



# FINA535

## Strategic Finance and Value Creation

### Spring 2008

#### Instructor

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#### Course Information

TIME: Saturdays,  
9:00 – 12:20 PM  
2:30 – 5:50 PM  
PLACE: Room 3008  
OFFICE HOURS: Any time, by ap-  
pointment

#### Objectives

The course discusses valuation frameworks that can readily be applied to improve business and strategic decision making. Alternative valuation approaches are considered. The focus of the course is on applying these techniques to leveraged buyouts and M&A transactions. The bulk of the time is devoted to understanding the role that mergers and acquisitions (M&A) play in corporate strategy. Why do firms undertake these transactions? What are the sources of value in these transactions? How much value gets created? Why do many mergers fail? How can firms engage in successful acquisitions? How do private equity firms create value in leveraged buyout (LBO) transactions? Students develop skills in valuation of acquisitions and private equity targets. This course uses a mix of lecture and case analysis.

#### Prerequisites

Students are assumed to have taken the corporate finance course (FINA512) in a previous term. It is assumed that you have a working knowledge of financial accounting, cash flows, Capital Asset Pricing Model (CAPM), capital budgeting, and capital structure.

## Readings

### Course materials

The course material consists of a number of case-studies and background readings. Additional handouts will be distributed in class.

### Textbook

Sheridan Titman and John D. Martin, "Valuation: The Art and Science of Corporate Investment Decisions", Addison Wesley, 2007.

### Supplementary Readings

Tim Koller, Mark Goedhart, and David Wessels, "Valuation: measuring and managing the value of companies", 4<sup>th</sup> ed., John Wiley and Sons, 2005.

Weston, F., M. Mitchell and J.H. Mulherin, "Takeovers, restructuring, and corporate governance," 4<sup>th</sup> ed., Prentice Hall, 2004.

## Grading

**Case write-ups** 30% OF GRADE

**Mid-term Exam** 25% OF GRADE

**Class-participation** 15% OF GRADE

**Term paper** 30% OF GRADE

## Auditing

Students may not audit this course. If you want to take this course, you would have to be registered in the course with the expectation of receiving a letter grade. Once registered, you cannot convert this into an audited course or expect to get an incomplete. Your only options are to drop the course during the add/drop period or to withdraw if permissible under existing regulations governing your program of study.

## Academic integrity

It is expected that you will support and maintain a high standard of academic integrity. Cheating on exams and other academic misconduct will result in a failing grade and additional sanctions. A gross violation of Academic Regulations is to use solutions to cases from a similar course taught by me or by another instructor, be it someone's class notes or case solutions, whether verbal or written.

## Course outline

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SESSION	TOPIC
February 16	<p>COURSE INTRODUCTION; VALUATION OF FIRMS</p> <p>DISCOUNTED CASH FLOW (DCF) VALUATION</p> <p><i>Valuation: The Art &amp; Science of Corporate Investment Decisions</i> Chapter 2 (Forecasting and Valuing Cash Flows) Chapter 4 (Estimating a Firm's Cost of Capital) Chapter 7 (Enterprise Valuation)</p> <p><i>Note:</i> On <b>February 23</b>, Gina Kao will conduct two Reuters session in the Reuters Lab (Room 4117, near lift 19). The first session is from 12:15 to 1:00 pm (for L1) and the second session is from 1:45 pm to 2:30 pm (for L2).</p>
February 23	<p>COMPARABLE FIRM AND COMPARABLE TRANSACTIONS ANALYSIS</p> <p><i>Valuation: The Art &amp; Science of Corporate Investment Decisions</i> Chapter 6 (Relative Valuation Using Market Comparables)</p> <p>ACQUISITION STRATEGIES</p> <p><i>Case:</i> PepsiCo's Bid for Quaker Oats (A), HBS 9-801-458</p> <ol style="list-style-type: none"><li>1. What are the most compelling reasons to merge Pepsi and Quaker?</li><li>2. What is the value of Quaker's businesses to Pepsi?</li><li>3. Put yourself in Enrico's shoes. What are the hurdles that could come up that would scuttle a deal. Come up with an effective negotiation strategy that minimizes these hurdles.</li></ol> <p>PAYMENT METHODS AND FINANCING</p> <p>Rappaport, A., Sirower, M.L., 1999. Stock or cash? The tradeoffs for buyers and sellers in mergers and acquisitions, Harvard Business Review (Nov-Dec), reprint 99611.</p> <p><b>Reuters Session: Room 4117, near lift 19.</b></p>
March 1	VALUATION OF SYNERGIES
CASE DUE	<p><i>Case:</i> Pinkerton(A), HBS 9-291-051</p> <p><b>Questions:</b></p> <ol style="list-style-type: none"><li>1. How can Wathen justify a \$100 million bid for Pinkerton? Value Pinkerton using DCF and multiples. What are the synergies in this deal and what are they worth?</li><li>2. What issues should be considered in bidding for Pinkerton? Are any of the synergies unique to Wathen?</li><li>3. If Wathen proceeds with a \$100 million bid for Pinkerton, should he finance the acquisition with debt or equity? Why?</li><li>4. How should Wathen respond to Morgan Stanley?</li></ol>

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SESSION	TOPIC
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March 8      CROSS-BORDER TRANSACTIONS

CASE DUE    *Case: Vodafone AirTouch's Bid for Mannesman, HBS 9-201-096*

**Questions on Vodafone's bid**

1. What is the strategic and economic rationale for Mannesman's acquisition of Orange? Did Mannesman overpay for Orange?
2. Vodafone AirTouch proposed that each Mannesman share would receive 53.7 Vodafone AirTouch shares, so that in the aggregate Mannesmann shareholders would own 47.2% share of the equity of the new combined firm.
  - (a) Describe the stock swap. As of December 17, what was the market value of Mannesmann's contribution to the combined firm? As a Mannesmann shareholder would you accept the current offer? As a Vodafone shareholder would you support the proposed transaction? (Use an average exchange ratio of  $1\text{£}=\text{€}1.5789$ .)
  - (b) What is the market estimate on December 17, 1999 of the likelihood of Vodafone AirTouch successfully acquiring Mannesmann. Assume that if the bid fails both firms would trade at the prices prevailing after the announcement of Mannesmann's acquisition of Orange but prior to rumours of Vodafone AirTouch acquiring Mannesmann.
  - (c) If the probability of a successful deal is 0.6, what is the market's estimate of the implied synergies from the deal.
  - (d) What is the present value of the expected synergies (in £) as shown in Exhibit 10 as of March 2000? Assume that the synergies related to revenue and costs grow at 4% annually past 2006, while savings from capital expenditure don't extend beyond 2006, and that the merger will not affect the firm's level of operating working capital.
  - (e) UK equities returned 7.7% (in £) over the UK risk-free rate for the period 1919-1993 and 6.8% over the UK risk-free rate for the period 1970-1996. How might this observation affect your decision?

SESSION	TOPIC
March 15	CORPORATE RESTRUCTURING TRANSACTIONS
CASE DUE	<i>Case: Lenovo's acquisition of IBM's PC business</i>
March 29 (a)	Mid-term Exam
March 29 (b)	ADJUSTED PRESENT VALUE METHOD <i>Valuation: The Art &amp; Science of Corporate Investment Decisions</i> Chapter 7 (Enterprise Valuation)
April 5	VALUE CREATION IN PRIVATE EQUITY TRANSACTIONS <i>Valuation: The Art &amp; Science of Corporate Investment Decisions</i> Chapter 8 (Valuation in a Private Equity Setting)
CASE DUE	<i>Case: Ducati &amp; Texas Pacific Group - A "Wild Ride" Leveraged Buy-out, HBS 9-801-359.</i>
	<ol style="list-style-type: none"> <li>1. What is the nature of the opportunity? Could the Ducati brand be expanded beyond motorcycles? Why? Why not?</li> <li>2. What is the value of Ducati at the time of the deal? How much TPG be willing to pay for 51% of the equity? Assume TPG's target rate of return for US deals is 35% (annualized).</li> <li>3. If TPG pursues the deal and purchase a stake in Ducati, what are the critical steps that TPG needs to take in order to make the deal successful?</li> </ol>
April 12	STUDENT PAPER PRESENTATIONS Note: This is a mandatory session for all students.