

# **Case Analysis (One Page)**

## **Temasek's Offer To Buy Olam International**

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## **1. What is the role of short sellers in the financial markets?**

- By selling borrowed stock, this adds liquidity to the market, which also reduce the bid-ask spread and transaction costs.
- “They do serve an important function by uncovering frauds and disciplining wayward firms”
- In other words, the incentive for short sellers to benefit from falling stock discourages firms to adopt deceptive management policies that may lead to negative market reaction.

## **2. Assess the validity of the accusations made by Muddy Waters and provide a balanced view of the saga.**

Muddy Waters claim are mostly true based on financial assessment:

- Excessive capital expenditure: YoY PPE increase and declining ROE and ROA
- Persistent negative free cash flows: True. Negative FCF between for all years 2009 to 2013.
- High debt levels: High financial leverage. Vulnerability to debt since ROA is smaller than interest rates on debt.

## **3. Analyze whether the Singapore stock market is characterized by semi-strong form efficiency.**

- Stock price behavior indicates semi-strong form efficiency on the Singapore stock market, including rapid price adjustment following information disclosure. (6% fall of share price upon Muddy Waters report)

## **4. Assess the sustainability of Olam’s business.**

- The current Olam business trends are not sustainable.
- Continuous negative cash flows
- Vulnerable to interest rate hikes making its results volatile: an increase of 100bp in the cost of debt would result in a net profit decrease of 18.5%.
- Lack of oversight by the board to commit to transparency, risk management and respect for bondholders and lenders. Refused to obtain a debt rating which could have helped its reputation.

## **5. Perform a discounted cash flow valuation with an attached sensitivity analysis.**

- See appendix A (below)
- More assumptions are needed to complete the DCF analysis, our assumptions indicated a share value of virtually zero.
- It is clear that the Temasek offer is way above the theoretical and market values.

## **6. Perform a relative valuation analysis.**

- See appendix B (below)

## **EXTRA: Should Olam sell its share to Temasek or not?**

- Temasek made a cash offer at a premium over the share value, meaning that they are somewhat confident of the value they are buying. If Olam is uncertain of its intrinsic value, the cash offer would be a good solution as it would provide them with upfront liquidity, whereas a stock offer could dilute shareholders’ ownership but also make the offer contingent on performance, which the firm seems to be unsure about.



## Appendix B

Using the following comparables, based on these criteria:

- Beta > 1.00 : Noble Group (1.77), Itochu Corporation (1.05), China Agri-Industries Holdings (1.04) vs Olam (1.56)
- Among the above, use those with Market cap < USD 20,000M : Noble (6,246), Itochu (18,559), China Agri-Industries (2,050) vs Olam ( $\$2.22 \times 2,442,409,869$  outstanding shares  $\times 1/1.25$  SGD/USD = 4,311)

### Market-comparable multiples:

	<u>EV/Sales</u>	<u>EV/Sales</u>	<u>EV/EBITDA</u>	<u>EV/EBITDA</u>
Noble:	0.109	0.103	9.207	8.263
Itochu:	0.341	0.334	12.463	11.773
China:	0.346	0.313	7.731	6.942
Average:	0.265	0.250	9.800	8.993

	<u>Sales</u>	<u>Sales</u>	<u>EBITDA</u>	<u>EBITDA</u>
Olam	23128346	24164994	1308370	1366955
EV	\$ 6,136,721.14	\$ 6,041,248.50	\$ 12,822,462.12	\$ 12,292,570.66

Based on Sales, Enterprise value for Olam in 2014-2015 is relatively estimated at \$6M, and based on its EBITDA it is estimated at \$12M.