Advanced Corporate Finance
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Guest Lecture Case: Autoassurance

A. Valuation
    1. Value the company using the comps method. What are appropriate comparable firms? (Note: It is not easy to find great comps that are in similar businesses, but do your best!)
    2. DCF
        i. Value Autoassurance (Enterprise Value) using WACC/APV. [1] You can use the projected financials provided in the case (also posted on Compass), assume zero leverage (*i.e.*, ignore the tax shield for now), a corporate tax rate of 35%, risk free rate of 5%, and a market risk premium of 6%, and forecast a terminal value based on a 6x EBITDA multiple.
        ii. Perform sensitivity analyses with the two variables that you think are the most critical for getting the value right.
    3. Combining the results of these valuation techniques, what valuation would you place on Autoassurance? Why?
B. Risks and opportunities
    1. How do you think the total market for ancillary F&I will grow over the next years? What do you see as major risks with the market? (you will need to do some reading outside the case about the overall market for this!)
    2. Based on the description of the company, do you see risks/opportunities in the current operations of the firm that could cause it to perform better or worse compared to the overall F&I market?
    3. What are characteristics of the company that would make this a suitable or unsuitable candidate for acquisition by a Private Equity buyer? Briefly describe some opportunities where it might be possible for a PE buyer to increase the value of the company.
C. Debt Financing

    Helle Capital has approached two lenders about financing the deal (See separate spreadsheet for details). Both lenders have offered a package that consists of a "Term A" that must be amortized according to a fixed schedule, and an optional "Term B" that will not need to be amortized. One of the lenders also wants to participate in a small piece of the equity at the same valuation as the PE fund. Which

[1] You will likely need to make a lot of assumptions and also get data outside the case (e.g., to calculate asset betas) to come up with estimates for discount rates, cash flows, terminal value multiples, etc… Dealing with imperfect/incomplete information is a common feature of the real world! For the asset cost of capital, I recommend calculating asset betas based on similar firms. For simplicity, you may assume depreciation will be equal to capital expenditures, that there's no net working capital, and that the company is unlevered. You can use a risk-free rate corresponding to the ten-year treasury rate in 2007), and a market risk premium of 6%.

lender should Helle pick, and should he pick both Term A and Term B or only term A? Briefly describe the most important tradeoffs when deciding which lender's package to take.

D. LBO model and returns: Suppose you buy the company for $70 million at the end of 2007, plus $2m in fees, use your preferred amount of leverage from part C and a seller note of $5m (that has an interest of 7% and is not amortized until you sell the company), the firm performs according to the forecast, and you sell the company for the same EV/EBITDA multiple (not including fees) as you bought it for at the end of 2012. For now assume that Helle Capital owns 100% of the equity (we will allow for co-investment by the current management in part 2(i) below.
    1. What IRR (return) would a PE fund earn on its equity investment over this period (*i.e.*, what's the IRR on the PE fund's original equity investment, after it sells the firm and pays off any possibly remaining debt)? Assume that the debt is paid back no faster than the lender's amortization schedule requires, and any extra available cash flows are used to pay dividends.[2]
    2. Perform a sensitivity analysis of your IRR (only change one assumption at a time):
        i. If the management of the company co-invests in the equity, split so that 20% is owned by the management team and 80% by Helle Capital
        ii. If you don't use any debt to finance the acquisition
        iii. The bank allows a dividend of $10m, financed by adding more Term B debt, at the end of year 3 (2010).
        iv. EBITDA ends up being only 70% as much as projected (this will also affect the terminal value!). Will you be able to amortize the debt as scheduled if this happens?
        v. You sell the company for a +1 higher EBITDA multiple higher than you purchased the company for

E. The decision
    1. At what (maximum) Enterprise Value would you consider this to be a good investment decision for Helle Capital?
    2. Due Diligence: What would you want to investigate further (e.g., about the market or the company) before you make a final decision?

[2] Recall from the DuPont case that Cash Available to Pay Down Debt = (EBIT-Interest)(1-taxrate)+Depr-Capex-ΔNWC (*i.e.*, ΔD is the value that sets FCFE equal to zero as long as the debt amount remains positive). You can assume that any interest tax shields can be discounted using r_d.