

University of California, Davis
Graduate School of Management
MGB272: Evaluation of Financial Information
Summer 2014

Instructor:	Gregory Perelman	Class Web site:	www.gperelman.com
Office Hours:	by appointment	Class Meetings:	see GSM schedule
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Course Objectives

In this course you will learn how to use financial information to value firms, projects, and securities in a variety of industries under different economic conditions. The course will be largely based on case studies and will focus on learning techniques of financial analysis, selecting an appropriate valuation model, analyzing the quality of financial data, finding an appropriate discount rate, and forecasting financial variables and cash flows. The course assumes that you have a good working knowledge of accounting, finance, and economics. ***Corporate finance course (MGB260) is strongly suggested as a prerequisite. Consult with faculty if this can be waived.***

Recommended Textbooks:

Principles of Corporate Finance, by Brealey, Myers, and Allen, 11th edition.

(ISBN: 978-0-07-803476-0)

OR

Corporate Finance, by Ross, Westerfield, and Jaffe, 10th edition, (ISBN: 0078034779).

Previous editions of either textbook are acceptable.

Cases and Notes will be available on the study.net. Other reading materials will be available on the class website www.gperelman.com

Note:

Business Valuation: Standard Approaches and Applications, UV6586; rev. Nov. 21, 2013

Course Format

Case analysis will involve building Excel models and conducting sensitivity analysis to assumptions in support of the final recommendation. Due to the labor-intensive nature of case preparation, it is strongly recommended that students work in groups to get ready for class. Attendance and participation are essential parts of the learning process in this course.

Grading Policies:

Individual class participation: 20%

Group cases write ups: 40%

Final individual project: 40%

Class Participation

This course is structured as a SEMINAR, which means you must come prepared for class discussions and actively participate in class to receive credit. If you expect to miss a class for any reason, send me an e-mail beforehand. In class discussions, entire groups may be asked to take stands and express their views on the case questions. At other times, individual students will be asked to do the same. Students can expect a mix of all approaches. Questions and discussions are encouraged throughout the course.

Case Analysis

In this class you will work with a team of 4-5 students on case studies. For every case, your team must submit the following:

- a) 3-5 pages write up (excluding exhibits) where you address the questions posted in the course schedule section below. If you include exhibits, please refer to them in the text and make clear why they are included.
- b) Power Point summary (a few slides) for in-class presentations – I will randomly call on groups to present their analysis
- c) Excel spreadsheet with your calculations, financial statements, data collected for your analysis, etc.

A few more comments on the write ups: no detailed background of the case is needed – a few lines will be sufficient. At the same time, do not assume that the reader knows every number in the case. The write up is a stand-alone document and should state major problems or opportunities facing the decision-maker, list alternative courses of actions and come up with a specific recommendations. It is important to make a decision given the available information provided within the case. You are welcome to use outside sources, but, as in real life, you will never have complete information and unlimited time to make your decisions. If you make any assumptions, clearly state them. The write-up should be professional and addressed to the CEO/CFO as an internal or consulting report. Write in complete and grammatically correct sentences. Avoid bulleted presentations.

All submitted files must follow naming conventions and include your name for individual work and team/case numbers for group submissions.

Final Project

The final *individual* project involves preparing a detailed financial analysis of a publicly traded company of your choice. You can pick a company in the industry where you are/were employed or in which you are interested. However, do not pick the company in which you are currently employed. If possible, avoid conglomerates with diverse lines of business (e.g. GE). The analysis should be based on the most recent financial statements issued by the company.

The following sections must be included in your paper:

- Business description: provide brief description of the company's industry and specific lines of business;
- Financial analysis: prepare analysis of the current and past performance and comparison to industry peers; calculate current Z score;
- Forecast: forecast the company's key drivers impacting expected financial performance, complete pro forma balance sheet and income statements; utilize macroeconomic indicators in forecasting company's expected performance (for example, how changes in Federal Reserve monetary policy and the level of interest rates might impact your company's business);
- Valuation: using the techniques discussed in this course (DCF, relative valuation, etc.) produce an estimate of the firm value. Focus on the value of a share of common stock and compare your valuation to the current market price, providing explanations for any differences. You may also want to conduct a sensitivity analysis by varying your discount rate and other crucial assumptions. You should only utilize publicly available information.

More details about the final project will be provided in class discussions and on the on the class website. Your final report should be 5-7 pages (excluding any supporting materials).

Project due date: August 30 (one week after the last class meeting)

COURSE SCHEDULE
(Tentative – subject to change)

Meeting	Topics, readings, and assignments
1 Fri Jun 20	<p>Introduction and review of financial statements, financial ratios and firm performance; ROE decomposition</p> <p>Suggested reading (chapters are given by Brealey, Myers, and Allen textbook – see Table of Content on the class website to find a comparable chapter in any other textbook): Chapter 28;</p>
2 Sat Jun 21	<p>Functions of a central bank, monetary policy and interest rates; analysis of balance sheet of a central bank; review of major central banks (FED, European Central Bank, Bank of England, Bank of Japan)</p> <p>Suggested reading: Ch. 3 (term structure of interest rates), 14 (financial markets and institutions)</p>
3 Fri Jul 11	<p>Financial statements analysis of a retail company in small business setting; loan application evaluation by lenders;</p> <p>Suggested reading: Ch. 30 (working capital management) Case: Santa Fe Trading Company</p> <p>Submit (due before class meeting): for this and all remaining cases - group case write up (address all questions at the end of the case), power point presentation, and Excel spreadsheet.</p>
4 Sat Jul 12	<p>Banking industry, financial statements, government regulations and capital requirements</p> <p>Suggested reading: Ch. 23-24 (bond ratings and varieties of debt)</p> <p>Case: Citigroup 2007: Financial Reporting and Regulatory Capital, 9-111-041; Rev. October 6, 2010</p> <p>Submit group case writeup where you address the following questions:</p> <ol style="list-style-type: none"> 1. What are the primary line items within Citigroups' balance sheet and income statement? Using the balance sheet as a reference, what happens during a "run on the bank"? 2. What are the major U.S. regulatory capital provisions, particularly for the Tier 1 Capital ratio? 3. Describe the major provisions of fair value accounting under SFAS 157. What does a measure like net income capture as the firm moves toward fair value? 4. Assume Citigroup experiences continuing losses in its trading account assets in Q1 2008, requiring a (net of tax) fair value decrease (considered to be permanent) of \$50 billion. How would this be recognized in the financial statements? How would this affect the Tier 1 capital ratio? 5. Under the scenario above, what strategic options can Citigroup management consider? 6. Is fair value accounting in the U.S. banking industry helped or hurt during the financial crisis (2007-2009)? What would you suggest standard setters and regulators do going forward?

<p>5 Fri Jul 25</p>	<p>Retail industry, business restructuring</p> <p>Suggested reading: Ch. 32 (private equity, bankruptcy)</p> <p>Case: Eddie Bauer (A) 9-110-008, Rev. February 28, 2013; (B) 9-110-009, Rev. August 3, 2010</p> <p>Submit group case writeup where you address the following questions:</p> <p>Case (A)</p> <ol style="list-style-type: none"> 1. What is Eddie Bauer’s strategy upon emerging from bankruptcy protection? What are the key success and risk factors associated with this strategy, for both the firm and its industry? 2. Where, if anywhere, in the financial statement are these success and risk factors reflected? Are any adjustments needed to better reflect economic reality? 3. How has Eddie Bauer performed in the past? What key measurers can be used to gauge the company’s success? 4. What are your expectations of Eddie Bauer’s future performance? Please evaluate management’s projections. 5. Should Bank of American and J.P. Morgan Chase continue to hold Eddie Bauer stock, or was the time to sell while it was valued at \$24 per share? <p>Case (B)</p> <ol style="list-style-type: none"> 6. Why should Eddie Bauer consider going private? 7. What is your assessment of Eddie Bauer’s performance since emerging from bankruptcy? 8. What are your expectations of the company’s future performance? 9. As an Eddie Bauer shareholder, would you vote to approve the proposed buyout at \$9.25 per share? Why?
<p>6 Sat Jul 26</p>	<p>Real estate industry, hostile bids</p> <p>Case: Simon’s Hostile Tender for Taubman (A), 9-205-052, Rev. January 19, 2006;</p> <p>Submit group case writeup where you address the following questions:</p> <ol style="list-style-type: none"> 1. As a Taubman Center, Inc. independent director, would you vote to accept the \$20 per share offer? Why or why not? What alternative courses of action would you consider? 2. How would you determine the company’s fair value? Please critique the Morgan Stanley analysis in Exhibit 9. Is the Morgan Stanley analysis using the “right” cap rate? How does the cap rate compare to the company’s cost of capital, per CAPM? 3. Why was the UPREIT structure invented? What problem did it solve? Be prepared to explain the “1998 Transactions” and either defend them or critique them. 4. Does this acquisition make strategic sense for Simon? Why or why not? If you were Simon, would you raise your bid further?
<p>7 Fri Aug 8</p>	<p>Health care industry; LBOs</p> <p>Suggested reading: Ch. 32 (leveraged buyouts)</p> <p>Case: HCA, Inc (A), 9-207-076, Rev. December 21, 2011</p> <p>Submit group case writeup where you address the following questions:</p> <ol style="list-style-type: none"> 1. Why is the senior management of HCA pursuing an LBO of the firm? 2. How is HCA performing? What are the challenges that the firm faces going forward without the LBO? How does the LBO help resolve any of those

	<p>challenges?</p> <ol style="list-style-type: none"> 3. Is the offer fair to shareholders? What should you compare the offer price to when deciding if an offer is fair or not? 4. Are there any reasons for shareholders to be concerned about the LBO process? What are the conflicts, if any? 5. If you were a member of the special committee evaluating the proposed LBO, would you recommend that the proposed deal be approved?
<p>8 Sat Aug 9</p>	<p>Oil industry, hostile takeovers</p> <p>Case: Kerr-MacGee, 9-207-020, Rev. July 25, 2012</p> <p>Submit group case writeup where you address the following questions:</p> <ol style="list-style-type: none"> 1. At \$57.79 per share at year-end 2004, and based on an analysis of the multiples of comparable firms, does Kerr-McGee's stock price appear to have been undervalued? 2. What are Icahn and Rosenstein thinking? How will their proposal work? Does it make sense? 3. Calculate the net present value of Kerr-McGee's oil and gas business if the firm were to immediately cease all exploration. 4. Calculate the net present value of exploring, developing and producing oil on the basis of a single barrel of oil found. 5. Based on the analysis above, should Kerr-McGee continue exploring for oil? 6. Why is Corbett opposed to restructuring the firm? How should he respond?
<p>9 Fri Aug 22</p>	<p>Consumer product industry, divestitures</p> <p>Suggested reading: Chapter 27 (international risk management), 31 (mergers)</p> <p>Case: Diageo Plc., 9-201-033, Rev. August 6, 2003</p> <p>Submit group case writeup where you address the following questions:</p> <ol style="list-style-type: none"> 1. How has Diageo historically managed its capital structure? 2. What is the static tradeoff theory (textbook version)? How would you apply it to Diageo's business prior to the sale of Pillsbury and spinoff of Burger King? 3. Why is Diageo selling Pillsbury and spinning off Burger King? How might value be created through these transactions? 4. Based on the results of the model, what recommendations would you make for Diageo's future capital structure? Does the model capture all of the important risk factors faced by Diageo? How might you adjust the recommendations from the model to adjust for any missing risk factors?
<p>10 Sat Aug 23</p>	<p>Education industry, subscriber models, DCF valuation, forecasting</p> <p>Case: Valuing Project Achieve, 9-201-080, January 8, 2001</p> <p>Submit group case writeup where you address the following questions:</p> <ol style="list-style-type: none"> 1. What is Project Achieve's competitive advantage? What uncertainties does it confront? 2. Nine public companies have been identified as comparable to Project Achieve. Which of these companies do you consider to be most comparable? How can Boyd use her research on comparable companies in her valuation of Project Achieve? 3. What discount rate should Boyd use in her valuation of Project Achieve? 4. Boyd anticipates that Project Achieve will have different types of users (customers). What are these customer types? What is the most likely type of

	<p>customer?</p> <ol style="list-style-type: none"> 5. What value does each customer type have to Project Achieve? 6. What value does each targeted customer have to Project Achieve? 7. What is the value of all Project Achieve's targeted customers? 8. What is the value of Project Achieve? 9. Boyd's potential investors have widely varying estimates of the value of Project Achieve. How will Boyd's valuation of Project Achieve contribute to her negotiations with potential investors? Why might their valuations differ from Boyd's? 10. Boyd's potential investors include angel investors, venture capitalists, a strategic investor, and Jostens, a school supply company. What are the advantages and possible disadvantages to Project Achieve of each type of investor? Which type of investor would you consider most suitable for Project Achieve?
	<p>Final project due August 30 (one week after the last class meeting).</p>