CHAPTER 1

Merger and Acquisitions Overview

The distinction between a merger, an acquisition, a divestiture, and other types of restructurings warrants some clarification. Transactions can come in a multitude of forms, can be a hybrid of several classifications, or in new markets can create a brand new classification altogether. Often some of the definitions are used interchangeably or are categorized differently. There has really been no set standard for these definitions, but I will attempt to simplify and clarify ahead. It is important to understand these core structures to better classify any individual transaction explored. Note that there are many excellent books that go through the subjective, regulatory, and legal aspects of mergers and acquisitions. This book is designed to give a technical and procedural approach, so I will brief you only on the major keywords.

Merger: A merger is fundamentally the combination of two or more business entities in which only one entity remains. The firms are typically similar in size. (Company A + Company B = Company A).

Consolidation: A consolidation is a combination of more than one business entity; however, an entirely new entity is created. (Company A + Company B = Company C).

Acquisition: An acquisition is the purchase of a business entity, entities, an asset, or assets. Although often used interchangeably, an acquisition differs from a merger in that the acquiring company (the acquirer) is typically significantly larger than the asset or entity being purchased (the target).

Acquisitions can take several forms, including the following:

- **Acquisition of assets:** An acquisition of assets is the purchase of an asset or group of assets, and the direct liabilities associated with those assets.

- **Acquisition of equity:** An acquisition of equity is the purchase of equity interest in a business entity. The differences between an acquisition of assets and an acquisition of equity are important from a legal, regulatory, accounting, and modeling perspective and will be detailed further later in the book.
- **Leveraged buyout:** A leveraged buyout (LBO) is an acquisition using a significant amount of debt to meet the cost of acquisition. Please see my book entitled *Leveraged Buyouts: A Practical Guide to Investment Banking and Private Equity* for a thorough analysis of leveraged buyouts.
- **Management buyout:** A management buyout (MBO) is a form of acquisition where a company's existing managers acquire a large part or all of the business entity.

  Acquisitions can be considered *hostile* or *friendly*, depending on the assertive nature of the process.
- **Friendly acquisition:** An acquisition accomplished in agreement with the target company's management and board of directors; a public offer of stock or cash for example is made by the acquiring firm, and the board of the target firm will publicly approve the terms.
- **Hostile acquisition:** An acquisition that is accomplished not by coming to an agreement with the target company's management or board of directors, but by going through other means to get acquisition approval, such as directly to the company's shareholders; a tender offer and a proxy fight are ways to solicit support from shareholders without direct approval from company management.

Mergers, consolidations, and acquisitions can be categorized further:

- **Horizontal:** A horizontal transaction is between business entities within the same industry. Such a combination would potentially increase market share of a business in that particular industry.
- **Vertical:** A vertical transaction is between business entities operating at different levels within an industry's supply chain. Synergies created by merging such firms would benefit both. A good example is within the oil and gas industry. In the oil and gas industry you have exploration and production (E&P) companies that drill for oil. Once oil is found, the wells are producing, and the energy is refined, distribution companies or pipeline companies transport the product to retail for access to the customer, such as a gas station. So in this example, an E&P company purchasing a pipeline company or a gas station would represent vertical integration—a vertical merger. In contrast, an E&P company purchasing another E&P company is a horizontal merger.

- **Conglomerate:** A transaction between two or more unrelated business entities—entities that basically have no business activity in common; there are two major types of conglomerate transactions: pure and mixed. Pure conglomerate transactions involve business entities that are completely unrelated, while mixed conglomerate transactions involve firms that are looking for product extensions or market extensions.

Divestiture: A divestiture is the sale of an interest of a business entity, an asset, or group of assets.

Divestitures can be delineated futher:

- **Asset divestiture:** An asset divestiture is the sale of an asset or group of assets. In Part Two of this book we will discuss a simple asset divestiture.
- **Spin-off:** A spin-off occurs when a parent company creates a separate entity and distributes shares in that entity to its shareholders as a dividend.
- **Equity carve-out:** An equity carve-out occurs when a parent company sells a percentage of the equity of a subsidiary to the public. This is also known as a partial IPO.

Other restructurings: Mergers, consolidations, acquisitions, and divestitures can all be considered types of business restructurings as they all involve some level of reorganization aimed to increase business profitability. Although the foregoing are just major categories, other types of business restructurings can be considered to help fuel growth. A share buyback, for example, is when a company buys back shares in the open market. This creates an antidilutive effect, hopefully fueling an increase in company stock price. A workforce reduction is another example of a way to reduce costs and improve earnings performance. Each of these strategies are other restructuring examples which aim in some way to improve business value.

Although not a complete overview, briefing the foregoing terminology should in the least give perspective on the analyses to follow. Again for more subjective detail on M&A definitions and process, there are plenty of M&A books out in the market to complement this book. The purpose of this book specifically is to illustrate the technical analysis quantifying the financial benefits of an M&A situation.

THE M&A PROCESS

Although there are many facets to M&A and the industry is constantly evolving, it is important to understand the possible steps an acquirer would take in order to pursue a target business. This will further help one understand the M&A process. The early stages of the process are considered *friendly*, and the latter *hostile*.

Casual pass: A casual pass is an informal inquiry made to business management. This can literally be done via e-mail, a letter, or a phone call. A solicitation to management to discuss "strategic alternatives" can be a suggestion for acquisition. Management can either respond or reject. A rejection would lead the acquirer to one of the next steps, and this can now be considered *hostile*.

Bear hug: A bear hug is a letter to company management regarding an acquisition and demanding a rapid response. The letter is not a proposal but rather a demand and arrives without warning. Often the bear hug action is made public and is utilized to encourage management to negotiate in a friendly manner.

Open market purchase: In an open market purchase the acquirer purchases shares in the open market. Although an interesting tactic, this can often end up unsuccessful if a majority of shareholders are *not* willing to sell their shares. However, if successful, this could lower the overall cost of the transaction as one blanketed control premium is no longer negotiated, among other reasons. We will discuss the control premium later in the book.

Proxy contest: In a proxy contest the acquirer seeks to gain shareholders' support to change the board of directors' or management's decision in some way to allow the acquisition to proceed. A proxy letter can be mailed out to every shareholder in an attempt to garner support in the form of "votes." Although the proxy strategy comes in several forms, it can prove to be unsuccessful if the target company stock is held by a large number of individuals.

Tender offer: A tender offer is a direct solicitation to purchase shareholders' shares. Because a significant purchase premium is involved in order to try to ensure that enough shareholders would be willing to sell their shares and allow the acquisition to proceed, the tender offer is a costly method of acquiring a business.

These major categories do have subcategories, and other methods of pursuing an acquisition do exist. But these major methods should help provide the most general perspective on acquisition procedure. Of course, *all* of the steps to an acquisition are vast and time-consuming, and consist of legal, regulation, research, and due diligence. But these are the major components designed to help you understand from a very high and investment banking–minded level where these acquisitions come from. Let see how this framework applies to Office Depot and OfficeMax.

OFFICE DEPOT AND OFFICEMAX

It is important to research various data sources for accurate information on the Office Depot and OfficeMax transaction. I would recommend going to both company websites and www.sec.gov for the most accurate information on the company and transaction. We have already found the February 20 press release from the investor relations section of the company website. To locate this press release, you can navigate to www.officedepot.com. At the bottom of the Office Depot home page is an "Investor Relations" button. (See Exhibit 1.1.)

To the left of this page under "Company Information," you can click the "Press Releases" link, where the press release can be found. You may have to adjust the drop-box located right under the "Keyword Search" box to select press releases from 2013, and then scroll down to find the exact February 20, 2013, press release entitled "OfficeMax and Office Depot Announce Merger of Equals to Create $18 Billion Global Office Solutions Company" (see Exhibit 1.2). We could have also gone to the Investor Relations section of OfficeMax to find a press release on the transaction.

U.S. Securities and Exchange Commission (SEC) filings are also a key resource for financial data on the companies involved in the transaction.

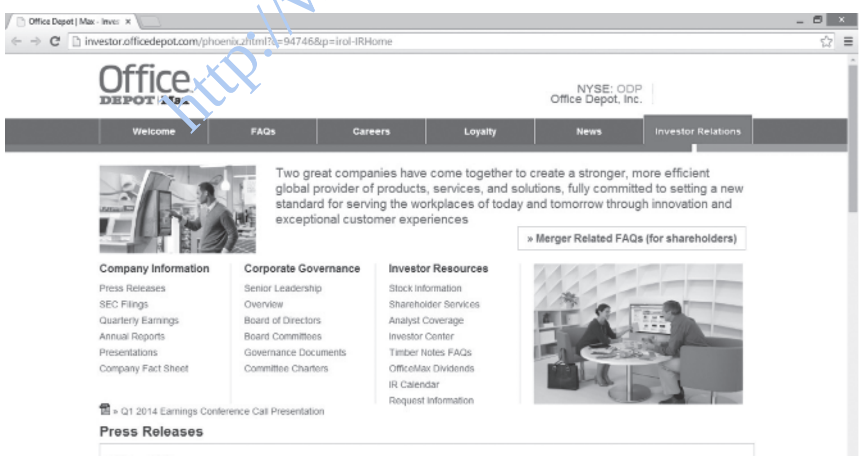

EXHIBIT 1.1 Office Depot Website—Investor Relations

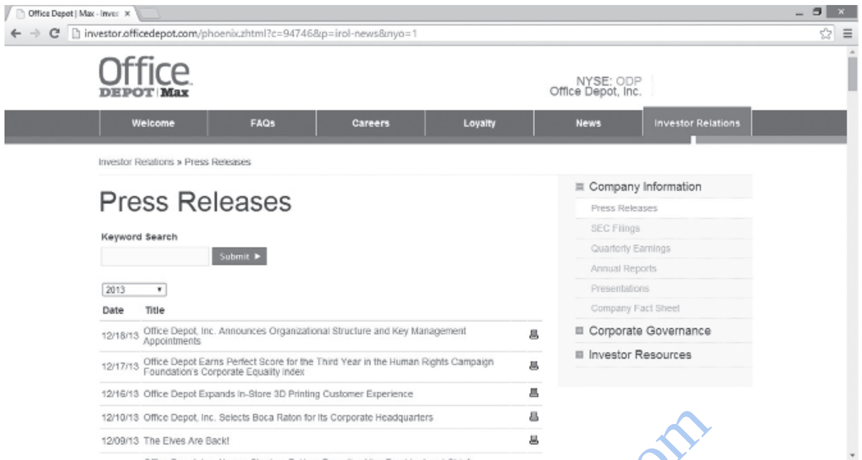

EXHIBIT 1.2 Office Depot Website—Press Releases

A proxy statement, Form S-4, and Form 8-K are examples of filings that may contain financial details on a transaction. The company's 10-K (annual financial filing) or 10-Q (quarterly financial filing) can also contain a paragraph discussing the consolidation.

We can navigate to the SEC website by typing "www.sec.gov."

At the top right of Exhibit 1.3 there is a "Company Filings" link. Clicking this link takes us to another page, where we can type in "Office Depot" in

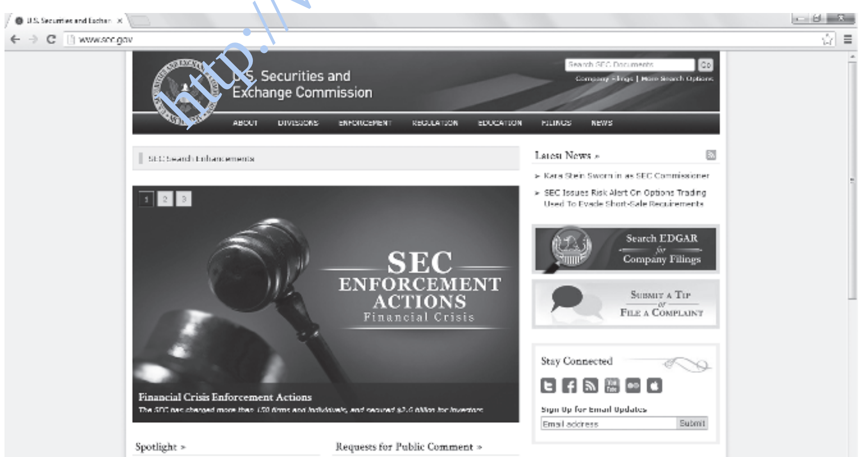

EXHIBIT 1.3 SEC Home Page

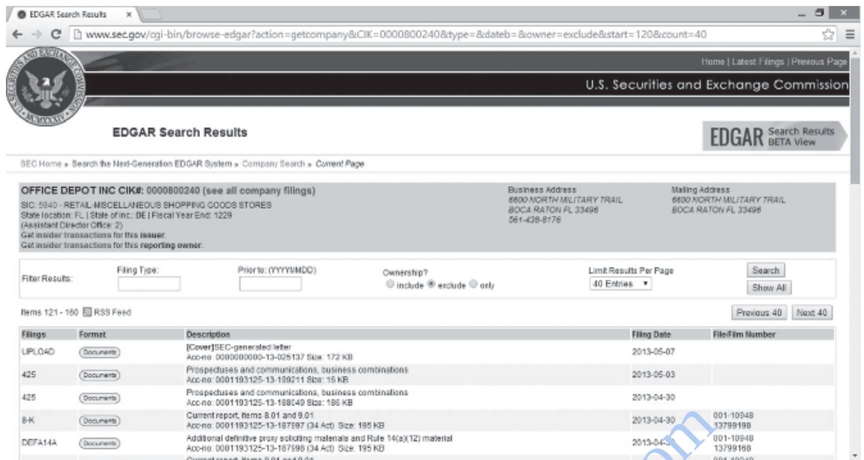

EXHIBIT 1.4 SEC Office Depot Public Filings

the "Company Name" search box, and click the "Search" button. This will reveal a list of filings for Office Depot. (See Exhibit 1.4.) We could have also done the same for "OfficeMax," the other entity involved in the transaction.

Here you may want to take some time poking around to look for documents that contain relevant information. After some searching, we found the Form S-4 dated April 9, 2013, entitled "Registration of Securities, Business Combinations." The title was an indicator that this document will describe the transaction. Opening this document reveals significant information on the merger. So we will use this document. (See Exhibit 1.5.) You can also find this document entitled "Form_S-4.pdf" on the website associated with the book.

Note that by the time this book is published more recent documents will certainly be available. For purposes of following the analysis in this book, I recommend digging up the documents described here. You can later update your model with more recent information once you have established the core modeling and analysis skills learned in this book.

Finally, other information sources, such as news releases or research reports, are good resources that may contain financial information on a merger. For now let's utilize just the information found in the S-4 report.

At the top of page 2 of the S-4 document, the title "JOINT PROXY STATEMENT/PROSPECTUS PROPOSED MERGER—YOUR VOTE IS IMPORTANT" indicates the document's purpose. This is a document soliciting shareholders to vote and approve the transaction. It is in this document where they explain the transaction in some detail, and so we will

Form S-4

www.sec.gov/Archives/edgar/data/800240/000119312513146740/d516531ds4.htm

The information in this joint proxy statement/prospectus is subject to completion and amendment. A registration statement relating to the securities described in this joint proxy statement/prospectus has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy these securities be accepted prior to the time the registration statement becomes effective. This joint proxy statement/prospectus shall not constitute an offer to sell or the solicitation of any offer to buy nor shall there be any sale of these securities in any jurisdiction, in which such offer, solicitation or sale would be unlawful prior to registration under the securities laws of any such jurisdiction.

PRELIMINARY—SUBJECT TO COMPLETION, DATED APRIL 9, 2013

Office DEPOT. OfficeMax®

JOINT PROXY STATEMENT/PROSPECTUS PROPOSED MERGER—YOUR VOTE IS IMPORTANT

The board of directors of each of Office Depot, Inc. ("Office Depot") and OfficeMax Incorporated ("OfficeMax") unanimously approved a strategic business combination structured as a merger of equals. Based upon the estimated number of shares of capital stock of the parties that will be outstanding immediately prior to the consummation of this business combination, we estimate that, upon consummation of the business combination, Office Depot stockholders will hold approximately [—]% and OfficeMax stockholders will hold approximately [—]% of the outstanding common stock of the combined company (assuming redemption of all outstanding shares of Office Depot convertible preferred stock).

This is an exciting and important event in each of our companies' histories, and we are very pleased to provide this document to you. It is a prospectus related to the proposed issuance by Office Depot of shares of its common stock, par value $0.01 per share (the "Office Depot common stock"), pursuant to an Agreement and Plan of Merger (as it may be amended from time to time, the "merger agreement") entered into by, among others, Office Depot and OfficeMax. Upon the terms and subject to the conditions set forth in the merger agreement, if the requisite stockholder approval and other approvals are obtained and the other closing conditions are satisfied or waived, through a series of transactions that are further described in this document, OfficeMax will become an indirect, wholly-owned subsidiary of Office Depot. This document is also a proxy statement of OfficeMax and Office Depot to use in soliciting proxies for their respective special meetings of stockholders. At Office Depot's special meeting of stockholders, stockholders of Office Depot will vote on, among other things, the proposal to issue shares of Office Depot common stock to the stockholders of OfficeMax pursuant to the merger agreement (the "Office Depot share issuance"). Under the rules of the New York Stock Exchange (the "NYSE"), Office Depot is required to obtain stockholder approval for the Office Depot share issuance. At OfficeMax's special meeting of stockholders, stockholders of OfficeMax will vote on, among other things, the proposal to adopt the merger agreement and to approve certain transactions contemplated by the merger agreement. Under the General Corporation Law of the State of Delaware, the approval of stockholders of OfficeMax must be obtained before the transactions can be completed.

The series of transactions described in this document include, among others, what are referred to in this document as the "first merger" and the "second merger." The first merger involves only OfficeMax and two of its subsidiaries. Pursuant to the merger agreement, at the effective time of the first merger, each outstanding share of common stock, par value $2.50 per share, of OfficeMax (the "OfficeMax common stock") will be converted into one share of common stock of Mapleby Holdings Merger Corporation ("New OfficeMax"). The first merger will result in a holding company structure for OfficeMax but will not affect the merger consideration that OfficeMax stockholders will receive at the effective time of the second merger pursuant to the merger agreement. Pursuant to the merger agreement, at the effective time of the second merger, each share of New OfficeMax common stock issued and outstanding immediately prior to the effective time of the second merger (excluding any shares of OfficeMax common stock held by Office Depot or its subsidiary Dogwood Merger Sub Inc. or held in treasury) will be converted into the right to receive 2.69 shares of Office Depot common stock, together with cash in lieu of fractional shares, if any, and unpaid dividends and distributions, if any, pursuant to the merger agreement. This exchange ratio is fixed and will not be adjusted for changes in the market value of shares of Office Depot common stock or OfficeMax common stock.

OfficeMax common stock currently trades on the NYSE under the ticker symbol "OMX," and Office Depot common stock currently trades on the NYSE under the ticker symbol "ODP." The Office Depot common stock being registered pursuant to the registration statement on Form S-4 (of which this joint proxy statement/prospectus forms a part) will be listed on the NYSE.

EXHIBIT 1.5 Office Depot S-4 Document

use this document to further analyze the transaction. Let's look at the first paragraph of page 2:

> The board of directors of each of Office Depot, Inc. ("Office Depot") and OfficeMax Incorporated ("OfficeMax") unanimously approved a strategic business combination structured as a merger of equals. Based upon the estimated number of shares of capital stock of the parties that will be outstanding immediately prior to the consummation of this business combination, we estimate that, upon consummation of the business combination, Office Depot stockholders will hold approximately [—]% and OfficeMax stockholders will hold approximately [—]% of the outstanding common stock of the combined company (assuming redemption of all outstanding shares of Office Depot convertible preferred stock).
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> **(Page 2, Form S-4, April 9, 2013)**

Here it is clearly stated in the first sentence that this is a merger. Office Depot and OfficeMax are two very large entities of similar size, combining to form one entity. The mechanics behind how this is done will be laid out in Part Three.

Is this transaction horizontal or vertical? Although such transactions can be a gray area in that there are likely elements of both, this would clearly lean toward a horizontal transaction. OfficeMax and Office Depot are not only both in the same industry but also clear competitors of each other, and so such a consolidation would increase their market share in this industry.

So from a subjective level this chapter should at least give you the very basic definitions relating to the M&A framework and process. Again I kept this brief as the true purpose of this book is to give a mechanical and technical understanding of the M&A process. The mechanics of M&A can be quite complex, so Part Two attempts to provide instruction on core transaction mechanics that we can use to piece together and form a large consolidation in Part Three. Before doing so, the next chapter will provide a refresher on financial statements as preparation.