agenda

1.
2.
3.

Introduction into M&A and Stakeholders

Corporate Finance 101

Mergers and Acquisition Fundamentals

The ultimate purpose of M&A is to **maximize the value of a business** through planning and implementing management resources while balancing risk and profitability.

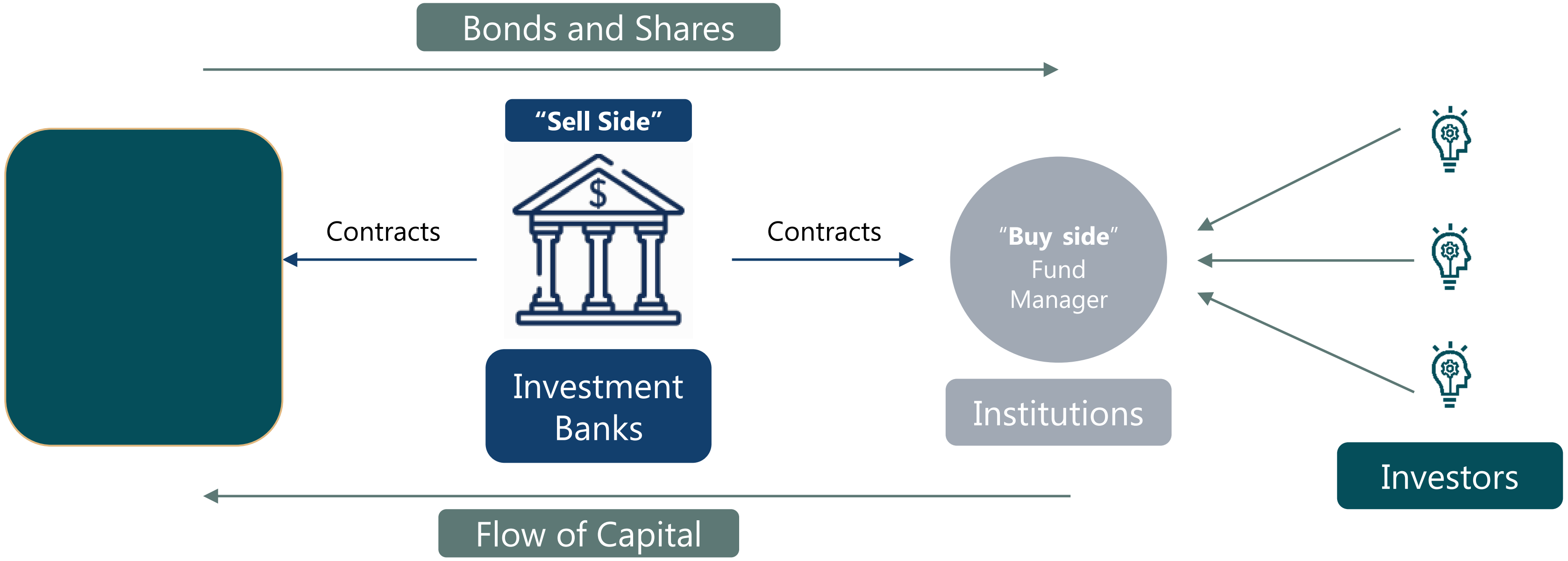
How?

- **Capital Investments (M&A)**
- Capital Financing
- Dividends and Return on Capital

Theory of Primary Market

Corporations are raising capital on primary market in order to finance Capital activities/investments.

- Operating CF (EBIT, OPR)
- CF from investing (CAPEX, divestitures)
- Financing CF (debt, equity)



Capital Investments

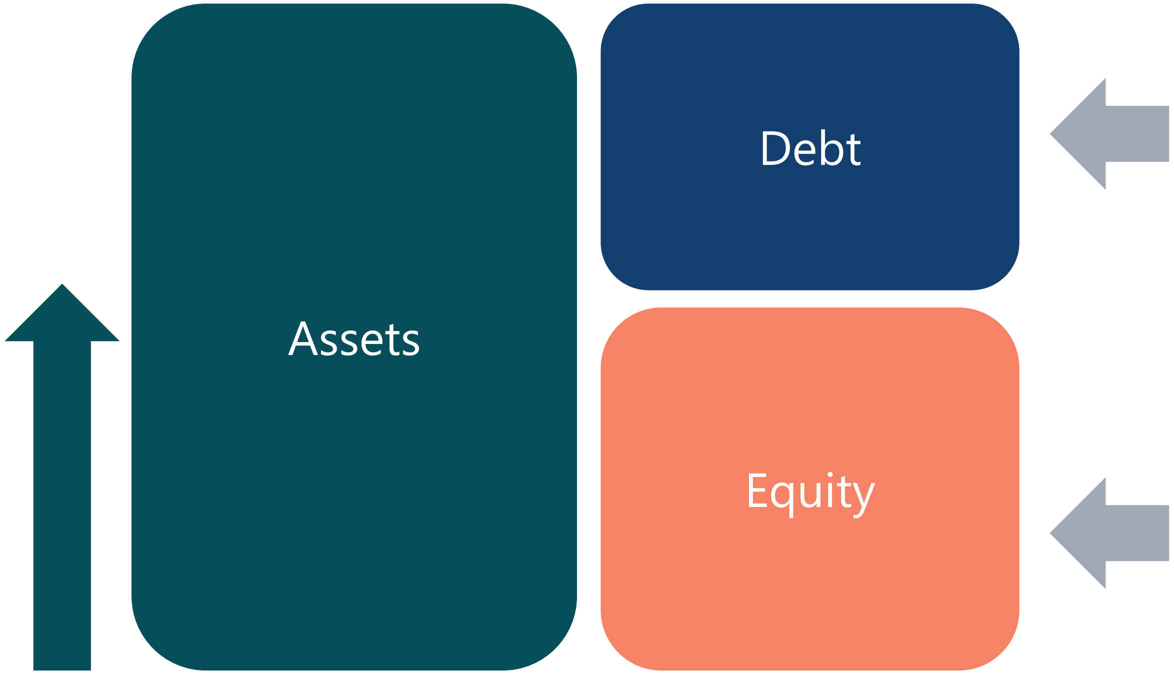
- CAPEX increase the assets of the company

- Opening a new factory

- Entering a new market

- **Acquiring another business – M&A**

- R&D activities



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Techniques for valuing the investment

Whether such investments are worthwhile depends on the approach that the company uses to evaluate them. A company may value the projects based on:

1

Net Present Value – NVP

- The value of all future cash flows (positive and negative) over the entire life of an investment discounted to the present.
  - Terminal Value: Value of free cash flow beyond the forecast period
    - TV = (FCF x (1+ Growth) / (Cost of Capital – Growth)

Internal Rate of Return – IRR

- The expected compound annual rate of return that will be earned on a project or investment.

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Mergers and Acquisitions (M&A)

Mergers and acquisitions is the process of companies buying, selling, or combining businesses.

Benefits	Potential Drawbacks
▪ Costs Savings ▪ Revenue enhancements ▪ Increase market share ▪ Enhance financial resources	▪ Overpaying ▪ Large expenses associated with the investment ▪ Negative reaction to the transaction ▪ Historically the larger the acquisition is, the harder to create value.

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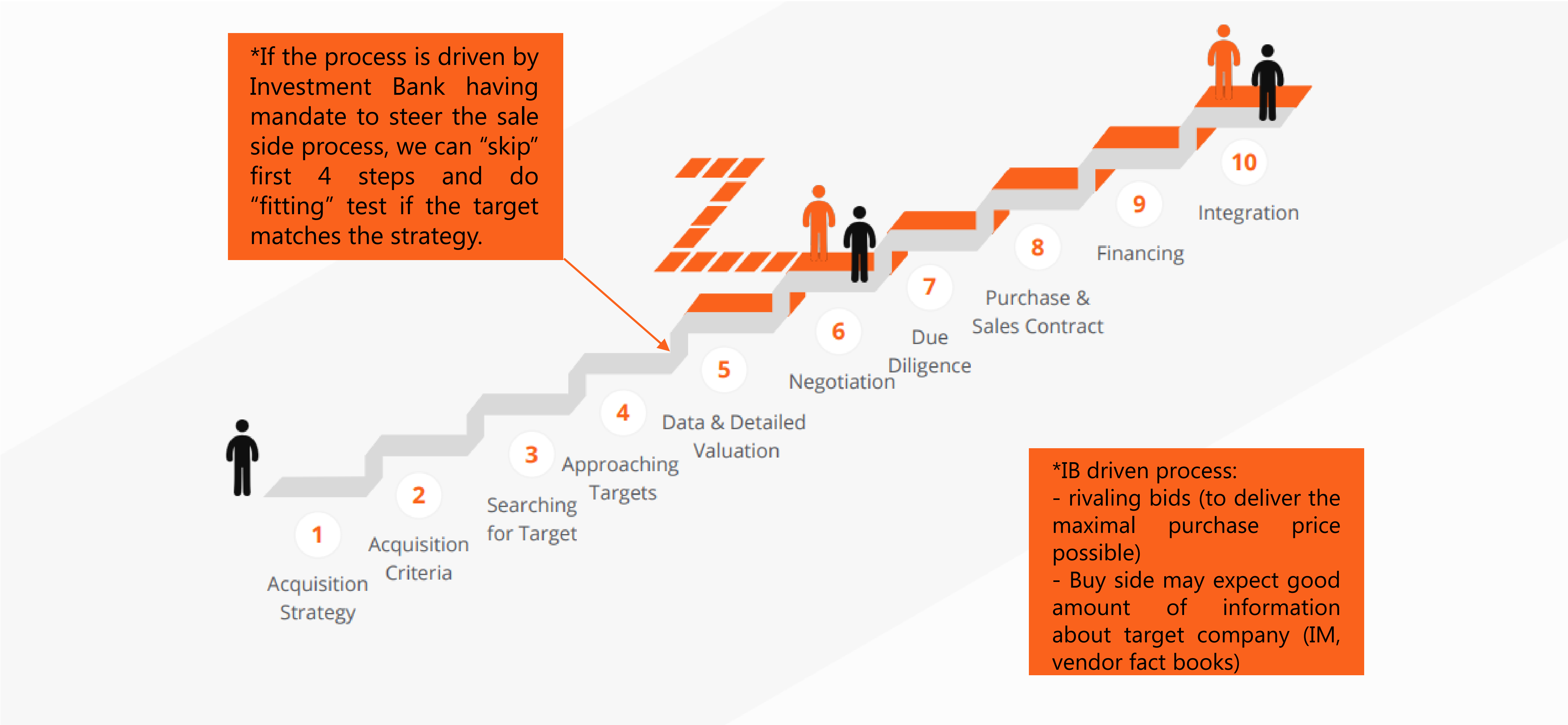
Acquisition Process

From 0 to 100 – customary M&A procedure



Strategic versus Financial Buyers

	Strategic Buyer	Financial Buyer
Proposition	▪ Operating Businesses ▪ Horizontal or Vertical Expansions ▪ Involves identifying and delivering operating synergies	▪ Private Equity (Financial Sponsor) ▪ Professional investor (non-operator) ▪ Leverage for maximum equity returns
ROI	▪ Tends to keep the acquired company without intention of divestiture ▪ Realizes the return through the synergies and combined business case	▪ Uses as much as debt as possible to finance the deal ▪ Has intention to sell out the target in the investment period ▪ Realizes the return through the exit strategies (IPO, Strategic sale, secondary sale, management buyout)

Valuation Techniques for M&A

Click to add subtitle

Asset Approach

(FMV of Ner Assets)

- Costs to Build

- Replacement Cost

- Liquidation Value

Intrinsic Value

(Income Approach)

- Discounted Cash Flow Method

- LBO Model

- Stand Alone Company (in isolation)
- Forecasting future performance, calculating future cashflows and **discounting back** to the present
- Focused on the fundamentals of the company

Relative Value

(Market Approach)

- Public Company Comparables

- Precedent Transactions

- Peers are easy to find
- Use of **multiples** to find the worth of the company (EV/EBITDA, P/E)
- More likely to reflect the **mood of the market** and produce a valuation that is closer to market than DCF
- Past M&A transactions – includes the takeover premium

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Acquisition Valuation Process

1. Value the target as stand-alone

Enterprise value

- Sales growth
- EBIT margin
- Operating tax
- Working capital requirements
- Capital expenditures

2. Value synergies

Hard (cost savings) and soft (revenue enhancements)

- Sales (volume & price)
- EBIT margin
  - Product mix
  - Overhead reductions
- Operating tax
  - Tax efficiency
  - Tax losses
- Working capital
  - Vendor relationships
- Capital expenditures
  - Efficiencies

- Analysis of Financial Statements – P&L, BS, CFS
- Forecasting Drivers
  1. Top Line
  2. Margins
  3. WC
  4. D&A and Capex

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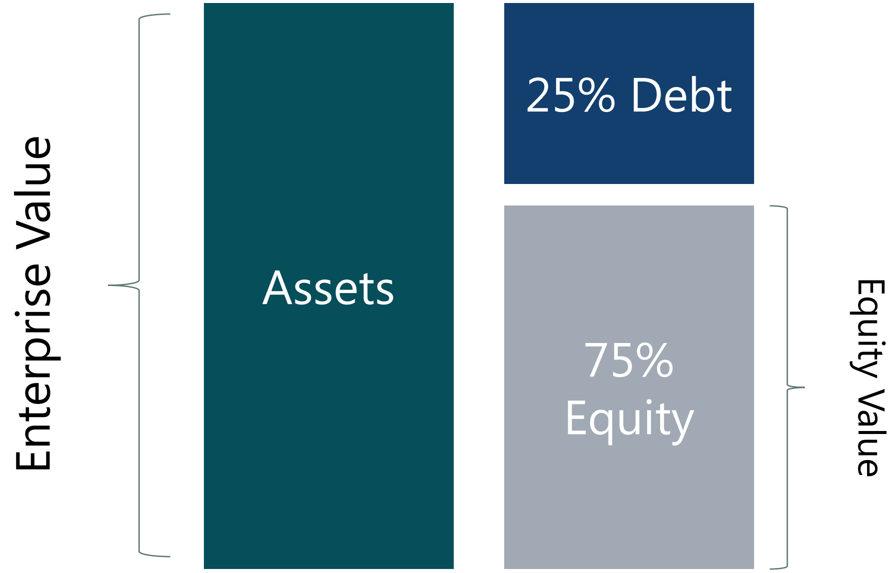
Enterprise Value vs. Equity Value



House Example

[redacted]

What is the value of a house?

1. 400 K CZK Equity – 100 K CZK Debt
2. 100 K CZK Equity – 400 K CZK Debt
3. 250 K CZK Equity – 250 K CZK Debt

Calculating Enterprise Value

Enterprise Value = Market Cap + (Net Debt: Debt - Cash)

Net Debt:

- **Includes** Bonds, Revolving Credit Line
- **Does not include** Accounts Payable, Deferred Revenues

Think about cash as offsetting debt because cash can be used to pay debt off

Cash is not included in firm value as it is not operating asset that generates cash

Valuation Tools – triangulation of data

DCF Model – Excel tool, that has features of 3 Statements Model, WC analysis, CAPEX and D&A, scenario modeling, synergies projections.

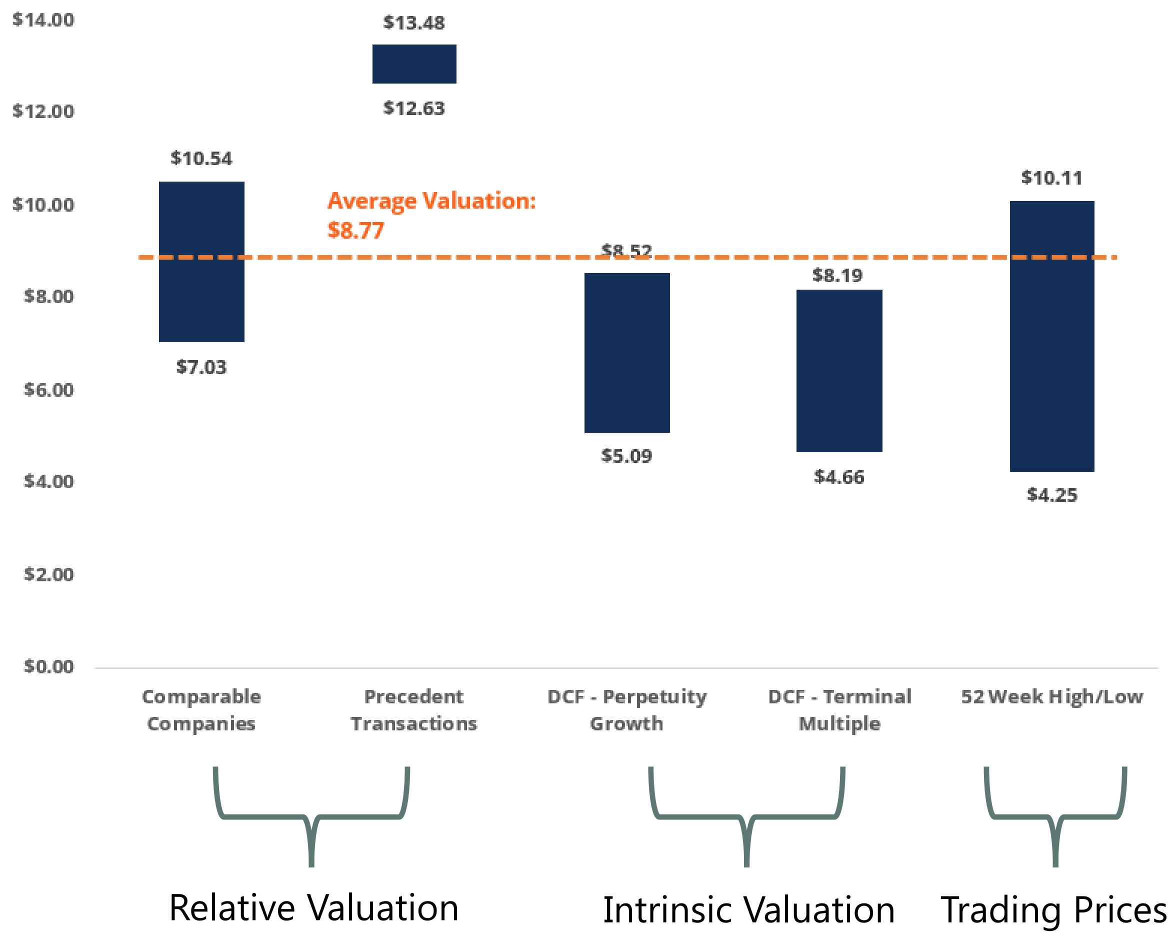
Precedent Transaction Analysis

Peer Companies	Industry	Location	Share Price	Shares Outstand.	Market Cap	Net Debt	Enterprise Value [1]	EBITDA 2022A	EBITDA 2023F	Net Income 2022A	Net Income 2023F	EV / EBITDA 2022A	EV / EBITDA 2023F	P / E [2] 2022A
			$	mm								x	x	x
Alpha.com	Supermarkets	Canada	21.70	368	7,992	2,150	10,142	1,086	1,097	553	586	9.3x	9.2x	14.5x
Big Bucks Company	Supermarkets	USA	35.88	301	10,796	50	10,846	2,169	2,212	770	809	5.0x	4.9x	14.0x
Centibillions Inc.	Supermarkets	USA	15.37	670	10,301	1,283	11,584	1,530	1,576	632	651	7.6x	7.4x	16.3x
Deep Pockets Ltd.	Supermarkets	USA	39.92	248	9,921	2,866	12,787	1,142	1,165	461	484	11.2x	11.0x	21.5x
Evergreen Co.	Supermarkets	Canada	45.63	261	11,932	396	12,328	2,055	2,096	693	700	6.0x	5.9x	17.2x
Fat Cat Inc.	Supermarkets	Canada	37.93	245	9,282	1,218	10,500	2,625	2,625	732	739	4.0x	4.0x	12.7x
Nav Inc.	Supermarkets	USA	46.36	379	17,569	17,200	34,769	4,688	4,688	1,092	1,168	7.4x	7.4x	16.1x
JJ Co.	Supermarkets	Canada	40.57	122	4,961	1,433	6,394	850	884	276	282	7.5x	7.2x	18.0x
LRM Ltd.	Supermarkets	Ghana	18.94	49	928	122	1,050	252	257	74	76	4.2x	4.1x	12.5x
Zhao Ltd.	Supermarkets	China	15.37	96	1,478	122	1,600	402	402	114	122	4.0x	4.0x	13.0x

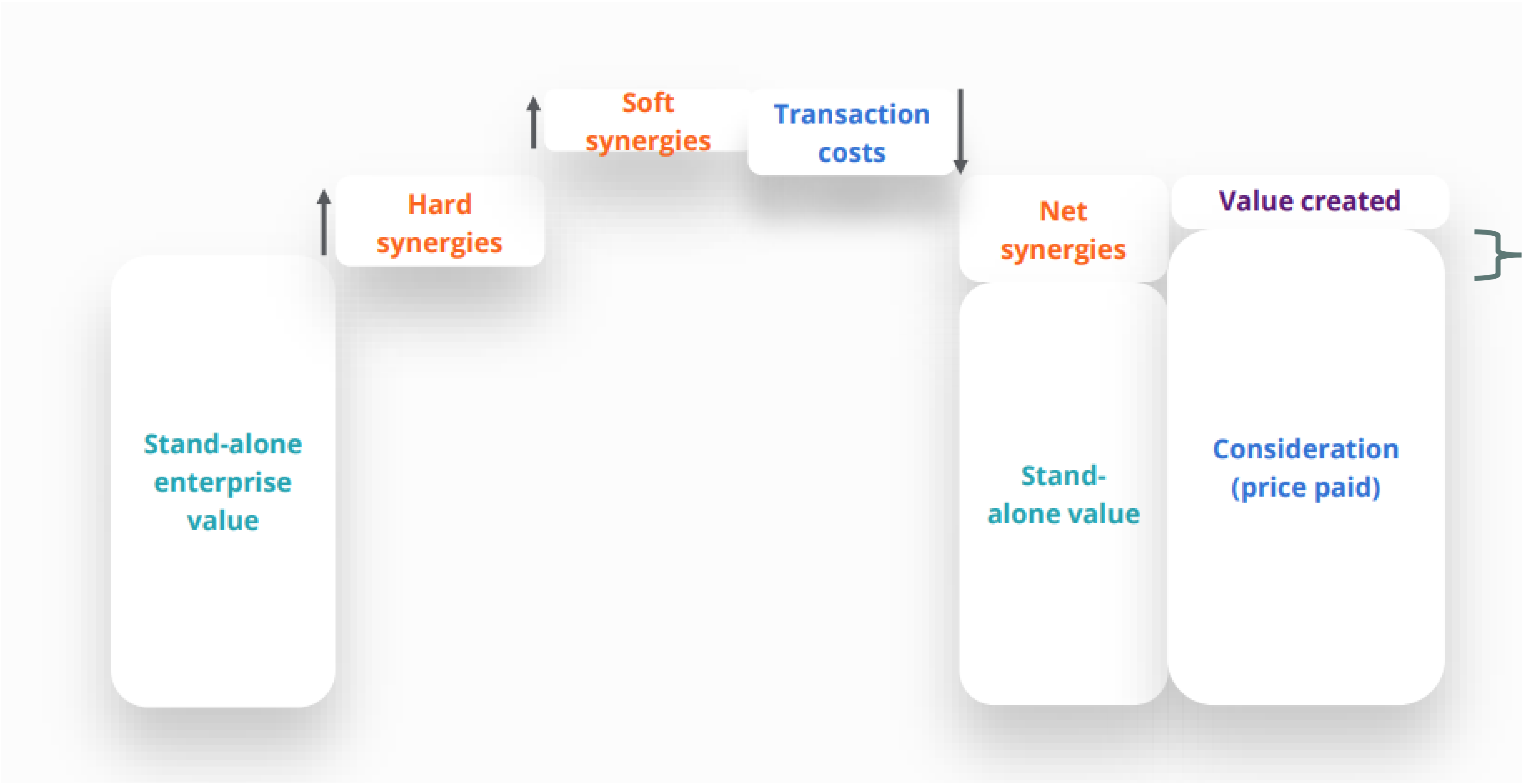
Comparable Company Analysis

Entity Name	TEV/ EBITDA (x)	TEV/ Total Revenue (x)	TEV/ EBIT (x)	Price/ EPS (x)	Price/ Tangible Book (x)	Price/ Forward EPS (x)	TEV/ Forward Total Revenue (x)	TEV/ Forward EBITDA (x)	TEV/ Forward EBIT (x)	Forward P/BV (x)
	LTM	LTM	LTM	LTM	LTM	NTM	NTM	NTM	NTM	FY0
Dell Technologies Inc. (NYSE:DELL)	16.48	1.12	19.07	25.92	NA	14.9	1.06	9.00	12.36	NM
Amphenol Corporation (NYSE:APH)	22.89	5.70	27.60	36.73	163.17	34.7	5.33	21.99	25.48	7.3
Cisco Systems, Inc. (NASDAQGS:CSCO)	10.20	3.28	11.67	15.10	36.66	14.2	3.47	NA	10.35	5.0
Corning Incorporated (NYSE:GLW)	11.90	2.76	26.28	47.75	3.22	17.4	2.56	9.25	14.23	2.3
Hewlett Packard Enterprise Company (NYSE:HPE)	6.03	1.16	12.48	12.01	7.95	9.2	1.09	5.78	10.41	1.0
HP Inc. (NYSE:HPQ)	6.82	0.71	8.67	8.77	NM	8.6	0.69	7.01	8.18	NM
Motorola Solutions, Inc. (NYSE:MSI)	20.93	6.28	25.41	35.04	NM	27.3	5.91	19.09	20.77	92.8
Western Digital Corporation (NASDAQGS:WDC)	NM	2.52	NM	NM	NM	17.0	1.87	9.61	14.66	1.2
Samsung Electronics Co., Ltd. (KOSE:A005930)	10.05	1.79	62.04	37.50	1.64	18.2	1.53	6.03	13.24	1.4
Legend Holdings Corporation (SEHK:3396)	4.32	0.27	6.52	NM	NM	3.6	0.26	3.73	5.50	0.3
Apple Inc. (NASDAQGS:AAPL)	**17.63**	**6.67**	**21.69**	**26.62**	**35.65**	**25.6**	**6.54**	**19.30**	**21.08**	**46.3**
Minimum			6.52	8.77	1.64	3.6	0.26	3.73	5.50	0.3
Median			19.07	30.48	7.95	16.0	1.70	9.00	12.80	1.9
Average			22.19	27.35	42.53	16.5	2.38	10.17	13.52	13.9
Maximum			62.04	47.75	163.17	34.7	5.91	21.99	25.48	92.8

Valuation outcome – how to present your findings



Acquisition Waterfall



Enterprise Value to Equity Bridge

Is a bridge how to arrive from Enterprise Value to Purchase Price (Consideration), typically contains net debt, working capital adjustments, NAV adjustments and any other considerations depending on the nature of the deal.

Acquisition rationale

Why are we doing this?

What is the deal thesis?

- Why should we buy this company?
- Would that increase our value?
- Can we leverage our legacy, experience and standards?
- Is the target capable of deliver these standards?
- What is the right price for the company?

How successful are acquisitions as a business strategy?

A programmatic approach with a clearly defined strategy achieved higher returns

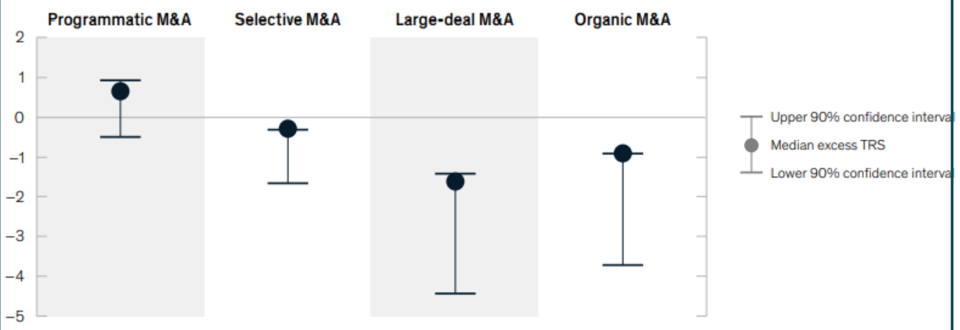
*Mc Kinsey study

- Programmatic M&A - defined as when a company makes multiple deals per year with a meaningful market cap contribution.
- Selective M&A - two or fewer deals per year
- Large-deal M&A – one large "big bang deal"
- Organic – Almost no M&A

Summary

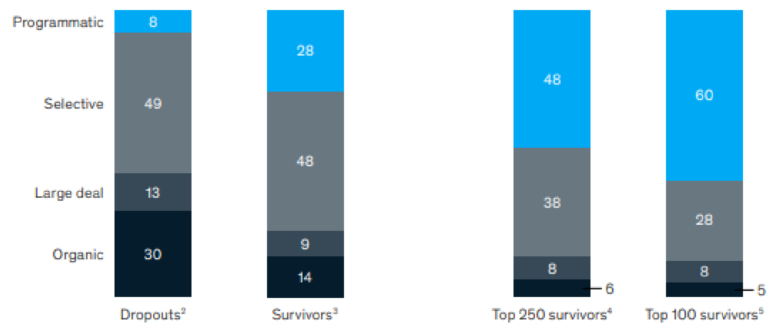
- Among programmatic acquirers, more deals means higher success
- The best companies have a clearly defined M&A blueprint linked to the long-term business strategy
- Won't work if you without clearly defined parameters
- Disciplined, organized and knowledgeable M&A people and processes are critical
- Programmatic acquiring companies are continually learning, adapting and improving

Median excess TRS that remained in the Global 1,000 from 2007 to 2017



Programmatic acquirers achieved excess total returns to shareholders that were higher than the median

Distribution of 2007 Global 1,000 companies in 2017



Programmatic acquirers composed 60 out of the top 100 companies after 10 years

*"How lots of small M&A deals add up to big value", Jeff Rudnicki, Kate Siegel, and Andy West (McKinsey & Company strategy and corporate finance practice July 2019)

1+1=3 (the concept of synergy)

Transaction adds value only if the two companies are worth more together than apart

How and why?

- Economies of Scale – reduce costs, increase profits (Tmobile-Sprint, completed in 2020)
- Industry consolidation and market power – mergers between competitors in the same industry (HP-Compaq, completed in 2001) – *horizontal integration*
- Vertical integration – buy a major supplier to produce “in house”. (Pepsico buying bottling company in 2009)
- Eliminating inefficiencies – powerful source gains, particularly in PE/LBO deals but also **strategic M&A**.
- Opportunity driven transactions – liquidity or valuation. (2008 Chase – Bear Sterns).

Q: in case you are in charge of the corporate development for 100 million company that is not growing, and you are about to acquire 100 million company that is not growing as well, what would be the combined value after the merger?

How much should we pay or Premia in M&A Deals

Companies tend to be paid with “premium”

- on average 20-30% - if the price for share/company is 10 CZK, the offer is in the range of 12-13 CKZ
- This means that transaction should increase value aby at least 30% of the target’s equity value.
- This is very important in negotiations, as outstanding shareholders are expecting more value out of the company
- Additionally, **strategic buyer is expected to pay even more for synergies that can be realized**. (*strategic premium*)

Q: how much premium would you expect as shareholder for your shares in case the company has negative FCF for two consecutive years in normal environment? (no negative market externalities)

Case Study

Wharton M&A case study 1

1. Intro:

Imagine you are corporate executive in the blue-chip making company for very traditional appliances and you know that **value creation** is driven by a clever balance of;

- Organic **revenue growth**
- Healthy **return on capital**
- **Sustainability of performance** (hard to pivot from one generation of product to another – majority of companies are one product wonders)
- And ability to **manage risk**

On the other hand, you are aware of the facts that recent research shows that companies **drive growth** through **three primary resources** ("*three pistons of growth*"):

- Portfolio momentum (your submarket are growing, having natural momentum)
- Market share (capturing the share in the environment where the competitors are attempting to copy, double any new market solutions)
- M&A (to compound the effect of growth)

2. Facts:

Set Top Boxes – the global market is becoming more versatile and dynamic as it provides several benefits to customers, such as pause and store facilities and easy deployment options. Demand for STB's are expected to grow at CAGR of 2.1% for upcoming five years. Your company is dominating this market, with huge market share and stable customer base.

Wireless Chipsets – combining the revenue of WiFi, Mobile, WiMAX, Mobile LTE, the overall wireless chipsets shipments are expected to reach CAGR of more than 29% for upcoming five years. The target company in this industry is relatively small and you have no presence in this market.

How do you pivot into the momentum?

what makes set top box go away?

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Wharton M&A case study 1

Capability Transition – Holistic Strategy Making

- As you evaluate adjacencies to your core business, consider your current capability set, as well as new capabilities required to meet the needs of your new customer set.
- Existing capabilities give you the permission to compete, new capabilities give you chance to win.

How do you pivot into the momentum?
what makes set top box go away?
Let's talk about characteristics of the chipset:
What are the physical characteristics that make the chips world class?

Leverage existing best-in-class capabilities	New capabilities required for success
Durable	Small and lighter
Competitive Price	Low power

If this list is empty during assessment, your team has not done research what it takes to be successful.

Wharton M&A case study 2

Tactical View of M&A

- If the goal is to grow the business, it is critical to leverage both internal capabilities development as well acquisition to:
  - Existing Customers
    1. Quantity: Provide new products and services to my existing customers? *(revenue = quantity x price, how do I use resources, (both internal development vs M&A) to develop new products and services that I can sell to my existing customers?)*
    2. Price: Improve quality, satisfaction to increase price? *What will allow me to increase my price? What are external companies that can help me to produce more quality products?*
    3. Duration/attrition: Make existing customer stickier?
  - New Customers:
    1. Acquire new customers for existing products?

From a tactical perspective, there will be a choice of internal development versus acquisition. From a more strategic perspective, a portfolio approach will consider both.

Do we make it, or we buy it?

Why do you want to develop internally? (leverage existing capabilities – do we put x number of engineers into work to develop that new chip internally?)

How quickly do we need to move? Are we missing out on an opportunity? If market is shifting faster than we can develop the product, maybe we should acquire.


Q&A

Thank you!

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