

Accounting, Analysis and Governance in Complex Deals

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Valuation & Pricing

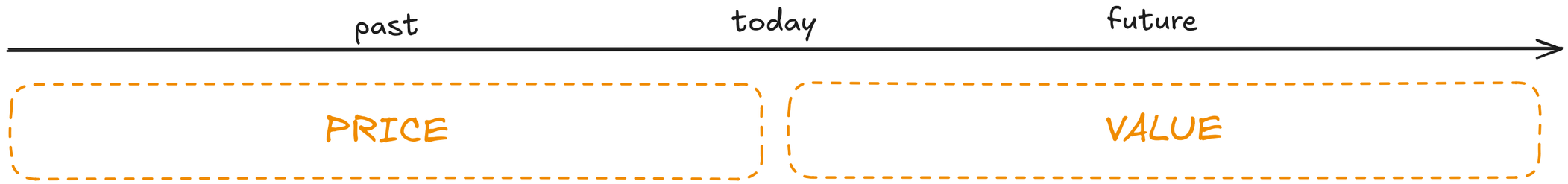
BMME303

Accounting, Analysis and Governance in Complex Deals

Value and Price

Setting the Stage

Value and Price Refer to Different Things



Price	Value
Observable/Unique	Can be Ambiguous
No Model	Model/Theory Needed

We will ignore this distinction and use the terms interchangeably

Lecture Overview

Structure and Learning Objectives

Key Topics

- Role of boards in acquisitions: fairness opinions
- Market-based valuation methods
  - Theory
  - Application

Learning Objectives

- Understand the role of boards in M&A transactions
- Evaluate the importance of fairness opinions
- Analyze different valuation methods
- Apply market-based valuation techniques

The Role of Boards (Again)

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The role of boards?

Valuation & Pricing

Fiduciary Responsibilities

- Duty of care: Make **informed decisions** with appropriate diligence
- Duty of loyalty: Act in shareholders' best interests, not self-interest (stewardship)

⇒ *How do these responsibilities influence the (target's) board with regard to valuation?*

Fiduciary Responsibilities

The role of boards?

- Board must determine whether a transaction is financially fair to shareholders!
- **Fairness opinions** help demonstrate fulfillment of these duties
  - FOs particularly important in transactions with potential **conflicts**
  - FO creates **documentation** of board's decision-making process

Item 4. ***The Solicitation or Recommendation***

Solicitation/Recommendation

The Board has reviewed the Offer with the assistance of the Company's management and legal and financial advisors and, after careful consideration, the Board has unanimously determined that the Offer is inadequate, undervalues the Company and is not in the best interests of the Company and its stockholders. **Accordingly, and for the reasons described in more detail below, the Board unanimously recommends that holders of Shares REJECT the Offer and NOT TENDER any Shares pursuant to the Offer.**

Fairness Opinion - Schedule 14D-9 by Beacon in response to QXO's acquisition offer (see this FT Summary for details on the case)

Fairness Opinions

Fiduciary Responsibilities

What is a Fairness Opinion?

- A professional evaluation *provided by* *investment banks* *or* *financial advisors*
- FO assesses whether transaction terms are financially fair to shareholders
- Not technically required by law but effectively mandated by case law and practice (USA)
- The actual value of fairness opinions is ambiguous:
  - Subjective choice of valuation methods
  - Can help in negotiations
  - Can provide information about mispricing and potential synergies

Fairness Opinions

Fiduciary Responsibilities

Historical Context

- Litigation: 1985 *Smith v. Van Gorkom* (Trans Union case)
- Delaware Supreme Court held directors personally liable for approving a merger without adequate information
- Created a strong incentive for boards to obtain independent fairness opinions
  - Established as a key protection against director liability
  - Now a standard component of significant corporate transactions

Who is Involved?

Fairness Opinions

Investment Banks and Financial Advisors

- Primary preparers of fairness opinions
- Apply valuation expertise, market knowledge, and analytical capabilities
- Typically receive significant fees for their services

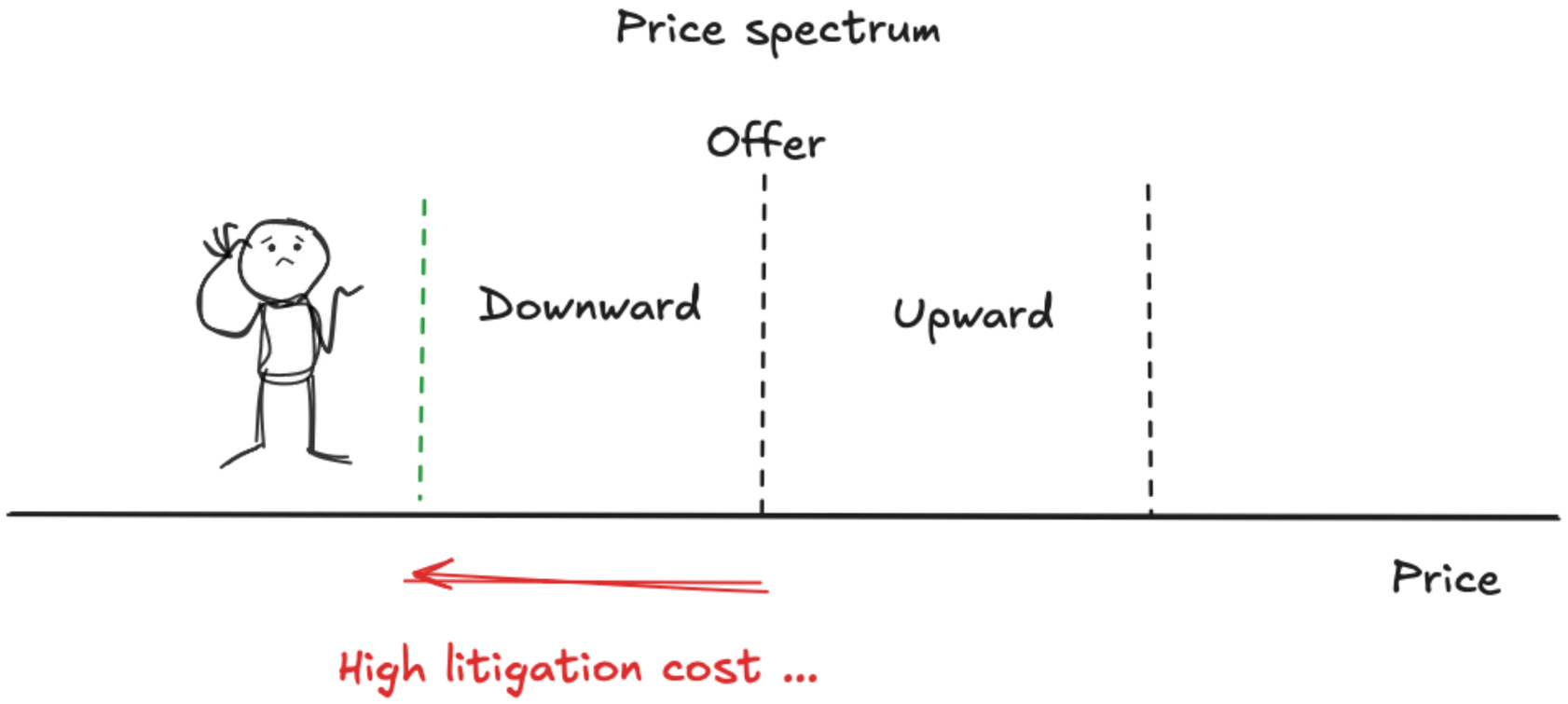
Corporate Boards

- Demonstrate fulfillment of fiduciary duties
- Manage conflicts of interest in transactions
- Hedge against personal liability although business judgment rule provides some protection

Fairness Opinions: Empirical Evidence

Fairness Opinions

Litigation Risk and Strategic M&A Valuations (Imperatore et al. 2024)



⟶ *litigation risk for the board (angry shareholders!) increases when offer/price approaches the lower bound of the price spectrum (laid out in the fairness opinion)*

Strategic Fairness Opinions?

Litigation Risk and Strategic M&A Valuations (Imperatore et al. 2024)

Research question

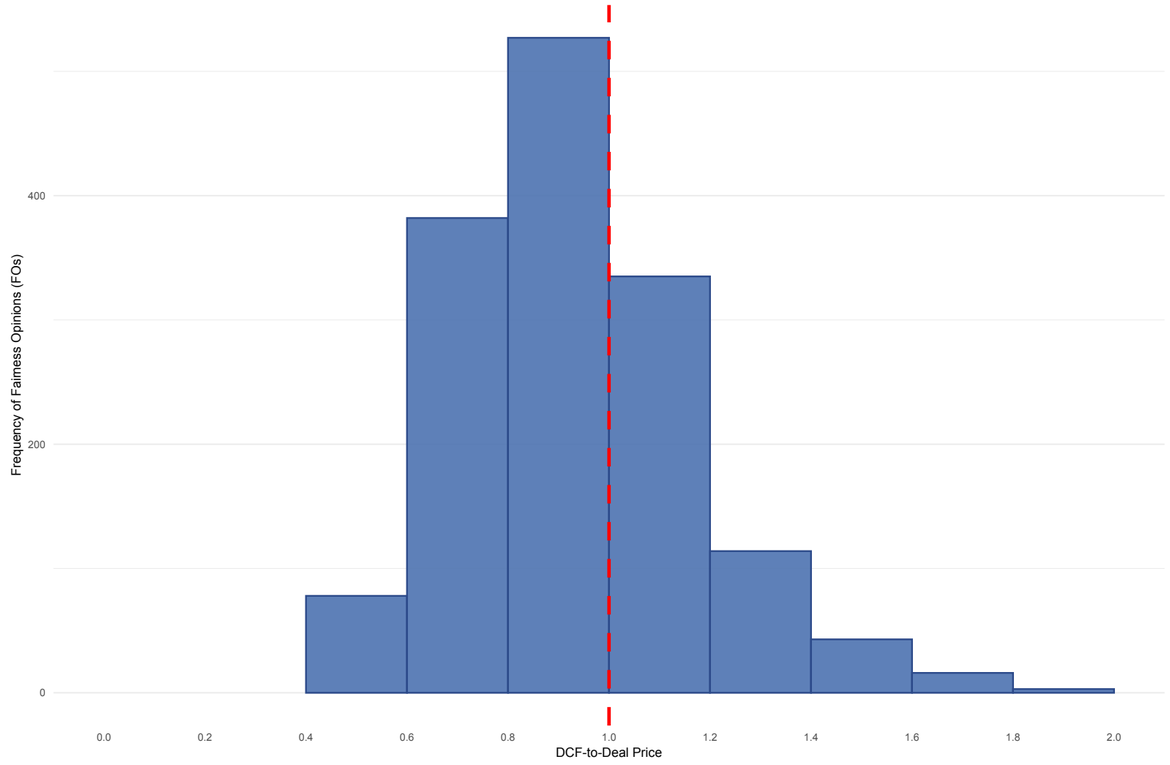
Does strategic target valuation in fairness opinions mitigate litigation risk for target boards?

Identification Strategy

- Measure strategic target valuation
  - *"We focus on the two most common valuation methods used in fairness opinions: Peer Comparables Analyses (PPP) and Discounted Cash Flow (DCF) analyses."*
- Exogenous variation in litigation risk

Strategic Fairness Opinions?

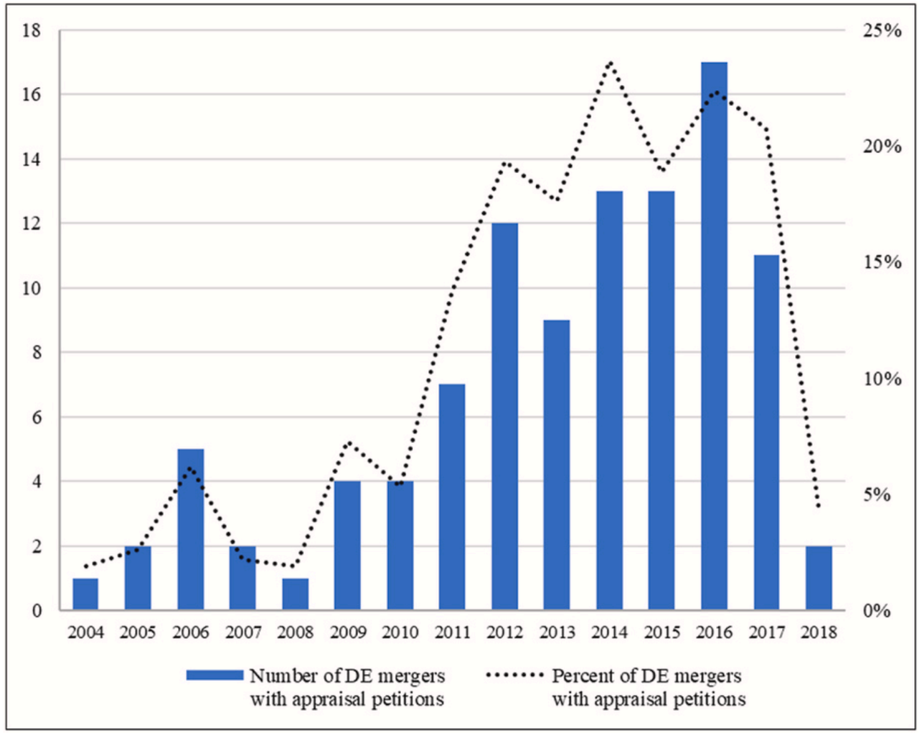
Litigation Risk and Strategic M&A Valuations (Imperatore et al. 2024)



⇒ *DCF valuations in FOs tend to fall below the actual purchase price more frequently than they fall above it*

Identification Strategy

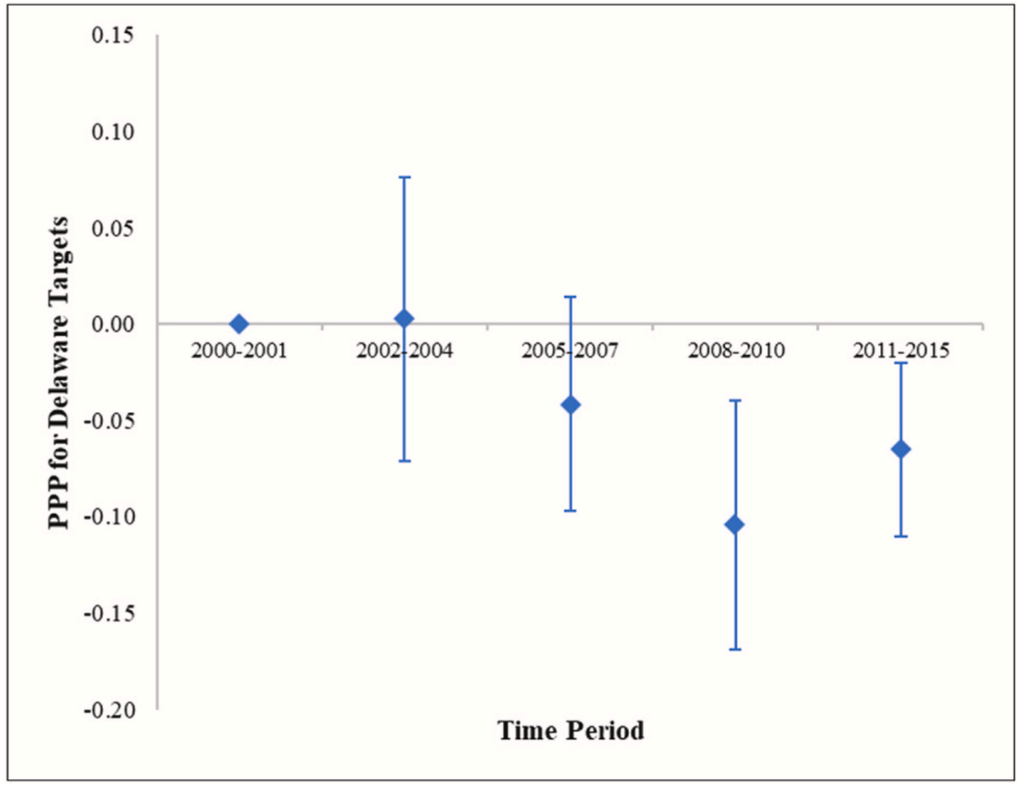
Litigation Risk and Strategic M&A Valuations (Imperatore et al. 2024)



Exploit variation in litigation risk that followed a landmark Delaware case in 2007 to answer RQ

FOs to Mitigate Litigation Risk?

Litigation Risk and Strategic M&A Valuations (Imperatore et al. 2024)



Main Findings

- FO valuations decline for DE targets
- Stronger decline for targets with higher agency risks (MBO, going dark)
- Consequences of downward bias in FO valuations:
  - Value of combined firm ↑
  - Acquisition premium ↓

Fairness Opinions: Case Study

Beacon vs. QXO

Fairness Opinions in Practice

Case

In the takeover (attempt) of Beacon by QXO, fairness opinions played a crucial role, albeit in an unusual manner. Instead of traditional (?) fairness opinions supporting a deal, Beacon's board sought "inadequacy opinions" or "unfairness opinions" to justify rejecting QXO's tender offer. Lazard and JPMorgan, two prominent investment banks, were engaged to provide these opinions. On February 5, 2025, Lazard presented its analysis orally, followed by JPMorgan offering its separate opinion. Both banks concluded that QXO's bid was too low.

Beacon vs. QXO

Fairness Opinions in Practice

Strategic Application

- Instead of support, used to reject it
- Detailed financial analyses were not published
- Advisors orally presented their analyses

Methodology

In connection with this opinion, we have:

(i) Reviewed the Offer to Purchase and the Schedule TO;

(ii) Reviewed certain publicly available historical business and financial information relating to the Company;

(iii) Reviewed various financial forecasts and other data provided to us by the Company relating to the business of the Company;

(iv) Held discussions with members of senior management of the Company with respect to the business and prospects of the Company and the strategic objectives of the Company;

(v) Reviewed public information with respect to certain other companies in lines of business we believe to be generally relevant in evaluating the business of the Company;

(vi) Reviewed the financial terms of certain business combinations involving companies in lines of business we believe to be generally relevant in evaluating the business of the Company;

(vii) Reviewed the historical stock prices and trading volumes of the Shares; and

(viii) Conducted such other financial studies, analyses and investigations as we deemed appropriate.

⇒ Both advisors concluded the bid was “financially inadequate”

Beacon vs. QXO

Fairness Opinions in Practice

Compensation Arrangements

Lazard

- $4,000,000 for initial inadequacy opinion
- $1.5m for each additional opinion ($7m cap)

JPMorgan

- $4,000,000 for providing the opinion
- $50 million+ success fee if Beacon ultimately acquired

Inherent Conflicts?

- **Misaligned incentives** between advisors and shareholders
  - Lazard is incentivized to provide exactly three opinions (to reach cap)
  - JPMorgan's dual role: help reject current bid but profit from eventual acquisition
- Role of **disclosure**?

Beacon vs. QXO

Fairness Opinions in Practice

Limited Disclosure Approach

- Beacon disclosed the existence of inadequacy opinions but minimal details
- No publication of:
  - Peer firms
  - Valuation assumptions
  - “Adequate” price ranges
- Less transparency than in typical fairness opinions supporting a deal

Potential Strategic Valuation Choices

- Selection of peer firms with
  - optimistically high valuations?
  - potentially influenced by advisor incentive structures
- Limited public disclosure prevents scrutiny of these choices

Board, Fairness Opinions, and Valuation

Key Takeaways

- **Fairness Opinions**: Essential for boards to fulfill fiduciary duties (care and loyalty) and manage litigation risk
- **Independent Assessments**: Evaluate transaction fairness for shareholders
- **Key Players**: Investment banks and financial advisors provide expertise
- **Strategic Use**: Increasingly used to reject or support deals (e.g., Beacon vs. QXO)
- **Challenges**:
  - Potential conflicts of interest (e.g., fee structures)
  - Additional information vs. protection from litigation

Thank You!



Appendix

References

Imperatore, Claudia, Gabriel Pündrich, Rodrigo S Verdi, and Benjamin P Yost. 2024. “Litigation risk and strategic M&A valuations.” *Journal of Accounting and Economics* 78 (1): 101671.

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