



Università degli Studi di Firenze

Advanced Corporate Finance

Lorenzo Parrini

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Introduction

Course structure

Course structure

3 credits – 24 h – 6 lessons

1. Corporate finance
2. Corporate valuation
3. M&A deals
4. M&A private equity
5. IPOs
6. Case discussions

Lesson 1 Corporate Finance

Lesson 1 Summary

1

Financial Statement Structure

- ITA GAAP vs IAS-IFRS
- Recent news in ITA GAAP legislation
- ITA GAAP structure
- IAS-IFRS structure
- Main accounting topics

2

Financial Statement Analysis

3

Business Plan

4

Company Financial Structure

5

M&A Transactions



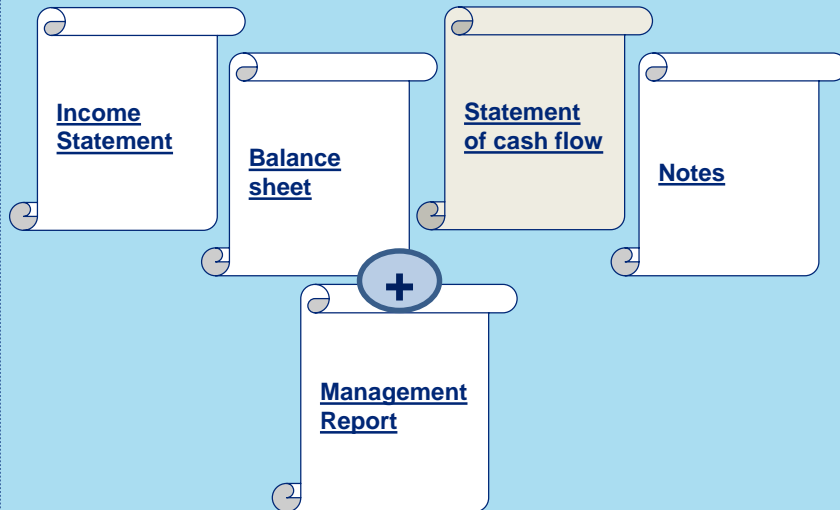
Financial statement structure

ITA Gaap vs IAS-IFRS

Financial Statement is Companies' primary informative document aimed to communicate results to stakeholders

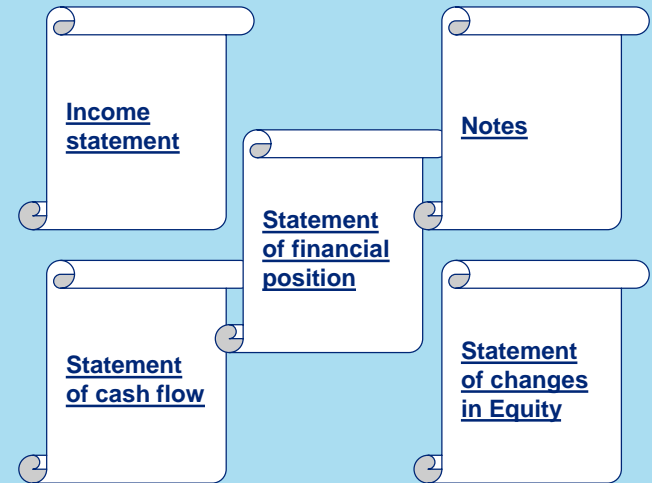
Contents and Structure

ITA GAAP



- Contents and format strictly defined by law (Italian Civil Code)
- Shareholders oriented
- Historical cost
- Prevalence of form over substance (eg. leasing accounting)

IAS - IFRS



- No strictly format established . IAS 1 defined only some required items in the P&L and some in the BS.
- Stakeholders oriented
- Fair Value estimates
- Prevalence of substance over form (eg. leasing accounting)
- No separate indication of extraordinary items

Notes: Under the new legislation of the Italian Gaap structure introduced by the Legislative Decree n. 139 of August 18, 2015, the Statement of cash flow has been included as mandatory primary informative document

Financial statement structure

Recent news in ITA Gaap legislation

After the publication on the "Gazzetta Ufficiale" – n. 205 of September 4, 2015 – the Legislative Decree n. 139 of August 18, 2015 was implemented in order to transpose the European Directive 2013/34/EU.

The law is in force since January 1, 2016. For comparative purposes, the 2015 items reported in 2016 financial statement must also be adjusted according to the new requirements.

Main news



Reporting principles

- Possibility to avoid obligations in terms of **recognition, measurement, presentation and disclosure**, whenever the effects of non-compliance will be irrelevant to the true and fair representation
- There are no more references to the economic function of assets and liabilities in favor of the **substance** of the transaction



Financial statements

- Innovations introduced in the **Balance Sheet** and **Income Statement** documents
- Introduction of the obligation to prepare the **Cash Flow Statement**

Balance Sheet

- The **treasury shares** are directly deducted from equity
- **Research and advertising costs** are not to be shown as fixed assets: only development costs can be capitalized
- Indication of the relationship between **credits and debts** with companies subjected to the control of the parent
- Introduction of the "**Reserve to hedge expected cash flows**" in the equity
- **Memorandum accounts** are not listed at the bottom of the Balance sheet: information will be provided in the Notes
- Specific items for **derivatives** have been included

Profit & Loss

- **Financial income and expenses** must be indicated separately from data regarding companies subject to control
- Specific items added for **derivatives** in the financial items section
- Elimination of Class "E" relative to the **extraordinary items**: income and expenses will be indicated in the Notes

Cash Flow Statement

- Obligation to prepare the Cash Flow Statement. That is not mandatory for companies that prepare the short-form annual financial statements and for micro-enterprises¹

Evaluation criteria

- **Goodwill** is amortized according to its useful life (or within a period that do not exceed 10 years)
- **Derivatives** are recognized at fair value
- **Credits and debts** will be represented at their amortized costs rather than their historical or nominal value

Notes: (1) Micro-enterprises are those companies with less than 10 employees and annual turnover / annual balance not exceeding € 2 million

Profit & Loss ex Codice Civile art. 2425 e 2425 bis

A) VALORE della PRODUZIONE

- A1. Ricavi delle vendite e delle prestazioni
- A2. Variazioni delle rimanenze di PiCL, SL, PF
- A3. Variazione dei lavori in corso su ordinazione
- A4. Incrementi di immobilizzazioni per lavori interni
- A5. Altri ricavi e proventi

Totale Valore della Produzione (A)

B) COSTI della PRODUZIONE

- B6. Per materie prime, sussidiarie, di consumo e merci
- B7. Per servizi
- B8. Per godimento beni di terzi
- B9. Per il personale
- B10. Ammortamenti e svalutazioni
- B11. Variazione rimanenze MP, sussidiarie, di consumo e merci
- B12. Accantonamenti per rischi
- B13. Altri accantonamenti
- B14. Oneri diversi di gestione

Totale Costi della Produzione (B)

(A-B) DIFFERENZA tra VALORE e COSTI della PRODUZIONE

C) PROVENTI e ONERI FINANZIARI

- C15. Proventi da partecipazioni
- C16. Altri proventi finanziari
- C17. Interessi passivi ed altri oneri finanziari
- C17bis. Utili e perdite su cambi

Totale Proventi ed Oneri finanziari

D) RETTIFICHE di VALORE di ATTIVITA' FINANZIARIE

- D18. Rivalutazioni
- D19. Svalutazioni

Totale Rettifiche di Valore di Attività Finanziarie

(A-B+/-C-D) RISULTATO PRIMA delle IMPOSTE

Imposte sul reddito dell'esercizio (*correnti, differite, anticipate*)

UTILE (PERDITA) dell'ESERCIZIO

Balance Sheet ex Codice Civile art. 2424

ATTIVO

A. CREDITI VERSO SOCI PER VERSAMENTI ANCORA DOVUTI

B. IMMOBILIZZAZIONI

- B I. Immobilizzazioni immateriali
- B II. Immobilizzazioni materiali
- B III. Immobilizzazioni finanziarie

C. ATTIVO CIRCOLANTE

- C I. Rimanenze
- C II. Crediti
 - C II.1 Verso clienti
 - C II.2 Verso imprese controllate
 - C II.3 Verso imprese collegate
 - C II.4 Verso controllanti
 - C II.5 Verso imprese sottoposte a controllo delle controllanti
 - C II.5-bis Tributari
 - C II.5-ter Imposte anticipate
 - C II.5-quater Verso altri
- C III. Attività finanziarie che non costituiscono immobilizzazioni
- C IV. Disponibilità liquide

D. RATEI E RISCONTI

PASSIVO

A. PATRIMONIO NETTO

B. FONDI PER RISCHI ED ONERI

C. TRATTAMENTO DI FINE RAPPORTO

D. DEBITI

- D.1 Obbligazioni
- D.2 Obbligazioni convertibili
- D.3 Debiti verso soci
- D.4 Debiti verso banche
- D.5 Debiti verso altri finanziatori
- D.6 Acconti
- D.7 Debiti verso fornitori
- D.8 Debiti rappresentati da titoli di credito
- D.9 Debiti verso imprese controllate
- D.10 Debiti verso imprese collegate
- D.11 Debiti verso controllanti
- D.11-bis Debiti verso imprese sottoposte al controllo delle controllanti
- D.12 Debiti tributari
- D.13 Debiti verso istituti di previdenza e sicurezza sociale
- D.14 Altri debiti

E. RATEI E RISCONTI

ITA Gaap structure – Cash Flow Statement

Under the new legislation, the Cash Flow Statement becomes a mandatory document for all entities required to prepare the financial statements on ordinary form, adding it to the Balance Sheet, the Income Statement and Notes

Cash Flow Statement ex Codice Civile art. 2425 ter



Stand-alone document that can synthesize the
yearly financial dynamic

Article 2425 ter CC, contrary to what is usually provided by the Civil Code for the other required reports, does not provide a rigid structure or a minimum content, but specific targets and objectives

Objectives

- ❖ Describe the amount and composition of cash and cash equivalents at beginning and at the end of the year
- ❖ Represent cash flows for the year, arising from:
 - Operating activities
 - Investing activities
 - Financing activities (including transactions with shareholders)

Financial statement structure

ITA Gaap structure – Notes

Notes ex Codice Civile art. 2427



Some details deserve information in terms of financial statements analysis and valuation:

- 2) Changes in fixed assets, with separate indication of each items, indicating: the cost, previous changes, depreciation, (...)
- 4) Changes in other asset and liability items (equity, provision funds, severance indemnity, ...)
- 7) Composition of: accruals, prepaid expenses, deferred incomes, any funds and reserves included into the Balance Sheet
- 9) The total amount of commitments, guarantees and potential liabilities not represented into the Balance Sheet
- 13) Composition of extraordinary items, whenever their amount is relevant
- 14) A separate prospect containing: a) description of temporary differences that led to the recognition of deferred tax assets, specifying the rate applied and any changes with respect to the previous year; b) the amount of the deferred tax assets recorder in relation to losses during the current or the previous period
- 16) The amount of remuneration paid to the board of directors and auditors, cumulatively for each category
- 19-bis) Loans made by shareholders to the company
- 22) Leasing operations

Management Report ex Codice Civile art. 2428

[1] The financial statements must be accompanied by a directors' report containing a faithful, balanced and comprehensive analysis of the situation of the company and about the performance and results of operations, both as a whole and in the various sectors in which it operates, also through subsidiaries, particularly with regard to costs, revenues and investments, as well as a description of the principal risks and uncertainties the company is exposed

Content

(...) Financial performance indicators and, where appropriate, relevant financial and non-specific activities of the company (...) with reference to the amounts reported in the financial statements and clarifications

[2] The report should in any case includes:

- 1) Research and development activities;
- 2) Relations with subsidiaries, affiliates, parent companies and companies controlled by the latter;
- 3) The number and nominal value of both treasury shares and shares of the parent companies held by the company (...), indicating the corresponding part of the capital;
- 4) The number and nominal value of both treasury shares and shares of the parent companies that have been purchased or sold
- 6) The business outlook;
- 6-bis) Information regarding the use of financial instruments by the company;

Financial statement structure

IAS-IFRS structure

Income Statement basic requirements

An entity has a choice of presenting:

- a single statement, with profit or loss and other comprehensive income presented in two sections, or
- two statements:
 - a separate statement of profit or loss
 - a statement of comprehensive income, immediately following the statement of profit or loss [IAS 1.10A]

Minimum items

Profit or loss section (or separate statement):

- Revenue
- Gains and losses from the write off of financial assets measured at amortized cost
- Finance costs
- Share of the profit or loss of associates and joint ventures accounted for using the equity method
- Certain gains or losses associated with the reclassification of financial assets
- Tax expenses
- A single amount for the total of discontinued items

OCI section (or statement):

- *Components of other comprehensive income classified by nature*
- *Share of the other comprehensive income of associates and joint ventures accounted for using EM*

Other comprehensive income items are:

- Assets revaluation
- Increase in financial assets available for sale
- Actuarial profit/loss
- The effects of change in foreign exchange rates

Balance Sheet basic requirements




IAS 1 does not prescribe the format of the statement of financial position. Assets can be presented current then non-current, or vice versa, and liabilities and equity can be presented current then non-current then equity, or vice versa.

Minimum items

- a) Property, Plant and Equipment
- b) Investment Property
- c) Intangibles Assets
- d) Financial assets
- e) Investment Accounting for using Equity Method
- f) Biological Assets
- g) Inventories
- h) Trade and other receivables
- i) Cash and cash equivalents
- j) Assets held for sale
- k) Trade and other payables
- l) Provisions
- m) Financial liabilities (excluding amounts shown under (k) and (l))
- n) Current tax Assets and Liabilities as defined in IAS 12
- o) Deferred tax liabilities and deferred tax assets, as defined in IAS 12
- p) Liabilities included in disposal groups
- q) Non-controlling interests, presented within equity
- r) Issued capital and reserves attributable to owners of the parent

Financial statement structure

Main accounting topics

	Ita GAAP	IAS-IFRS
 <p>Financial Leasing</p>	<p><u>P&L</u></p> <p>Rental cost</p> <p><u>Notes</u></p> <p>Detailed information</p>	<p><u>P&L</u></p> <p>Amortization Cost</p> <p>Financial Charge</p> <p><u>BS</u></p> <p>Asset</p> <p>Financial Debt</p>
 <p>Inventory</p>	<p><u>Applicable valuation criteria</u></p> <ul style="list-style-type: none"> Weighted Average Cost FIFO LIFO 	<p><u>Applicable valuation criteria</u></p> <ul style="list-style-type: none"> Weighted Average Cost FIFO
 <p>Intangibles</p>	<p>Many Admissible Categories</p> <p>Amortization process</p>	<p>Limited Admissible Categories</p> <p>Amortization process</p> <p>Impairment test</p>

Lesson 1 Summary

1

Financial Statement Structure

2

Financial Statement Analysis

- **Overview**

- **Income Statement Reclassification**

- **Balance sheet Reclassification**

- **Income statement and balance sheet**

- **Cash Flow Statement**

- **Financial Ratios**

3

Business Plan

4

Company Financial Structure

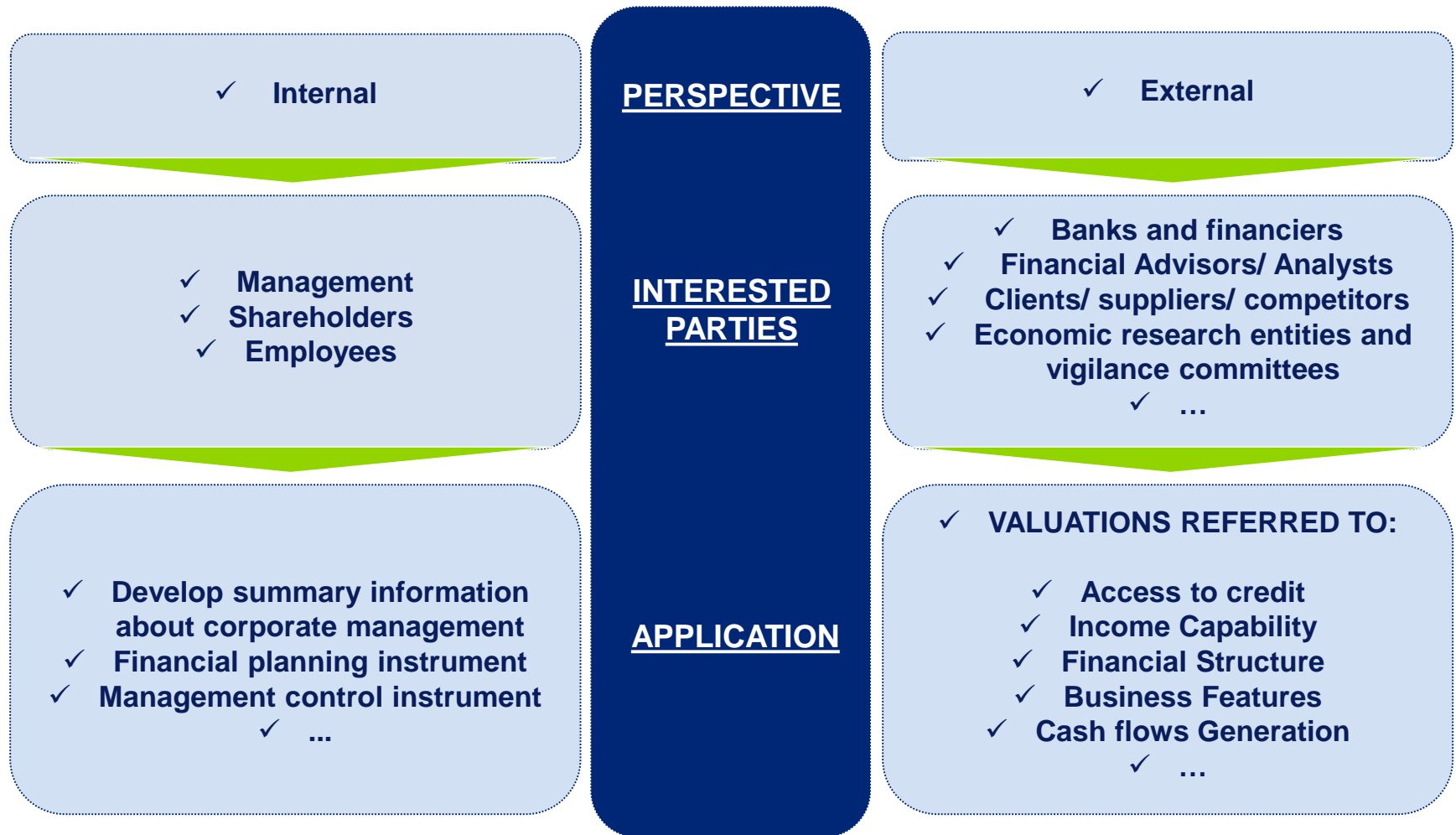
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M&A Transactions

Financial statement analysis

Overview

Financial Statement Analysis is aimed to acquire and develop information about corporate management, that is branched in its **economic and financial aspects**

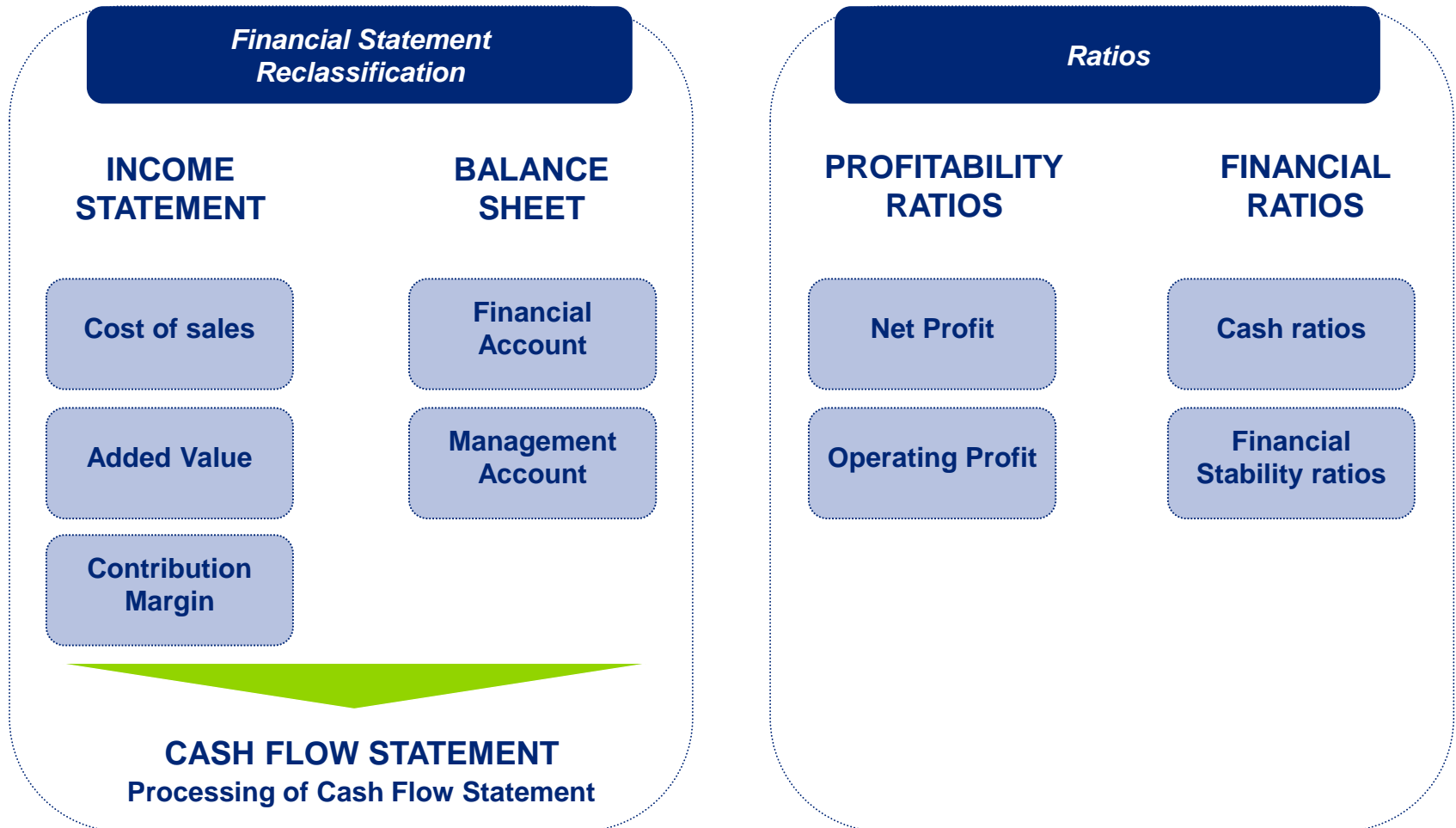


Financial statement analysis

Overview

Financial statement Analysis can be ideally divided into two steps:

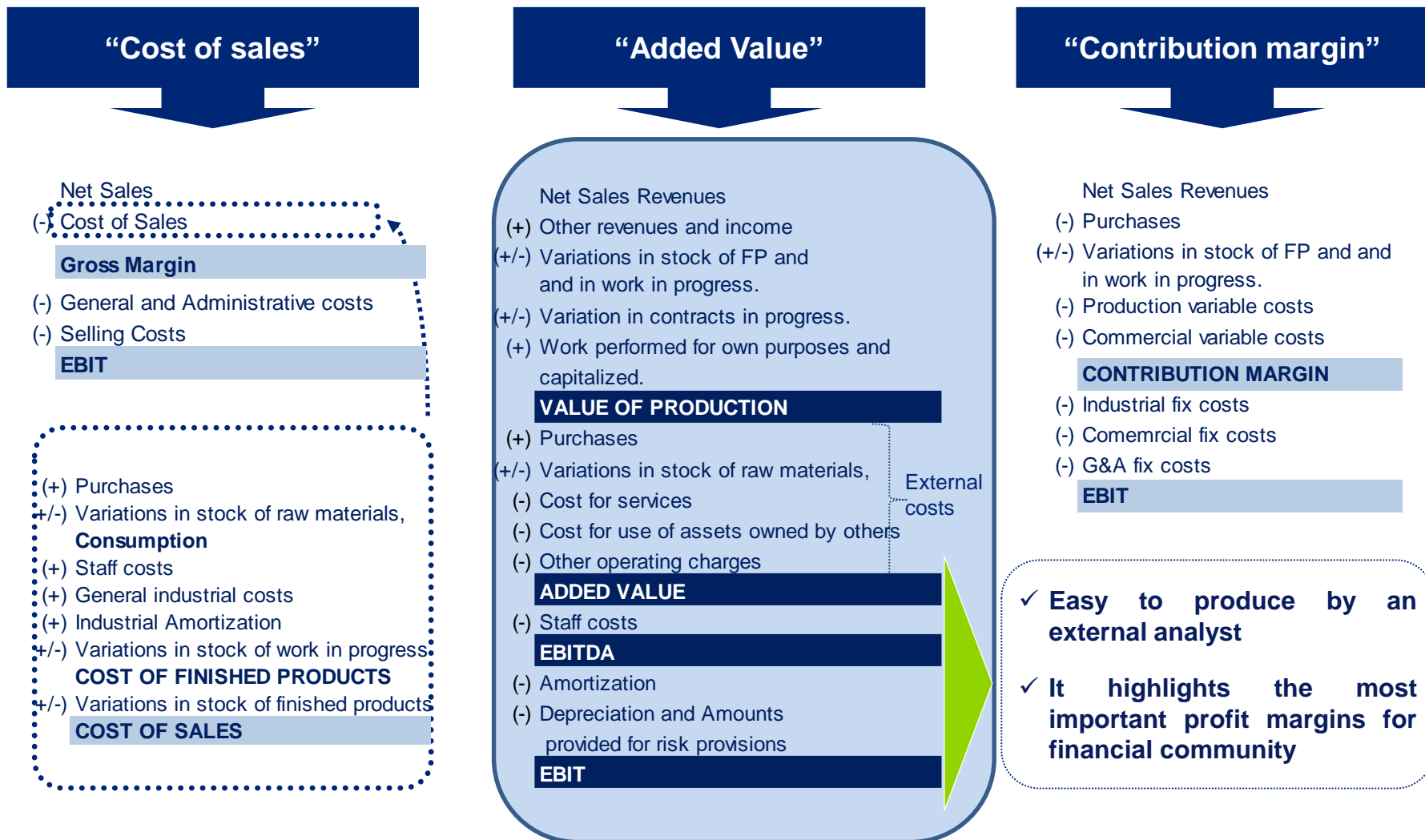
- 1) Income statement and Balance sheet **Reclassification**
- 2) Construction and analysis of performance **Ratios**



Financial statement analysis

Income statement reclassification

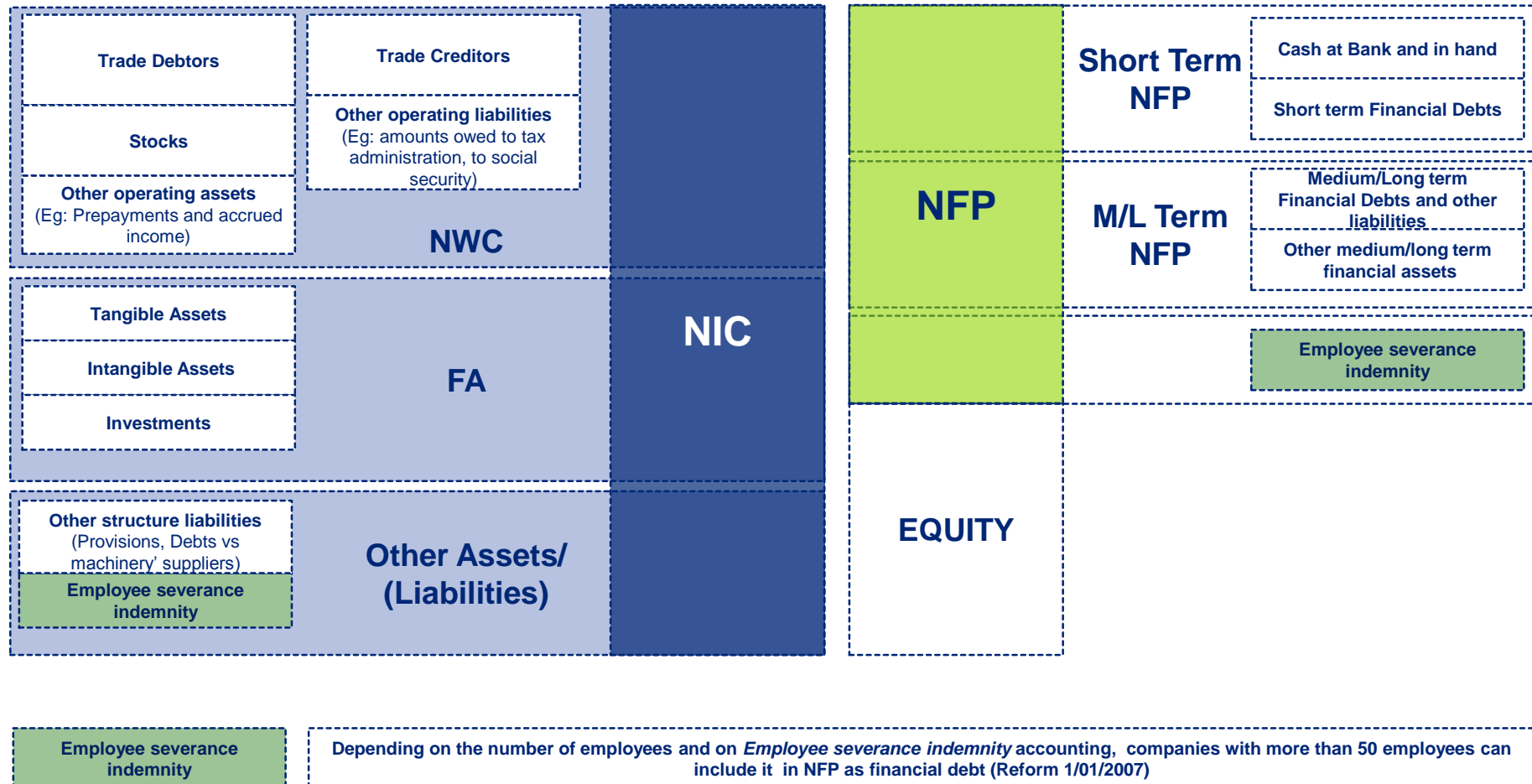
The main methods of income statement reclassification highlight operating profit (characteristic activity) from different points of view.



Financial statement analysis

Balance sheet reclassification

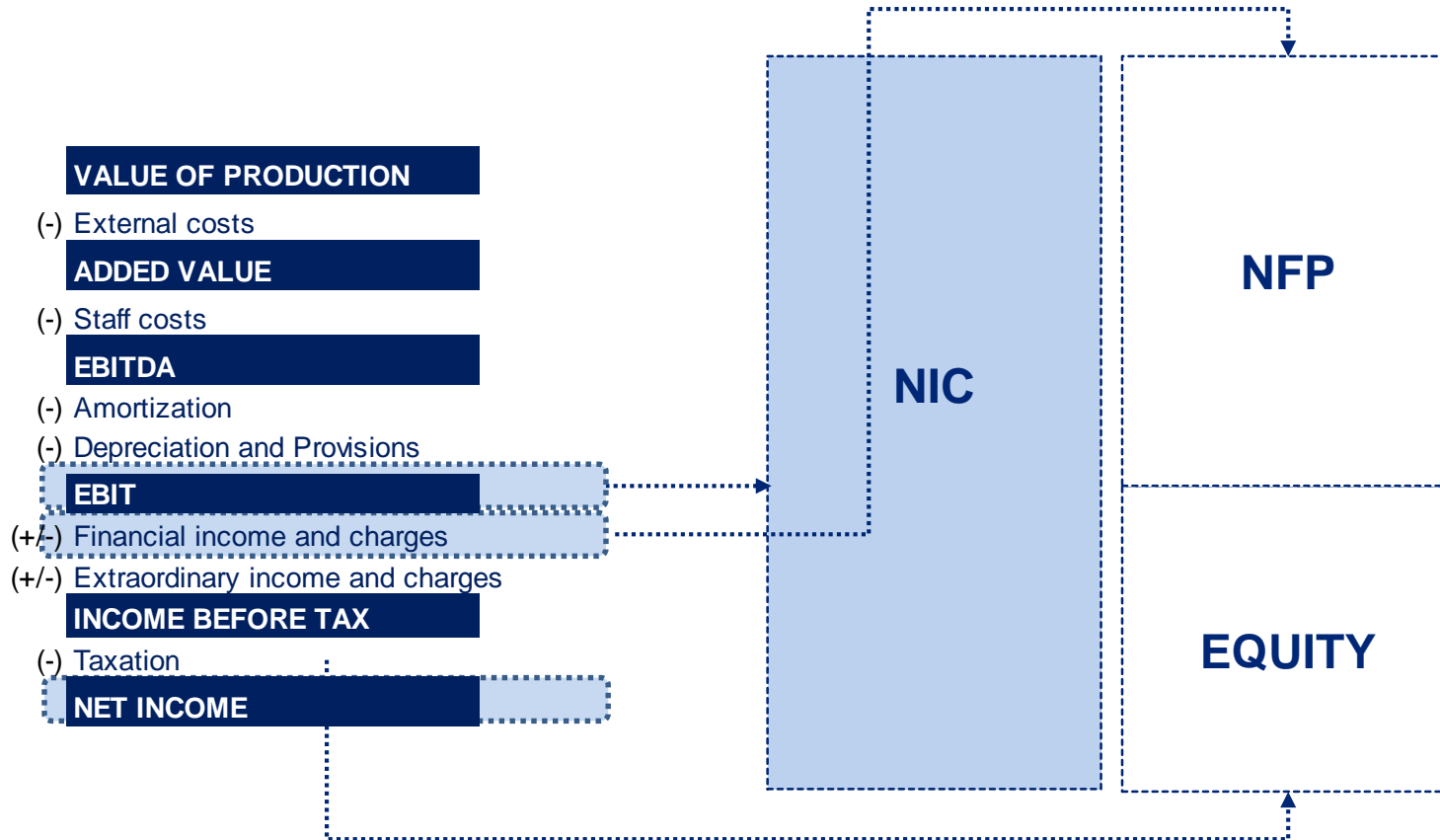
The “**Management Account Method**” allows analyst to identify the main *Asset classes* that origin financial requirement: Net Working Capital (NWC), Fixed assets (FA) and Net Invested Capital (NIC), together with *Financial sources*: Net financial Position (NFP) and Equity (E).



Financial statement analysis

Income statement and balance sheet

The **Management Account Method** underlines also the coverage of net financial requirement expressed by NIC. It helps in finding logical connections with Income statement



Financial statement analysis

Cash flow statement

Cash flow Statement shows Company capability of cash generation (cash inflows) or cash absorption (cash outflows) during the year

Main financing sources and main cash uses are:

CASH INFLOWS

- ✓ Operating Cash Flow (EBITDA +/- Changes in NWC)
- ✓ Paying Increase in capital stock
- ✓ Opening of loans payable (capital)
- ✓ Proceed of active loans (capital + interests)
- ✓ Sell of fix assets
- ✓ Grants received

CASH OUTFLOWS

- ✓ Decrease in capital stock (es. Dividend distribution)
- ✓ Payment of payable loans (capital + charges)
- ✓ Opening of active loans (capital)
- ✓ Acquisition of fix assets
- ✓ Use (payment) of provisions
- ✓ Tax payment

Financial statement analysis

Cash flow statement

Cash Flow Statement highlights the generation and absorption of financial resources occurred during the year, divided into the main management areas

Initial Cash at Bank and in Hand
EBIT (A)
Taxes on Ebit (B)
NOPLAT (C = A+B)
Depreciation and Amortization (d)
GROSS CASH FLOW (E = C+D)
Changes in NWC (F)
CAPEX (G)
Changes in Funds (H)
FREE CASH FLOW (I = F+G+H)
Financial income and charges (L)
Tax on financial area (M)
Net financial income and charges (N = L-M)
New M/L term financing (O)
M/L T financing reimbursement (P)
M/L T Financial Activities Cash Flow (Q = O-P)
Equity increase (R)
Dividends and other equity decrease (S)
Equity Cash Flow (T = R-S)
CASH FLOW FROM FINANCING (U = Q+T)
Extraordinary income and charges (V)
Tax on extraordinary area (W)
NET INTEREST AND CHARGES NOT OPERATIVE (X = V-W)
CASH FLOW GENERATED (ABSORBED) (W= I+N+U+X)
Final Cash at Bank and in Hand

Cash Flow Statement is a very important input in Corporate valuation, because it represents company's cash flow production through characteristic operating activity (excluding capex)

Financial statement analysis

Financial ratios

Statements reclassification is also necessary for the construction of **interrelated indicators** that allow to focus the analysis on economic and financial performances

Profitability Ratios
Ebitda Margin% = Ebitda / Revenues
Ebit Margin% (ROS) = Ebit / Revenues
ROI = Ebit / NIC
ROE = Net Income / Equity
Extraordinary area (S) = Income before tax / Ordinary Income
Tax (T) = Net Income / Income before tax
ROE = [Roi+(Roi-Rod)*NFP/E]*S*T

Financial Ratios
Stock Turnover (DIO) = Net Revenues / Stocks
Raw Material turnover = RM stock / RM consumptions *365
Finish Product turnover = FP stock / cost of goods sold *365
Days sales outstanding DSO= (receivables/(revenues*(1+VAT))*365
Days payables outstanding DPO= (payables/(purchases*(1+VAT))*365
NWC turnover = Revenues/NWC
FIXED asset turnover = Revenues/ Fixed Assets
Debt level = NFP/Equity
Debt incidence = NFP/(Equity+NFP)
NFP/EBITDA
Interest Coverage Ratio = EBIT / Interests
Debt Service Coverage Ratio = Cash Flow / (Loan payments+ loan interests)

Turnover index

Debt ratios

Financial statement analysis

Financial ratios

Turnover trend and margins

- ✓ A decrease registered for 2 or more consecutive years can suggest that a decline phase has started

Ebitda Margin

- ✓ Lower than direct competitors: the Company is less competitive and in the medium term it can led to a crisis state.

Financial Charges/Ebit

- ✓ Higher than 60-70%: results are vulnerable

Intangibles/Ebitda

- ✓ Higher than 4-5 times: difficulty to cover amortizations and impairment

ROI

- ✓ Less than 5-6% or lower than cost of debt: the financial leverage tend to be negative.

NFP/Ebitda

- ✓ More than 5 times: doubts about pay back capability

NFP/Equity

- ✓ Higher than 2 times: excessive debt dependence

Lesson 1 Summary

- 1 Financial Statement Structure
- 2 Financial Statement Analysis
- 3 Business Plan
 - Overview
 - Strategic Plan Process
 - Strategic Analysis
 - Assumptions
 - Financial Planning
 - Qualifications
 - Sensitivity analysis
 - Pre and Post Money
- 4 Company Financial Structure
- 5 M&A Transactions

Overview: aim and role

Business Plan Aim and Role

The Business Plan is an important tool for internal management and external analysis

What is a BP?

- It defines Company strategic plans
- It shows how the Company intends to pursue these plans
- It shows the consistency between results and assumptions

The BP is first of all an internal document necessary for management as it describes the business and the future plans, but it's also useful for external subjects.

Starting from the current company situation and from the present needs, document aim is to show Company's future evolution. Particular focus is given to business strengths, at the same time evidence of the weaknesses and the actions necessary to minimize them.

What's the aim of a BP?

- Internal management tool
- Banks
- Fund raising

The BP is always necessary in a fund raising situation: for banks in case of debt negotiation or re-negotiation; for grants by Public Authority; for financial and strategic investors in case of debt or equity investments.

Many holding companies request the annual preparation of BP to subsidiaries

Anyway the BP is first of all a fundamental instrument for internal management and planning

Overview: potential recipients

<u>Business Plan potential recipients</u>		
The BP must be able to meet the recipients' needs		
Recipient	Key question	Main topics
Internal Use	<ul style="list-style-type: none">• Strategies• Action plan• Goals• Need of changes• Performance monitoring• Need of external resources	The BP is a systematic instrument for business management and planning and for performances measurement. It allows to highlight company's needs in terms of financial resources, human resources, investments, etc..
Banks	<ul style="list-style-type: none">• Loan amount• Financing destination• Payback schedule• Capability of payment• Corporate reaction to extraordinary events• Available guarantees	Banks are mainly interested in the comprehension of business risks.
Private Equity and Stock Exchange	<ul style="list-style-type: none">• Amount of Investment• Destination of Investment/Financing• Return of Investment• Possible way-out	Investors are mainly interested in the comprehension of business outlooks, through the analysis of: <ul style="list-style-type: none">• Track record of the company, the management and the market,• Comprehension of outlooks rationality,• Key drivers for company success (in particular the management)• Clients (purchase criteria and future perspectives)

Business Plan

Strategic Plan Process

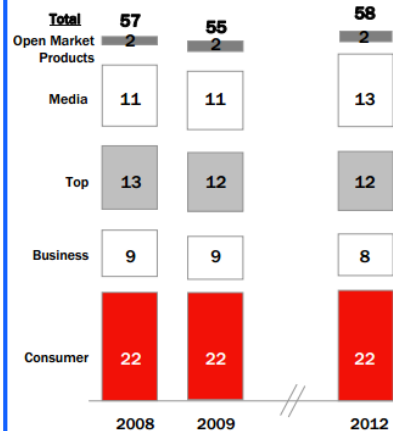


Business Plan

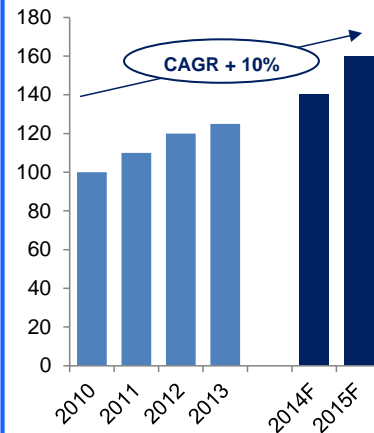
Strategic analysis: Market Analysis

Market analysis

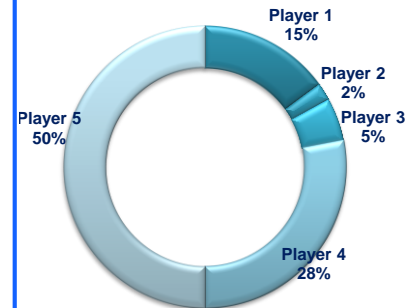
Market definition and dimensioning



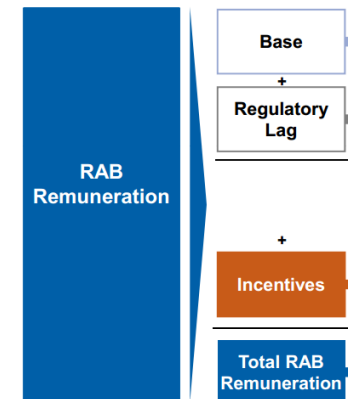
Trend analysis and key driver analysis



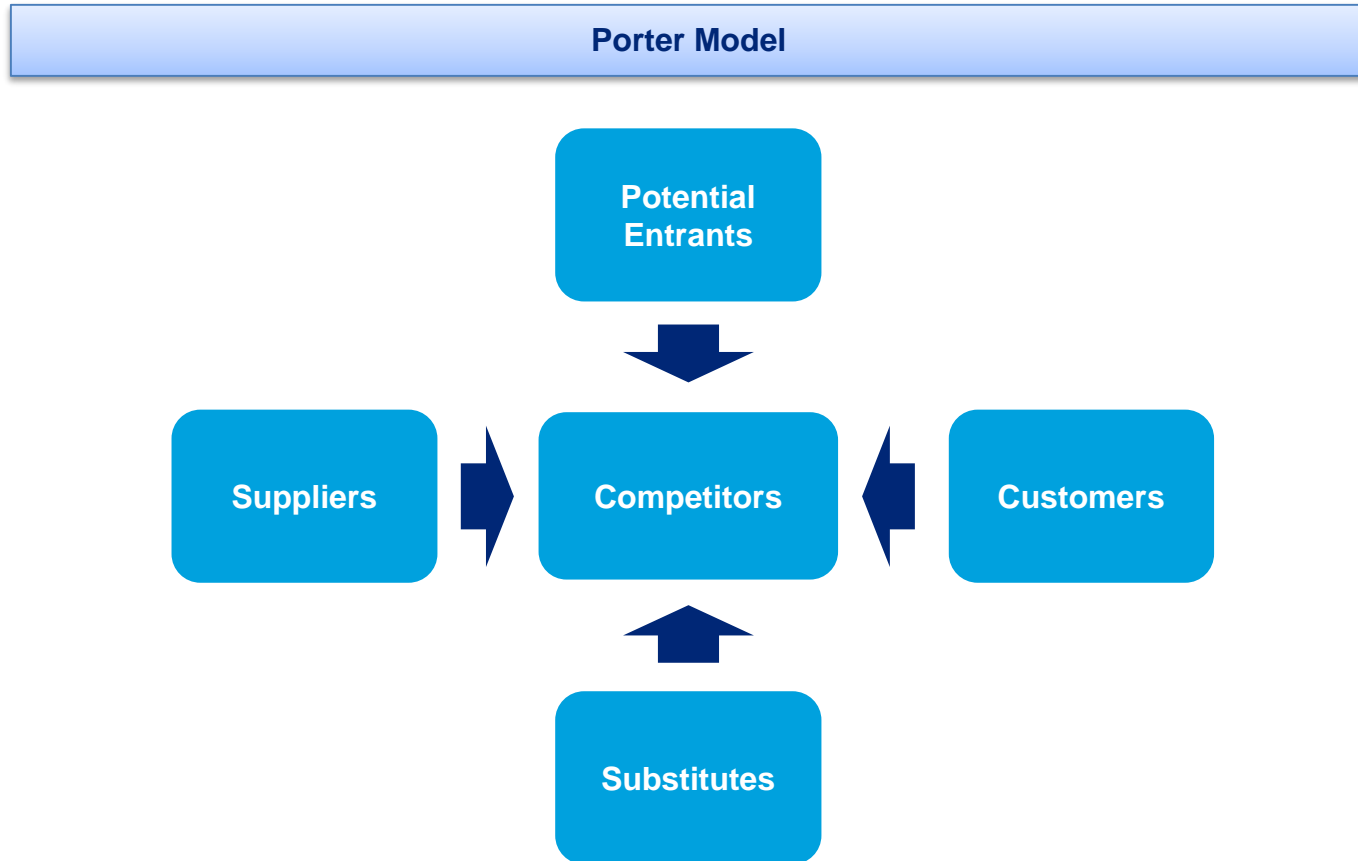
Concentration levels and trend



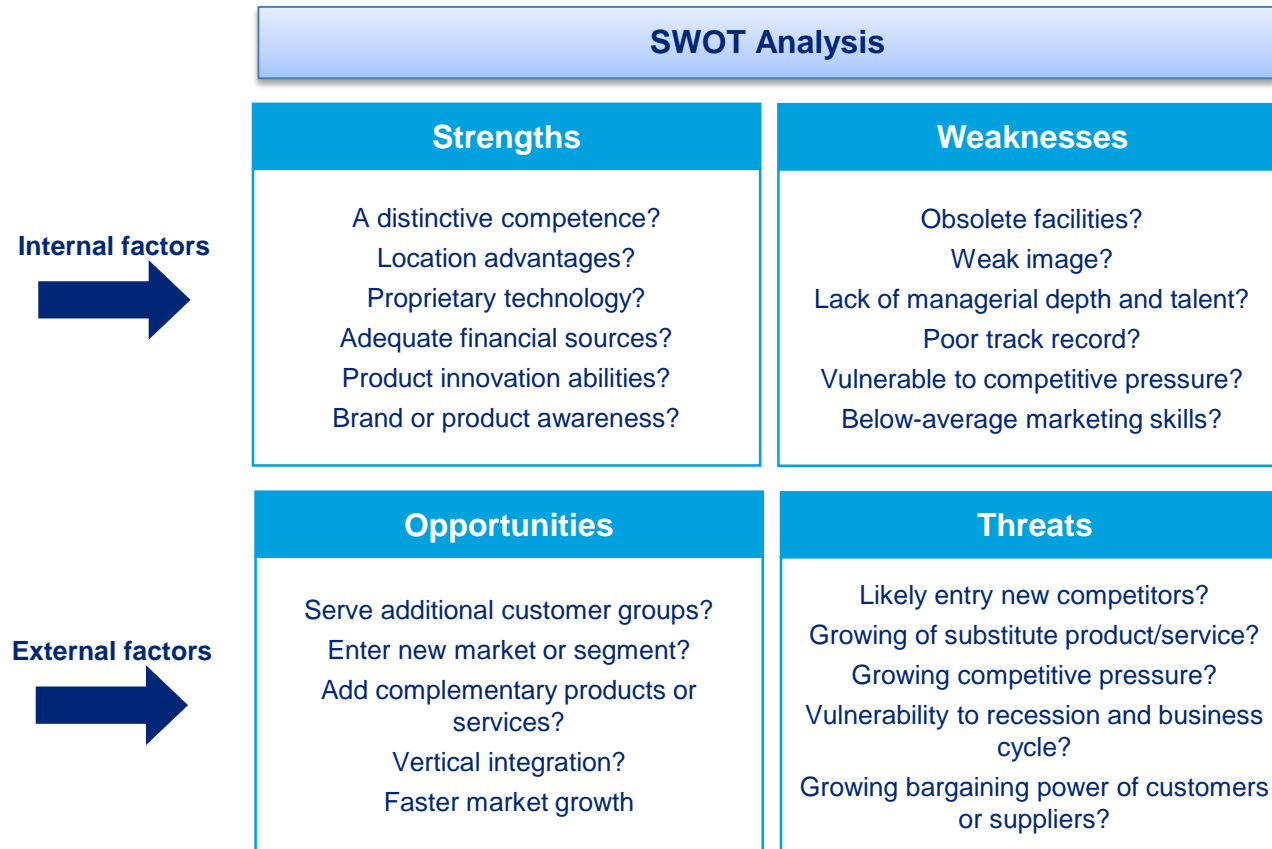
Regulatory aspects



Strategic analysis: Competitive scenario



Strategic analysis: Business Analysis



Business Plan

Action Plan

Action Plan

All the action which permits the realization of the strategic aims, with specification of the impact in financial terms and the estimated timetable for the implementation

Investments

- ❖ Indication about:
 - the sum total,
 - the type,
 - timetable

Organizational impact

- ❖ In terms of:
 - Business Model
 - Managerial structure
 - Corporate workforce
 - Geographic areas to be covered
 - Distribution channels and commercial structure

Portfolio

- ❖ Any measures on products/services/brand portfolio

Customer target

- ❖ The action by means of which one intends to create a possible variation of the customer target to serve.

Manager responsibility

- ❖ The system of responsibility or rather indication of the managers responsible for the scheduled action

Restrictions

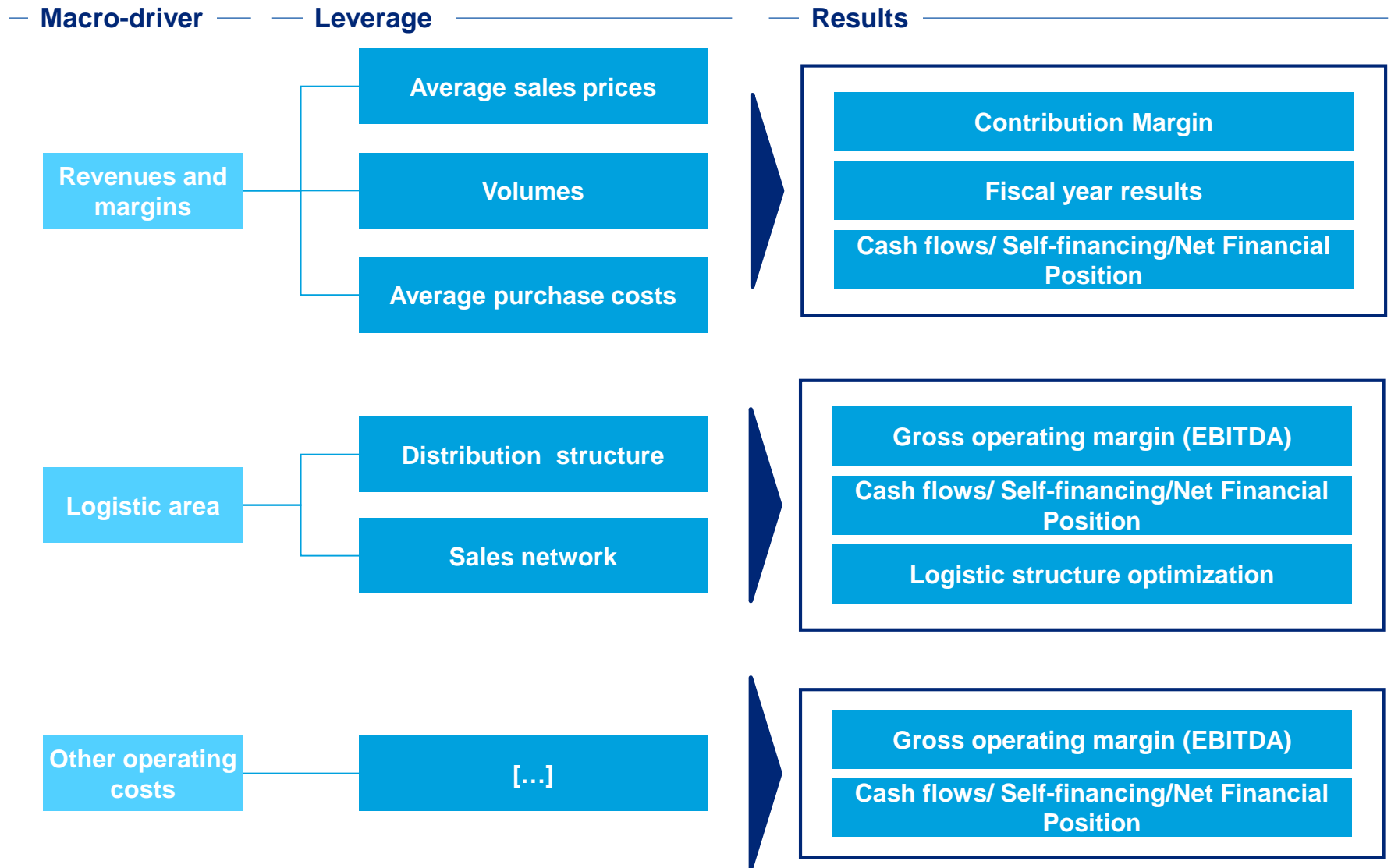
- ❖ The conditions/restrictions which may influence the possibility of accomplishing the action.



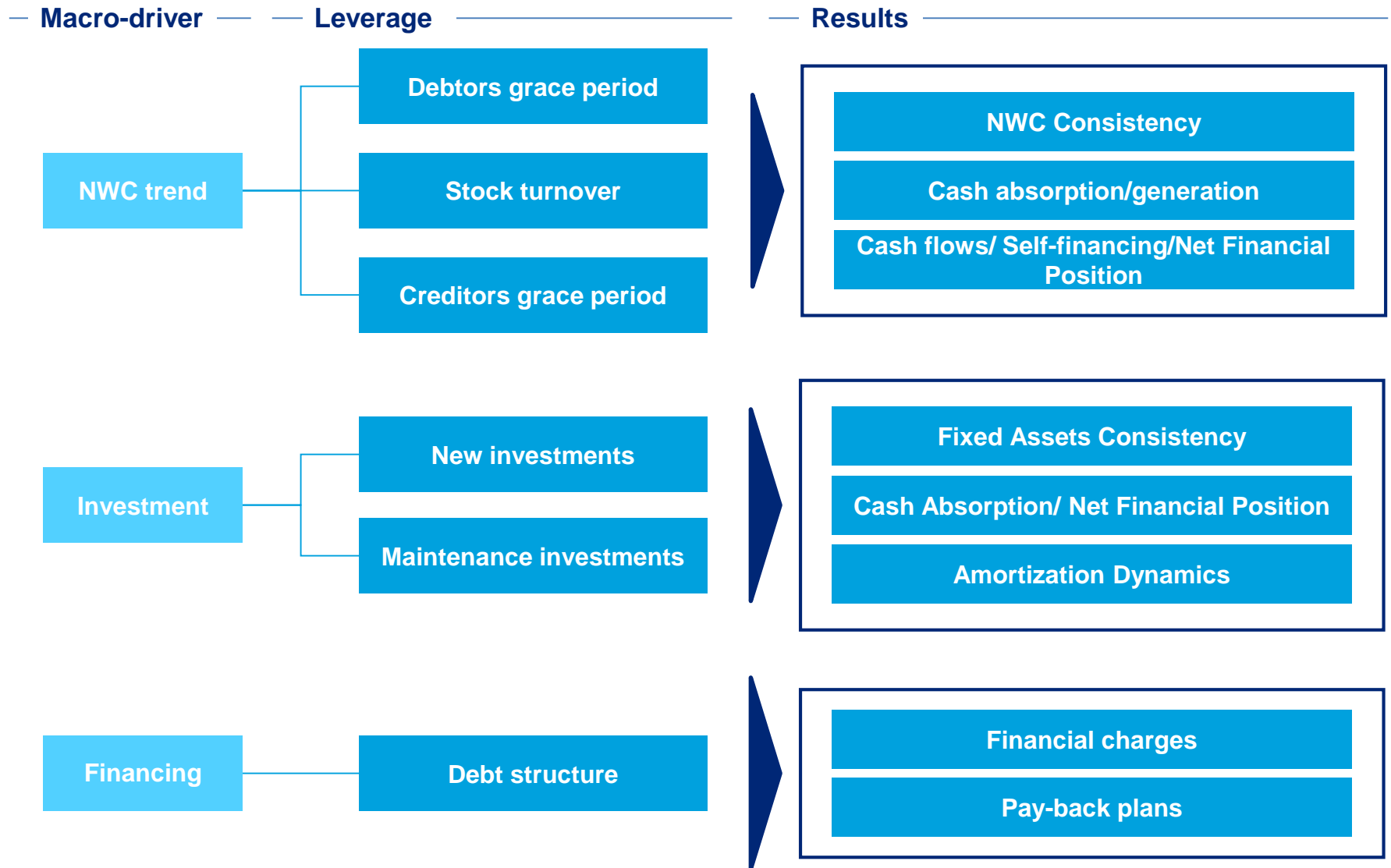
<u>Strategic Aim</u>	<u>Action</u>	<u>Timetable</u>	<u>Cost reduction</u>	<u>Responsibility</u>
Reducing operating costs	Reduction of production workforce by 40 units	June 2015	1.000	Operation manager
	Replacement and reduction of suppliers	March 2015	3.000	
	Rationalization of logistic flow	October 2015	2.000	
	Internalization of plant maintenance and employment of specialized staff	June 2015	1.000	

Business Plan

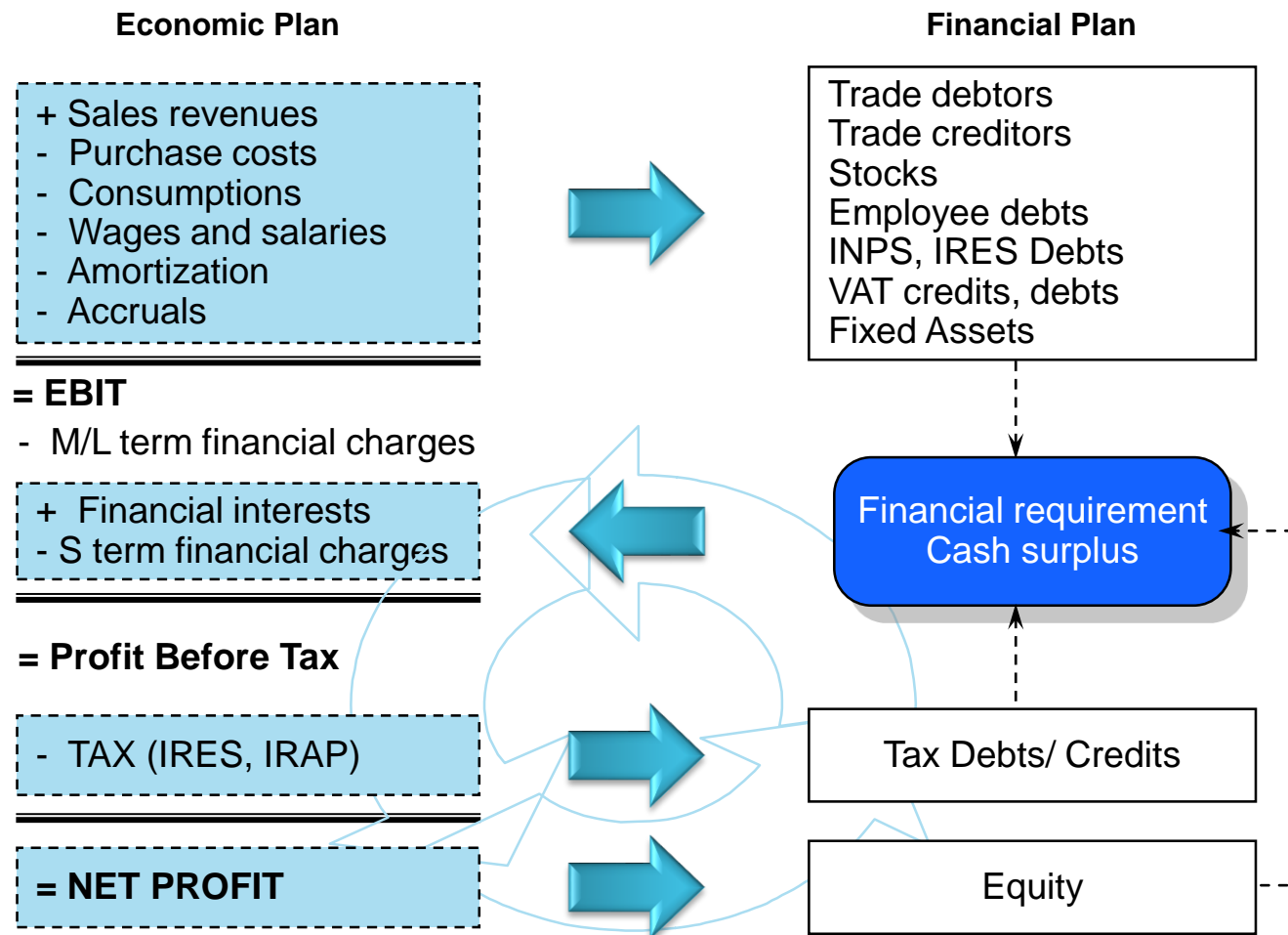
Assumptions: Economic Plan



Assumptions: Financial Plan

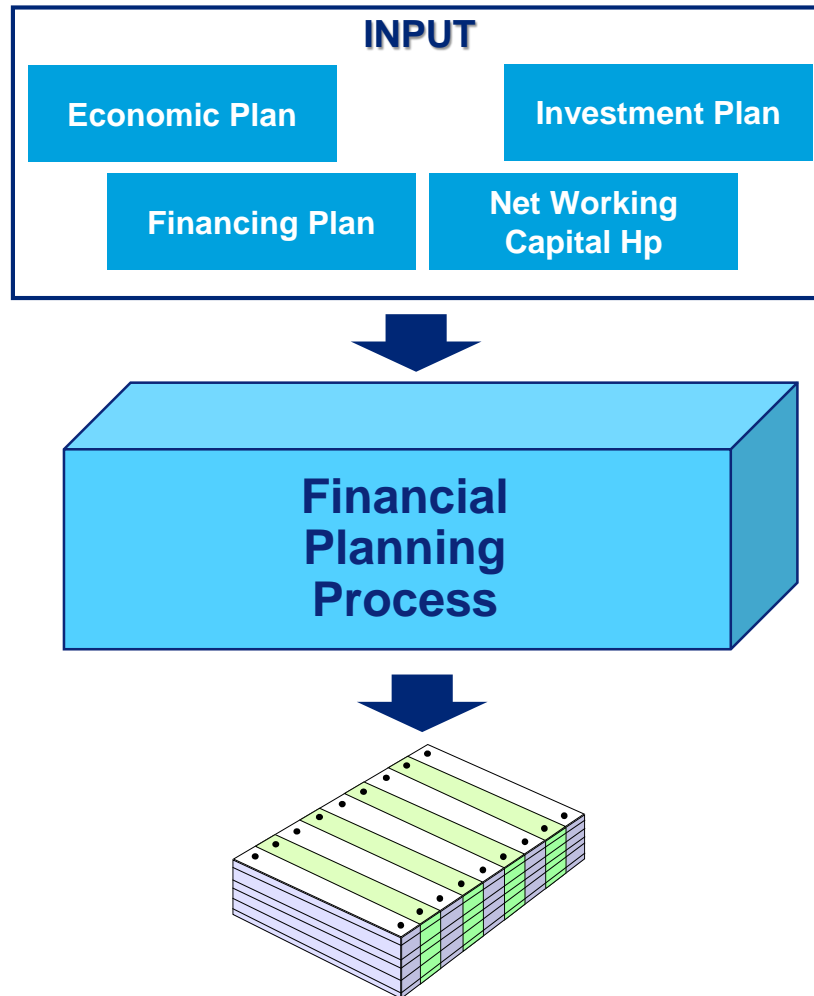


Connections Economic Plan – Financial Plan



Business Plan

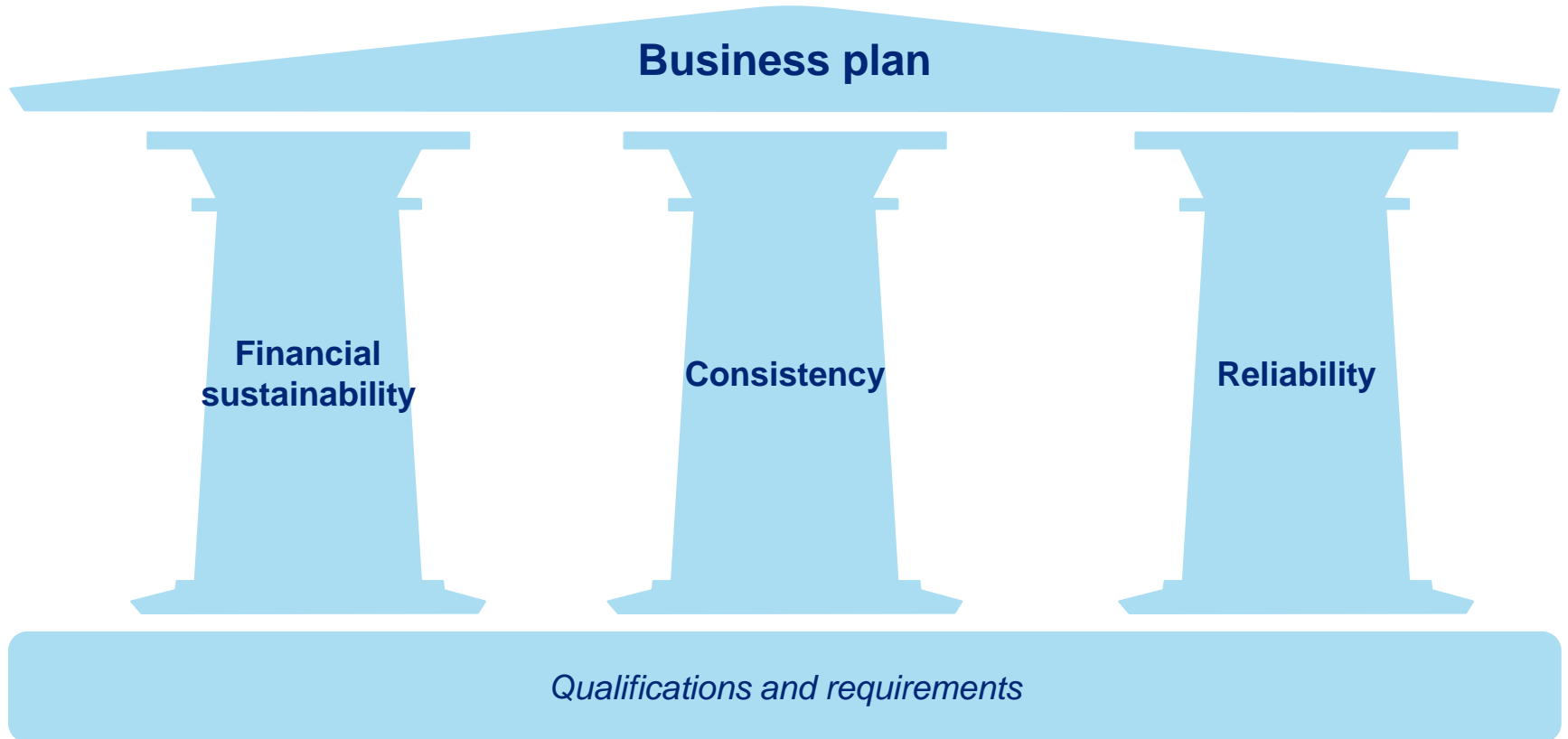
Financial Planning



Economic – Financial Plan

- The information needed depend on BP purpose
- However it's possible to identify a minimum set of input
 - ❧ **Economic plan up to EBITDA**
 - ❧ **Fixed Assets amortization plan**
 - ❧ **Investments and divestments plan**
 - ❧ **Long term financing amortization plan**
 - ❧ **Net working Capital elements**
- Input depending on Business Plan's purpose:
 - ❧ NEW long term financing plan
 - ❧ Dividend distribution hypothesis
 - ❧ Way-out hypothesis
 - ❧ Detail information

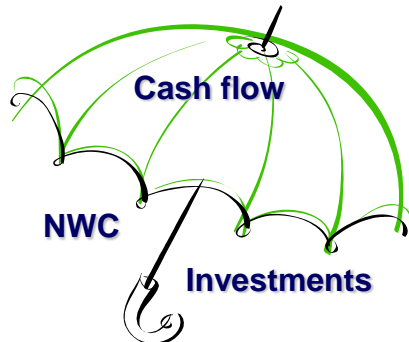
Business Plan Qualifications





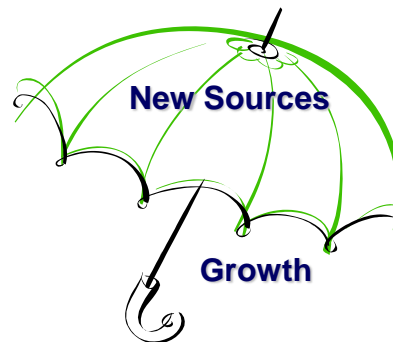
Financial sustainability

1.



Cash flow sufficient to cover NWC needs and net maintenance/replacement investments

2.



The recourse to new sources (Debt and Equity) should be finalized to cover financial needs relative to growth

3.



Balance between type of sources and investments

4.

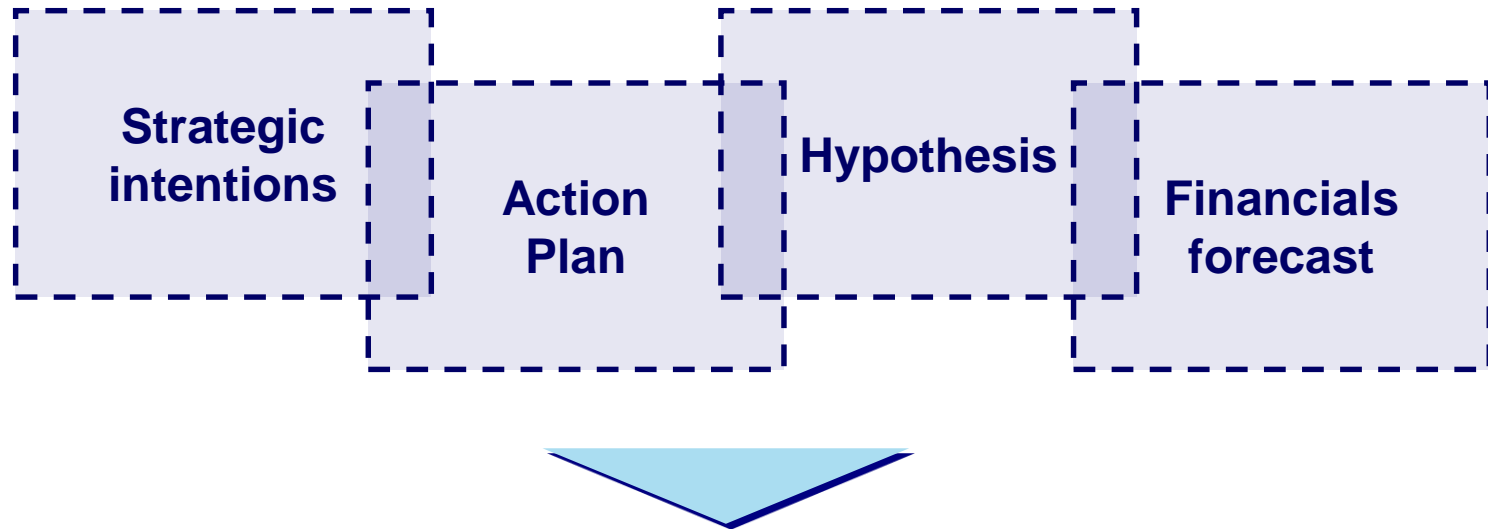


Debt consistent with company's reimbursement capability (D/E, DSCR, risk profile)

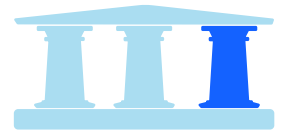


Consistency

This requisite relates to an “internal” dimension of the plan and materializes where all the aspects are consistent with one another



Compatibility between strategic choices, action plans, timetable and future available sources (human, organizational, technological and financial)



Reliability

Compatibility with the dynamics of the competitive context

Compatibility with the historical results
(growth rate, NWC trend, efficiency improvement perspectives...)

Visibility of the forecast data

Sensitivity analysis
(test different scenarios)

Business Plan

Sensitivity analysis

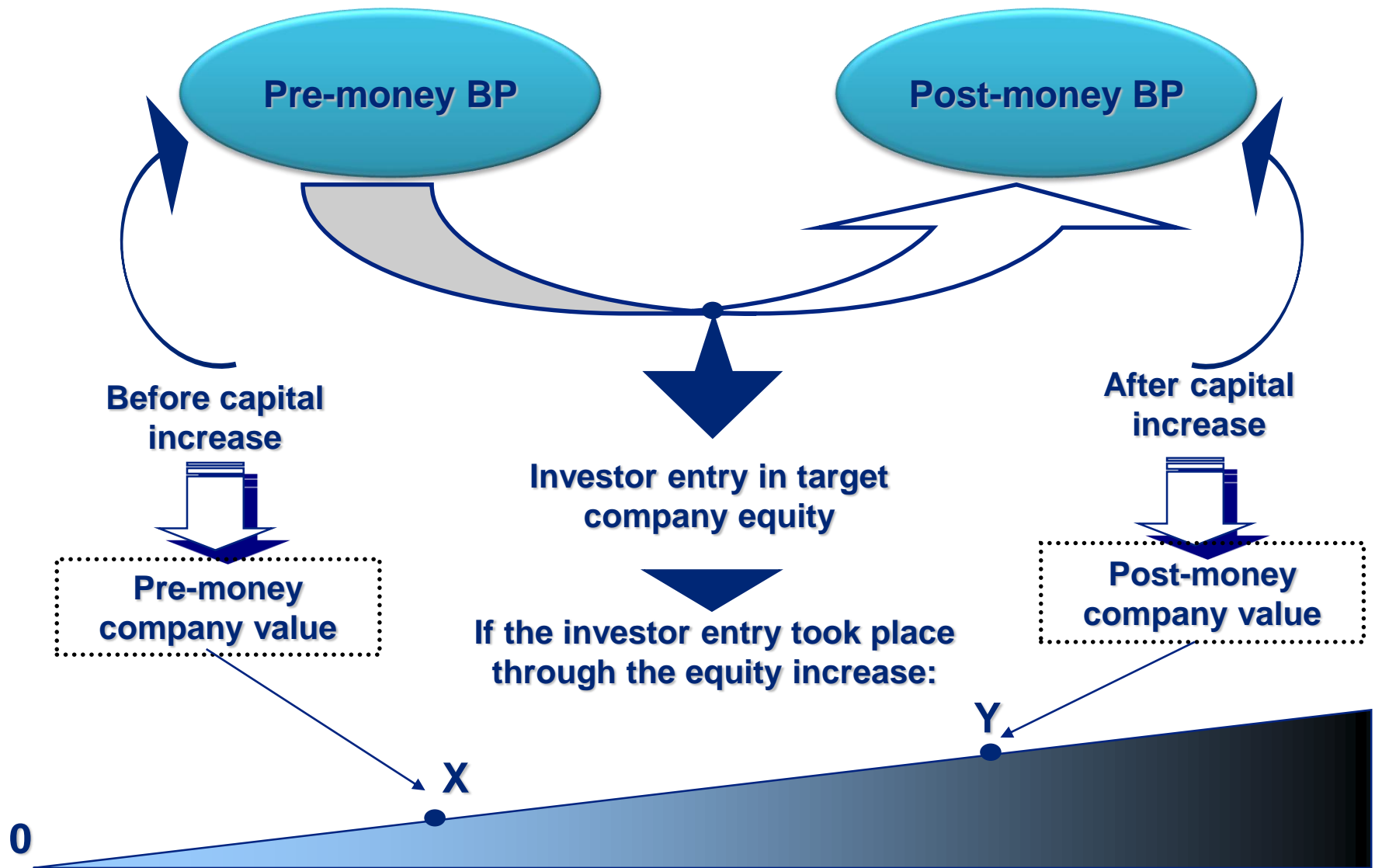
<u>Sensitivity analysis</u>	
To concentrate the sensitivity analysis on:	<ul style="list-style-type: none">❖ the main key value drivers,❖ the most significant external sector-based variables,❖ the most relevant implementation actions❖ the possible integration of the companies recently acquired
The sensitivity analysis should be presented with respect to:	<ul style="list-style-type: none">❖ more optimist scenarios❖ more pessimistic scenarios
Demonstrating the effect on:	<ul style="list-style-type: none">❖ main economic data (for example: sales revenue, operating margin, net profit)❖ main financial data (for example: net financial position, investments)
The simulations will have	<ul style="list-style-type: none">❖ to be supported by detailed and justifiable theories❖ the results will have to be comparable in terms of parameters/indexes utilized.

AIM:

Demonstrate economical and financial sustainability even in less probable, but possible, scenarios

Business Plan

Pre and Post Money



Lesson 1 Summary

- 1 Financial Statement Structure
- 2 Financial Statement Analysis
- 3 Business Plan
- 4 Company Financial Structure
 - Financing sources
 - Risks and performances
 - Financing sources: Company life cycle
- 5 M&A Transactions

Company Financial Structure

Financing sources

Financial sources used for financing company's activity can be classify in respect to

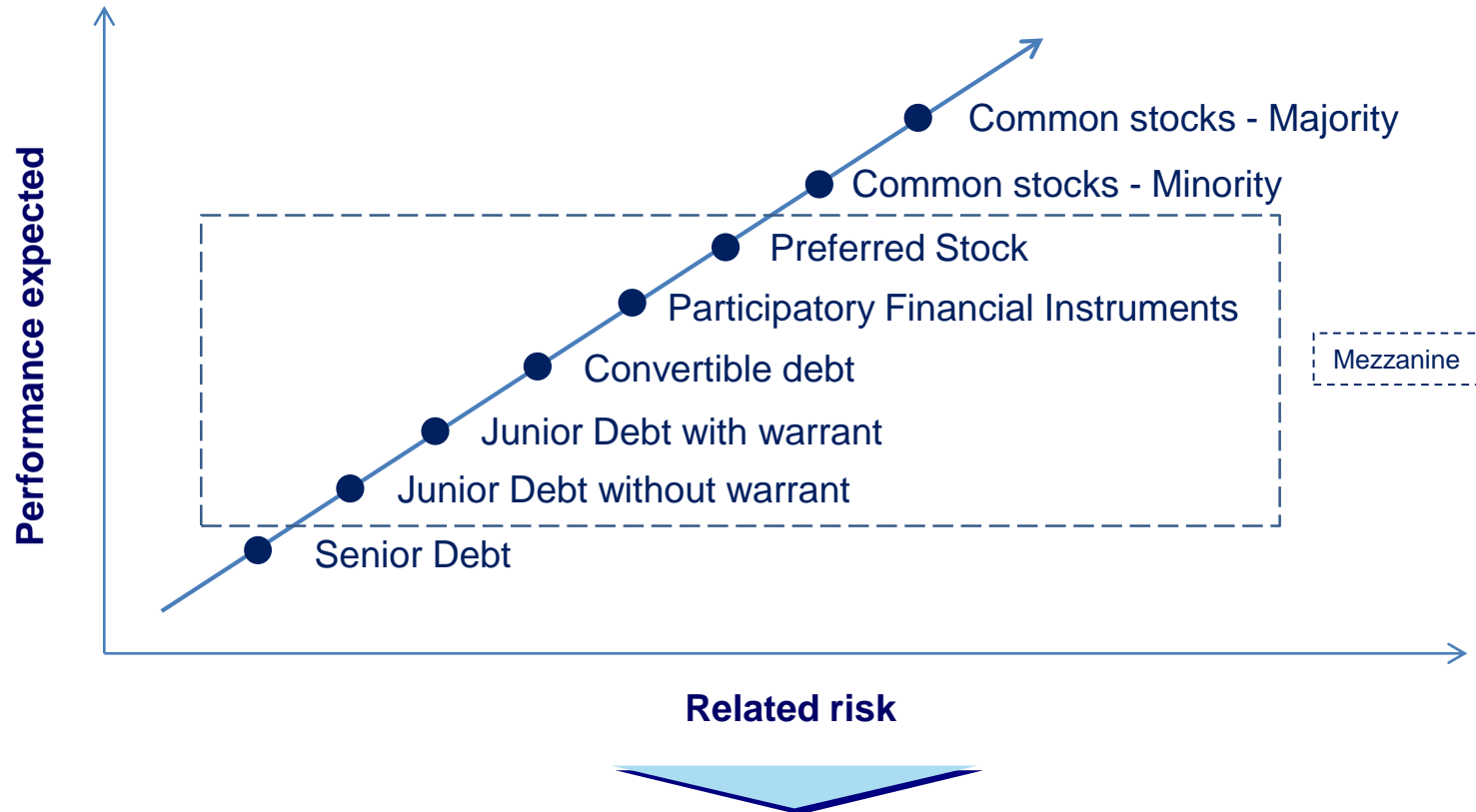
- ✓ the nature of the financing tool;
- ✓ the nature of the financier



Company Financial Structure

Financing sources

Different financing tools have different risk-performance relationship.



A company chooses the best mix related to its status and needs.

Company Financial Structure

Risk and performance

Senior debt

- ❖ Cheapest and main source of finance
- ❖ Secured and usually unrated

Repayment	<ul style="list-style-type: none">• Term loans with fixed repayment schedule
Tenor	<ul style="list-style-type: none">• 6 years or less (amortization gives a 3-4 year average life)
Interest rate	<ul style="list-style-type: none">• EURIBOR +2 to 4% but it depends on country and risk
Mid market leverage multiple	<ul style="list-style-type: none">• 3.4x EBITDA (Thomson Reuters)
Lender	<ul style="list-style-type: none">• Mainly banks
Structure	<ul style="list-style-type: none">• Senior tranches often structured as two or more tranches (A, B, C and sometimes D)
Use	<ul style="list-style-type: none">• Revolving loans can be used for cyclical firms

Company Financial Structure

Risk and performance

Mini Bond

- ❖ Term is used to refer to debt securities (bonds) made easier due to package of reforms introduced by Decreto Sviluppo, Decreto Sviluppo bis and Decreto Destinazione Italia.
- ❖ Aim is to facilitate access by small and medium sized companies (SMEs) and unlisted companies to capital markets as alternative method of funding and thereby encouraging economic growth.
- ❖ Main effect of the reform is a reduction of legal and tax restrictions if the securities are traded on a regulated market or multilateral trading facility such ExtraMOT Pro.
 - Withholding Tax: issuer no longer required to apply 20% withholding tax on interest;
 - Deductibility of Interest
 - Deductibility of costs of issuance
 - Disapplication of limit of no more than twice the aggregate of a company's equity

Repayment

- Term loans with fixed repayment schedule

Tenor

- 3-7 years (amortizing or bullet repayment)

Interest rate

- average 6-7% but it depends on company and risk

Lender

- Professional investors

Company Financial Structure

Risk and performance

Junior debt

- ❖ Subordinated to senior debt on interest and capital. Subordination can be achieved:
 - Contractual via an inter creditor agreement
 - Structural – a creditor lend or invest in a company through a holding company
- ❖ The cost is higher than senior debt because of poor quality security
- ❖ Secured by: second charge on fixed assets, subordinated to senior debt, based on excess cash flow

Tenor	• 5-10 years
Interest rate	• cash coupon of EURIBOR +3% - 7%, with target IRR of 15% - 25%
Mid market leverage multiple	• 1.3x EBITDA (Thomson Reuters)
Lender	• Professional investors and seller

Company Financial Structure

Risk and performance

Mezzanine debt

- ❖ Financing source between a company's senior debt and equity: subordinate in priority of payment to senior debt, but senior in rank to common stock or equity.
- ❖ More expensive than senior debt but less rigid
- ❖ Secured by a second or third charge on assets
- ❖ Target lower interest rate with participation in equity or performance: warrants, payments linked to performance

Repayment	<ul style="list-style-type: none"> • Bullet payment
Tenor	<ul style="list-style-type: none"> • 8-10 years
Interest rate	<ul style="list-style-type: none"> • EURIBOR + 7% to 11% and some maybe rolled up into a PIK contract
Mid market leverage multiple	<ul style="list-style-type: none"> • 3.4x EBITDA (Thomson Reuters)
Lender	<ul style="list-style-type: none"> • Professional investors

Payment In Kind

- Non standard hybrid instrument
- Total return target of 20-25% IRR in two parts
 - ✓ contractual return (semi annual accretion)
 - ✓ warrants
- Usually structurally subordinated to debt
- Some prepayment restrictions

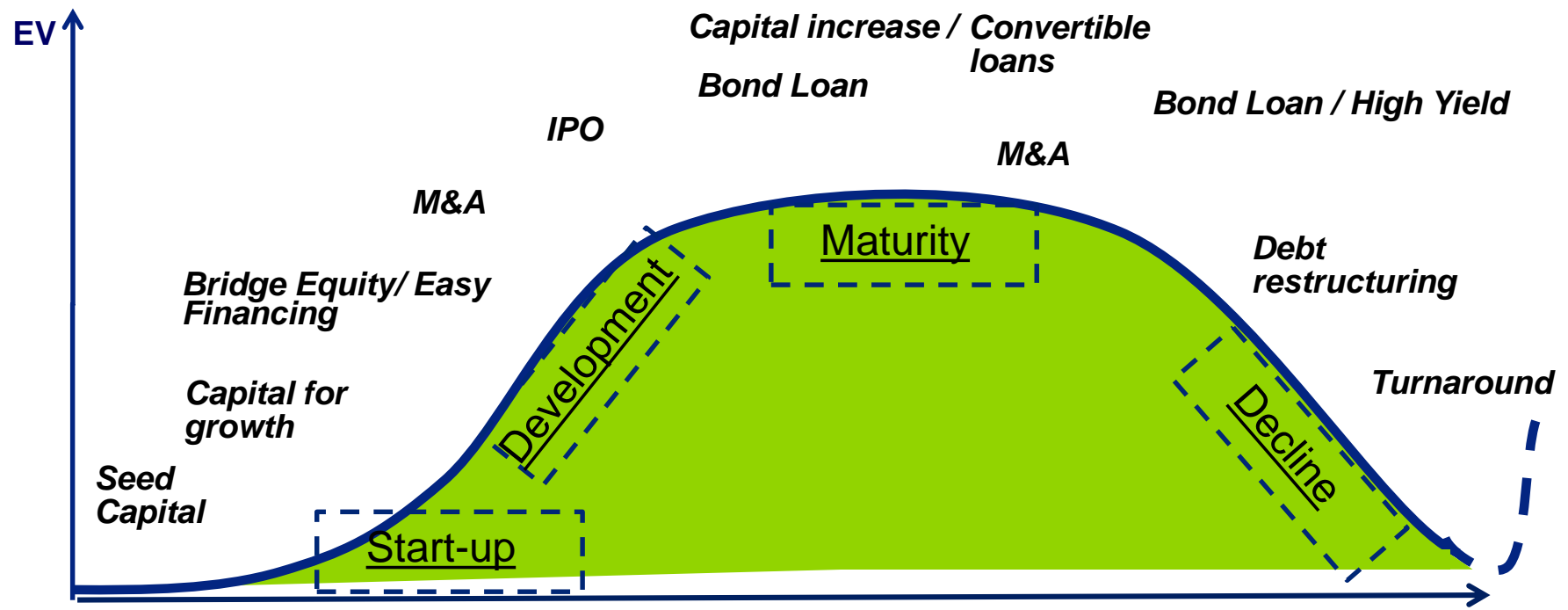
Company Financial Structure

Risk and performance

<u>Equity</u>	
Shareholders	<ul style="list-style-type: none">• Equity increase by existing shareholders
Stock Exchange	<ul style="list-style-type: none">• Listed in MTA, Star segment and AIM
Private Equity	<ul style="list-style-type: none">• Equity increase by financial investors
Venture capital	<ul style="list-style-type: none">• Financing for start-up companies or companies with a high risk profile that offer the potential for above average future profits.

Financing sources: Company life cycle

In relation to Company's life cycle phase there are typical extraordinary transactions



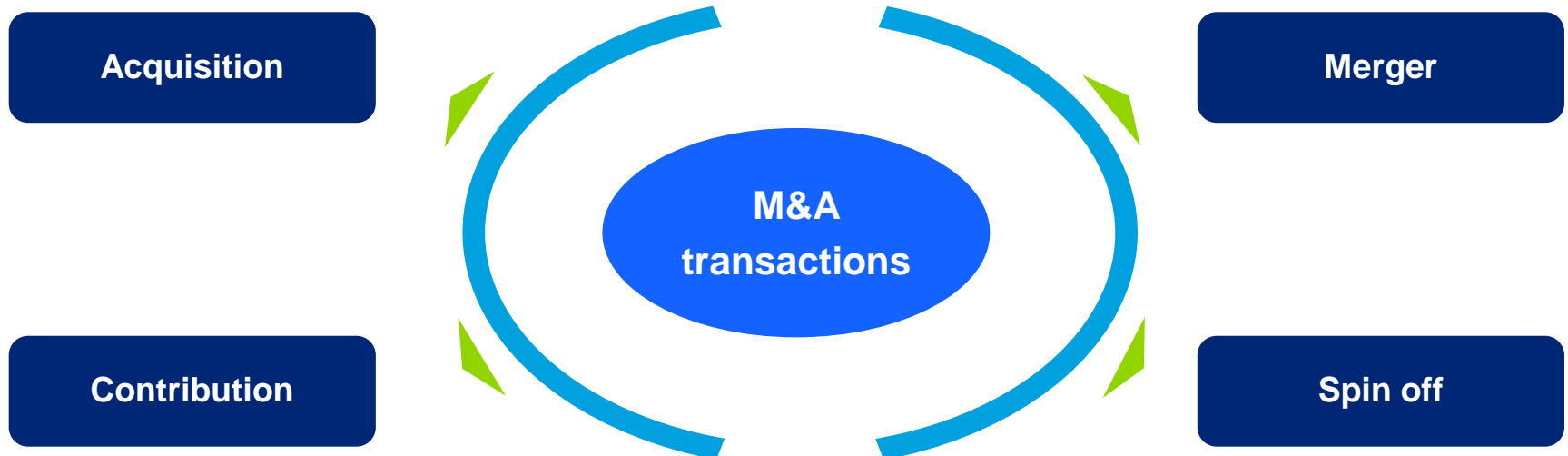
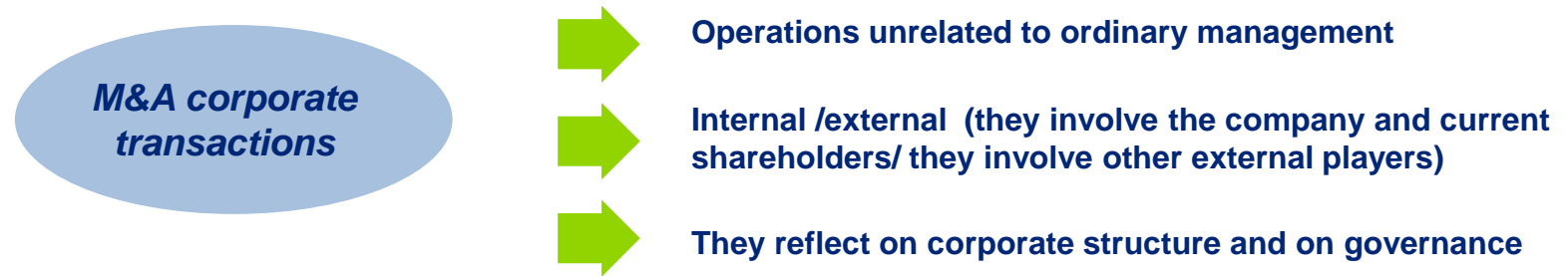
Lesson 1 Summary

- 1 Financial Statement Structure
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- 5 M&A Transactions
 - The role of corporate finance in M&A transaction
 - Acquisition
 - Contribution
 - Merger
 - Spin off

M&A transactions

The role of corporate finance in M&A transaction

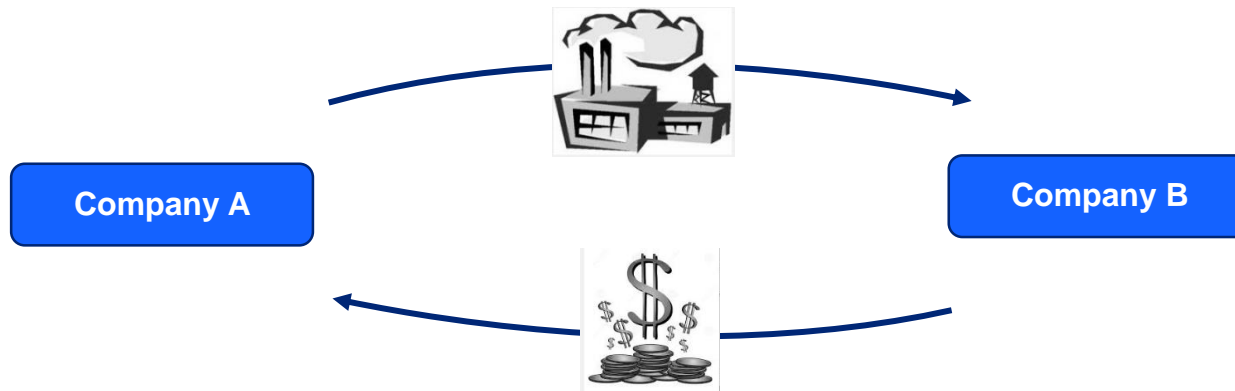
An extraordinary corporate transaction represents an important discontinuity phase during a company life cycle. It's aimed at supporting the operating growth path, with the objective of creating value.



M&A transactions

Acquisition

The Acquisition is the operation through which a subject buys the ownership of a company, or a line of business, in order to assume the control.



Legislation

- ✓ **Art 2556 – 2560 Italian Civil Code**
- ✓ Attention to staff debts and fiscal debts (D.lgs 472/1997)

M&A transactions

Acquisition: accounting implications

Accounting implications

Before Acquisition

Seller Balance Sheet

Assets	1000	Equity	100
		Debt	900

Buyer Balance Sheet

Cash	1000	Equity	1000
------	------	--------	------

After Acquisition

Seller Balance Sheet

Assets	1000	Equity	100
Cash	200	Debt	900
		Capital Gain	100

Buyer Balance Sheet

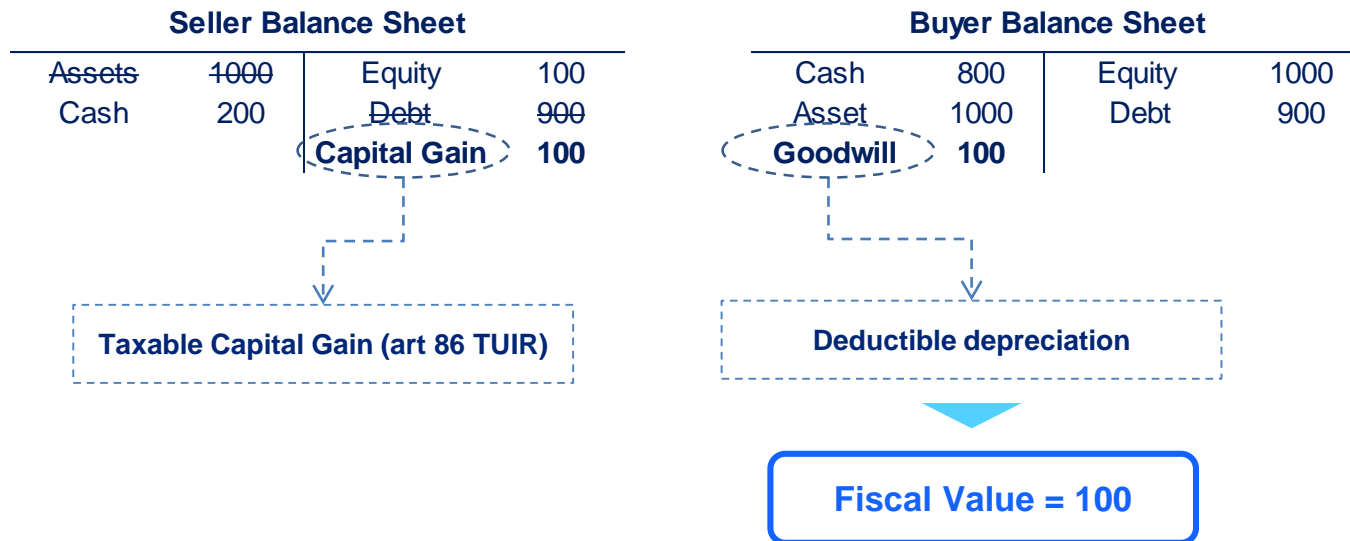
Cash	800	Equity	1000
Asset	1000	Debt	900
Goodwill	100		

Economic Value of Acquisition = 200

Notes: assumption that historical values are equal to fiscal values

M&A transactions

Acquisition: tax implications

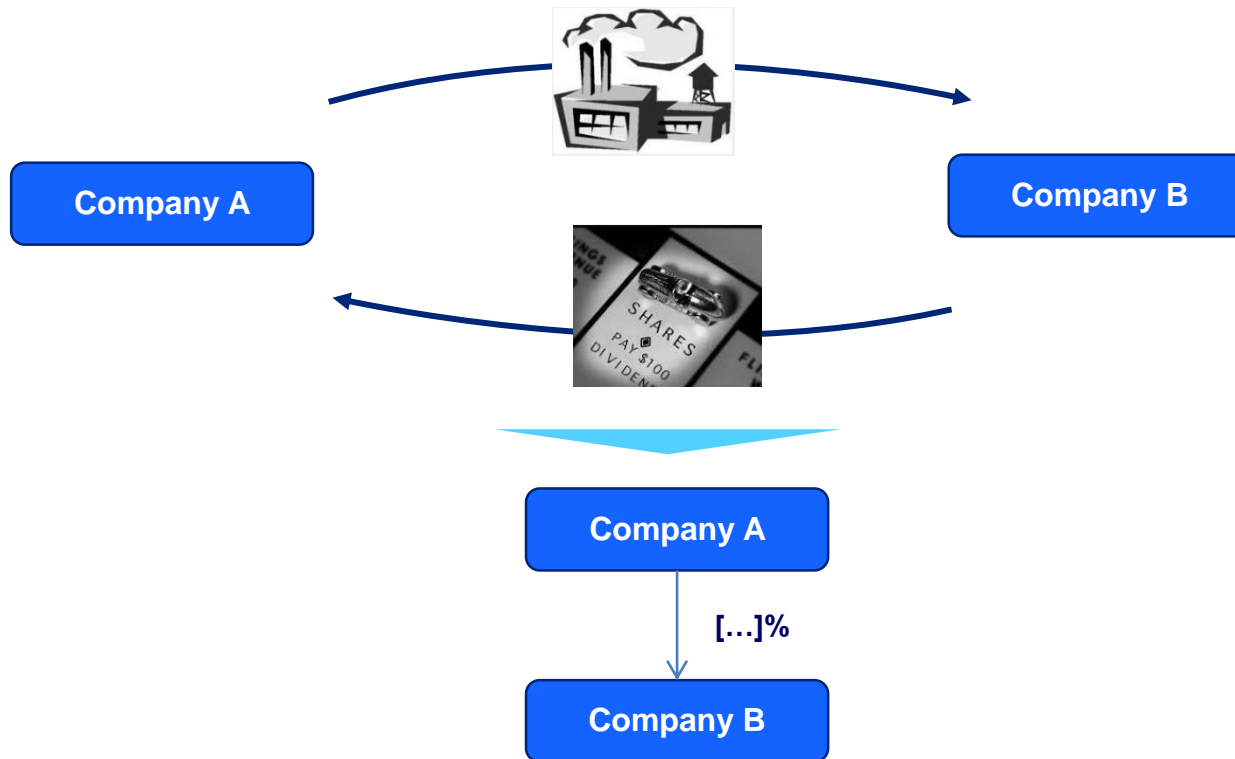


Acquisition operation is subject to registration fee on the basis of acquired asset type (eg. 3% goodwill, 9% property, etc.)

M&A transactions

Contribution

The contribution consists of a transfer of a company or a line of business to another company receiving as offset stocks of this last



Legislation

- ✓ **Art. 2342, 2343, 2440 Italian Civil Code: S.p.A.**
- ✓ **Art. 2464, 2465 Italian Civil Code: S.r.l.**
- ✓ The operation of contribution requires an estimate survey by an accounting expert

Contribution: accounting implications

Accounting implications

Historical values

Current values

Substitutive
regime

Neutral regime

Historical values: The conferrer accounts the shares at historical values, writing off assets and liabilities object of contribution

- No capital gain
- No goodwill

Situation Ante contribution

Assets	100	Equity	100
--------	-----	--------	-----

Conferrer post contribution

Shares	100	Equity	100
--------	-----	--------	-----

Beneficiary post contribution

Assets	100	Equity	100
--------	-----	--------	-----

Notes: assumption that historical values are equal to fiscal values

Contribution: accounting implications

Accounting implications

Current values – Substitute Regime: the conferrer accounts the received shares in exchange for the contribution at the survey value and writes off all the assets and liabilities object of contribution.

- The capital gain can be submitted to substitute regime.
- The beneficiary accounts the value of contribution dividing it into all the assets and liabilities included goodwill.

Company A ante contribution

Assets	100	Equity	100
--------	-----	--------	-----

Company B post contribution

Shares	150	Equity	100
		Capital Gain	43
		Tax debt	7

Beneficiary post contribution

Assets	100	Equity	150
Goodwill	50		

Economic Value = 150

Current values – Neutral Regime: the conferrer accounts the shares received in exchange for the contribution at the survey value and writes off all the assets and liabilities object of contribution. The survey values affects only for accounting and not for tax purpose. In fact for tax purpose affects only historical values.

- The capital gain accounts only for accounting (Income Statement E20), and it will not be taxed
- In the conferee accounts only historical values affects for tax purpose.

Company A ante contribution

Assets	100	Equity	100
--------	-----	--------	-----

Company B post contribution

Shares	150	Equity	100
		Capital Gain	50

Beneficiary post contribution

Assets	100	Equity	150
Goodwill	50		

Economic Value = 150

M&A transactions

Contribution: tax implications

Substitutive regime:
Fiscal value relevant (Tax
from 12% to 16%)

Company B post contribution			
Shares	150	Equity	100
		Capital Gain	43
		Tax debt	7

Diagram showing the flow of values:

- Shares (150) → Fiscal value 150
- Capital Gain (43) → Tax relevant
- Tax debt (7) → Tax relevant

Beneficiary post contribution			
Assets	100	Equity	150
Goodwill	50		

Diagram showing the flow of values:

- Goodwill (50) → Deductible depreciation

Neutral regime:
Fiscal value not relevant

Company B post contribution			
Shares	150	Equity	100
		Capital Gain	50

Diagram showing the flow of values:

- Shares (150) → Fiscal value 100
- Capital Gain (50) → No fiscal relevance

Beneficiary post contribution			
Assets	100	Equity	150
Goodwill	50		

Diagram showing the flow of values:

- Goodwill (50) → No fiscal relevance

Contribution operation is subject to fixed registration fee of 200€ and fixed mortgage tax of 200€

M&A transactions

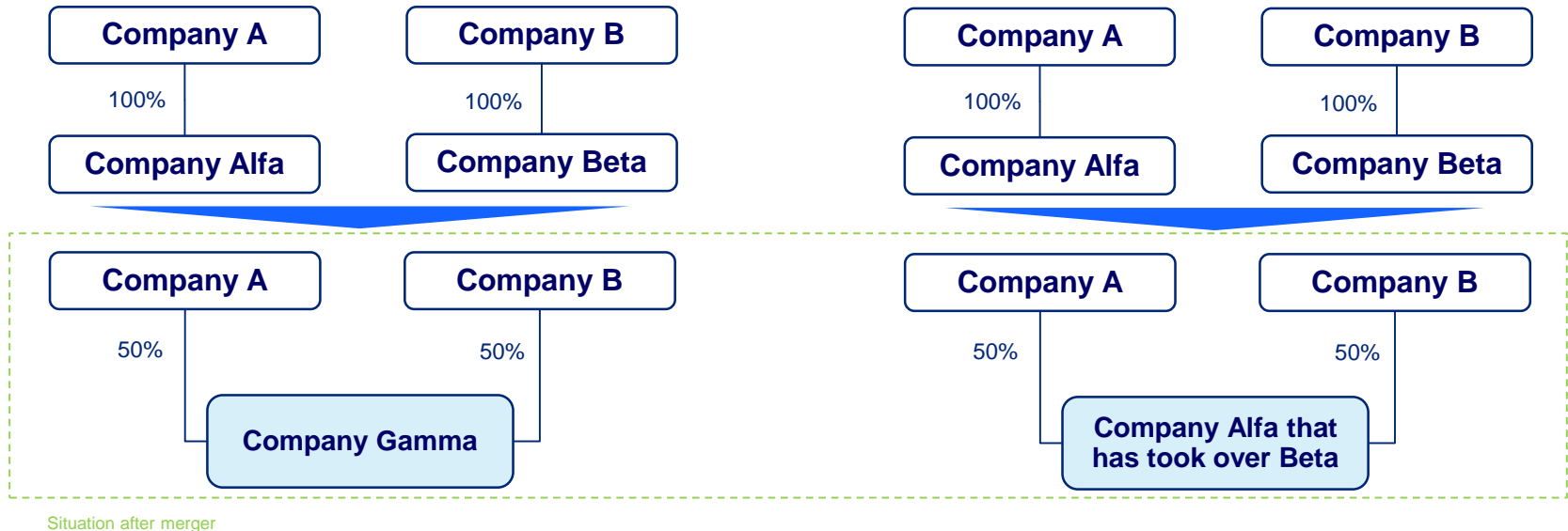
Merger

Statutory merger

- ✓ Two or more companies merge their capital in a brand new company.

Improper merger

- ✓ Combination of two or more companies, where a company incorporates the capital of the combining companies.



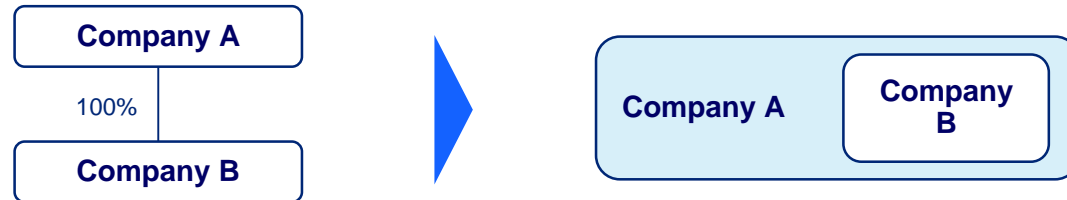
Legislation

- ✓ Art 2501 to 2504 Italian Civil Code

Merger: accounting implications

Accounting implications

Annulment GAP



Deficit GAP

A Before merger

Stock in B	100	Equity	100
------------	-----	--------	-----

B Before merger

Assets	50	Equity	50
--------	----	--------	----

A After merger

Assets	50	Equity	100
Annulment GAP	50		

It amounts to the positive difference between the value of the share merged and the value of B equity

Surplus GAP

A Before merger

Stock in B	100	Equity	100
------------	-----	--------	-----

B Before merger

Assets	150	Equity	150
--------	-----	--------	-----

A After merger

Assets	150	Equity	100
		Annulment GAP	50

It amounts to the negative difference between the value of the stock merged and B equity

Accounting implications

SWAP GAP

Company A

Company B

Company A

Company B

Deficit GAP

A Before merger

Assets	100	Equity	100
--------	-----	--------	-----

HP: economic value 100

B Before merger

Assets	50	Equity	50
--------	----	--------	----

HP: economic value 100

A After merger

Assets	150	Equity	100
SWAP GAP	50	Stock increase	100

It amounts to the positive difference between the stock increase and B equity (economic value > historical value)

Surplus GAP

A Before merger

Stock in B	100	Equity	100
------------	-----	--------	-----

HP: economic value 100

B Before merger

Assets	150	Equity	150
--------	-----	--------	-----

HP: economic value 100

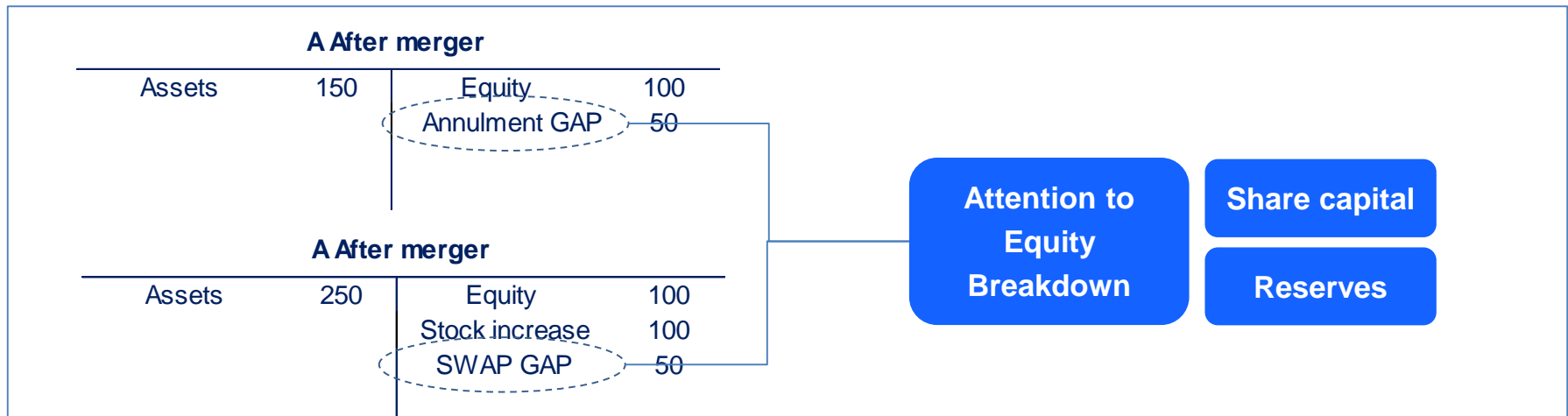
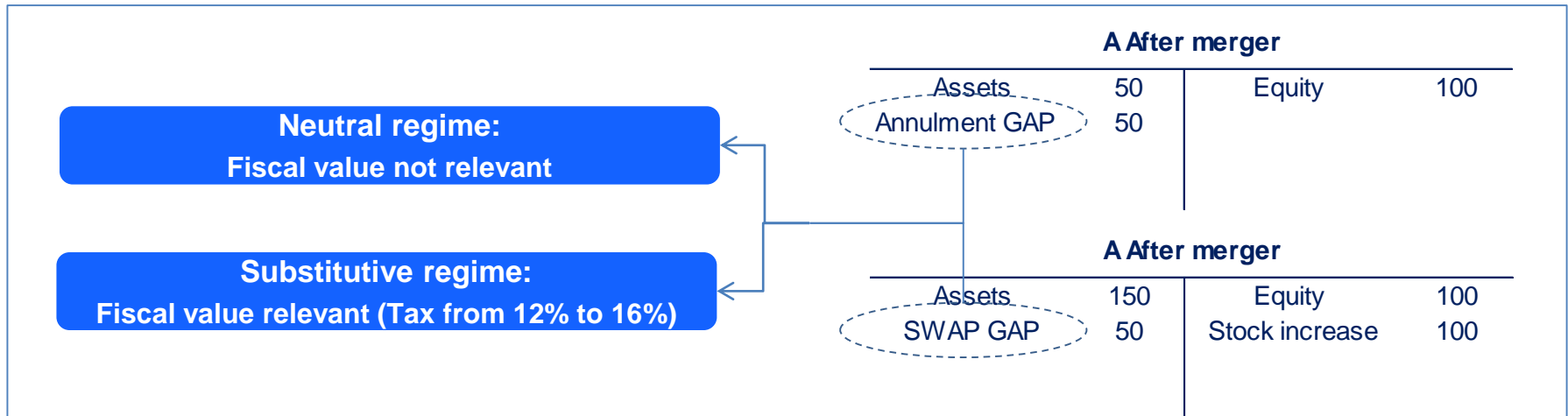
A After merger

Assets	250	Equity	100
		Stock-increase	100
		SWAP GAP	50

It amounts to the negative difference between the stock increase and B equity (economic value < historical value)

M&A transactions

Merger: tax implications



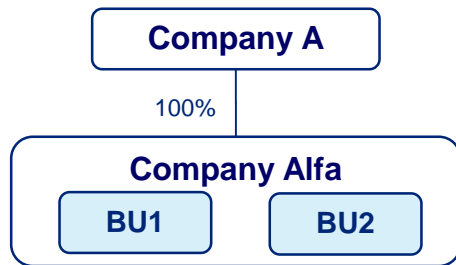
Merger operation is subject to fixed registration fee of 200€ and fixed mortgage tax of 200€

M&A transactions

Spin off

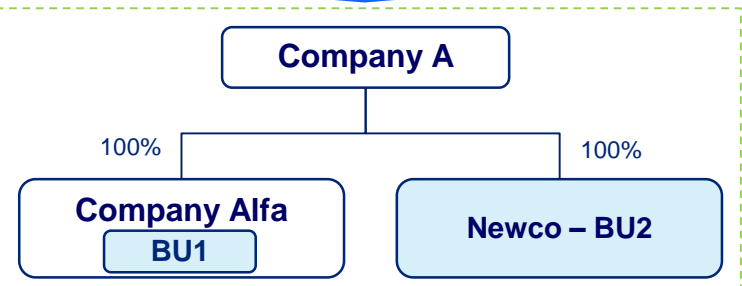
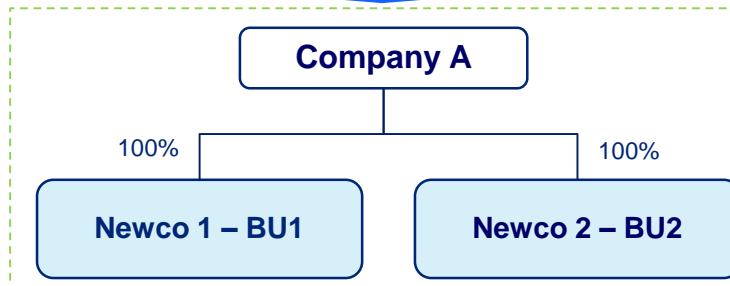
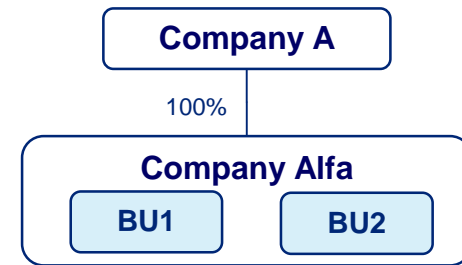
Total spin off

- ✓ Corporate divestiture that results in two or more new/existing companies



Partial spin off

- ✓ Corporate divestiture that results in two or more companies, but the parent company continues its activity



Legislation

- ✓ Art 2506 CC

Spin off: accounting implications

Accounting implications

Annulment GAP



Deficit GAP

A Company

BU 1	100	Equity	250
BU 2	150		

B Beneficiary

Stock in A	400	Equity	400
------------	-----	--------	-----

B After spin off

BU 1	100	Equity	400
Stock in A	240		
Annulment GAP	60		

BU1 is the object of the spin off and its real economic value is 160
 BU2 real economic value is 240
 B after spin off annuls the 40% of the stock in A (the percentage of BU1 in the total asset of A)

The Annulment GAP amounts to the positive difference between the cost of the annulled stock (160) and the book value of the BU1 (100)

Surplus GAP

A Parent

BU 1	200	Equity	250
BU 2	50		

B Beneficiary

Stock in A	400	Equity	400
------------	-----	--------	-----

B After spin off

BU 1	200	Equity	400
Stock in A	240	Annulment GAP	40

BU1 is the object of the spin off and its real economic value is 160
 BU2 real economic value is 240
 B after spin off annuls the 40% of the stock in A (the percentage of BU1 in the total asset of A)

The Annulment GAP amounts to the negative difference between the cost of the annulled stock (160) and the book value of the BU1 (200)

Accounting implications

SWAP GAP



Deficit GAP

A Company

BU 1	100	Equity	250
BU 2	150		

Economic Value of BU1 is 250

B Beneficiary

Assets	50	Equity	50
--------	----	--------	----

B After spin off

BU 1	100	Equity	50
Assets	50	Equity Increase	250
	150		

SWAP GAP

The SWAP GAP amounts to the positive difference between the equity increase of the beneficiary company and the book value of the BU1

Surplus GAP

A Parent

BU 1	100	Equity	250
BU 2	150		

Economic Value of BU1 is 50

B Beneficiary

Assets	50	Equity	50
--------	----	--------	----

B After spin off

BU 1	100	Equity	50
Assets	50	Equity Increase	50
		SWAP GAP	50

The SWAP GAP amounts to the negative difference between the equity increase of the beneficiary company and the book value of the BU1

M&A transactions

Spin off: tax implications

Neutral regime:
Fiscal value not relevant

Substitutive regime:
Fiscal value relevant (Tax from 12% to 16%)

B After spin off

BU 1	100	Equity	400
Stock in A	240		
Annulment GAP	60		

B After spin off

BU 1	100	Equity	50
Assets	50	Equity Increase	250
SWAP GAP	150		

B After spin off

BU 1	200	Equity	400
Stock in A	240	Annulment GAP	40

B After spin off

BU 1	100	Equity	50
Assets	50	Equity Increase	50
		SWAP GAP	50

**Attention to
Equity
Breakdown**

Share capital

Reserves

Spin off operation is subject to fixed registration fee of 200€ and fixed mortgage tax of 200€