1.6.1 Case Study 1

Valuation Issues Exercise[1]

Unit:	Study Unit 3 – Strategic Treasury Solutions
Case:	Case study 1 – Treasury opportunities
Date:	1 September 2016
Summary:	Exercise examining the range of values of Teleware to Victor, and highlighting the main sensitivities.
Key words:	shareholder value, valuation, sensitivity, tax, adjusted present value, risk management

In this exercise we will move on to the heart of the matter; estimating the effect of the acquisition on Victor's shareholder value. Victor's stated policy is to make acquisitions which increase shareholder value, so we need to make sure that an acquisition of Teleware would deliver on this undertaking. On the face of it this appears an entirely objective test; but as we shall see, there are some substantial assumptions and judgemental inputs to Victor's perception of Teleware's value.

Use the background case material for Teleware, your text book, readings and any other resources you consider applicable. You will need the Teleware Acquisition Calculations spreadsheet for these questions.

Question 1

Referring to the Teleware Acquisition Calculations spreadsheet "Summary" worksheet, you can see that:

Value of equity to be acquired by Victor = USD 3,483 m
Price Victor would pay at $17 per share = USD 3,660 m

Based on these figures, the acquisition would be value-destructive in the amount of about USD 177 m. You note that:

- This amount (representing around 5% of the consideration) is well within the range for which further investigation would be required, with a detailed analysis of the assumptions underlying the figures and the sensitivities.
- At this stage it is therefore not possible to recommend either that the acquisition proceed, or that it be abandoned….more work is required in order to ensure a sound recommendation is made.

Perform a sensitivity evaluation of the risks around the value of the acquisition to Victor.

[1] Post your responses to the various questions and discuss your thoughts and responses in the Case study 1 forum in light of the answers posted by fellow group members and the model answer released by the tutors. You are expected to post during the Case study 1 timeline – see course site U3/Case 1 for dates.

Student notes

Try to keep this at the headline level, changing input variables as appropriate. Consider especially:

- Sensitivity of the present value of the Teleware cash flows (including terminal value) to an estimate of the Romanian and Czech risk free, inflation and growth rates.
- Sensitivities arising from actual financial performance turning out better or worse than currently modelled. How reasonable do the expectations appear?
- Outputs most sensitive to changes in FX and tax rates (tax is considered in detail in the APV analysis below so only a summary view is required here).
- What additional assistance could Value at Risk techniques provide to this analysis?

Question 2

The APV tax shield is a crucial element of the value of Teleware to Victor. It is substantially a judgemental number, yet it underpins a supposedly objective evaluation of the effect on shareholder value.

a) Comment on the overall value of the tax shield to Victor compared to local competitors for the acquisition.
b) Discuss in detail the principal uncertainties inherent in the calculation and quantify the range of possible values for the tax shield.

Student Notes

a) Comparative value:

- What are the differences between a local acquirer putting in debt and Victor doing so?

b) Principal uncertainties:

- Consider how much debt Victor should bring in to the tax shield. As modelled, is the debt that the Teleware companies can sustain consistent with Victor's target A rating (estimate 2x EBITDA max)? Or should the tax shield relate to the whole acquisition debt, as it is all being shielded?
- Consider the appropriate tax rate to apply – group, local or the tax rate of borrowing entity?
- Consider the discount rate to use – equity, debt or an average?
- Finally estimate the range of the tax shield valuation (and hence the consequential effect on the effect of the acquisition on shareholder value).