USC Marshall School of Business

FBE 421 Financial Analysis and Valuation

Syllabus – Fall 2012
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Please format e-mail communications using appropriate subject headings (FBE 421 and your name).

Lecture Class
Mon./Wed. 4-5:50pm — Room: JKP 110

Office Hours:

8/27-10/1	Due to a busy travel schedule for EMBA and GEMBA, during this time office hours will be held by appointment only.
10/3-10/24	Before/after class (by appointment)
10/24-12/5	10:30am-12:30pm and after class (by appointment)
	Special office hours will be scheduled for exam preparation.

Introduction and Course Objective

This course develops and uses tools of financial analysis to evaluate the performance and assess the value of companies in an industry context. The course covers various valuation approaches and financial analysis needed for project and 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.

This course covers the theory and practice of corporate finance and valuation. You need the theory to understand why companies and financial markets behave the way they do. This course will show you how managers and analysts use financial theory to solve practical problems. Our coverage of the material is designed to allow you to become comfortable with the fundamentals so that you can improve your proficiency in participating in future financial and strategic discussions within a company or organization and with external analysts and service providers. Among the course goals:

- To give you the capacity to understand the theory and apply techniques in corporate finance and valuation.
- To develop your analytical skills and communication strategies for discussing financial analysis and valuation.
- To give you the big picture of valuation, so you can understand how things fit together.
- To expose you to the language of financial analysis and valuation.

Prerequisite Knowledge
This course assumes that the background knowledge of students include basic finance (BUAD 306) 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. Note: You are responsible for reviewing your basic finance and accounting concepts ASAP. The pace and schedule of topics covered in this class does not allow for review of these concepts, so please be prepared.

Note about Class Participation
Please arrive to class on time and prepared for lecture. Be prepared for cold calling, bring your name card to class. Please handle mobile phone/blackberry, text messaging outside of class and perform unrelated web browsing outside of class. Please come to class rested (if you sleep in class you will be asked to leave). Laptops may be used only for class purposes.

Learning Objectives
Following completion of the course students will be capable of:
Focusing on Value Creation
- Understanding that the goal of the firm is value creation. Value creation is fundamentally more important than that of growing revenues, earnings per share, maximizing volume and/or market share. Companies and business units create value by investing capital in positive net present value (NPV) projects.

Financial Statement Analysis
- Gaining proficiency in financial statement analysis and evaluation of performance metrics. 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:
- Applying enterprise valuation methodologies including market multiples, precedent transactions and discounted cash flow analysis (DCF).
    - 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
    - Equity Capital Raising Transactions, Initial Public Offerings
    - Valuation in Practice, Corporate Control & Agency Problems
    - Mergers & Acquisitions
    - Leveraged Buyouts (LBOs)/Management Buyouts
    - Valuation in Private Equity Setting & Venture Capital

Required Materials

Textbook: *Valuation: Measuring and Managing the Value of Companies, 5th Edition* (Wiley Finance) Tim Koller, Marc Goedhart, David Wessels, ISBN: 9780470424704

Cases: The course pack can be purchased online at the following link (each case is $3.95):

http://cb.hbsp.harvard.edu/cb/access/14618078

Index of HBS Notes & Handouts:		*Source:*
1)	Solving the Puzzle of the Cash Flow Statement (HBS)	BH103
2)	Statements of Cash Flows: Three examples (HBS)	#9-193-103
3)	The Role of Private Equity Firms in Merger and Acquisition Transactions	#9-206-101
Index of HBS Cases:		
1)	Porsche Changes Tack	#TB0067
2)	Bed Bath and Beyond	#9-196-123
3)	Interco	#9-291-033
4)	United Parcel Service IPO	#9-103-015
5)	Spyder Active Sports	#9-206-027

- **Other:** Slides, handouts and supplemental readings/articles on Blackboard. Financial calculator capable of performing discounted cash flows, IRR and other financial calculations. Please bring to every class. In most cases we will use excel spreadsheets to review calculations.
- **Recommended Reading:** *The Wall Street Journal*, *The Economist*, *Barron's*, *Forbes* (available through http://mymarshall.usc.edu or Crocker Business Library). Wall Street Journal Student Subscriptions are available for $29.95 for 15 weeks. http://wsjstudent.com

Grading Summary
Final grades represent how you perform in the class relative to other students. The average grade target for this class is a 3.3/4 (B+).

	Course Grade Breakdown
Class Participation	5%
Group Peer Evaluation	5%
Final Group Valuation Project 12/12/12	30%
Midterm 1 Exam: 9/26/12	30%
Midterm 2 Exam: 11/14/12	30%
Total	100%

Case Analysis and Class Participation (5%)
We will analyze real companies and work through problems by analyzing different scenarios and courses of action. In your analysis of our HBS case studies you should place yourself in the role of the decision maker as you read through the situation and identify the problems and issues. The next step is to perform the necessary analysis. To get the most out of cases, you should read and reflect on the case individually, and then meet in study group teams prior to class to "warm up" and

discuss your findings with other classmates. In class we will probe underlying issues, compare different alternatives, and finally, suggest courses of action in light of the objectives of the case.

The cases have been included in the curriculum as a means to provide this self-study and practice in analysis. Study groups should prepare and hand-in a pre-session case study analysis at the beginning of class. Questions for the cases are provided on pages 8-13. For most of the HBS cases you will receive supplementary excel spreadsheets via Blackboard.

Final Valuation Group Project & Peer Evaluation (35%): Work in a group of your choice (3-6 students) on the final valuation project. 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. An overview of the final project deliverable will be provided on insert date and will be posted in the "Assignments" section on Blackboard. You will be asked to present your final case on our Final Exam date. Attendance is mandatory. You will also be asked to complete a peer evaluation of each team member, which will be considered in the final grading assessment.

Exams (60%)

Questions will include both qualitative and quantitative questions from material covered in class, and presented in the readings (textbook, course reader, examples posted, class discussion). There are no make-up exams. Exams are closed-book, closed-note (no-formula sheets).

Retention of Graded Coursework

Final exams and all other graded work which affected the course grade will be retained for one year after the end of the course ***if*** the graded work has not been returned to the student; i.e., if I returned a graded paper to you, it is your responsibility to file it.

Technology Policy

Laptop and Internet usage is not permitted during academic or professional sessions unless otherwise stated. Use of other personal communication devices, such as cell phones, is considered unprofessional and is not permitted during academic or professional sessions. ANY e-devices (cell phones, PDAs, I-Phones, Blackberries, other texting devices, laptops, I-pods) must be completely turned off during class time. No student may record any lecture, class discussion or meeting with me without my prior express written permission. 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.

Statement for Students with Disabilities

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 me as early in the semester as possible. DSP is located in STU 301 and is open 8:30 a.m.–5:00 p.m., Monday through Friday. The phone number for DSP is (213) 740-0776.

Statement on Academic Integrity

USC seeks to maintain an optimal learning environment. General principles of academic honesty include the concept of respect for the intellectual property of others, the expectation that individual work will be submitted unless otherwise allowed by an instructor, and the obligations both to protect one's own academic work from misuse by others as well as to avoid using another's work as one's own. All students are expected to understand and abide by these principles. SCampus, the Student Guidebook, contains the Student Conduct Code in Section 11.00, while the recommended sanctions are located in Appendix A. http://www.usc.edu/dept/publications/SCAMPUS/gov/

Students will be referred to the Office of Student Judicial Affairs and Community Standards for further review, should there be any suspicion of academic dishonesty. The Review process can be found at: http://www.usc.edu/student-affairs/SJACS/ Failure to adhere to the academic conduct standards set forth by these guidelines and our programs will not be tolerated by the USC Marshall community and can lead to dismissal.

Emergency Preparedness/Course Continuity

In case of emergency, and travel to campus is difficult, USC executive leadership will announce an electronic way for instructors to teach students in their residence halls or homes using a combination of Blackboard, teleconferencing, and other technologies. Instructors should be prepared to assign students a "Plan B" project that can be completed at a distance. For additional information about maintaining your classes in an emergency please access: http://cst.usc.edu/services/emergencyprep.html

Other

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.

Schedule of Class Session

Date and Topic	Readings and Learning Objectives
Week 1 8/27-8/29 *Course Overview* *Foundations of Value*	Reading: Koller Chapters 1-2, skim Chapter 17 *Learning Objectives* • Understand that the goal of the firm is value creation. Value creation is fundamentally more important than that of growing revenues, earnings per share, maximizing volume and/or market share. Companies and business units create value by investing capital in positive net present value (NPV) projects. • Introduce concepts of value creation and discuss emotions and mispricing in the market and the benefit of conducting fundamental analysis.
9/3	**Labor Day Holiday – No Class Session**
Week 2 9/5 *Financial Statement Analysis (FSA)* *Forecasting Performance*	Reading: Koller Chapters 7, 8, 9, Statement of Cash Flow Readings *Due: Bring Student Biography to Class (See Blackboard for Example)* *Learning Objectives* • Gain proficiency in financial statement analysis and evaluation of performance metrics. We will review examples considering ratios and performance metrics. • Perform analysis of cash flow statements to understand a firm's historical performance and important forecast drivers. • Understand and reorganize the financial statements to ensure we value operations and non-operating assets separately. Review the drivers of free cash flow including return on invested capital (ROIC), operating net working capital, invested capital (CapEx) and other special considerations such as excess cash and marketable securities, minority interest, etc.
Week 3 9/10 *FSA and Forecasting*	Discussion Case: Porsche Changes Tack Reading: Solving the Puzzle of the Cash Flow Statement (HBS) BH103 9/10: Statements of Cash Flows: Three examples (HBS) 9-193-103 (in-class) *Learning Objectives:* • Analyze cash flow statements of Alpha, Beta and Gamma. • Evaluate the degree to which a firm's financial statements capture the underlying business reality, recognizing accounting distortions and/or earnings manipulation and assessing long-term earnings and/or cash flow potential so that we may forecast a firm's financial performance. This includes assessing a firm's future earning potential and financial health (assessing growth, value drivers and risks).
Week 3/4 9/12 *FSA and Forecasting* 9/17	Continue FSA Forecasting, discuss earnings manipulation and normalization. Discussion Case: Bed Bath and Beyond • BBBY Case: Analyze a specialty retailer and its industry competitors. Conduct a complete financial statement analysis of the company. Discuss treatment of off-balance sheet financing (operating leases).

<table>
<tr><th>Date</th><th>Readings and Learning Objectives</th></tr>
<tr><td>Week 4
9/19
Frameworks for Valuation</td><td>Reading: Koller Chapters 6, 10, 11, 12, 13 (skim Appendix A-D)
Learning Objectives:
Discuss enterprise valuation methodologies including WACC-based discounted cash flow analysis (DCF), Economic Profit and Adjusted Present Value (APV).
Understand techniques for estimating terminal value (continuing value) and Weighted Average Cost of Capital (WACC)
Discuss sensitivity analysis of key variables and interpretation of results.</td></tr>
<tr><td>Week 5
9/24
9/26</td><td>
Midterm Review
Midterm Exam</td></tr>
<tr><td>Week 6
10/1
10/3</td><td>
Special Topic or Speaker (TBD)
Continue Valuation Frameworks discussion</td></tr>
<tr><td>Week 7
10/8-10/10
Private Equity</td><td>Discussion Case: Interco
Reading: The Role of Private Equity Firms in Merger and Acquisition Transactions
Learning Objectives:
Continue valuation frameworks discussion
Discuss “Sum of the Parts” valuation approach
In the Interco case discussion we will review a third party valuation and introduce the concept of “agency problems.”
Understand the role of third party valuation service providers
Introduce private equity and discuss leveraged and management buyouts
Discuss the importance of private equity firms as a vital source of capital for start-ups as well as more operationally mature firms. A private equity firm is a financial intermediary that is involved in raising pools of capital to invest in companies.</td></tr>
<tr><td>Week 8
10/15-10/17
The Market Approach</td><td>Reading: Koller Chapter 14, skim Chapter 34
Discussion Case: UPS IPO
Learning Objectives:
Understand how to use Multiples to Triangulate DCF Results
Apply relative valuation in the context of valuation for initial public offerings</td></tr>
<tr><td>Week 9
10/22-10/24
Mergers and Acquisitions</td><td>Reading: Koller Chapter 21
Learning Objectives:
Understand the value creation framework for M&A
Discuss approaches for valuing synergies resulting from M&A
Discuss alternatives to M&A (buy-build-partner, minority investment) and drivers of M&A (motives/benefits)
Discuss cross border M&A including Coca-Cola Co.’s failed bid for China Huiyuan Juice Group. We will evaluate whether the transaction proposed by Coke had the potential to create value for its shareholders and whether the valuation was justified based on the quality of the target asset and the potential benefits to Coke.</td></tr>
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Date	Readings and Discussion Questions
Week 10 10/29-10/31 *Private Company Valuation*	Reading: Koller Chapter 34 Discussion Case: Spyder Active Sports Learning Objectives: ▪ 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.
Week 11 11/5-11/7	Introduce Final Valuation Group Project
Week 12 11/12 **11/14**	Midterm Review **Midterm Exam**
Week 13 11/19	Special Topic
11/21	**Thanksgiving Holiday**
Week 14 11/26-11/28 *Venture Capital*	Reading: TBD *Learning Objectives:* ▪ Discuss the Venture Capital Method approach to valuing early stage companies. ▪ Understand the approach and methodologies VCs use to arrive at the valuation for an investment. ▪ Discuss staged-financing.
Week 15 12/3-12/5	Course Wrap-Up
Final Exam Period 12/12	Final Project Presentations and Debrief – ***Attendance is Mandatory*** 4:30pm-6:30pm

Week 3: Discussion Case
Porsche Changes Tack

The announcement of Porsche's (Germany) intention to take a 20% equity interest in Volkswagen (Germany) in September 2005 was greeted with outright opposition on the part of many shareholders in both Volkswagen and Porsche. Major investment banks immediately downgraded Porsche from a buy to a sell, arguing that the returns on the massive investment, some €3 billion, would likely never accrue to shareholders. Although Porsche and VW were currently co-producing the Porsche Cayenne and Volkswagen Touareg, this ownership interest would take the two companies far down a path of cooperation way beyond the manufacture of a sport utility vehicle. Although Porsche had explained its investment decision to be one which would assure the stability of its future cooperation with VW, many critics saw it as a choice of preserving the stakes of the Porsche and Piëch families at the expense of nonfamily shareholders.

Learning Objective:
To evaluate whether or not Porsche management is acting in the best interests of all shareholders. This question is then linked to a more detailed understanding of return on invested capital (ROIC). This strategic change by Porsche is analyzed in the context of its likely impacts on ROIC, the implications of those changes, and a return to the debate of what is best for Porsche's stakeholders.

Discussion Topics:
- Differences in management between publicly and privately held companies
- Stockholder wealth maximization versus stakeholder capitalism
- Measures of financial performance: what does ROIC offer?
- What has been causing the changes in Porsche's ROIC?

Week 4: Discussion Case
Bed Bath and Beyond

This case examines how accurately investors have incorporated information about the growth strategy of Bed Bath & Beyond (BBBY) into share price, especially given the changing competitive environment in the house wares industry and the recent Barron's article pointing to several negative indicators at BBBY.

Discussion Questions:
- It is late August 1994. You are an up and coming Equity Research Analyst at an investment banking firm and are preparing your "Initiation of Coverage" report on BBBY. You are aware of Leslie Norton's statements that appeared in Barron's on 8/8/94 (page 1 of the case), and the recent stock performance of BBBY (before and just after the Barron's article). The only other materials you have are those presented in the case.
- Perform financial statement analysis and a strategic analysis of Bed Bath & Beyond while also assessing the company's business, operating, and expansion strategy. Identify potential red flags in the financial statements. Evaluate BBBY's performance relative to its peers/competitors.
- Is BBBY's growth strategy sustainable?
- Evaluate the Balance Sheet and Statement of Cash Flows and footnotes including information on its capital and operating leases. In your opinion, is BBBY capable of financing its growth and expansion program for the remainder of 1994 and on into fiscal 1995?
- What is your opinion on the company's future forecast of sales, profit margins, and cash flow? Would you advise investors to Buy, Sell or Hold BBBY stock?
- Evaluate the market valuation of BBBY stock; is it justified by the fundamentals and earnings growth prospects of the company?

Week 7: Discussion Case
Interco

Interco is a company that owned several highly visible branded products, including Converse shoes, London Fog and Ethan Allen furniture. The management of Interco received an unsolicited offer to buy the company from an investor group led by the Rales brothers. The offer involved a substantial premium over the market value of the company, but the management chose to resist the hostile acquisition. As a part of their effort they hired the prestigious investment-banking firm Wasserstein Perella to perform a valuation of the company. The valuation and the methodology are described in the case study.

Learning Objective:

Review a third party valuation and introduce the concept of "agency problems". The phrase "agency problems" refers to the potential for conflicts of interest between the shareholders of a public company and its managers (i.e., poor governance). Shareholders will value the cash flows that they actually expect the management will deliver to them in the future. Moreover, managers will not necessarily be interested in pursuing the shareholders' best interests in running a company. As a result, if we are to understand how market values are really determined, we must understand the potential for shareholders' and managers' interests to diverge.

Discussion Questions:

- Consider the summary of the takeover offer in exhibit 9. Was this a fair offer?
- Critique the valuation presented to Interco Board of Directors on August 8, 1988 by advisor Wasserstein, Perella & Co. (exhibits 9-13). In your opinion, were Wasserstein's assumptions reasonable? Hint: were they engaging in M.S.U.?
- Evaluate the management policies of Interco and assess whether you think the company would be more valuable under current management or under management by the Rales brothers.

Week 8: Discussion Case
United Parcel Service IPO

Learning Objective:

Examine the valuation of United Parcel Service (UPS) at the time of its IPO in mid-1999. Consider the choices a firm has for its capital structure and how these change over a firm's life cycle. Discuss the process of an IPO and how the market approach 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.

Discussion Questions:

- What is United Parcel Service's ("UPS") motivation for its IPO? What are the pros/cons 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.
- Assessing the value of an IPO candidate is typically done through valuation estimation methods including a DCF analysis or the market approach/relative valuation (applying a benchmark multiple such as a Price/Earnings ratio or Price/Book ratio). 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 - do you agree with the investment bankers that FedEx should be used as valuation benchmarks for UPS? Or do you agree with UPS managements' view that the "best of breed" company approach should be applied to determine the company's public market valuation? Estimate the implied IPO valuation for UPS based on the market approach and assumptions/data provided.

Week 10: Discussion
Spyder Active Sports
Valuing a Private High-Growth Company
Evaluation of Strategic Alternatives

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.
- 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. A Discounted Cash Flow (DCF) valuation of Spyder requires assumptions that are not mentioned in the case.[1]
- 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.
- Note that 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

[1]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-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 and textbook on WACC 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 Marriott divisional cost of capital example with Lodging and Restaurants. It is up to you what assumptions you would like to make on 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 Spread for 2004 (in basis points) on page 132 of the Titman Martin text.

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.

- Compare the alternative transactions described on the last page of the case. Which one would you choose if you were David Jacobs? Which one would you choose if you were CHB or Shimokubo?

Optional Research Exercise

Your task is to familiarize your audience with a company and its current situation. The purpose of the exercise is to familiarize yourself with valuable resources available to you as a USC student and to improve your ability to ask important questions in assessing a company's performance and future outlook. Many of the questions in this exercise will be relevant in the final valuation project. Crocker Library's electronic resources and databases can be found in the MyMarshall portal under "Marshall Explorer, Library Resources." Please contact Marshall Research Librarians if you have reasonable questions related to accessing electronic resources locating information.

Identify a publicly traded company and go find the company overview.[2] What business is the company in? Identify industry peers/competitors. What is its market capitalization? What average multiple does the company trade at? For example: EV/Sales, EV/EBITDA, P/E. What is its trend in EBITDA profit margin, revenue and earnings growth, ROE, ROIC? How does the company's performance compare to its peer group? Does the company pay a dividend? Has the company performed acquisitions or share repurchases?

Skim through the Managements' Discussion and Analysis (MD&A) in the company's most recent Form 10-K and 10-Q. The purpose of the MD&A is to provide a narrative explanation, through the eyes of management, of how an entity has performed in the past, its financial condition, and its future prospects. The section contains a description of the most recent performance period and some of the key factors that influenced the business of the company, and sometimes includes overview of the company's past, present, and future. MD&A typically describes the corporation's liquidity position, capital resources, results of its operations, underlying causes of material changes in financial statement items (such as asset impairment and restructuring charges), events of unusual or infrequent nature (such as mergers and acquisitions or share buybacks), positive and negative trends, effects of inflation, domestic and international market risks, and significant uncertainties.

Perform a news search for relevant events. When is the company's next earnings call? Locate the transcript for the company's most recent earnings call. Locate the stock ownership information for the company. When did the company go public (IPO)? How many classes of stock are there? What is the ownership breakdown between insiders and institutional investors versus public float? In the event that there are more than one class of shares is there information on voting rights? Review the historical stock performance of the company. Does the company have Preferred Stock outstanding?

Locate the debt information for the company. Does the company have debt in its capital structure? What is the historical borrowing rate for the company's debt? If the company has publicly traded bonds locate the recent price of the bonds and yield to maturity, coupon rate, etc. What is the company's Debt/EBITDA and/or Debt/Equity ratio? What is the company's current credit rating? When was its most recent debt financing?

Using Crocker electronic resources locate a recent Equity Research Report on your company. What is the analyst's rating and price-target? Does the analyst state his/her valuation approach or investment thesis? Does the analyst identify potential risks to the valuation? Does the report include a peer comparison or valuation implied from the market approach/price multiples? Locate the analyst's projections for earnings per share (EPS) growth. Compare this with Yahoo! Finance "Analyst Opinion" and "Analyst Estimates." Draft 2-3 questions that you would direct to the company's management to gain a better perspective on its strategy, financial performance or future outlook. Provide a performance rating of the company based on your findings.

[2] For this exercise it may be easier to find data such as equity research if the company has a public equity market capitalization above $1-2Billion.