

Mergerstat/CPS
Common Questions with Answers

Control Premia Teleconference
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Question 1:

Describe the proper use of the Mergerstat Control Premium -- how should it be selected for a given engagement?

Answer 1:

The most likely case for the use of the Control Premium study would be for publicly traded company whose quoted market price could serve as a fair value estimate.

Lower valuations are used by the acquirer to evaluate internal synergies, with higher valuations justified by expected value of external synergies such as goodwill.

The CPS can also be used for valuations of private companies with determining multiples price to book, price to revenue, and EBITDA multiples being used for companies of similar size

Question 2:

It seems the unaffected price plays a very large role in calculating the control premium -- can you elaborate on how it is determined -- is there a methodology anyone can replicate?

Answer 2:

The unaffected price is a reflection of what the quoted market price would be for the stock of a public company prior to being manipulated by news, rumors, or any corporate activity by the company.

We calculate the unaffected price by going through news wire sources and company filings, searching for any news which could influence an unnatural movement in the stock price

Question 3:

How does Mergerstat determine the four transaction types (conglomerate, financial, vertical and horizontal)?

Answer 3:

By definition, they are as follows:

- **Horizontal** – both the target and acquirer are in the same industry and they compete directly in the same product lines or markets. This is a strategic transaction. For example when 2 banks are combining, it is horizontal because they are in the same business line. In most cases, the reason behind such transaction is to create an economies of scale

- **Vertical** – the target and acquirer are involved in different stages of the production process, such as when a manufacturer acquires a distributor. This is a strategic transaction.
- **Financial** – the acquirer is a financial buyer. The buyer may be funded by a buy-out fund or specially formed group of private investors or achieved through a leveraged buyout. The motivation is not strategic, but financial and has the backing of outside investors. Other examples would be acquisitions by public shells and Management Buy-Out deals.
- **Conglomerate** – the target and the acquirer are in completely unrelated industries such as when a hotel acquires a radio station or when a waste collection company acquires auto distributors.

Question 4:

What is the source of the information in the Control Premium Study?

Answer 4:

The sources of the information used include SEC/Government/Regulatory Filings and public announcements for Mergers & Acquisition transactions. Transactions included are only for when a public target is being acquired. An analyst will conduct further research into supporting press releases and sec filings to find the unaffected price

Question 5:

Is there any theoretical research that affirms that the inverse of a control premium is an implied minority discount -- or is this simply accepted in the business valuations profession?

Answer 5:

The minority discount is widely perceived of as the inverse of the control premium, where as an acquirer would assumingly pay a higher price for control in a company and pay a lesser amount for a minority stake

An alternative theory used by appraisers and other professionals, was that the control premiums that were observed in the public markets tended to be paid by strategic buyers, or buyers that had the ability to derive synergies from combinations or had other, specific, strategic intent.

There is another large category of buyers of companies, the financial buyer. Financial buyers may not have the ability to derive synergies from an acquisition, but they can seek financial returns from their investments.

Question 6:

It seems that there is some confusion in the marketplace about the difference between the Mergerstat Control Premium Study and the Mergerstat Review -- can you please elaborate on the differences and how this may affect a business appraiser?

Answer 6:

The Mergerstat Control Premium Study focuses specifically on transactions where a controlling interest in a public target is being acquired, whereas the Mergerstat Review is an annual compilation of solely US and Cross-Border transactions. The main difference between the two publications is that the CPS focuses on share prices by using the unaffected price, while the Mergerstat Review uses the 5-day prior to announcement premium, which technically speaking can mean that this share price can be manipulated by corporate activity from more than five days prior to announcement.

Question 7:

Why does Mergerstat only include transactions where the valuation multiples fall in the following ranges: Price/Sales: 0-10X; Price/Income: 0-40X; Price/Book Value: 0-10X; TIC/EBIT: 0-35X and TIC/EBITDA: 0- 25X? How were these ranges selected and doesn't this introduce a bias into the data?

Answer 7:

These values were established as acceptable ranges when the study was first put together in the early 1990s. The ranges were developed and verified through Mergerstat's relationships with investment banking firms [specifically HLHZ]. While it is true that excluding multiples from the ranges could introduce bias, our experience has been that the vast majority of transactions fall within these ranges (for at least one category).