Index

Abnormal returns analysis, 94–96, 171n4 Accounting issues. See Financial reporting Acquisitions: Frier Manufacturing analysis, 41-43 indifference price, 152 market for, 106-111 private vs. public firms, 105-106, 128 tax issues, 42-43, 141-151 value-creation strategy, 17-20 Aggregate demand sale price (ADSP), 139 Altman, Edward, 82 Altman's Z score, 82-85 American Finance Society, 12 American Stock Exchange, 109 Amihud, Yakov, 92 Ang, James, 106, 109, 171n6 (Chap. 7), 172n8 Annual Statement Studies (RMA), 50 Arbitrage pricing theory (APT), 70 ARCO (oil), 17 Asset-based valuation, defined, 45 Assets, tangible vs. intangible, 162–164 Asset sales, 42-43, 141-146, 152 Auction market, defined, 93 Axiom Valuation Solutions, 50, 74, 76 Babaev, Eliaz, 32 Bajaj, Mukesh, 99 Baker, H. Kent, 95 Balance sheets, Tentex, 54-55, 84 Bankruptcy, 12 Benchmarking: method of multiples vs. DCF, 62-68 wages, 47-50 Beta values: calculating, 71-82 Kaplan/Ruback analysis, 65–68 and volatility, 129 zero, 78, 170n6

Black-Scholes model, 120–129 Bronfman, Edgar, Jr., 22 Buildup method, 70-71, 88-89 Bureau of Labor Statistics, 50 Business-as-usual (BAU) buyer, 27, 114-117 Business-as-usual value, 13. See also Goingconcern value Business unit valuation, 157-161 Buyer, IRS-defined, 1-4 Campo, John P., 31 Capital asset pricing model. See CAPM Capital gains, 139-141 Capital structure. See also Value creation components of, 69 maximizing, 10-25, 167n2 (Chap. 2) optimal, 10–11 productivity and, 37-38 of Tentex, 64-65 CAPM, 66-68, 70-71, 129 CAR, 171n4 Carlson Companies Inc., 31 Carreyrou, John, 22 Carve-outs, 25 Case studies: acquisitions, 18-19 Frier Manufacturing, 33-44 goodwill impairment, 155-157 oil industry, 15–18 Sarbanes-Oxley impact, 30-32 Tentex, 46–56, 59–65, 82–85 Vivendi vs. MGM, 22 Cash cow value, 12-14, 36-37 Cash flow: determinants of, 37-39 FMV and, 3 MVM and, 11 valuation model, 46-56

C corporations: liquidity issues, 91, 104 optimal capital structure, 167n2 (Chap. 2) preferred stock, 88-89 tax issues, 133-152 Celleration Inc., 32 Cochrane, John, 82 Cogan, Marshall, 31 Compensation issues, 47-50, 102-103, 108 Competitive advantage period: defined, 123 sustaining, 14-15, 169n6 and valuation metrics, 58-59 Constant growth model. See Gordon-Shapiro model Contractual-legal standard, 162 Control gap, 25-28, 43-44 Controlling interest. See also Control premium FASB on, 158–159 and liquidity discount, 91, 101-104 vs. minority interest, 4-5, 105 Control premium: comparative data, 130-132 defined, 18, 105-106, 167n4 estimating model, 113-123 for family-owned businesses, 111–113 for privately held firms, 106-111 regression analysis, 109–110, 123–128 test data, 130-132 volatility factor, 121-123, 129 Convertible preferred stock, defined, 88 Cost of capital: after-tax, 173n3 (Chap. 8) C corporations, 167n2 (Chap. 2) components of, 69-70, 89 debt, 82-85 equity, 70-82 and goodwill valuation, 161-162 preferred stock, 88-89 tax considerations, 135-136 Creating value. See Value creation Credit risk, 82-85 Cumulative abnormal return. See CAR Data Security Corporation, 100

Davis, J. Denis, 171n10 Dealer market, defined, 93 Debt, 10–12, 36, 82–85 Dengell, F. R., III, 171n7 Depreciation, 43, 51-56, 133, 140-141 Diamond-Shamrock (oil), 17 Disclosure issues. See Transparency Discounted cash flow (DCF): calculating, 56-62 vs. method of multiples, 65-68 valuation model, 45-46, 159-162, 165 Discretionary expenses, 50-51, 108 Divestitures, 20-25, 145-146 Due diligence, 28 EBay, n9, 174 EBITDA multiple, 169n10 Economy, U.S., 58 Edelman, Richard B., 95 Emory, John D., Jr., 97-98 Emory, John D., Sr., 97-98 Employees, 47-50, 80, 102-103, 108 Equity, 6-7, 25, 70-82 Erickson, Merle, 133-134, 146 Ethics issues: Sarbanes-Oxley Act, 30-32 transparency, 28-30 Event studies, stock market, 94-97 Excess cash, 168n4 (Chap. 4) Excess returns, 80-82 Expenses: discretionary, 50-51, 108 interest, 168n3 (Chap. 4) Fair market value (FMV): components of, 2-4 controlling vs. minority interest, 4-5 defined, 1-2, 173nn1-3 (Chap. 9) goodwill impairment, 153-154, 162-164 strategic value, 5-7 Fair value, 1-2, 158, 173n1 (Chap. 9) Family businesses: compensation, 47-50, 102-103, 108 takeover market for, 111-113 FASB, 1, 153-165, 173nn1-7 (Chap. 9), 174n8, 174n10 Feldman, Stanley Jay, 38 Ferris, Stephen P., 171n10

Financial Accounting Standards Board. See FASB

Financial reporting: goodwill accounting rules, 153-165 transparency in, 28-32 Financing, sources of, 12 Foreign firms, acquisitions by, 106 Fox, Richard, 10, 33-44 Free cash flow, defined, 59. See also Discounted cash flow Frier Manufacturing, 10, 33-44 General Electric Co., 22 General Utilities Doctrine, 23 Gleason, Kimberly, 111 Going-concern value, 5-6, 10-15, 36-37 Gompers, P., 80-82 Good governance, 28-30 Goodwill: defined, 153 measuring value of, 157-165 testing for impairment, 153-157 Gordon-Shapiro model, 57-58, 64 GovernanceMetrics, 28 Grabowski, Roger J., 173n1 (Chap. 8) Gross, Walter L., Jr., 167n1 (Preface) Gross v. Commissioner, 173n2 (Chap. 8) Hamada equation, 78, 129 Hertzel, Michael, 97, 99, 103 Hewlett-Packard (HP), 41-43 Hypothetical transaction, defined, 2-3

Ibbotson Associates, 70–79 Illiquidity. See Liquidity Impairment, goodwill: defined, 153-154 measuring, 157-165 testing for, 154-157 Income-based valuation, defined, 45 Income statements, Tentex, 48-49, 52-53 Indifference equations, 152 Information signaling, 93-94, 95 Initial public offerings (IPOs): and liquidity discount, 97-98 valuation analysis, 66-68 Intangible assets, vs. tangible, 162-164 Interest expense, 168n3 (Chap. 4) In the money, defined, 172n7 Intrinsic value, 167n2 (Chap. 1), 172n7 Investment strategies. See Value creation

Investment value, defined, 1. See also Strategic value IRS: fair market value, 1 liquidity discount and, 92 338 elections, 42-43, 137, 139-146 Jackson, Dick, 30 Kaplan, Steven N., 66-68 Key-personnel insurance, 80 Koeplin, John, 102–103 Kohers, Ninon, 106, 109, 171n6 (Chap. 7), 172n8 LeBoef, Lamb, Green & MacRae LLP, 31 Lerner, J., 80-82 Leverage: impact on beta, 76-78 LBO analysis, 20, 66-68 as strategic initiative, 12 Leveraged buyouts (LBOs), 20, 66-68 Levered vs. unlevered beta, 72-73, 76-78 Liberty Media Corp., 22 Limited liability companies (LLCs), 138 Liquidity: as control gap factor, 44 discounts, 91-104, 161, 170n5 (Chap. 6) public vs. private firms, 20 spin-offs-related, 23 S vs. C corporations, 91, 138 as valuation standard, 1, 3 Majluf, N. S., 98 Malone, John, 22 Management buyouts (MBOs), 20 Managing for value model (MVM): capital structure optimization, 10-25 components of, 9-11 control gap, 25-28 transparency issues, 28-32 Margin ratios, 37-40 Marketability discount, 91, 161. See also Liquidity Market price, defined, 168n1 (Chap. 4) McConnell, John J., 95 Mendelson, Haim, 92

Mergerstat/Shannon Pratt, 124, 172n12

Mesa Petroleum, 16, 172n13

Method of multiples: calculating, 56-58, 62-65 vs. discounted cash flow, 65-68 as valuation model, 45-46 Metrics, valuation. See Valuation metrics Metro-Goldwyn-Mayer (MGM), 22 Miller, Merton, 12, 167n2 (Chap. 2) Minority interest: vs. controlling interest, 4-5, 117 discount equation (MD), 167n4 liquidity discount and, 91, 101-104 Modigliani, Franco, 167n2 (Chap. 2) Monopoly rents, 14, 58 Multiples. See Method of multiples Murray, Matt, 30-32 Myers, S. C., 98

NAICS, 46 Nasdaq, 93-97, 109 Negative control premiums, 124 Nelson, Marilyn Carlson, 31 Net operating profit after taxes. See NOPAT Nickels, Kevin, 32 No-growth value, 11 Nonconstant growth model, 58-62 Nontransaction valuations, defined, 113 NOPAT, 51-53, 68, 169n5 North American Industry Classification System. See NAICS NYSE: as benchmark, 70-71, 74 and control premium, 109 liquidity factor, 91-94

Oil industry, restructuring, 15–17, 172n13 Operating segment, defined, 173n4 (Chap. 9) Operating unit, value of, 173n6 (Chap. 9) Option pricing model, 114, 120–129 OTC markets, 92–97, 109 Ownership, controlling vs. minority, 4–5

Peers, Martin, 22
Pennathur, Anita, 111
Petitioners v. Commissioner of Internal Revenue, 167n1 (Preface)
Phillips Petroleum, 16
Picchi, Bernard, 15, 168n3 (Chap. 2)
Pickens, T. Boone, 172n13
Pink sheets, defined, 93
Preferred stock, 86–89
Price ratios. See Ratio analysis Productivity, 37-39 Pure control value, 6-7, 113-128 Radisson Hotels, 31 Ratio analysis: C vs. S corporations, 146-151 EBITDA, 169n10 peer firms, 62-65 profit margins, 37-39 valuation models, 56-62 Rational participants, defined, 4 Reasonably informed party, defined, 2 - 3Record keeping. See Financial reporting Redgrave, Martyn R., 31 Reeb, David, 111 **Regression analysis:** coefficients, 171n12 control premium, 109-110, 123-128 cost of capital, 71-75 liquidity discount, 97-101 Reporting-unit valuation, 157-161 Restricted stock discounts, 98-101 Restructuring: acquisition-related, 17-20 divestiture-related, 20-25 Frier Manufacturing, 39-44 oil industry, 15-17, 172n13 Retention rate, capital, 58-59 Revenue multiple, 62, 169n12 **Risk** assessment: beta analysis, 66-68, 70-82 firm-specific, 80-82 by industry, 72-75 preferred stock, 88-89 Risk Management Association (RMA), 50-51, 168n2 (Chap. 4) Road & Rail Services Inc., 30 Ruback, Robert, 66-68 Russell 500 index, as benchmark, 35 Sales volume, cash flow and, 37 Salomon Brothers, 15 Sanger, Gary C., 95 Sarbanes-Oxley Act, 30-32 Sarin, Atulya, 171n10 SBA 7(a) program, 85 Schipper, Katherine, 25 S corporations:

capital constraints on, 137–138 capital structure issues, 12, 69, 88

liquidity issues, 91, 104 tax issues, 133-152 SEC rules, restricted stock, 98, 99 Securities markets, liquidity of, 92-97. See also NYSE Seller, IRS-defined, 1-4 Separability standard, asset, 162 7(a) loan program (SBA), 85 Shapiro, Alan, 171n13 SIC codes: for industry betas, 72-75 in liquidity studies, 102 for S vs. C corp. comparisons, 146 Silber, William L., 97-101 Size premium, 78-80, 82, 85 Small Business Administration, 12 Small business investment companies (SBICs), 12 Smith, Abbie, 25 Smith, Richard, 97, 99, 103 Spin-offs, 23-25 Stock, Bonds, Bills, and Inflation (Ibbotson), 71 Stock exchanges. See Securities markets Stock sales, 42-43, 92, 141-146, 152 Strategic business units (SBUs), defined, 23 Strategic buyer, defined, 27 Strategic value: FMV and, 5-7 MVM and, 11-25 Structure of the Oil Industry (Picchi), 168n3 (Chap. 2) Subsidiaries: creating vs. acquiring, 40-42 tax issues, 143-149 Sullivan, Timothy, 38 Sumbeta, defined, 76. See also Beta Synergy value, 6-7, 17-18, 114-120, 122-128 Tangible assets, vs. intangible, 162-164 Target premium, defined, 17–18 Tax issues: acquisitions, 42-43, 141-152 calculating NOPAT, 51-53 capital gains, 139-141 capital structure and, 12, 14 control premium, 113 divestitures, 145-146 liquidity discounts, 92

S vs. C corporations, 133-139, 149-152

spin-offs, 23

Tax Reform Act of 1986, 139 Tentex, 46-56, 59-65, 82-85 T.G.I. Friday's, 31 338(h)(10) election, 42-43, 137, 139-146 Time to expiration, 121–123 Time value of money, 97-98 Trace International Holdings Inc., Transparency, benefits of, 28-32 U-Bid, n9, 174 Universal Pictures, 22 Unocal (oil company), 16, 172n13 U.S. Department of Commerce, 50 Valuation metrics: cash flow considerations, 46-56 discounted cash flow vs. method of multiples formulas and calculations, 56-65 methods of analysis, 45-46 Valuation standards, 1-7 Value circle framework, 10-11, 34. See also Managing for value model Value creation. See also Managing for value model (MVM) acquisitions, 17-20 carve-outs, 25 components of, 37-39 divestitures, 20-25 guidelines, 14-17 spin-offs, 23-25 Venture capital, 80-82 VentureOne, 82 Viacom Inc., 22 Vivendi Universal SA, 22 Volatility factors, 121–123, 129 Wages. See Compensation issues

Wall Street Journal: on Sarbanes-Oxley Act, 30-32 on Vivendi vs. MGM, 22 Wang, Shiing-wu, 133-134, 146 Weighted average cost of capital (WACC): calculating, 88-89 defined, 69-70 Wruck, K. H., 99

Zero beta, 170n6 Z score model, 82-85