

Basics of Mergers & Acquisitions (M&A)

What Is Mergers & Acquisitions?

Mergers and Acquisitions (M&A) refer to transactions in which companies combine, purchase, or sell businesses, assets, or ownership interests to achieve strategic, financial, or operational objectives.

- **Merger:** Two companies combine to form a single new entity (often between equals).
- **Acquisition:** One company purchases another and assumes control (the acquired company may continue to operate independently or be fully integrated).

Mergers and acquisitions are powerful tools for growth, transformation, and value creation—but they require rigorous planning, disciplined execution, and experienced leadership. When strategy, valuation, diligence, and integration are aligned, M&A can become a lasting competitive advantage rather than a costly distraction. While commonly grouped together, mergers and acquisitions differ in structure, governance impact, and integration complexity.

Why Companies Pursue M&A

Organizations pursue M&A to accelerate growth or transformation, enhance capabilities, or create value beyond what organic growth can deliver.

Common strategic drivers include:

- Expanding market or entering new geographies
- Acquiring new products, technologies, capability or intellectual property
- Achieving cost synergies, economies of scale and operational efficiencies
- Strengthening competitive positioning
- Diversifying revenue streams
- Optimizing capital structure or unlocking shareholder value

Successful M&A aligns clearly with long-term strategy—not just short-term financial gains.

Types of M&A Transactions

1. Horizontal Transactions

Between companies in the same industry and at the same stage of the value chain.

Example: Two competitors merging to increase market share.

2. Vertical Transactions

Between companies at different stages of the supply chain.

Example: A manufacturer acquiring a key supplier.

3. Conglomerate Transactions

Between unrelated businesses in different industries.

Example: A holding company acquiring a business in a new sector.

4. Strategic vs. Financial Acquisitions

- **Strategic buyers** seek long-term operational and strategic benefits.
- **Financial buyers** (e.g., private equity) focus on value creation through operational improvements and exit opportunities.

Key Stages of the M&A Process

1. Strategy & Target Identification

- Define acquisition objectives
- Establish investment and risk criteria
- Identify and screen potential targets
- Assess strategic fit and value creation potential

2. Valuation & Deal Structuring

- Financial modeling and valuation (DCF, comparables, precedent transactions)
- Determine purchase price and consideration (cash, stock, debt, earn-outs)
- Evaluate and structure the transaction for tax, accounting and financing impact and efficiency

3. Due Diligence

- Detail review and analysis of financial, operational, legal, tax, IT, HR, commercial and contracts
- Identify risks, liabilities, and integration challenges
- Validate assumptions underlying valuation

4. Negotiation & Signing

- Negotiate the terms and conditions of purchase agreement
- Define representations, warranties, indemnities, and closing conditions
- Secure board, regulatory, and shareholder approvals as required

5. Integration & Value Realization

- Execute post-merger integration
- Align systems, processes, people, and culture
- Track synergies and performance against the deal thesis

Valuation Fundamentals in M&A

Valuation in M&A determines **enterprise value, equity value, and deal economics** and support what a business is worth, pricing, return expectation and accounting outcomes. It is both **analytical** and **judgment-based**, grounded in forward-looking assumptions on business potentials, consolidations, competition, market share etc.

Two major types of valuations are **Enterprise Value vs. Equity Value**.

- **Enterprise Value (EV)** = Value of the operating business
- **Equity Value** = EV – Net Debt ± Other adjustments

Most M&A deals are priced on **Enterprise Value**, then converted to equity value at closing.

Common valuation methods include:

1. **Discounted Cash Flow (DCF):** Values business based future cash flows discounted cash flows to present value

Key steps:

- Forecast free cash flows (typically 5–10 years)
- Estimate terminal value
- Determine discount rate (WACC)
- Discount cash flows to present value

Used when:

- Forecasts are reliable
- Company has stable or growing cash flows

Strengths:

- Intrinsic and forward-looking
- Captures business-specific drivers

Limitations:

- Highly sensitive to assumptions
- Requires reliable forecasts

2. **Comparable Company Analysis: Benchmarks against peers/competitors.**

Common multiples:

- EV / EBITDA
- EV / Revenue
- P / E

Used for:

- Market benchmarking
- Valuation sanity checks

Strengths:

- Market-based and intuitive
- Useful for range validation

Limitations:

- True comparables may not exist
- Market conditions can distort value

3. **Precedent Transactions:** Analyzes pricing paid in similar deals in past transactions

Key considerations:

- Control premiums
- Deal timing and market cycles
- Synergy expectations

Strengths:

- Reflects actual acquisition pricing
- Includes control value

Limitations:

- Limited transparency
- Historical conditions may differ

Adjustments in M&A Valuation

- Normalized EBITDA (non-recurring items removed)
- Synergy valuation (cost savings, revenue growth). It is generally buyer specific
- Working capital normalization
- Capital expenditure requirements
- Risk adjustments and scenario analysis
- Owner compensation normalization

Valuation results in a **value range**, not a single number.

Structure of Acquisitions: Asset Purchase vs. Equity Purchase**A. Asset Purchase**

In an **asset purchase**, the buyer acquires selected assets and assumes selected liabilities.

Key features:

- Buyer chooses which assets and liabilities to acquire and controls liability exposure
- Legal entity remains with seller
- Often preferred for risk mitigation

Advantages:

- Liability protection
- Step-up in asset tax basis
- Greater flexibility
- Selective acquisition

Disadvantages:

- Contract and license reassignments required
- Potential operational disruption

- May not transfer all intangibles automatically

B. Equity Purchase (Stock Purchase)

In an **equity purchase**, the buyer acquires ownership of the target entity.

Key features:

- All assets and liabilities transfer by default
- Legal entity continues to exist

Advantages:

- Simpler transfer of contracts and licenses
- Operational continuity
- Often preferred by sellers (tax efficiency)

Disadvantages:

- Buyer assumes all known and unknown liabilities
- Limited tax basis step-up (unless structured)

C. Hybrid Structures

- **Section 338(h)(10) election** (US): Equity deal treated as asset purchase for tax purposes
- **Merger structures:** Forward merger, reverse merger
- **Carve-outs:** Acquisition of part of a business

Purchase Price Allocation (PPA)

After closing the transaction, buyers must allocate the purchase price to:

- Tangible assets
- Identifiable intangible assets
- Liabilities assumed
- Residual goodwill

PPA is typically completed within **12 months post-close (measurement period)** and has a direct impact on future earnings and impairment risk. PPA is typically performed by independent valuation specialists.

Why PPA Matters

- Impacts future amortization expense
- Affects EBITDA vs. net income
- Influences impairment risk
- Drives tax and deferred tax outcomes

Goodwill and Intangible Assets

A. What Is Goodwill?

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired. It is the premium paid over the net assets acquired. The premium is consideration for the strategic values of future business that not separately identifiable and intangible assets which reflect intellectual properties (patents, trademarks, copyrights), brand reputation, trade names, customer relationships, assembled workforce, technologies, contracts & licenses, expected synergies, future growth potential. For accounting purpose, goodwill is considered as residual amount of premium after separating value of intangible assets acquired.

Key accounting treatment for goodwill:

- Recorded only in acquisitions
- Not amortized
- Tested annually (or upon triggering events) for impairment

Intangible assets are identical intangible assets such as reflects intellectual properties (patents, trademarks, copyrights), brand reputation, customer relationships, assembled workforce, technologies, contracts & licenses are accounted separately based on valuation.

Accounting treatment:

- Recorded at fair value
- Amortized over useful life (except indefinite-lived assets)
- Subject to impairment testing
- Indefinite-lived intangibles (e.g., certain trademarks) are not amortized

Risks and Challenges in M&A

Despite strong strategic rationale, many deals underperform due to execution risks.

Key challenges include:

- Overpaying or unrealistic synergy assumptions
- Cultural misalignment and talent loss
- Poor integration planning or execution
- Inadequate due diligence
- Disruption to core business operations

Effective governance and disciplined execution are critical to managing these risks.

What Drives M&A Success

Successful M&A is not defined at deal close—it is defined by long-term value creation.

Best practices include:

- Clear strategic rationale and investment thesis
- Early and comprehensive integration planning

- Strong leadership and accountability
- Transparent communication with stakeholders
- Continuous performance measurement post-close

Post-Close Accounting, Integration & Governance

Accounting & Reporting

- Finalize purchase price
- Complete PPA (ASC 805)
- Record goodwill and intangibles
- Establish amortization schedules
- Assess deferred tax impacts

Controls & Systems

- Align accounting policies
- Integrate ERP and reporting systems
- Update internal controls

Performance & Value Tracking

- Monitor synergy realization
- Compare actual results to deal model
- Identify goodwill impairment indicators

Key Takeaways

- M&A is a strategic tool, not a financial shortcut
- Valuation is assumption-driven and range-based
- Goodwill and intangibles materially affect post-close earnings
- Deal structure drives tax, risk, and accounting outcomes
- Long-term value is determined after closing—not at signing
- Post-close execution determines whether value is realized or destroyed