
Lecture Class:

Mon./Wed. 4-5:50pm

Room: JKP 110

Office Hours:

By appointment

I will be on campus Mondays and Wednesdays and some Fridays and Saturdays for EMBA teaching assignments

Teachers Assistants:

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Course Description and Topics

This course develops and uses tools of financial and valuation analysis to evaluate the performance and assess the value of companies.

Value Creation

- Understand that the goal of the firm is value creation. Return on capital and growth drive 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.

Core Valuation Techniques and Financial Analysis

- Gain proficiency in performing discounted cash flow valuation analysis to value a company. This includes analyzing historical performance, benchmarking and strategic analysis and forecasting free cash flows, estimating the appropriate cost of capital, identify sources of value, interpretation of results.
- Analyze market multiples and precedent merger and acquisition transaction analysis to perform the market approach to valuation.

Managing for Value and Using Valuation for Decision Making

- Utilize and interpret financial data and applying valuation techniques to make decisions about courses of action for a firm.
- Discuss methods for creating value through mergers and acquisitions, divestitures and restructuring.

Other Valuation Issues and Special Situations

- Explore the challenges of valuing high-growth and private companies.
- Learn about the process of venture capital and early stage financing.
- Discuss leveraged buyouts and the approach to valuing highly leveraged companies.

Course Learning Objectives

This course covers the theory and practice of financial analysis and valuation. Our coverage of the material is designed to allow you to become comfortable with the fundamentals so that you may improve your proficiency in participating in future financial and strategic discussions within a company or organization and with external analysts and service providers. Learning goals include:

1. Understand the key aspects of financial analysis and valuation to effectively manage different types of enterprises. Students will gain knowledge of the following areas: accounting, finance, strategy and industry analysis.
2. Demonstrate critical thinking skills in the application of techniques in financial analysis and valuation. Students will gather, categorize, analyze, interpret, and evaluate relevant qualitative and quantitative information and develop the ability to be creative and innovative through the completion of a final valuation project.
3. Develop communication strategies for discussing financial analysis and valuation. This includes effective oral and written presentations of quantitative and valuation analysis. Conduct research using a broad range of sources, synthesizing and judging the quality of collected information and support written or oral claims logically and persuasively.
4. Apply valuation in a global context, considering the interplay of international markets, and economic, social and cultural issues. Students will consider issues involved in cross-border M&A and valuation analysis.

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 with our three cases can be purchased online at the following link (each case is \$3.95):

<https://cb.hbsp.harvard.edu/cbmp/access/20588779>

Course Notes

Slides, handouts and supplemental readings/articles will be posted on Blackboard. Notes or recordings made by students based on a university class or lecture may only be made for purposes of individual or group study, or for other non-commercial purposes that reasonably arise from the student's membership in the class or attendance at the university. This restriction also applies to any information distributed, disseminated or in any way displayed for use in relationship to the class, whether obtained in class, via email or otherwise on the Internet, or via any other medium. Actions in violation of this policy constitute a violation of the Student Conduct Code, and may subject an individual or entity to university discipline and/or legal proceedings.

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 subscription rates are available: <http://wsjstudent.com>

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. Please review your basic finance and accounting concepts. The pace and schedule of topics covered in this class does not allow for review of these concepts.

Class Participation

Please arrive to class on time and prepared. Be prepared for cold calling, bring your name card to class. Please handle mobile phone and 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.

Grading Policies

Final grades represent how you perform in the class relative to other students. Historically, the average grade target for this class is a 3.3/4 (B+). Three items are considered when assigning final grades: 1) your average weighted score as a percentage of the available points for all assignments (the points you receive divided by the number of points possible) 2) the overall average percentage score within the class 3) your ranking among all students in the class.

	<u>Grade Breakdown</u>
Assignment/Case Analysis and Participation	20%
Group Peer Evaluation	5%
Final Group Valuation Project	25%
Midterm 1 Exam:	25%
Midterm 2 Exam:	25%
Total	<hr/> 100%

Class Participation

High Score:

- Regular attendance and active and consistent participation in the class sessions with insightful questions and comments.
- Consistently very high levels of preparation for class sessions and activities.
- Superior and sophisticated understanding, insights, and syntheses of the course material as reflected in group assignments and case analysis and class discussions.
- Proactive and very high levels of involvement in the group assignments.
- Very high levels of professionalism manifested in interactions with speakers and classmates.

Case Analysis

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. For most of the HBS cases you will receive supplementary excel spreadsheets via Blackboard.

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. Three cases (Hansson, Spyder and the Proposed Merger of Perdigao and Sadia) will be turned in as a written deliverable. Please work on your cases in groups of 3-6 people. Do your best to work through the case utilizing readings and other supporting materials. Seeking assistance or “hints” from the instructor, the T.A. or past students is not authorized. You are authorized to work on the case assignments with others but you all must be prepared to discuss the case in class. If you choose to work with other students please submit only one copy of your case write-up. A written case analysis should consist of a 2-4 page written (executive summary) using a standard font and font size (such as Times New Roman size 11-12), addressing the case questions with supporting computations and tables in a separate appendix (if relevant).

Assignment and 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.

Assignment/Case Submission Policy

Assignments must be turned in on the due date/time electronically via Blackboard. Any assignment turned in late, even if by only a few minutes, will receive a grade deduction (for example, if your work is a B+ grade, you will be given a C+ grade). If your Internet breaks down on the due date, you must deliver a hard copy at the beginning of class on that day. If you are unable to attend class on that day, make arrangements for it to be delivered to the classroom or to my box by the start of class. Late or not, however, you must complete all required assignments to pass this course.

Final Valuation Group Project & Peer Evaluation: 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 posted in the “Assignments” section on Blackboard no later than November 8th. You will be asked to present your final case on our Final Exam date, December 11th. 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

Students will need a financial calculator capable of performing discounted cash flows, IRR and other financial calculations. Exam questions will include both qualitative and quantitative questions from material covered in class, and presented in the readings (textbook, cases, 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.

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	Topics	Readings	Deliverables
Week 1 26-Aug 28-Aug	Foundations of Value Course Overview Foundations of Value	Syllabus Koller Chapters 1-2	
Week 2 2-Sep 4-Sep	Foundations of Value Labor Day Holiday ROIC, Growth and Value Creation	Koller Chapters 3-4	Student Biography
Week 3 9-Sep 11-Sep	Foundations of Value Reorganizing the Financial Statements Analyzing Performance	Koller Chapter 7 Koller Chapter 8 (skim)	Value Creation Assignment
Week 4 16-Sep 18-Sep	Valuation In Practice Capital Budgeting Frameworks for Valuation	Koller Chapter 6, 9-13	
Week 5 23-Sep 25-Sep	Core Valuation Techniques Discuss Hansson Case Special Topic: TBA		Hansson Case
Week 6 30-Sep 2-Oct	Core Valuation Techniques Special Topic: TBA Frameworks for Valuation	Koller Chapter 6, 9-13	
Week 7 7-Oct 9-Oct	Core Valuation Techniques Frameworks for Valuation Market Approach	Koller Chapter 6, 9-13 Chapter 14	
Week 8 14-Oct 16-Oct	Core Valuation Techniques Market Approach Midterm Exam	Chapter 14	Midterm Exam
Week 9 21-Oct 23-Oct	Special Situations Private Company Valuation Discuss Spyder Case	skim Chapter 34	Spyder Case
Week 10 28-Oct 30-Oct	Managing Value Mergers and Acquisitions Mergers and Acquisitions	Chapter 21 Chapter 21	
Week 11 4-Nov 6-Nov	Special Topic: TBA Introduce Final Project		
Week 12 11-Nov 13-Nov	Managing Value M&A Guest Speaker Discuss Perdigao and Sadia Case		Perdigao and Sadia Case
Week 13 18-Nov 20-Nov	Review Midterm Exam		Midterm Exam
Week 14 25-Nov 27-Nov	Special Topic: TBA Thanksgiving Holiday		
Week 15 2-Dec 4-Dec	Special Situations Venture Capital Course Wrap-Up		
Final Exam 11-Dec	Final Project Presentations and Debrief – Attendance is Mandatory 4:30pm-6:30pm		

Value Creation Assignment due September 11th

Review the online article “Creating value: An interactive tutorial” November 2010
<http://tinyurl.com/qd5hdnf>

In this video presentation, McKinsey partner Tim Koller explores the four guiding principles of corporate finance that all executives can use to focus on value creation during strategic decisions. In the video about the core-of-value principle, he mentions that a typical large company in the U.S. and Europe is valued at 15-16x Price/Earnings. Analyze two comparable publicly traded companies¹ to gain familiarity with their business model and strategy. Observe each company’s valuation multiples such as P/E. Perform financial analysis and review any trends in performance. Consider financial metrics such as ROE, ROIC, growth, etc. Calculate free cash flow for both companies and perform a benchmarking comparison of each company and their historical financial performance.

Material covered in chapters 1-4, 7-8 will assist with this analysis.

Discussion Questions:

- Identify and discuss real examples of competitive advantages for the companies you have selected and whether you expect them to sustain high ROE and ROIC over a long period of time.
- Discuss the characteristics that justify either a higher or lower valuation? Provide your observations and build a case as to why you believe the market has valued your two companies correctly or incorrectly.
- Discuss the three generic sources of a company’s growth, their relative importance for its growth and what this means for a company’s strategy. If you were part of the management team of one of the companies that you selected which major type of growth would you pursue and why?

¹If you don’t have an industry or company that interests you, please analyze Target and Wal-Mart’s financial metrics and compare to the data discussed by Koller. You may also wish to analyze Home Depot and Lowes since the text uses this example in Chapter 7.

Expansion and Risk at Hansson Private Label Case due September 23rd

DCF analysis is a key building block for valuation. In this session 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. This case also reviews the time value of money mechanics of discounting investment cash flows to estimate project value.

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.

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

Discussion Questions:

- 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 submit the group's Excel case analysis.*
- 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?

Spyder Active Sports Due October 23rd
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.
- 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 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?

Perdigao and Sadia Case due November 13th

In April 2009, Perdigão was contemplating the acquisition of Sadia and a merger of the two companies. The intended share-swap transaction between two of Brazil's biggest food companies would allow Perdigão to dramatically grow its domestic and international market shares and become one of the world's largest players in the food production industry. The company would also increase profit margins through benefiting from synergies. However, Sadia had significant short- and long-debt that it was unlikely to be able to service. In this case you must determine whether Perdigão should acquire Sadia, establish the basis of the proposed share exchange and assess whether or not the resulting debt burden of the combined companies would be manageable. This case also allows application of core valuation techniques and applying these tools for decision making.

Case Discussion Questions:

- Taking the viewpoint of Perdigão, perform an analysis of the merger opportunity with Sadia. Does the acquisition make strategic sense?
- Utilizing the DCF method, estimate how much Sadia is worth to Perdigão on a stand-alone basis.
- Discuss the possible types of government interventions that could take place and their implications, especially for the anticipated synergies from the deal.
- How would you structure the deal? If the companies were to swap shares instead of a cash transaction, what should be the exchange ratio between Perdigão's and Sadia's shares?
- Is it financially feasible to go forward with the merger, i.e., could the merged company handle its combined financial problems? What alternatives are available to solve the company's immediate and future financing problems?

Final Project Presentations and Debrief
Attendance is Mandatory
Wednesday, December 11, 4:30-6:30pm

The Case Study Topic will be introduced in class on November 6th (Tentative)

Final Deliverable

- Prepare a summary report of your company valuation for the investment committee. The cover sheet of each report should contain the first and last names of the students submitting the assignment arranged alphabetically.
- Groups will be selected at random to present their recommendations (please prepare 5-10 PowerPoint slides with an overview of your valuation and analysis) on the final exam date.
- Provide two printed copies of both your report and your PowerPoint slides on the final exam date. Your instructor will ask you to complete a peer evaluation of each team member, which will be considered in the final grading assessment.

Your final report should include the following:

- Present your concluded value (or range of values) for the company. (A summary “football-field” graph is recommended).
- Discuss your Cost of Capital analysis.
- Discuss your forecast for the company. Specifically, address the key drivers and provide support/rationale for your assumptions.
- Discuss your DCF conclusion and your calculation of the terminal value for the DCF. Indicate which assumptions in the model are the most important drivers of value (which assumptions impact value estimate the most and provide a sensitivity analysis of the value based on these assumptions).
 - Discuss and describe the risks to attainment of your share price target including competition, costs for technology development and deployment, content acquisition, and changing macroeconomic factors.
- Discuss your Market Approach results for the value indication of Pandora (Comparable Company Analysis and Precedent Transaction).
 - Discuss any issues related to control and marketability with respect to your selected multiples for the Market Comps and Market Transactions.
- Reconcile the results of your DCF and Market Approaches, i.e., explain your value conclusion based on the indications of value from each approach. Consider issues such: If your value indications differ, is this reasonable? Would this imply the need for any adjustments to your cash flow forecast, WACC, or market multiples, or perhaps the reliance on one approach versus the other? Does your team feel it is more appropriate to weight one valuation method more heavily for your assessment of value?