M&A As One Component Of A Business Planning Course

Lyman Johnson  
*Washington and Lee University School of Law, johnsonlp@wlu.edu*

Sean Leuba

Follow this and additional works at:  [http://digitalcommons.wcl.american.edu/aublr](http://digitalcommons.wcl.american.edu/aublr)

Part of the [Business Organizations Law Commons](http://digitalcommons.wcl.american.edu/aublr), and the [Secured Transactions Commons](http://digitalcommons.wcl.american.edu/aublr)

**Recommended Citation**


Available at: [http://digitalcommons.wcl.american.edu/aublr/vol3/iss1/8](http://digitalcommons.wcl.american.edu/aublr/vol3/iss1/8)
M&A AS ONE COMPONENT OF A BUSINESS PLANNING COURSE

LYMAN JOHNSON* AND SEAN LEUBA**

Introduction ........................................................................................................... 100

I. The Case For An Experiential, Transactional M&A Course
   Module............................................................................................................. 100
   A. Experiential Learning ............................................................................ 101
   B. Transactional Offering As Experiential ............................................. 101
   C. Costs of A Module Approach ............................................................... 102
   D. Benefits Of A Module Approach ......................................................... 102

II. The Three Parts of the M&A Module .......................................................... 103

III. The Deal Person's Role in Class ................................................................. 105
   A. Introduction ............................................................................................ 105
      1. Overview of M&A Market ................................................................. 106
      2. The Lawyer's Key Role ............................................................... 106
      3. Corporate Organizational Structure ........................................... 107
      4. The Law School Role .................................................................... 107
   B. Strategy Development and Target Identification ............................... 108
   C. Transaction Execution ........................................................................ 110
      1. The NDA ......................................................................................... 110
      2. The Deal Team ............................................................................. 111
      3. The Letter of Intent; Valuation ................................................... 112
      4. Due Diligence; Definitive Agreements; Closing; Post- Closing .... 113

Conclusion ........................................................................................................... 114

* Robert O. Bentley Professor of Law, Washington and Lee University School of Law; LeJeune Distinguished Chair in Law, University of St. Thomas (Minneapolis) School of Law. The Frances Lewis Law Center at Washington & Lee University and the University of St. Thomas (Minneapolis) provided financial support for Professor Johnson's work.

** Director in Caterpillar Inc.'s Corporate M&A Group.
INTRODUCTION

This Article describes how law schools can teach mergers and acquisitions ("M&A") as one component of a business planning course that also addresses other stages of a business's development, such as the start-up and financing of growth stages. This approach to covering M&A is in contrast to a curricular offering that focuses solely on M&A for an entire semester. The benefits and costs of such an M&A module approach are identified, and the key pedagogical features of the M&A segment are explained. One critical factor for successful pedagogy is for the professor to collaborate with both an experienced transactional lawyer and a seasoned transactional business person. Effective partnering in this way requires the professor to articulate clearly to those cohorts the importance of transmitting practical knowledge and experience, to be sure, but doing so while being especially mindful of the teaching/learning process itself. For those lawyers and business persons who can successfully combine deep sophistication with attentiveness to the teaching function—a challenge in one or two-day "cameo" appearances—the pedagogical payoff is immense. This Article pays special attention to the crucial role of the business "deal person" in this approach to M&A.

We begin this Article by describing how such an offering fits into, and enhances, current efforts to improve legal education by making it more experiential, specifically in an advanced transactional offering where significant attention, but not an entire semester, is devoted to M&A. We then describe the way in which, as a professor and a business person, we collaborate to structure and conduct such an M&A component.

I. THE CASE FOR AN EXPERIENTIAL, TRANSACTIONAL M&A COURSE MODULE

Professor Johnson's Business Planning Practicum is an intensive, five-credit simulation with enrollment limited to 15-20 second-semester 3L students. These students have completed at least the basic business associations class and the introductory income tax course at Washington & Lee ("W&L"). 1 Many students, however, also have taken an additional corporations course, 2 and offerings such as securities regulation, business tax, bankruptcy, and other business-related offerings. All 3L students at

---

1. The "basic" business associations course at Washington & Lee (W&L) is called Close Business Arrangements. It covers all common forms of business arrangements in the closely held business setting.

2. The next corporations course in the business law sequence at W&L is called Publicly Held Businesses. It covers the range of issues pertaining specifically to public corporations.
W&L, moreover, must take a demanding two-week Immersion course at the beginning of the second semester that focuses on transactional work.

The Business Planning Practicum is just one offering in W&L’s pioneering 3L curriculum, which in 2008, was made entirely experiential. This major reform was in the works already when the influential Carnegie Report was released in early 2007. The Carnegie Report famously leveled criticisms at law schools for failing to better equip their graduates for practice. Since publication of the Carnegie Report and W&L’s adoption of dramatic curricular changes, a large number of law schools have been moving toward adopting more practice-ready approaches to legal education.

A. Experiential Learning

By “experiential,” at W&L we mean situating students in lawyer-like settings where they engage in lawyer-like tasks and produce lawyer-like work product. The learning process is student-centered, not professor-centered. Students plan and manage the workflow, but—given the university setting—they are provided with very close supervision by, and access to, a senior lawyer-professor. The relationship is similar to a tutorial and is designed to forge a strong mentor-protégé relationship. Much of this learning takes place in our numerous Practicums—which are simulations—but clinics and externships also play a central role.

B. Transactional Offering As Experiential

Because transactional offerings are well-suited for experiential learning, there has been a proliferation of a variety of such courses that focus exclusively on M&A or related transactional work. At W&L, for example, we offer such deal-only offerings as: Cross-Border Transactions Practicum; Mergers & Acquisitions Practicum; “Deals” Practicum; and Real Estate Transactions Practicum.6


These offerings, and others like them at many law schools across the country, can play a key role in providing a more realistic, sophisticated, and practice-oriented curriculum in business law. At the same time, law students can also gain a great deal in a more holistic Business Planning offering that examines a business at different stages in its life cycle—that is, the start-up/formation stage, the early to mid-stage financing/growth phase; and the exit (sale or divestiture) stage. In other words, in an offering where the M&A module fits into a larger, but still entirely business law and business-oriented, planning course. In a 13 or 14-week semester, such an M&A segment would comprise about three to four weeks.

C. Costs of A Module Approach

There are certain costs to approaching M&A—a notoriously complex area—in this compressed manner, rather than in a full-blown, semester-long course. The most obvious drawback of the module approach is the inability to examine technical, high level, deal-only issues in depth and with a sustained opportunity for feedback and redrafting. At the same time, perhaps some (maybe much) of that nuance and sophistication—old hat to a lawyer with ten or more years of experience—is simply lost on novice law students anyway. In addition, a real pedagogical challenge, particularly for especially experienced professors (and lawyers), is to recall that they have moved far away from students in both depth of understanding and experience. Thus, the perennial temptation to explore overly subtle concepts and intriguing alleyways must be firmly resisted in favor of pitching the course to a savvy, but still inexperienced, group of law students.

D. Benefits Of A Module Approach

There are several benefits of having an M&A component within a larger transactional planning course. First, it contextualizes M&A work by situating it into a larger business life-cycle framework. Second, such an approach can counter somewhat the cyclical nature of M&A work, which can ebb and flow. By addressing other business planning transactions as well, a down cycle in deal flow in any given year still leaves much to talk about—for instance, start-ups and the “how-to’s” of financing existing businesses. This serves to usefully diversify the knowledge base of law students, which in itself makes them more practice-ready and employable.

Third, an M&A module provides exposure to M&A work for students who will do some—maybe a great deal of—M&A work but who will also

7. Some students, it should be noted, take both the Business Planning Practicum and another M&A-only offering, but not many.
do other types of legal work. Relatedly, such a course component offers insights into M&A work to those students who will work in small or medium-sized law firms—or other practice settings—where deal work is just one of several practice areas they will see.

Notwithstanding decided benefits to such an approach, such a compressed treatment of M&A requires careful collaboration with both a very experienced deal lawyer and a business person actively engaged in deal-making. Here too, there are several benefits of such partnering. Students gain multiple and varied perspectives on a subject. Students also come to appreciate how different participants in M&A transactions have different roles, priorities, protocols, and expectations. Furthermore, students observe different styles used by senior persons in communicating and interacting with novices in a deal setting, a crucial element in their professional training.

Another benefit of our collaborative approach is that students have more opportunities to learn (and use) "the lingo." It is easy for M&A veterans to forget that the rich and colorful M&A idiom is not a native tongue but, like any foreign language, must be learned. Finally, because sophisticated M&A work tends to change with the economy, market conditions, and evolving deal practices (themselves often a result of evolving legal clarification or uncertainty), students gain an important and valuable sense of being au courant and up to date from savvy guest speakers.

II. THE THREE PARTS OF THE M&A MODULE

Believing that there are numerous benefits to addressing M&A within a larger business planning course and to collaborating in this endeavor, Professor Johnson for many years has partnered with others in teaching this segment. The M&A segment itself has three aspects: Professor Johnson's involvement; participation by an experienced business person actively engaged in buying and/or selling businesses; and the involvement of an experienced and sophisticated deal lawyer. 8

Professor Johnson spends approximately six hours, spread over three class sessions, introducing M&A work. Briefly, because this portion of the course is not the focus of this Article, a host of issues are addressed during this phase of the course. 9 These include: an overview of a deal; various

8. W&L is extremely fortunate to have devoted, loyal alumni who help in our teaching efforts. This has been gratifyingly true in Professor Johnson's course. He has benefitted in recent years from the substantial assistance of the following W&L graduates: Bill Boardman, Jim Seevers, Brian Hagee, Wyatt Deal, David Freed, Hugh Wellons, Sean Leuba, and Rob Ricca.

9. For one example of what Professor Johnson does, see LYMAN P. Q. JOHNSON, WASH. & LEE PUB. LEGAL STUDIES RESEARCH PAPER NO. 2011-6 & ST. THOMAS LEGAL
forms of and reasons for structuring transactions in different ways; motives of sellers and buyers (including strategic versus financial buyers); tax considerations; deal protection and walk rights; due diligence concerns; privilege issues; the young lawyer's role; and other foundational, stage-setting issues. Necessarily, given the vast amount of information, very extensive pre-class readings are assigned and class sessions themselves are lectures affording students numerous opportunities to ask questions. One critical goal for the future, consistent with the experiential quality of the Practicum, is to find more and better ways for students to engage in active learning in this module. Students draft and redraft letters of intent in a prior course component and they are again exposed to those here, but more "hands on" opportunities are needed.

As to the savvy deal lawyer's role, this too is not the focus of the current Article, but, in brief, the goal here is simple. This lawyer, given approximately three or four hours in one class session, must selectively address key practical issues in the M&A area. In particular, this lawyer should really hone in on what a more senior lawyer—whether a partner or senior associate—desires and expects a junior lawyer to know about M&A when that junior lawyer shows up on a deal. This session is always productive, but it seems to go especially well when a senior associate or new partner handles it. This is because students relate quite well to someone not all that farther along than them in career terms, at least compared to a senior partner, and because framing the session as "what you need to know to work on my deal" is a real attention grabber for students. It also goes well because that younger lawyer likely still remembers being a law student, and so he or she can more readily and empathetically place himself or herself on the other side of the lectern.

As to the business person, as noted, the key requirements are ongoing experience in deal-making and a strong ability to relate to law students. In recent years, Sean Leuba has partnered with Professor Johnson. Mr. Leuba has both a law degree from W&L and an MBA from the University of Chicago. He practiced at Arnold & Porter before joining Caterpillar, where initially he did law work and now leads acquisitions for Caterpillar. Obviously, Sean approaches this responsibility as a strategic buyer, not a financial (private equity) buyer, and it is helpful for students to understand the different goals and techniques of these two types of buyers. The next


10. See infra Part III.

11. Rob Ricca, now at the Wilson Sonsini law firm in Palo Alto, is currently preparing such an article.
part of this Article describes what Mr. Leuba does for his part in the M&A module.

III. THE DEAL PERSON’S ROLE IN CLASS

A. Introduction

There are several overarching goals for this part, which is ideally four hours in length. First, it seeks to disabuse law students of their faulty lawyer-centric vision of the business world, including the deal world. Second, it is designed to help students see how/where/when the lawyer’s role fits into a larger transaction and how a transaction itself is designed to advance a larger corporate strategy. Third, this part aims to assist students in forming a more grounded and informed professional identity of themselves as lawyers, including the need to meet client expectations, the ways in which they add business value, and the reality that they will face recurrent ethical challenges.

To provide context for Mr. Leuba’s remarks, he opens his presentation to students with a short biography and brief explanation as to why he is speaking to them. What follows now is Mr. Leuba’s description of his presentation.

I graduated from Washington and Lee University School of Law in 1997 and started my practice in the Corporate group of Arnold & Porter LLP, a Washington D.C. based international law firm. After two years, I moved in-house to Caterpillar Inc., a large, American industrial corporation as a transactional lawyer. While practicing in-house, I attended the University of Chicago Graduate School of Business and earned my MBA in Finance in 2003. I left the practice of law and joined the Strategy & Business Development (“S&BD”) Division at Caterpillar in 2004. I have made a few moves since that time, but for the most part, have been focusing on mergers and acquisitions, joint ventures and alliances, on the business side, for the past nine years.

My presentation in Professor Johnson’s Practicum is always given in April, toward the end of the spring semester. We do this because I act as a bridge between the three years of law school and the practicing, client-paying world that the 3Ls will soon be entering. In my current role as an executive in the S&BD Division, I am constantly interacting with lawyers of all types such as transactional, tax, environmental, labor and employment, and others. In presenting to the Business Planning class, I give my perspective on two main topics: (a) a brief overview of an acquisition from strategy to closing; and, (b) my view of what characteristics are demonstrated by the most effective deal lawyers.
1. Overview of M&A Market

I typically begin with an overview of the current state of the M&A market. In 2013, for example, the mergers and acquisitions market is healthy. In 2012, acquirers completed $2.7 trillion of announced global M&A transaction volume.\(^{12}\) This is down from a high of $4.7 trillion in 2007, the height of the most recent leveraged buyout boom, but is up substantially from the low of $2.3 trillion in 2009.\(^{13}\) Of deals closed in 2012, there was a fairly even split around the globe with the Americas comprising about 44 percent, EMEA (Europe, Middle East and Africa) at about 37 percent, and Asia at about 19 percent.\(^{14}\) There are several reasons that contribute to the strength of the current market. Cash on corporate balance sheets is at a historical high with over $3 trillion of excess cash.\(^{15}\) Financing costs are very low with central banks around the globe continuing to fight the 2008–2009 recession with high liquidity. Valuations appear reasonable with relatively low forward P/E ratios. And private equity funds must use the cash that they raised prior to the 2008–2009 recession or risk having to return it to the limited partners.

I emphasize to students that these transactions are not just occurring in New York, London, or Beijing. M&A deals of all sizes occur in all regions of the United States and around the world. The overwhelming majority of these deals are less than $1 billion in consideration. This helps students see the importance of M&A work in small and mid-size markets, and that there are excellent opportunities for M&A work in all markets.

2. The Lawyer's Key Role

For any given deal that I am involved in, there are several attorneys participating on behalf of each of the buyer and the seller. The M&A generalist lawyer leads a team in completing all of the due diligence of a target across multiple areas. This attorney also leads a team in drafting and negotiating the numerous definitive agreements for a transaction. M&A


transactions, of course, not only require the generalist team, but frequently there are specialists involved from tax, environmental, labor and employment, intellectual property, and other areas. If a transaction requires lenders, then there are additional lawyers involved to obtain and provide the credit facility. If a deal is public (or the debt will be public), then there are also securities lawyers involved.

3. Corporate Organizational Structure

At the next stage of my four-hour presentation, I review the organizational structure of a typical large American industrial company. A typical American industrial company will have its divisions split into one of three functions. The first are the operating divisions, in which reside product research and development, design, manufacturing, and operations. The second group is the sales and marketing divisions. The operating divisions “sell” the products via a transfer price to the sales and marketing divisions who then market and sell the products to the company’s customer base. The third group is composed of the service divisions. These divisions include: Legal, Accounting, Human Resources, Tax, Treasury, and Information Technology.

4. The Law School Role

It is my view that law schools can play a role in aiding the M&A business world and the law firms serving that world. They can do so by better exposing those graduating students interested in commercial work to the issues arising in mergers and acquisitions. With sixteen years of experience on both the legal and business side of deal-making, I have concluded that a critical element of that M&A exposure is for law students to have a better, more complete and holistic perspective on acquisitions. Clients today want many characteristics in their lawyers, but foremost, clients desire a lawyer who is a complete advisor. The most valuable M&A lawyers are the ones who not only give excellent legal advice, but also have an understanding of their client’s broader business goals and at least a cursory understanding of how to achieve those goals. For example: What is the client’s short and long term strategy? How do acquisitions fit within and advance that strategy? What are the key business drivers that must be achieved to ensure success? Which particular acquisition targets can best enable a client to execute on its strategy? What are the specific risks of a target as it is integrated into an acquirer? What mitigation plans can be developed? If a lawyer has a working understanding of these broader points, the lawyer can become invaluable to the client. The lawyer can move from just being a legal technician hired for a specific matter, to one who is a valued member of the business team and who, in doing so,
becomes a complete counselor and trusted advisor. This will then lead to a deeper, longer and ultimately more satisfying client relationship.

B. Strategy Development and Target Identification

After explaining that there is abundant M&A activity occurring across all deal sizes and geographies and that, in my view, the best lawyers are the ones that understand more than just the law, I take the students through a high-level discussion of corporate strategy development. Why do companies undertake acquisitions? Acquisitions are an arduous process, fraught with risk, they can be very expensive, and they frequently fail. The primary driver of acquisitions is growth. The overwhelming majority of companies, whether it be small community banks or a Fortune 500 behemoth, want to grow. This can be growth in sales, profit, or market share. Growth generally leads to more profits, a higher share price (if public), more money to invest in facilities and people, greater engagement among the employees, more confidence with customers, and many other positive benefits. Growth typically drives corporate behavior.

There are many ways companies can grow. They may invest in the sales and marketing team in an attempt to gain incremental customers. They may have strong R&D budgets, improve existing products, and innovate and develop new technologies or products. They may invest in new geographic locations with facilities and a heightened sales presence. Or, they may acquire other companies and use the acquisition to launch growth.

A well-developed corporate strategy will guide management in the best manner to execute growth plans. At its essence, the growth strategy attempts to answer three basic questions: (1) What industries or segments do we wish to grow in; (2) why do we want to undertake those actions; and, (3) how are we going execute those plans (i.e., new products, new facilities, supply agreements, joint ventures, acquisitions)?

The new industries, products, markets, or customers a company wishes to pursue will flow directly from the fundamental mission and purpose of an organization. For a company’s management to properly set the course of growth, they must fully understand their goals for the business. Companies that are viewed as best-in-class acquirers develop a set of filters through which they run all growth initiatives. Management derives these filters from the vision, the mission, and the long-term strategy of the organization. These filters apply even before a company decides which method is the best manner to grow; it is at the earlier stage of evaluating whether a company should even enter this market segment. Some examples of filters include the following questions. What is the addressable market size of an industry? What is the aggregate growth rate?
for the industry? Are the customers in a particular industry profitable and what is their margin? What do the customers in the industry value? Are the customers price buyers or premium buyers? Does the industry value differentiated technology or is it more of a commodity-type industry? Is it a global industry or a regional one? What are the barriers of entry into a particular industry? To answer the first two questions above, “What markets and why?” a company identifies particular industries, the “what.” and applies its filters to determine the “why.”

Once a company elects to enter a particular market, then it turns to the execution alternatives, or the “How are we going to enter?” There are many different execution alternatives including the following: (a) internal development, (b) supply agreement, (c) co-development with a supply agreement, (d) greenfield facility (if new factories are required), (e) equity joint venture, and (f) acquisition. In deciding the best method to grow into an industry, companies develop a set of Critical Success Factors (“CSFs”). These CSFs are similar to the filters described above, but instead of relating to a particular industry, the CSFs relate to goals within a particular industry. Examples of CSFs include: What is the speed to market? What are the financial metrics, such as sales, operating profit, internal rate of return (“IRR”), net present value (“NPV”), cash flow, and return on invested capital (“ROIC”), of each of the options (e.g., internal development v. supply agreement v. acquisition)? Does the company have available capacity at any of the existing facilities? Is there protected IP that would prevent the company from undertaking a new product program? Are there multiple, competent suppliers to choose from for a product sourcing? After evaluating the alternatives against the CSFs, a company will develop a prioritized list of growth alternatives.

Assuming the company determines an acquisition is the best option to pursue, the process of target identification begins. Acquiring companies will begin an examination of existing companies in the targeted industry. A third set of filters is established to prioritize the potential targets. These filters may include, among others: (a) what is the financial performance of the targeted companies; (b) where are the companies located, including management centers, engineering centers, manufacturing footprint, and distribution centers; (c) who are the customers and what type of customers are they; (d) what is the distribution channel, i.e., direct or through dealers; (e) what is the competitive position and market share of each company within the industry; and (f) what is the culture of the company and will it fit within the acquiring company. At the end of this exercise, the acquiring company should have a list of potential targets prioritized by desirability.

A significant amount of time and effort goes into developing a corporate growth strategy, determining the best manner in which to execute on that growth, and if an acquisition is involved, deciding on the priority ranking
of potential targets. Law students, like many lawyers, generally do not appreciate this business reality. The best-in-class companies with sophisticated business development teams are constantly evaluating industries, markets, and the key players in those markets.

At this point in my presentation, I attempt to clearly relate the corporate strategy back to the attorney’s role in an organization. The best attorneys understand growth strategy development and execution process and how their clients approach it. They understand the corporate strategy, understand the risk appetite of their clients, and provide constructive and insightful advice to their clients as they develop and execute on their growth strategies. It is critical in today’s environment that corporate counselors go beyond the provision of mere legal advice and become a proactive, comprehensive advisor. To do that, lawyers must possess a solid understanding of strategy and execution alternatives. It is best that law students learn this lesson early in their careers.

C. Transaction Execution

After I provide an overview of corporate strategy development and execution alternatives, I then move to the more tactical discussion of transaction mechanics. This is intended to provide 3Ls with my perspective on the flow of an M&A deal and some of the key legal and business items that frequently arise. If in their first year of practice they work on an acquisition, they will have had some brief exposure to the issue because I have touched on it.

Once the acquirer determines that an acquisition is the best method to achieve growth, and it has developed the list of prioritized target candidates, it begins the process of contacting those targets. This is typically done via a communication from the acquirer’s Business Development Department (“BD”) to the Target’s CFO or BD group, but other methods such as CEO to CEO or business unit to the BD group are common. It can be as simple as stating that the acquirer is interested in exploring ways that the two companies can cooperate or create value together.

1. The NDA

At this point, Non-Disclosure Agreements (“NDAs”) may be exchanged and executed. I will hand out to students a sample NDA and discuss the key points in the document. Lawyers are very much involved at this point in the process. They will take the lead on negotiating the NDAs, as well as, on the buyer’s side, starting preliminary due diligence on the potential target.
The initial meeting will typically be small and include between four and eight representatives combined. Topics will range from general business discussions, macroeconomic views, each other's business outlook, and effective ways that the two companies can increase shareholder value by working together. The important element, whether at this meeting or at a subsequent follow up call, is to explore whether the potential target is truly interested in being acquired.

2. The Deal Team

If a target is willing to explore selling, the teams from each party will expand. The acquiring company will form a Deal Team with an M&A expert from BD in the lead, a business unit operational person, the business unit controller, and the M&A lawyer assigned to the project. Lawyers will take an increasingly large role from this point until the transaction closes. Having a lawyer who understands the corporate strategy, the business unit strategy, the industry in general, and a working knowledge of the potential target helps the acquiring company tremendously. These types of lawyers are much better able to provide constructive counseling and advice to the Deal Team because they have a working understanding of how a company is seeking to achieve its overall strategy through this particular acquisition.

The Deal Team then prepares a Preliminary Information Request List and delivers it to the target. This is one-page document with two main requests: (1) a description of the business; and, (2) financial information. I have a sample that I hand out to the students and we review the key points. Under the first category, the acquirer seeks information related to products, customers, competitors, real estate footprint, capacity expansion plans, human resources, material litigation, and other material risks. Under the second category, the acquirer seeks the current business plan, the historical financial statements, and a list of planned financial projects for at least the next few years.

The purpose of this information request is to enable the acquiring company to confirm its view of strategic fit, begin building a financial model (including positive and negative synergies), and start its work on risk assessment. The acquiring company also starts to develop a preliminary valuation of the target and to build its internal business case for making an acquisition of the target.

As the acquirer is reviewing this initial information, it is common for the target to invite the acquirer for a site visit and management presentation. The team of people for both parties involved in the transaction grows larger to include operational personnel, human resources, information technology, additional lawyers around specific areas, and additional personnel from the accounting group.
The management meeting will typically include a three to four hour presentation and a facility visit to one of the target's operations. It can be an all day affair if the target wishes to provide fulsome information. Attendees will usually include the expanded team described above and external advisors hired by the acquirer and target. The materials presented in the management meeting will follow an outline similar to this: (1) Company Overview, (2) Investment Highlights, (3) Industry Overview, (4) Business Overview (products & end-markets, business segments, technology, sales & marketing and operations), (5) Growth Opportunities, (6) Financial Review, and (7) Conclusion. Upon completing review of this information, the acquirer should be in position to make a determination whether to go forward and, if so, to formulate a conditional valuation offer and transactional structure to the target.

When the preliminary valuation is complete and the acquirer has the necessary internal approvals, it launches price and structure negotiations with the target. This process can take many rounds and usually culminates with an in-person meeting between senior members of each company. At the conclusion of this process, a handshake understanding is reached and parties move to the Letter of Intent.

3. The Letter of Intent; Valuation

A Letter of Intent ("LOI") within the M&A context is mostly a non-binding agreement on certain key elements of a deal. The document can vary in length from a few pages to more than a dozen depending on the complexity of the deal and how many key terms the parties wish to negotiate prior to the definitive agreements. I distribute a sample LOI to the class and review key terms with them. There may be binding sections such as confidentiality and exclusivity provisions. The most important elements contained in the LOI are the purchase price and other deal terms, which typically are non-binding.

The primary technique for developing a valuation of a target is to use the Discounted Cash Flow ("DCF") method and to then use trading comparables and earnings multiples as a check. The DCF method derives a cash flow amount for each year of the model (usually a five-year or ten-year model), assigns a terminal value for the years beyond the initial model period, and then discounts those cash flows to present value by using an appropriate discount rate. This model will produce a discrete stand-alone valuation, the NPV based on the discounted yearly cash flows and the discounted terminal value. The NPV is then checked against comparable recent transaction prices and current public company trading multiples.

During my presentation, I show a sample DCF model and walk the class through the major elements. While I do not expect the students to become
valuation experts in the twenty minutes that I review it, it is very helpful for them to have an understanding of the primary method by which acquirers value targets. Valuation is so fundamental to a business person’s view of acquisitions that I believe it critical that an M&A lawyer at least have some familiarity with how acquirers place a value on targets. This topic will come up for students in their first actual acquisition transaction.

There is tremendous “art” in the supposed science of DCF modeling given the numerous assumptions that must be made. There are assumptions around all aspects of the forecasted income statement, including annual revenues, material costs, indirect costs, overhead costs, the industry growth rates, future recessions, etc. Additionally, small changes in the chosen discount rate can significantly impact the NPV. Generally, the riskier a particular transaction, the higher the discount rate, and the lower the risk, the lower the discount rate. In today’s current climate of very inexpensive debt, discount rates of nine- to twelve-percent are common.

Acquirers will develop at least two DCF valuations. The first is the standalone value model. This model views the target company on an independent, standalone basis. What is the value of the company if it were an independent business? The second valuation model is the synergistic valuation. This model examines the target company and derives a valuation as if the target company were a part of the acquirer. All of the synergies, both positive and negative, are included in the synergistic value. Examples of positive synergies include cost synergies such as lower material cost, reductions in head-count due to a combined business, manufacturing process efficiency improvements, and revenue synergies, such as a stronger distribution network that the acquirer can bring to the target’s products. Examples of negative synergies include additional costs related to benefit plans, start-up and integration costs, and customer flight.

Lawyers are deeply involved, and frequently take the lead, in the negotiation and drafting of the LOI. As the most important element of the LOI, the valuation is a critical element that excellent transactional lawyers should understand. The best advisors are the ones who understand the value-drivers of a transaction and are able to appropriately structure and document a transaction around those value-drivers, in addition to the more typical risk mitigation provisions well-known to deal lawyers.

4. Due Diligence; Definitive Agreements; Closing; Post-Closing

After the signing of the LOI, both parties are in full-blown deal mode. The number of personnel involved in the transaction increases significantly as the acquirer launches extensive due diligence. This is a comprehensive investigation of the target. The acquirer is attempting to validate its DCF
model and is searching for all appropriate risk items and then developing a mitigation plan. Additionally, the acquirer has launched its post-closing integration team and uses due diligence to begin mapping out the integration plan and prioritizing areas of focus on Day 1 post-closing.

At the conclusion of due diligence, the parties move to the negotiation and drafting of definitive agreements. Lawyers are very much in the lead at this point and the deal team is focused on obtaining all of the necessary internal approvals, supporting the legal team, and negotiating the final documents.

At this point in the presentation to students, I shift to a much more legally focused discussion. I distribute a sample stock purchase agreement and review key elements such as reps and warranties, indemnities, MAC clauses, and conditions to closing. I flag important areas of risk and negotiation that the students are likely to come across in their first year of practice. I also discuss the differences in deals where the target is a public company compared to private. I briefly cover auctions as well, which are inherently different than negotiated acquisitions where the acquirer approaches the target. Lastly, I touch on acquisitions by financial buyers and how they are different from transactions where there is a strategic buyer.

The aim of this portion of my presentation is not only to build on Professor Johnson’s prior discussion of M&A and to set up the ensuing more lawyer-centered presentation to be given the following week by a deal lawyer, but also to supply what frequently is lacking in the legal education of business law students. In brief, such students—in M&A classes and all business law courses—must understand what their future clients’ goals are in any particular setting. Only by doing so can a lawyer serve as the knowledgeable, trusted advisor that all companies desire.

CONCLUSION

Experiential learning is here to stay in legal education. Business law courses are ideally suited to this form of pedagogy, and professors in this field have designed a wide variety of offerings. For those who seek a business life-cycle approach to experiential learning, business planning courses give students an opportunity to work on different stages of a company’s growth. M&A can be one component of such a holistic offering. We have described what we have discovered to be an effective approach in the M&A area, the key to which is a collaboration that draws on the business person’s and the professor’s respective strengths.

16. Some due diligence, of course, continues post-signing.