Marshall School of Business Spring 2011
FBE 529: Financial Analysis & Valuation

Section:	Date/Time:	Location
15401 15402	Tuesday/Thursday 3:30-4:50pm Tuesday 6:30-9:30pm	JKP 210 JKP 104

Julia Plotts, Assistant Professor of Clinical Finance & Business Economics

E-mail: plotts@marshall.usc.edu Please format e-mail communications using appropriate subject headings (FBE 529 Spring 2011 and your name).
Course website: on Blackboard http://blackboard.usc.edu
Office Hours: Tuesdays 5-6:30pm (by appointment)
USC Office: Bridge Hall 307E, Office: (213) 821-6798

Course Objectives: This course develops and uses tools of financial analysis to evaluate the performance and assess the value of individual companies in an industry context. The course covers various valuation approaches and financial analysis needed for enterprise valuation. You will learn to assess a firm's business and competitive strategy and whether it is creating value for shareholders. This will involve applying tools of financial analysis and several valuation methodologies to evaluate a company's strategic and competitive positioning, financial performance, and strategic alternatives. An important aspect of this course will be to bridge financial theory and practice with valuation, capital structure analysis, and corporate strategy in the context of real world implications.

Prerequisite Knowledge:

This course assumes that the background knowledge of students include basic finance (Prerequisite: GSBA 521b or GSBA 548) and accounting. It will be assumed that students are comfortable with the topics of standard corporate finance texts such as Ross, Westerfield and Jaffe or Brealey & Myers.

Instructor: Julia Plotts teaches corporate finance and financial analysis and valuation in the EMBA (Los Angeles and San Diego), GEMBA (Shanghai), MBA.PM, and undergraduate programs at USC. She is the lead faculty for the Marshall Learning About International Commerce program (Hong Kong 2008, 2009, Sydney 2010, 2011). She is faculty advisor to the CFA® Challenge Team, Marshall Case Team and Trojan Investing Society. Her teaching has been recognized with several awards, including the USC Mellon Mentoring Award (2010), the Dean's Award for Community (2010), the USC Parents Association Teaching and Mentoring Award (2009), and the USC Marshall Golden Apple Award for Teaching Excellence (2005, 2007, 2010). Prior to joining the Marshall faculty, Plotts worked within the investment-banking group of Banc of America Securities. Her transaction experience included executing mergers and acquisitions, leveraged buyout, recapitalization and capital raising via equity and debt. Plotts worked in the Financial Institutions Group of Davis Polk & Wardwell in New York and Washington, D.C. and served on the majority legislative staff of the United States House of Representatives Committee on Banking and Financial Services, and the Subcommittee on Capital Markets, Securities & Government Sponsored Enterprises during the 104th United States Congress. She has served as a visiting faculty member at the Swiss Finance School of Business and the University of Melbourne. She teaches Equity Asset Valuation (Level 2) in the CFA® review program for the CFA® Society of Los Angeles.

Learning Objectives:

Financial Statement Analysis:

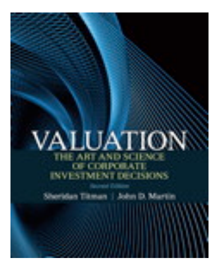
- Reviewing and assessing a firm's financial statements utilizing performance ratios, historical analysis, strategic analysis and overall market assessment of a firm. This includes evaluating the degree to which a firm's financial statements capture the underlying business reality. Recognizing accounting distortions and/or earnings manipulation and restating financials for purposes of analysis.
- Assessing Long Term Earnings and/or Cash Flow Potential: Forecasting a firm's financial performance. This includes assessing firms' future earning potential and financial health (assessing growth, value drivers and risks).

Using Valuation for Decision Making:

- Utilizing and interpreting financial data and applying valuation techniques to make decisions about courses of action for a firm. Valuing companies using various valuation models and assessing a firm's business and competitive strategy and whether it is creating value for shareholders. Topics covered:
    - Estimating a Firm's Equity and Enterprise Value for investment and change of control analysis
    - Estimating a Firm's Cost of Capital: CAPM, Arbitrage Pricing Theory and alternatives to CAPM, Weighted Average Cost of Capital
    - Valuing Firms with a Changing Capital Structure & Adjusted Present Value Method of Enterprise Valuation (APV)
    - Relative Valuation using Market Comparables/Price Multiples
    - Equity Capital Raising Transactions, Initial Public Offerings
    - Valuation in Practice, Corporate Control & Agency Problems, Mergers & Acquisitions, Leveraged Buyouts (LBOs)
    - Valuation in Private Equity Setting & Venture Capital

Course Materials:

<u>Required Textbook</u>



Valuation: The Art and Science of Corporate Investment Decisions

Sheridan Titman, University of Texas at Austin and John D. Martin, Baylor University ISBN-10: 0136117872 ISBN-13: 9780136117872

Publisher: Prentice Hall 7/22/2010

Note on the text: I will be using the 2nd edition (all syllabus and schedule references are to the 2/e), however you may use either the 1st or 2nd edition. I am a contributor to the text - the 1st edition is missing a chapter on financial statement analysis but I will share a PDF of that chapter on request with anyone using the old version.

Required Harvard Cases and Notes

Three Harvard Notes: 1) Solving the Puzzle of the CF Statement (HBS) BH103; 2) Statements of Cash Flows: 3 examples (HBS); 3) The Role of Private Equity Firms in Merger and Acquisition Transactions (HBS). Four Harvard Cases: 1) Warren E. Buffett, 2005 (Darden); 2) Hansson Private Label Case (HBS); 3) United Parcel Service IPO (HBS) and 4) Spyder Active Sports in 2004 (HBS). These may be purchased online through our Harvard Business School Publishing course link: http://cb.hbsp.harvard.edu/cb/access/7828024

You need to register on the site to create a user name if you do not already have one. Once you have registered, you can log in to see the course materials. Some course materials are in PDF documents, and you can open them with Adobe Reader.

HBS eLearning materials include a link you can use to gain access to them. You will have access to these materials for 6 months. After you register, you can get to the course again by doing the following:

1. Visit hbsp.harvard.edu and log in.
2. Click My Courses, and then click this course name: USC MBA Spring 2011 Financial Analysis and Valuation

I hope you find this a convenient way to access your course materials. If you have any questions about the materials, please contact me.

Other: Slides, handouts and supplemental readings/articles will be posted on Blackboard. Financial calculator capable of discounting cash flows and other financial calculations. Examples: HP 12-C or 10BII or TI-BA II Plus. *Please bring to every class.*

Recommended: Dictionary of Finance and Investment Terms (Barron's Financial Guides), *The Wall Street Journal*, *The Economist*, *Barron's*, *BusinessWeek, Fortune, New York Times Deal Book* http://dealbook.nytimes.com/, *Forbes* - available through http://mymarshall.usc.edu or Crocker Business Library - and other financial news and/or market analysis websites.

Grading Criteria: final grades for this course will be based on the following criteria:

Examinations: 60%

Class Participation and Case Analysis: 15%

Valuation Project and Peer Evaluation: 25%

Midterm on 3/1/11 (30%) Final Exam on 5/10/11 (30%)

Questions will include both qualitative and quantitative questions from material covered in class, and presented in the readings (textbook, cases, examples posted, class discussion).

Class Participation and Case Analysis (15%)

You are expected to participate in class discussions and with guest speakers. You will receive an instructor assessment of your participation. The assessment will reflect performance on periodic practice assignments, case discussion and the quantity and quality of an individual's contribution to the classroom-learning environment, and other issues discussed in class, as well as attendance.

To learn financial analysis and valuation we will analyze real companies and work through problems by analyzing different scenarios and courses of action. The cases have been included in the curriculum as a means to provide this self-study and practice in analysis. Students will be asked to prepare case study analysis on (3) HBS cases this semester; all cases are used as a means to assess class participation assessment.

1. **Hansson Private Label Case (HBS) deliverable due 2/8/11**
2. **United Parcel Service IPO (HBS) deliverable due 2/22/11**
3. **Spyder Active Sports (HBS) deliverable due 4/26/11**

Work in a group of your choice (3-5 students). You will be required to complete a peer analysis rating the contributions of each teach member. Case discussion questions are listed on pages 7-11 of this syllabus. Please refer to Blackboard for supplementary excel spreadsheets and other materials. A written case analysis should consist of a 2-3 page written executive summary using a standard font and font size (such as Times New Roman size 12) and 1" margins, addressing the case questions with supporting computations and tables in a separate appendix (if relevant). All case assignments are due on their respective due dates at the beginning of class. No late work will be accepted. For each case, only one copy should be submitted by each group at the start of the session. Please e-mail a single copy of the report (PDF, Word and Excel format as appropriate) to plotts@marshall.usc.edu. The cover sheet of each written assignment should contain the first and last names of the students submitting the assignment arranged alphabetically. All of the names of the members in the group must appear at the top of the memo to receive credit.

Case grading is based on the quality of your analysis, how well you support your assumptions and apply valuation techniques, and the judgment you exercise and on the professionalism of your presentations. The quality of work product should be reflective of what you would be comfortable presenting to a current or prospective employer. Case grades will be determined relative to the analyses of other groups in the class. Groups will be randomly selected to verbally present their findings on both the graded and discussion cases during the class session.

Material from these cases may be included in the examination.

Valuation Project due 4/5/11 & Peer Evaluation (25%): Work in a group of your choice (3-5 students) on the valuation project. An overview of the project deliverable will be provided in class and will be posted in the "Assignments" section on Blackboard.

No Extra-Credit Assignments

In fairness to other students, there will be no extra-credit assignments. Requests for extra-credit assignments to make up poor performance on an exam will not be granted.

No Recording and Copyright Notice

No student may record any lecture, class discussion or meeting with me without my prior express written permission. The word "record" or the act of recording includes, but is not limited to, any and all means by which sound or visual images can be stored, duplicated or retransmitted whether by an electro-mechanical, analog, digital, wire, electronic or other device or any other means of signal encoding. I reserve all rights, including copyright, to my lectures, course syllabi and related materials, including summaries, prior exams and all supplementary course materials available to the students enrolled in my class whether posted on Blackboard or otherwise.

The material presented and the classroom discussions are not intended to be financial advice to students in connection with any issue(s) they or others may have. If students have a financial matter, they are advised to promptly consult an experienced professional who can fully review the facts and advise them accordingly.

Code of Ethics & Academic Integrity:

The use of unauthorized material, communication with fellow students during an examination, attempting to benefit from the work of another student, and similar behavior that defeats the intent of an examination, or other class work is unacceptable to the University. It is often difficult to distinguish between a culpable act and inadvertent behavior resulting from the nervous tensions accompanying examinations. Where a clear violation has occurred, however, the instructor may disqualify the student's work as unacceptable and assign a failing mark on the paper. All students at the University of Southern California have an inherent responsibility to uphold the principles of academic integrity and to support each other and the faculty in maintaining a classroom atmosphere that is conducive to orderly and honest conduct. Students must understand and uphold the rules printed in the Student Conduct Code in the USC SCampus handbook, regarding examination behavior, fabrication, plagiarism, and other types of academic dishonesty. Violations will result in a failing course grade and referral to the University's judicial system.

Student Disability

Any student requesting academic accommodations based on a disability is required to register with Disability Services and Programs (DSP) each semester. A letter of verification for approved accommodations can be obtained from DSP. Please be sure the letter is delivered to be as early in the semester as possible. DSP is located in STU 301 and is open 8:30 AM to 5:00 PM, Monday through Friday. The phone number for DSP is (213) 740-0776.

Marshall School of Business Spring 2011
FBE 529: Financial Analysis & Valuation

Spring 2011 Course Outline, Assigned Readings, Schedule of Assignments and Exams

Week:	Topic:	Readings & Assignments:
11-Jan	**Course Introduction**	Syllabus & Chapter 1 Titman Martin
18-Jan	**Fundamental Analysis - Intrinsic Value**	***Warren E. Buffett, 2005 (Darden Case) HBS***
	January 20th Section 15401 Guest Speaker on Research Tools - Laptop recommended	
25-Jan	**Forecasting Financial Performance**	
	Review of Balance Sheet, IS, CFS	Chapter 6 Titman Martin
	Financial Statement Analysis	Financial Statement Analysis Handouts (Blackboard)
	Ratios Analysis, Profitability, Efficiency, Liquidity	Statement of CF: 3 examples (HBS) 9-193-103
	Leverage, Credit Ratings and Covenants	Solving the Puzzle of the CF Statement (HBS) BH103
	January 25th Section 15402 Guest Speaker on Research Tools - Laptop recommended	
1-Feb	**Forecasting & Valuing Cash Flows**	Chapters 2-3 Titman Martin
8-Feb	**Estimating Cost of Capital**	Chapters 4-5 Titman Martin
	Valuation for Project Analysis	***Hansson Private Label Case (HBS) deliverable due***
15-Feb	**Relative Valuation Using Market Comparables**	Chapter 8 Titman Martin
22-Feb	**IPO Valuation**	***United Parcel Service IPO (HBS) deliverable due***
1-Mar	***Midterm Exam 30%***	
8-Mar	**Enterprise Valuation**	Chapter 9 Titman Martin
15-Mar	**Spring Recess**	
22-Mar	**Enterprise Valuation**	
29-Mar	**Valuation in a Private Equity Setting**	Chapter 10 Titman Martin
5-Apr	**Special Topic**	***Group Valuation Project deliverable due (25%)***
12-Apr	**Mergers & Acquisitions**	See Readings on Blackboard on M&A
	Earnings Dilution, Incentive Compensation	Nestle's $4B Acquisition of Kraft's Frozen Pizza Business
	and Project Selection	Chapter 7
19-Apr	**Mergers & Acquisitions**	The Role of Private Equity Firms in M&A Transactions (HBS)
26-Apr	**Private Company Valuation**	***Spyder Active Sports 2004 (HBS) deliverable due***
10-May	***Final Exam 30%***	***2-4pm for section 15401, 7-9pm for section 15402***

Marshall School of Business Spring 2011
FBE 529: Financial Analysis & Valuation

Case Discussion January 18: Warren E. Buffett, 2005[1]

Objectives:

To introduce the concept of intrinsic value and to study one of the most successful investors in the world, Warren E. Buffett.[2]

Warren E. Buffett, 2005 HBS#UV0016 (Darden)

On May 24, 2005, Warren Buffett, the chairman and chief executive officer of Berkshire Hathaway Inc., announced that MidAmerican Energy Holdings Company, a subsidiary of Berkshire Hathaway, would acquire the electric utility PacifiCorp. In Buffett's largest deal since 1998, and the 2nd largest of his entire career, MidAmerican would purchase PacifiCorp from its parent, Scottish Power plc, for $5.1 billion in cash and $4.3 billion in liabilities and preferred stock.

Case Discussion Questions:

- What were the key principles that guided Buffett? Could these be broadly applied in the 21st century, or were they unique to Buffett and his time?
- From an understanding of these principles, analysts hoped to illuminate the acquisition of PacifiCorp. What were Buffett's probable motives in the acquisition?
- What did Buffett's offer say about his valuation of PacifiCorp, and how would it compare with valuations for other regulated utilities?
- Would Berkshire's acquisition of PacifiCorp prove to be a success? How would Buffett define success?
- What is the possible meaning of the changes in stock price for Berkshire Hathaway and Scottish Power plc on the day of the acquisition announcement? Specifically, what does the $2.17-billion gain in Berkshire's market value of equity imply about the intrinsic value of PacifiCorp?
- Based on the multiples for comparable regulated utilities, what is the range of possible values for PacifiCorp? What questions might you have about this range?
- Assess the bid for PacifiCorp. How does it compare with the firm's intrinsic value?
- How well has Berkshire Hathaway performed? How well has it performed in the aggregate? What about its investment in MidAmerican Energy Holdings?
- What is your assessment of Berkshire's investments in Buffett's "Big Four": American Express, Coca-Cola, Gillette, and Wells Fargo?
- From Warren Buffett's perspective, what is the intrinsic value? Why is it accorded such importance? How is it estimated? What are the alternatives to intrinsic value? Why does Buffett reject them?
- Critically assess Buffett's investment philosophy. Be prepared to identify points where you agree and disagree with him.
- Should Berkshire Hathaway's shareholders endorse the acquisition of PacifiCorp?

---

[1] There is no case deliverable due for the Warren Buffett case. Please be prepared to discuss in class.
[2] In 1999, Buffett was named the top money manager of the twentieth century in a survey by the Carson Group. In 2007, he was listed among Time's 100 Most Influential People in the world. In 2010, the White House announced that President Obama would be awarding him the Presidential Medal of Freedom.

Marshall School of Business Spring 2011
FBE 529: Financial Analysis & Valuation

Group Case Due February 8: Project Analysis Using DCF
Applying NPV in Corporate Investment Decisions
Estimating Cost of Capital

Objectives:
DCF analysis is a key building block for valuation. In this case analysis we will review the process for applying DCF analysis to a capital budgeting proposal. The case includes a comprehensive forecasting example that focuses on the process one goes through to link production capacity utilization, units sold, unit revenues and unit costs to investment cash flows, including an analysis of working capital. This case also reviews the time value of money mechanics of discounting investment cash flows to estimate project value, and risk and return, divisional hurdle rates and Weighted Average Cost of Capital.

The case addresses the static problem of the optimal mix of debt and equity in the firm's financing. We will attempt to understand both the theoretical concept and the practical determination of a firm's weighted average cost of capital (WACC) and the role of cost of capital in investment analysis and valuation.

We will: 1) introduce the standard financial tools for assessing the attractiveness of a proposed capital investment; 2) discuss the complementing of discounted cash flow analysis with industry analysis; 3) examine issues surrounding capital planning process, especially as it applies to a large investment; 4) explore how a company uses the Capital Asset Pricing Model (CAPM) to compute the cost of capital for a project. Cover the use of Weighted Average Cost of Capital (WACC) formula and the mechanics of applying it to the capital budgeting process. Corresponds with Chapters 1-6 of Titman Martin text.

Expansion and Risk at Hansson Private Label, Inc.: Evaluating Investment in the Goliath Facility HBS#4021

HPL, a manufacturer of private-label personal care products must decide whether to fund an unprecedented expansion of manufacturing capacity.

Case Discussion Questions:
- Briefly evaluate and comment on HPL's historical performance.
- Utilizing the data provided in the exhibits, determine whether the project is attractive in strategic and economic terms. Calculate the total project cash flows, NPV, and IRR, given the supplied project forecasts. Should Hansson accept or reject the project proposal?
    - *Please include the group's spreadsheet/excel analysis as an exhibit.*
- To which key assumptions is the NPV most sensitive? What, if anything, might be done to mitigate the project risks? If Hansson wants to decline the expansion proposal, what practical alternative options does he have?
- Evaluate the determination of WACC/hurdle rate for Hansson. What are the appropriate assumptions for the calculation of cost of equity and the cost of debt?

Marshall School of Business Spring 2011
FBE 529: Financial Analysis & Valuation

Group Case Due February 22: Financial Statement Analysis and IPO Valuation

Objective:
Consider the choices a firm has for its capital structure - debt vs. equity - and how these change over a firm's life cycle. Discuss the process of an initial public offering and how relative valuation using market comparables is used to price an IPO. We will highlight the impact of market conditions on a company's valuation and ability to raise funds in an IPO. Corresponds with Chapters 6, 8 of Titman Martin text.

United Parcel Service IPO #9-103-015 Examines the valuation of United Parcel Service (UPS) at the time of its IPO in mid-1999.

Case Discussion Questions:

- What is United Parcel Service's ("UPS") motivation for its IPO? What are the potential benefits and downsides to this decision to raise capital through the public equity markets?
- Based on the industry trends and market share data provided in the case about the package delivery industry, what are UPS's strengths and weaknesses relative to its other competitors. What is your opinion on the company's future forecast of sales, profit margins, and cash flow? Would you advise investors to participate in the IPO?
- Perform financial statement analysis and a strategic analysis of the company while also assessing the company's performance relative to its peer FedEx. Evaluate the company's assets, leverage, and footnotes including information on its capital and operating leases.
- Assessing the value of an IPO candidate is typically done through valuation estimation methods including the income approach (discounted cash flow analysis) or the market approach/relative valuation (applying a benchmark multiple such as a P/E ratio or Price/Book ratio).[3] If we consider this latter "market-approach" to estimate the value of UPS at the time of its IPO, respond to the questions raised at the end of the case[4] - do you agree with the investment bankers' valuation approach for UPS? Or do you agree with UPS managements' view that the "best of breed" approach should be applied to determine the company's public market valuation?[5] Estimate the implied IPO valuation for UPS based on the market approach and assumptions/data provided.

---

[3] Also referred to as relative valuation or valuation using market comparables: selecting and analyzing comparable publicly traded firms and applying a standardized multiple to determine an implied value of an asset or firm. Chapter 8 of Titman Martin explains the method in detail and provides an overview of pricing an IPO. If we planned to take a technology start-up public through an IPO and it had annual net earnings (net income) of $10 million and comparable firm (given cash flow, growth and risk characteristics) trade in the public markets for 35x Price/Earnings it would result in the IPO Company's equity valuation at $350 million. Basic real estate valuation techniques are similar – where the benchmark valuation multiple would be $ per square meter/foot etc. Real estate professionals often refer to analyzing the "comps" or comparable properties that have sold in a geographic area to determine a fair market value for the property.

[4] Page 11 of the UPS case under the heading "Offer Pricing"

[5] Exhibit 6 and 13 of the UPS case provide data on FedEx valuation multiples and the "Best of Breed" premiums on other industries.

Group Case Due April 26: Evaluating Strategic Alternatives for a Private Company

Objective:
Discuss valuation issues of a privately owned company; evaluate alternative ways to harvest wealth from a private company. Discuss family business issues and entrepreneurial finance. Assess an expansion/high-growth phase company's strategic alternatives and an owner's consideration of timing of "exit" options. Corresponds with Chapters 6-7-8 of Titman Martin text.

Required Case Study: Spyder Active Sports #9-206-027

David Jacobs founded a high-end ski apparel company in 1978. He successfully built and grew the company, establishing a major international brand that appealed to ski racers and other active skiers. In 1995, he sought external financing to support further growth of the company and structured a financial deal with CHB Capital Partners, a private equity firm in Denver. By 2004, Jacobs was ready to consider alternative types of equity transactions that would provide a source of liquidity to him and his family, including sale of Spyder to another apparel company and sale of a large block of stock to a private equity firm.

Case Discussion Questions:

Please note that excel spreadsheets with financial data from the Spyder exhibits are available on Blackboard.

- Identify the different "exit" options that are feasible for Spyder in 2004, and analyze the benefits and costs of each alternative. Is this a good time to sell the business? Consider the interests and needs of the owner(s), the current state and future prospects of the company, and the current state of the financial markets.
- Perform a valuation of the company using both the Income (Discounted Cash Flow) and Market Approach (Peer public comparables and Merger and Acquisition comparables). Please include the group's spreadsheet/excel analysis as an exhibit.
    - o Discounted cash flow valuation: Calculate Spyder's forecasted Free Cash Flow to the Firm using exhibit 5 of the case. Estimate Spyder's terminal value. At what point will Spyder reach the end of its high-growth period? Determine the appropriate discount rate for this analysis - Spyder's Weighted Average Cost of Capital (WACC) or a potential buyer's required rate of return (IRR)? A Discounted Cash Flow (DCF) valuation of Spyder requires assumptions that are not mentioned in the case.[6]

[6]Tax rate if determined from the income statement ranges from 16% to 45%. It is acceptable to consider a constant corporate tax rate (i.e. 35%)? Tax rate details were not given or discussed, and since Spyder has international operations and those foreign tax rates weren't mentioned, it is acceptable to assume an average tax rate based on the data provided or a corporate tax rate assumption.
- Risk-free rate and Market Risk Premium (MRP) for CAPM (Ke) is not given in the case. The case didn't give a risk-free rate, but the 10 and 20-yr. treasury rate for the time of the case is available on Yahoo finance. The yield on a 20-

Spyder Case Discussion Questions (continued):

- Spyder is not publicly-traded on a stock exchange, but we can still apply the market approach to estimate the company's implied value (much like we did with UPS's IPO). Evaluate the financial data provided for Spyder and also the comparable publicly-traded company price multiples and comparable past merger and acquisition price multiples.[7]
- Compare the alternative transactions described on the last page of the case. Which alternative would you pursue if you were David Jacobs? In your view does Jacobs have differing interests on which strategic alternative to pursue as compared to Shimokuba, Jake Jacobs or CHB?

---

year Treasury bond was 4.77% on 3/31/2004. The market risk premium assumption of 5-6% per our discussion is fine (this would be assuming a method of analyzing historical and predicted returns).
- Betas for comparable firms is provided in exhibit 11. Refer to lecture material on WACC (and Chapter 4 of Titman Martin text) regarding levering and unlevering beta and perform an analysis for an "implied" Spyder beta. If you choose to use this approach it is similar to what we did in the Hansson case. You will need to determine appropriate assumptions for firms comparable to Spyder.
- Capital Structure: Spyder is not publicly traded; can we use book value for V, E, and D in this case? If the #1 step in a WACC is capital structure weights for the firm being analyzed you should make a determination that ties with your recommendation, for example if you think Jacobs should buy out his partner he would most likely need to take on debt to do so. If you feel they should sell to a strategic or financial buyer then this has different capital structure implications. If you feel they should remain 100% equity financed due to their life cycle stage then that is also a fair assumption. Make an assumption based on book values or using industry figures to calculate the target capital structure is also a reasonable assumption. WACC can be determined using the industry figures and making assumption on cost of debt. For example, if Spyder is an implied AA it would have a pre-tax cost of debt of around 5-6% (according to the 20-year Treasury Bond rate and the Reuter Corporate Spreads (in basis points) in the Titman Martin text.

[7] The implied value of Spyder via the market approach will be impacted by the type of buyer (strategic or financial) and type of sale (majority/controlling stake vs. minority interest/non-controlling stake). A strategic buyer seeking a controlling stake is an acquirer that might be able to achieve synergies (cost savings) or benefits from the acquisition (and they are typically willing to pay for control). An example might be Nike. A financial buyer is an investor group (like CHB) who would not be able to achieve synergies. They might be looking for an investment that will get them an IRR that compensates them for their investment and for their assistance and expertise as a company grows. They typically are not looking to hold the investment long term, and would ultimately want to exit their investment and harvest a return on investment within a specified period of years.