Case study of bg group

Education

A. METHODOLOGIES: 1. The Weighted Average Cost of Capital (WACC) Approach: This method offers a wide range of advantages. For instance, the Capital Assets Pricing Model (CAPM) is employed in the calculation of the Cost of Equity. Thus, the discounted rate of 7. 58 percent used in figure 1. 12 Appendix is likely to be precise. The total value of the firm is $4. 73 billion. Nonetheless, in view of the probabilities of forecasting errors in the estimation of cash flows, the degree of precision does not guarantee an accurate result.

Another drawback of the approach would be thefailureto allow for the impacts of real options available to management on future cash flows. Hence, this method is considered as an alternative for crosschecking. The assumptions are the dividends grow constantly in perpetuity at 3 percent and the debt ratio is also constant at 28. 1 percent. For further analysis, please refer to item 2a and 3c in the Appraisal. 2. The EBIT Multiples Approach: Under this methodology, the debt-equity ratio was not required. Thus, the value of the firm is approximately $4. 3 billion after liquidity discount was taken into account. This yields an insignificantly different result compared to the result under the WACC method. However, since the average EBIT multiples strongly depend on the comparable companies in the industry, reliable information is less likely to be available in practice. Therefore, another approach is employed. 3. Adjusted Present Value (APV) Approach: The APV method is more complicated than two methods mentioned earlier inasmuch as it takes account of unlevered value of the firm and the interest tax shield.

Recent complexity of the method notwithstanding, APV provides management with an explicit valuation of interest tax shield and an assumption of constant debt-equity ratio is unnecessary. According to figure 1. 10, the total value of the firm before synergies is $5. 02 billion. Nonetheless, this method ignores the costs of financial distress, which might lead to an overvaluation of the firm with a significantly high debt ratio. 4. Conclusion: Under different methods employed above, the range of difference appears to be immaterial.

Thus, the value of the firm before synergies is expected to be approximately $4. 89 billion on average. For the purpose of consistency, APV method is selected for further analysis of the value of the firm both before and after synergies. B. FINANCIAL ANALYSIS: 1. Free Cash Flows (FCFs) Valuation: The present value of the cash flows is calculated based on the WACC rate and it is estimated at $1. 28 billion. The rate is used by reason of the assumption of different components, for instance cost of equity and cost of debt. For further information of the assumption, please refer to the Appraisal. . Terminal Values and Long-term Growth: The terminal value before synergies is $3. 45 billion whereas this amount after synergies is $8. 36 billion. In details, the synergies revenues and the backhaul synergies savings are the major contributors to the significant difference. Additionally, the terminal value represents the market value of free cash flows from AirThread Connections at all future dates. This, thereby, lends the analyst the plausibility to believe that the discounted rate is equal to the WACC rate of 7. 58 percent.

Lastly, to be conservative, that is, in the worst scenario, the figure of growth rate obtained in the Appraisal is around 3. 0 percent. 3. Non-operating

Investment in Equity Affiliates: This amount of $1. 72 billion is equal to Equity in Earnings of Affiliates times the historic P/E multiple for the industry at 19. 1. These investments are valued under the market multiple approach because a thorough due diligence is not possible to be conducted. 4. Value of Operating Assets: This value is equivalent to the present value of the target company on a going concern basis.

It is estimated at $5. 02 billion before the synergies and at $10. 38 billion after the synergies. However, since the value of non-operating assets is not taken into account, the total value of the target company is not fully reflected. 5. Enterprise Value: The Enterprise value is equal to the sum of the value of operating assets and the value of nonoperating assets. i. Before Synergies: In this case, the synergies related business revenues and the backhaul synergies savings are not considered. The FCFs ppear to be more immaterial accordingly. It, therefore, leads to a lower Intermediate Term Value of $1. 57 billion and a lower Enterprise Value of $6. 74 billion. ii. After Synergies: With the effect of synergies, the FCFs and, thus, the Enterprise Value of $12. 1 billion appear to be more material. Importantly, the significant difference is contributed by the cost-saving efficiency in backhaul costs and the network utilization. Thus, more advantages would occur. Firstly, administrative expenses such as auditing fees are reduced.

Secondly, the market share will, in essence, increase and monopoly gains due to large regional client bases from the target company could be expected. The company will be able to set a higher price and to increase a sheer volume of sales. Also, the company will gain more reputation and the cost of capital will be lower accordingly. Lastly, due to its new size, the

company will have more bargain power and the relationships with banking entities will be better. Consequently, the cost of borrowing tends to decrease.