

Financial Analysis: A User Approach
Chapter 10
Business Combinations

Motivations for a Combination:

- Economies of scale
- Horizontal Integration
- Vertical Integration
- Conglomerates

Accounting for Combinations:

- Ignore all the pooling of interests material in the chapter (this is too old to be important for us) – only focus on Purchase Method material
- Basic idea – compare the value given in the acquisition (cash, equity, debt) to the fair value of the net assets received (A-L) and record goodwill for the difference

Example: On January 1, 2008 Ortiz Corporation purchased Santiago Company by paying \$350,000 cash. On that day Santiago had the following balance sheet:

**Santiago Company
Balance Sheet
January 1, 2008**

Cash	\$50,000	Accounts Payable	\$200,000
Receivables	90,000	Stockholders' Equity	235,000
Inventory	100,000		
Land	40,000		
Buildings, net	75,000		
Equipment, net	70,000		
Trademarks	10,000		
Total Assets	<u>\$435,000</u>	Total Liab. & SHE	<u>\$435,000</u>

All amounts are at fair value except the following:

Account	Fair Value
Inventory	125,000
Land	60,000
Trademarks	15,000

Accounts	Debit	Credit
Cash	50,000	
Receivables	90,000	
Inventory	125,000	
Land	60,000	
Buildings	75,000	
Equipment	70,000	
Trademarks	15,000	
Goodwill	*65,000	
Accounts Payable		200,000
Cash		350,000

*350,000 – (50+90+125+60+75+70+15-200)

Goodwill

- Goodwill is not amortized as it is viewed as an indefinite life intangible, instead it is assessed for impairment annually in a two-step process
 - Step 1- Recoverability Test
 - Step 2 - Measure the Implied Value of Goodwill and Record Impairment Loss, if any

Market Reactions to Acquisitions

- In most cases the acquirer will pay an acquisition premium of up to 50% of current price, with 30% being common
- In most cases the acquirer's stock price will go down after the announcement due to earnings dilution related to shares issued
- Acquisitions are very tricky to pull off and can be both a great success and a source of substantial value loss
 - Successes
 - Pepsico acquires Quaker Oats which includes Gatorade
 - Cisco has built most of the company by acquiring others with recent acquisitions including Linksys (home wireless networks), Pure Digital (flip camera), Webex (video conferencing), and Scientific Atlanta (satellite and cable company gear)

- Google purchased YouTube, Postini, DoubleClick, FeedBurner (53 deals in less than 10 years)
- Failures
 - Daimler/Chrysler
 - AOL/Time Warner
 - Wachovia/Golden West
 - Spring/Nextel
- Regulatory Issues
 - In the U.S. all major mergers and acquisitions must pass regulatory muster
 - Federal Trade Commission review
 - Other regulatory reviews
 - European Union
 - Other Countries Including China

Example: STX Acquisition of Maxtor

8-K dated 12-20-05

Entry into a Material Definitive Agreement.

On December 20, 2005, Maxtor Corporation, a Delaware corporation (“Maxtor”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Seagate Technology, an exempted company incorporated with limited liability under the laws of the Cayman Islands (“Seagate”), and MD Merger Corporation, a Delaware corporation and a direct wholly-owned subsidiary of Seagate (“Merger Sub”), by which Seagate has agreed to acquire Maxtor (the “Merger”). The Merger Agreement has been unanimously approved by the Boards of Directors of both Maxtor and Seagate.

Subject to the terms and conditions of the Merger Agreement, at the effective time of the Merger, each issued and outstanding share of common stock of Maxtor would be converted into the right to receive 0.37 shares of Seagate common stock. The merger is intended to qualify as a tax-free reorganization under Section 368(a) of the Internal Revenue Code of 1986, as amended.

Consummation of the Merger is subject to several closing conditions, including the adoption of the Merger Agreement by the stockholders of Maxtor, the approval of the issuance of shares of Seagate common stock in the Merger by the stockholders of Seagate, the receipt of antitrust approvals or the expiration of applicable waiting periods in certain jurisdictions set forth in Exhibit A to the Merger Agreement, the absence of certain governmental restraints, and effectiveness of a Form S-4 registration statement to be filed by Seagate.

The Merger Agreement contains certain termination rights for both Maxtor and Seagate and provides that a specified fee must be paid by one party to the other in connection with certain termination events. In certain specified circumstances, Seagate must pay Maxtor a termination fee of \$300 million (generally in the event necessary antitrust approval is not obtained or governmental regulatory restraints prevent the transaction, or the transaction has not been consummated prior to March 20, 2007, with certain exceptions if the Maxtor stockholders have not adopted the Merger Agreement). In other specified circumstances, Maxtor must pay Seagate a termination fee of \$53 million (generally in the event the Board of Directors of Maxtor changes its recommendation that its stockholders adopt the Merger Agreement, or elects to pursue an alternative acquisition proposal from a third party).

8-K Dated 5-17-06 Item 8.01. Other Events

On May 17, 2006, we issued a press release to announce that the shareholders of Seagate Technology (the “Company”) and Maxtor Corporation (“Maxtor”) have approved a previously announced definitive merger agreement under which Seagate will acquire Maxtor in an all stock transaction. With all required regulatory and shareholder approvals now secured, it is expected that the transaction will close in 2-3 business days and that Maxtor shares will cease to be listed on the New York Stock Exchange at that time. A copy of this press release is attached to this Current Report on Form 8-K as Exhibit 99.1.

10-K – Dated September 11, 2006 (Y/E - June 30, 2006)

Acquisition of Maxtor Corporation

On May 19, 2006, we acquired Maxtor Corporation in a stock for stock transaction. We expect the acquisition of Maxtor to build on our foundation as the leading global disc drive company, leveraging the strength of our significant operating scale to drive product innovation and maximize operational efficiencies. We believe the combined company will be well-positioned to accelerate delivery of a diverse set of compelling and cost-effective solutions to the growing customer base for data storage products.

The acquisition provides us with enhanced scale, greater capacity and an increased customer base which we expect will allow us to eventually achieve significant cost synergies from leveraging our research and development platform, reducing product and supply chain costs, as well as scaling our sales, marketing and administrative infrastructure. We also acquired a final assembly and test manufacturing facility in Suzhou, China, significantly increasing our China-based manufacturing presence, as well as the retail and branded solutions operations of Maxtor and the right to use the Maxtor brand and other related trade names. The acquisition has also provided us access to talented personnel in the branded solution, product development, and other key functional areas.

We are engaged in integration and restructuring processes whereby we are driving to replace Maxtor-designed disc drive products with Seagate-designed disc drive products. We expect this process to be substantially complete by the end of calendar year 2006. We foresee there to be a transitional period through the first six months of fiscal year 2007 during which we expect the inefficient use of the Maxtor manufacturing infrastructure as we wind down the volume of Maxtor-designed disc drive products and incur up-front investment needed for capacity additions to support the ramp-up of Seagate-designed disc drive products. In addition, work force reductions took place after the transaction closed as we addressed the redundancies that exists between the two companies and will continue to be implemented based on production transitions, customer support and administrative requirements.

Acquisition of Maxtor Corporation

On December 20, 2005, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Maxtor Corporation, a Delaware corporation, and MD Merger Corporation, a Delaware corporation and direct wholly-owned subsidiary of Seagate, by which Seagate agreed to acquire Maxtor (the “Merger”), and whereby Maxtor would become a wholly owned subsidiary of Seagate. On May 19, 2006, we completed the acquisition of Maxtor in a stock for stock transaction. The acquisition was structured to qualify as a tax-free reorganization and we have accounted for the acquisition in accordance with SFAS No. 141, Business Combinations (“SFAS 141”). The combination of the two companies’ brands and the related product lines represent the most differentiated storage offering to customers and enhance Seagate’s scale and capacity to better drive technology advances and accelerate delivery of a wide range of differentiated products and cost-effective solutions to a growing base of customers.

Under the terms of the Merger Agreement, each share of Maxtor common stock was exchanged for 0.37 of our common shares. We issued approximately 96.9 million of our common shares to Maxtor's stockholders. Based on the average closing price of our common shares on the NYSE for the two days prior to, including, and two days subsequent to the public announcement of the merger (December 21, 2005) of \$20.02 and including capitalized acquisition-related costs and the fair value of options assumed and nonvested shares exchanged, the transaction was valued for accounting purposes at approximately \$2.0 billion. We also assumed all outstanding options to purchase Maxtor common stock with a weighted-average exercise price of \$16.10 per share. Each option assumed was converted into an option to purchase one of our common shares after applying the 0.37 exchange ratio. In total, we assumed and converted Maxtor options into options to purchase approximately 7.1 million of our common shares. In addition, we assumed and converted all outstanding Maxtor nonvested stock into approximately 1.3 million of our nonvested shares, based on the exchange ratio. The fair value of options assumed and nonvested shares exchanged had a fair value of approximately \$86 million. See Note 10 of the Notes to Consolidated Financial Statements elsewhere in this report.

We have identified and recorded the assets, including specifically identifiable intangible assets, and liabilities assumed from Maxtor at their estimated fair values as at May 19, 2006, the date of acquisition and allocated the residual value of approximately \$2.5 billion to goodwill. The values assigned to certain acquired assets and liabilities are preliminary, are based on information available as of June 30, 2006, and may be adjusted as further information becomes available during the allocation period of up to 12 months from the acquisition date. Maxtor is now a wholly-owned subsidiary of ours and the results of Maxtor's operations have been included in our consolidated financial statements after the May 19, 2006 acquisition date.