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EQUITY IN A NUTSHELL

LEVEL

M&As: always different, always challenging

In its December 2015 press release, Dealogic, a British based financial markets platform offering analytical data, indicated that the global volume of mergers and acquisitions (M&As) in the year was set to exceed USD 5.0 trn, beating the 2007 record of USD 4.6 trn. Ten M&As of over USD 50 bn each were announced in 2015, setting a new record with a combined worth of nearly USD 800 bn. The largest deals were the planned USD 160 bn merger of Pfizer and Allergan and the USD 117.4 bn bid Anheuser-Busch Inbev made for SABMiller. These are among the only eight transactions on record valued over USD 100 bn.

However, in April 2016, the Pfizer–Allergan merger got called off, and it was not the only one. Dealogic's 'First Half 2016 Review' revealed that USD 606.4 bn of M&A volume was withdrawn in the first six months of the year. The M&A market cooled down with transactions down to USD 758.5 bn in the first quarter and USD 951.6 bn in the second after three consecutive quarters with a deal value of over USD 1 trn. Transaction volume declined 18% YoY in 1H16. So far this year, the top-three transactions are Bayer's USD 63.4 bn offer for Monsanto (May 23), ChemChina's USD 46.7 bn bid for Syngenta (February 3) and Softbank's proposed USD 31.6 bn acquisition of ARM Holdings (July 18).

Two types of takeovers

A takeover bid can be **friendly or hostile**. Friendly offers have the consent and support of the target's board before final approval is sought from shareholders, whereas in a hostile offer, the bidder skips the consultation phase and makes its offer directly to the target's shareholders.

The acquisition type influences the offered price. Hostile bids have a higher cash part and acquisition premium, i.e., the difference in percentage between the price offered and the target's stock price.

After the closing of the transaction, the integration process starts. The ability to execute this constructively, with the target's management cooperating, significantly increases the chances of a successful integration. Unsurprisingly, a hostile takeover often means that the target's management is reshuffled or even replaced completely.

Further, divestitures and reorganisations tend to be more radical in hostile takeovers as such an acquirer may be interested only in some of the target's activities, and so divesting non-core businesses and cutting costs enable it to rapidly reduce acquisition-related debt.

Of course, the nature of a bid can change during the process. If friendly attempts fail at some point in time, the bidder can go hostile. Conversely, a hostile offer can become friendly if the acquirer succeeds in convincing the target's board and management of the industrial and financial logic of the transaction and hence wins their formal support.

A company can be acquired by its own management and/or outside investors. The former is called a management buyout, and if debt is the main source of funding for the transaction, it is known as a leveraged buyout. In most cases, a leveraged buyout changes a publicly traded company into a purely private one. More commonly, however, the acquirer is another company.

Four types of acquisitions

The NYU Stern School of Business distinguishes four ways in which a company can be acquired: **Mergers and consolidations** need a friendly approach as in both cases, each board has to agree on the deal and request for shareholder approval.

The difference is that in a merger, the target ceases to exist and becomes part of the acquirer; while in a consolidation, a new company is created after the merger, and the stockholders of both receive shares of the newly created entity.

Tender offers, on the contrary, bypass the target's board and directly make an offer to the shareholders. In practice, a tender becomes a merger if a sufficient number of shareholders accept the offer, and hence the bidder gains control of the target. However,

as long as there are shareholders who refuse the offer, the acquired company continues to exist.

Mergers, consolidations and tender offers all involve a transfer of ownership of the target's legal entity to the acquirer. Through a **purchase of assets**, the buying company only purchases (part of) the assets of the selling company. After the deal, the acquired company's legal structure continues to exist with the same shareholders. Although a stock and an asset purchase appear alike, they differ significantly in their accounting rules and the tax effects for both the buying and selling parties.

Five types of mergers

Depending on the economic function, purpose of the business transaction and relationship between the combining companies, the Minority Business Development Agency of the United States Department of Commerce defines five types of mergers: horizontal, vertical, market extension, product extension, and conglomerates.

A **horizontal merger** has two companies active in the same line of business and aims to significantly increase market share. As the two are often competitors, their operations are likely to be similar, with the significant overlap creating important cost-cutting potential.

A **vertical merger** is the combination of companies offering different products or services that are related to the same finished product or final service. This combination of companies active at different levels in an industry's supply chain not only increases efficiency but also allows for cost reductions.

A **market-extension merger** is attractive for two firms producing and/or selling the same product in different markets, as it gives the combined group a larger client base while still offering cost-cutting potential.

A **product-extension merger**, on the other hand, involves a combination of companies selling/rendering related products/services in the same market. The merger aims to group complementary offerings so as to expand the client base and reduce costs.

Finally, **conglomerates** are the result of the merger of two or more companies that have totally different and unrelated businesses. Pure conglomerates have nothing in common: combining has the sole objective of reducing investment risk by diversification, while a merger of mixed conglomerates may also aim to gain market or product extensions.

One single aim

Increasing growth, cutting costs, market/product extensions, moving up the value chain, gaining market share, removing excess capacity from the industry, following clients, etc. all are just means to serve the one and only goal of M&A, i.e., **value creation**.

However, M&A is bound to destroy value if done for tax considerations, personal incentive or bootstrapping earnings (short-term EPS increase in a share-for-share exchange when the acquirer's P/E is higher than the target's P/E, if the former does not decline post merger).

But even with the best of effort and motive, creating value through M&A is difficult. Literature on the subject indicates that less than half of all M&A deals succeed in creating value for shareholders.

BCG's June 2011 report 'Riding the Next Wave in M&A' concludes: "When publicly listed companies acquire other public companies, the deal on average destroys value for the acquirer in both the short and longer term."

BCG also surveyed corporate leaders on why their acquisitions failed in an October 2015 report, 'From Buying Growth to Building Value.' The most-often cited reasons fell into three categories: poor deal preparation and execution, inadequate post-merger integration and bad market timing.

However, the research also showed that companies that acquire only rarely have a much lower success rate (43%) than more experienced acquirers. Specifically, in a five-year period, companies that made 2–5 deals had a success rate of 51%, while those that made >5 acquisitions showed a 54% success rate. The data also indicated that the more experienced the acquirer, the higher is the shareholder return, both in the short and the long term.

Conclusion

In 2015, the M&A market boomed and was set to beat the 2007 record. However, some deals got called off afterwards.

Every M&A transaction has its own particularities and industrial and/or financial logic, which will eventually determine the final structuring of the deal.

M&A are only a means to serve one goal: value creation. And this is exactly where the shoe pinches as less than half of all M&A deals succeed in creating shareholder value.

However, while practice may not make perfect, research indicates that serial acquirers are more likely to create value than one-time acquirers.

As M&A involves a premium over the market price and as value creation for the acquiring company is not a given, it is better to be invested in the target than in the acquirer.

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Investment Rating Definitions:

Buy	Stock that is expected to outperform its MSCI sector index over a 12-month investment horizon.
Neutral	Stock that is expected to perform in line with its MSCI sector index over a 12-month investment horizon.
Sell	Stock that is expected to underperform its MSCI sector index over a 12-month investment horizon.
Restricted	Covered stock that is not rated or assigned a target price as the Societe Generale group has a capital market transaction with that company.

Product Risk Rating	The product category of single equity, stock, share is rated at '4'. In order to draw the attention of potential investors to the risk linked to each investment solution, Societe Generale Private Banking has ranked each product according to its own specific risk scale from the lowest risk (class 0) to the highest risk (class 4). The risk classification is a Societe Generale Private Banking internal risk indicator. These internal indicators are based on the Value at Risk 95% 1 year (VaR). The VaR corresponds to the maximum amount that the portfolio being considered could lose in normal market conditions over a given period with a given probability (past performances and simulations of performance shall not be considered as a reliable indicator of future performance). If the VaR 95% 1 year is y%, this means that there is a 95% probability that the portfolio will not lose more than y% of its value in one year.

Risk Levels	Losses
0 - Lowest Risk	There is a 95% probability that the product will not depreciate in value in one year.
1 - Low Risk	There is a 95% probability that the product will not lose more than 5% of its value in one year.
2 - Medium Risk	There is a 95% probability that the product will not lose more than 15% of its value in one year.
3 - High Risk	There is a 95% probability that the product will not lose more than 30% of its value in one year.
4 - Highest Risk	There is a minimum of 5% probability that the product will lose more than 30% of its value in one year.

Glossary (1/2)

Societe Generale Private Banking Investment Universe

Societe Generale Private Banking defines and maintains an investment universe, aiming at ensuring the liquidity and the meaningful coverage of companies subject to potential investments. This investment universe complies with rules defined as follows:

- **Issuers are constituents of MSCI indices**: The constituents of the indices retained cover developed and emerging countries with increased precision (average market capitalisation) for Germany, Belgium, France, the UK and Switzerland.
- **Market Capitalisation**: To avoid the inclusion of securities whose market capitalisation could be too low in light of the potential investments by clients and/or managers, only securities whose market capitalisation is greater than €500 mn have been chosen.
- **Liquidity**: To ensure minimum liquidity for investments, only securities with a six-month average daily trading volume greater than EUR 300,000 are selected.
- **Reliable Financial Information**: Only securities tracked by at least three sell side financial analysts are included in the universe.
- **Social and Environmental Responsibility Policy of SG Group**: Societe Generale has defined a framework for Social and Environmental Responsibility. This framework sets out restrictions on listed securities identified by SG Group and deleted from the universe.

Societe Generale Private Banking Recommended Universe

The Recommended Universe is made of companies from the Investment Universe as defined by Societe Generale Private Banking guidelines. Members are chosen by Equity Solutions. There are no lower nor upper limits on the number of stocks in the Recommended Universe. There is no specific constraint in term of geographical or industry representation. A company from the recommended universe can be subject to a rating change, as decided by the Equity Solutions expert covering the company. When a stock is downgraded to a Sell rating, it is still followed for at least 3-month, after which Equity Solutions issues a coverage termination alert.

Financial Terms and Acronyms

ADR (American Depositary Receipt): is a negotiable certificate issued by a US bank representing a specified number of shares in a foreign stock that is traded on a US exchange. ADRs are denominated in US dollars, with the underlying security held by a US financial institution overseas.

BACKLOG: often refers to a company's sales orders waiting to be fulfilled. Even if it provides the revenue visibility, the companies usually try to avoid to have an extensive backlog because that creates the risk of unmet demand and thus can have negative impact on future earnings

BENCHMARK: is, generally, a broad market, market-segment stock or bond index that is used as a reference to evaluate the performance of a security, mutual fund or investment manager.

BV (Book Value): is the total value of net assets of a company. It consists of the firm's fixed assets plus its current assets, minus short-term liabilities, long-term creditors and any provisions.

BV/S (Book Value Per Share): is the total value of the net assets of a company divided by the total number of outstanding shares.

C/I (Cost Income Ratio): is used for valuing banks. It shows a company's costs in relation to its income. Formula: (Operating Costs/Operating Income)*100.

CAGR (Compound Annual Growth Rate): is a term used for the geometric progression ratio that provides a constant rate of return over a specific time period.

CAPEX (Capital Expenditure): is the fund used by the company to acquire or upgrade the physical assets such as property, industrial buildings or equipment. The most capital intensive industries include oil, telecom and utilities.

CAR (Capital Adequacy Ratio): is a measure of a bank's capital. It is expressed as a percentage of a bank's risk-weighted credit exposures. Formula: (Tier One Capital + Tier Two Capital)/Risk Weighted Assets.

CET I (Common Equity Tier I Ratio) : is a measure of the bank's common equity capital as a percentage of risk-weighted assets. It is generally compared to a defined benchmark stipulated by the regulatory authority to determine whether a bank is sufficiently capitalised.

DIVIDEND YIELD: Dividend per share or DPS (total dividend paid out divided by the total number of shares) expressed as a percentage of current stock price.

Financial Terms and Acronyms (contd.)

EBIT Margin: Ratio that expresses EBIT as a percentage of total sales (EBIT/Sales*100); also referred to as operating margin.

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): profit before taking into account interest payments, income taxes and non-cash operating expenses (depreciation and amortisation). It is calculated as a company's gross income minus its cash operating expenses only.

EM (Emerging Market) :is a country that has some characteristics of a developed market, but does not meet standards to be a developed market. This includes countries that may become developed markets in the future or were in the past.

EPS (Earnings Per Share): is the division of total net profit by the number of shares.

EV (Enterprise Value) is a measure of a company's value, often used as an alternative to straightforward market capitalisation. It is calculated as (market cap + debt + minority interest + preferred shares) − total cash − cash equivalents.

EV/EBITDA: compares the total value of the company to its EBITDA.

EV/SALES: compares the total value of the company to its sales.

FCF (Free Cash Flow): represents the difference between operating cash flow and capital expenditures and shows the company's ability to generate shareholder's value after laying out the money required to maintain or expand its asset base. Without enough cash, it would be difficult for a company to develop new products, make acquisitions, pay dividends and reduce debt.

FFO (Funds from Operations): measures a REIT's operating performance. It is net income plus gains (minus losses) from property sale and purchase. Non-cash expenses like depreciation and amortisation are added back because value of real estate tends to rise over time rather than depreciating like other fixed assets and investments. FFO per share is often used in place of earnings per share when analysing REITs.

FY1 (Fiscal Year One): refers to the current fiscal year.

FY2 (Fiscal Year Two): refers to the next fiscal year.

FY16E: Fiscal year 2016 estimation, **FY17E:** Fiscal year 2017 estimation

GDP (Gross Domestic Product): is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

GDR (Global Depositary Receipt): is very similar to an ADR. It is a bank certificate issued in more than one country for shares in a foreign company. The shares are held by a foreign branch of an international bank. The shares trade as domestic shares, but are offered for sale globally through the various bank branches.

GOODWILL: is an intangible asset that arises as a result of the acquisition of one company by another company for a premium value and can have as origin the value of a company's brand name, solid customer base, good customer relations, good employee relations and any patents or proprietary technology.

GROSS INCOME: gross profit calculated as a company's total sales minus its cost of goods sold (COGS) that corresponds to labour and production costs.

GROSS MARGIN: expresses gross income as a percentage of total sales (Gross Income/Sales*100).

IPO (Initial Public Offering): is the first sale of stock by a private company to the public to expand its growth or, sometimes, repay its debt.

LIKE FOR LIKE (LFL) GROWTH: is a measure of growth in sales, adjusted for new or divested businesses. This is a widely used indicator of retailers' performance. This adjustment is important in businesses that show a significant change through expansion, disposals or closures.

LTV (Loan-To-Value Ratio): is a financial term used to express the ratio of a loan to the value of an asset purchased. The term is commonly used by financial institutions and real estate companies to represent the ratio of the loan as a percentage of the total appraised value of real property.

NAV (Net Asset Value): is similar to book value and is also called per investment unit. NAV is the marked-to-market value of the company's property investments less liabilities.

ND (Net Debt): is calculated as a company's total debt minus cash and other similar liquid assets.

NET MARGIN: is a financial ratio which measures the profitability of the net income of a company. Formula: Net Profit/Sales.

NI (Net Income or Bottom Line): represents a company's total earnings (or profit) which is calculated by adjusting revenues for the costs, depreciation, interest, taxes and other expenses.

Glossary (2/2)

ORGANIC GROWTH: is the growth rate that a company can achieve by increasing its output and enhancing sales, excluding any profits or growth from takeovers or M&A activities.

P/E or PER (Price Earnings Ratio): reflects the trading price of a share in relation to the expected earnings. Formula: Share Price/Earnings Per Share.

P/TBVS (Price To Tangible Book Value): expresses the share price with regard to the accounting value of the company. Formula: Share Price/Tangible Book Value Per Share.

PAYOUT RATIO: is the proportion of earnings paid out as dividends to shareholders and typically expressed as a percentage. A lower payout ratio is generally preferable to a higher payout ratio. A ratio greater than 100% indicates the company is paying out more in dividends than it makes in net income.

PMI (Purchasing Managers Index): is an indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment

PROFIT WARNING: is the announcement made by the company before its earnings release indicating the investors that its earnings would not meet the analysts' expectations.

RWA (Risk Weighted Assets): is a measure of the bank's assets, weighted according to their risk. It involves the risk weighting of both on and off-balance-sheet exposures. It is generally used to calculate risk-based capital ratio which is the ratio of a bank's capital to its risk weighted assets.

REVENUE GROWTH: Illustrates the growth of sales over a given period.

ROA (Return on assets): a financial ratio that is calculated as net income divided by total assets and shows how profitable a company is relative to its total assets

ROC (Return on invested capital): a profitability ratio which is calculated as net income minus dividends divided by total invested capital.

ROE (Return On Equity): The amount of net income returned as a percentage of shareholders' equity. Return on equity measures a corporation's profitability by disclosing how much profit a company generates with the money shareholders have invested.

SHARE BUYBACK (Share Repurchase): A program by which a company buys back its own shares from the marketplace, reducing the number of outstanding shares. It usually indicates that the company's shares are undervalued and pushes the share prices up. SHAREHOLDER'S EQUITY: is the amount of the funds contributed by the owners (the stockholders) plus the retained earnings (or losses).

STOCK SPLIT: is a corporate action in which the company divides its existing shares into multiple shares to make shares seem more affordable for small investors without changing the underlying value of the company.

TBV (Tangible Book Value): is the book value excluding intangible assets.

TBV/S (Tangible Book Value Per Share): allows to estimate the accounting value of a company by measuring its stockholders' equity per share. Formula: Re-valued Net Assets/Total Shares of Company.

WACC (Weighted Average Cost of Capital): also referred to as the firm's cost of capital, it is the rate that a company is expected to pay on an average to all its security holders to finance its assets.

WORKING CAPITAL: is the difference between a company's current assets and current liabilities and shows whether the company has sufficient short-term assets to cover its short-term debts.

Indices

MSCI AC WORLD: is a free float-adjusted market capitalisation weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index consists of the following 23 developed market country indexes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK, and the US (as of 2 June 2014).

MSCI AC ASIA PACIFIC: is a free float-adjusted market capitalisation weighted index that is designed to measure the equity market performance of the developed and emerging markets in the Pacific region. The MSCI AC Pacific Free Index consists of the following 12 developed and emerging market countries: Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Taiwan, and Thailand (as of 2 June 2014).

MSCI EUROPE: is a free float-adjusted market capitalisation weighted index that is designed to measure the equity market performance of the developed markets in Europe. The MSCI Europe Index consists of the following 15 developed market country indexes: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the UK (as of 2 June 2014).

MSCI EMERGING MARKETS: is a free float-adjusted market capitalisation index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 23 emerging market country indexes: Brazil, Chile, China, Colombia, the Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, the Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey* and the UAE (as of 2 June 2014).

MSCI WORLD HIGH DIVIDEND YIELD: is based on the MSCI World Index, its parent index, and includes large- and mid-cap stocks across 23 Developed Markets (DM) countries (as of 31 March 2014). The index is designed to reflect the performance of equities in the parent index (excluding REITs) with higher dividend income and quality characteristics than average dividend yields that are both sustainable and persistent.

MSCI WORLD VALUE: captures large- and mid-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries (as of 31 March 2014). The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. With 853 constituents, the index targets 50% coverage of the free float-adjusted market capitalisation of the MSCI World Index.

MSCI WORLD GROWTH: captures large- and mid-cap securities exhibiting overall growth style characteristics across 23 Developed Markets countries (as of 31 March 2014). The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend.

MSCI WORLD SMALL CAP: captures small cap representation across 23 Developed Markets (DM) countries (as of 31 March 2014). With 4,302 constituents, the index covers approximately 14% of the free float-adjusted market capitalisation in each country.

MSCI WORLD LARGE CAP: captures large-cap representation across 23 Developed Markets (DM) countries (as of 31 March 2014). With 737 constituents, the index covers approximately 70% of the free float-adjusted market capitalisation in each country.

MSCI LATAM: captures large- and mid-cap representation across five emerging market (EM) countries (as of 31 March 2014) in Latin America. With 137 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in each country.

MSCI EMERGING ASIA: captures large and mid-cap representation across eight EM countries (as of 31 March 2014). With 537 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in each country.

MSCI RUSSIA: is designed to measure the performance of the large- and mid-cap segments of the Russian market. With 22 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in Russia.

MSCI BRAZIL: is designed to measure the performance of the large- and mid-cap segments of the Brazilian market. With 70 constituents, the index covers about 85% of the Brazilian equity universe.

MSCI INDIA: is designed to measure the performance of the large- and mid-cap segments of the Indian market. With 64 constituents, the index covers approximately 85% of the Indian equity universe.

Euro Stoxx 50: is the leading blue-chip index for the eurozone and provides a blue-chip representation of supersector leaders in the Eurozone. The index covers 50 stocks from 12 Eurozone countries. The Index is licensed to financial institutions to serve as underlying for a wide range of investment products such as Exchange Traded Funds (ETF), Futures and Options and structured products.

FTSE 100: comprises the 100 most highly capitalised blue chip companies, representing approximately 81% of the UK market. It is used extensively as a basis for investment products, such as derivatives and exchange-traded funds.

S&P 500: includes 500 leading companies in the leading industries of the US economy. It is a core component of the US indices that could be used as building blocks for portfolio construction. It is also the US component of S&P Global 1200.

Sources: FactSet, MSCI global equity indexes, SGPB

Important Disclosures

SG is acting as joint mandated lead arranger & bookrunner with Anheuser-Busch InBev for the financing of the acquisition of SABMiller.
SG acted as joint bookrunner in Anheuser-Busch Inbev's bond issue (4yr, 4yr, 6yr, 9yr, 12yr, 20yr).

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