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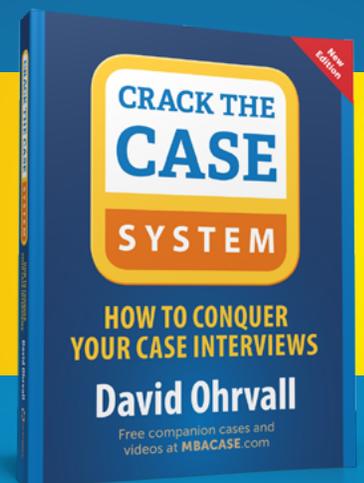
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CASE **403**

Blaustahl

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FOUNDER OF MBACASE.COM





Blaustahl

Frankfurt, Germany

Blaustahl needs to test its mettle with an acquisition. Can you help it find one for a steal?

403
FULL
 ★★★

FRANKFURT CITY FACTS

- ▶ Germany's financial and transportation center; largest financial center in continental Europe
- ▶ Home of the European Central Bank, which sets monetary policy for the Eurozone economy
- ▶ The highest concentration of jobs and of homeowners in Germany



TRAIN Profile				
Type	Region	Analysis	Industry	Number
	<p>FRANKFURT, GERMANY Population: 667,000 Currency: Euro, EUR, €</p>	<p>Valuation</p>	<p>Metals & Mining</p>	

Solo Practice with Video Assist

1. Find your videos
2. Set up
3. Listen to question
4. Recap
5. Create your plan
6. Present your plan
7. Stop and study
8. Reinforce



Partner Practice

1. Set up
2. Present the case question
3. Recap
4. Create your plan
5. Present your plan
6. Stop and study
7. Reinforce

Interview Guide

Case Situation and Question

Blaustahl is a \$2B producer of rebar steel based in Frankfurt, Germany. Its primary customers are German and Baltic construction companies. Over the past five years, Blau has experienced declining profitability. Looking for strategic options, it is considering whether to acquire Tiger Steel, a \$1B producer based in Pittsburgh, USA. Tiger looks attractive because it recently developed a technology for producing high-quality steel. Additionally, its customers include aircraft manufacturers and US government agencies.

Blau has asked you to determine whether or not it should acquire Tiger. Walk me through your evaluation.

Case Twist

You discover that three other US-based steel companies are close to implementing their own process technologies for making high-quality steel. Additionally, you discover that several of Tiger's clients do not plan to re-contract because Tiger's prices are much higher than the competition. How will your advice be impacted by each discovery?

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Feedback

Physical Skills	Weak	Strong
Body Language	①	② ③
Verbal	①	② ③
Listening	①	② ③
Thinking Skills		
Hypothesis Generation	①	② ③
Comfort with Ambiguity	①	② ③
Initial Plan & Output	①	② ③
Data Analysis	①	② ③
Basic Business Intuition	①	② ③
Integration	①	② ③
2nd Level Insights	①	② ③
Creativity	①	② ③

Total Score _____ / 33

Intro Facts (Tell the Candidate if Asked)

Organization: Blau and Tiger are both public companies. Assume US accounting standards.

Financing: Blau is financed 50% with equity and 50% with debt. Tiger is 100% equity.

Customer contracts: Tiger's customers renegotiate contracts every 4 years. Blau's customers renegotiate contracts every year.

Customer loyalty: Blau has retained 80% of its customers the last 5 years; Tiger, 100%.

Customer requirements: Tiger's government clients do not need to source only from US suppliers.

Products: Blau produces low- and medium-grade steel for construction. Tiger makes high-quality steel for aircraft and NASA, even without the new technology.

Competitors: Blau faces two similar-sized European competitors, both of whom also suffer from declining profits.

Market: The market for steel among German and Baltic construction companies is fairly strong, but not enough to keep prices stable. The market among US aircraft manufacturers and government is stable.

Key Insights (Do Not Tell the Candidate)

Quality: Tiger's customers want higher-quality steel but Blau's customers do not need it.

Technology: Blau can use Tiger's new technology in its own processes, but it may take up to three years to implement given the differences in their equipment.

Contracts: Several of Tiger's customers have begun to solicit Tiger's competitors for price proposals.

Mid-case Data (Tell Only at Appropriate Time)

Give handout: After hearing the candidate's initial rationale and questions, ask the candidate to review Handout A.

Expect a precise answer: Ensure candidate uses current price, comps, precedent transactions, and DCF approaches (candidate will need to calculate free cash flow). If necessary, ask for the math. Follow how his logic fits with your data sheet.

Give clue: To calculate DCF, the candidate will need to estimate a growth rate and a discount rate. Ask how he will estimate these rates using existing info. If he calculates WACC, ensure he derives K_D and K_E . K_E comes from the CAPM, so ensure he walks through how to estimate β , r_f , and r_m . (See any finance textbook for a list of definitions.)

Case Flow and Milestones

1 Present Main Question

Interviewer should read through the case and know the timing for questions, data, and hints. Take on a personality (friendly, firm, or foe). Present the case question. Candidate will then likely recap and clarify, ask for time to think, form a plan on paper, and present his plan.

2 Assess Structure

Candidate should discuss why Blau wants to acquire Tiger and how that would affect its profitability. If the candidate jumps right into valuation, push back. Ask, "First, help me understand why Blau wants Tiger," and look for his reasoning. When discussing valuation, he should have a precise answer (see Mid-Case Data).

GIVE
HANDOUT A

3 Look for Specifics

Acquisition will involve a revenue synergy, from obtaining new customers and intellectual property for steelmaking; it will also involve a cost synergy, from obtaining redundant operations. These assets together will drive growth in profits and cash flow.

4 Guide Discussion

Give Handout B and follow the steps from Mid-Case Data and Handout & Data Timing. After the candidate performs the valuations, ask for the logic around the growth and discount rates he chooses. If necessary, ask, "What methods should Blau use to find that multiple?" If the candidate asks for comps, provide Handout C.

GIVE
HANDOUTS B & C

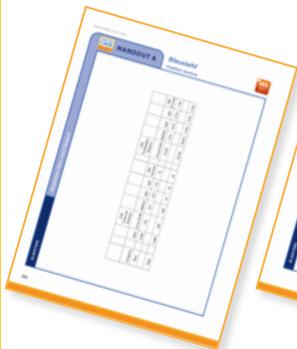
5 Get Recommendation

A good recommendation should explain why Blau would acquire Tiger, and then support or reject that view using comparables analysis and DCF. The candidate should note that Tiger's DCF multiple is far higher than other multiples, suggesting that Tiger is undervalued from Blau's perspective. He might also suggest that Blau has an over-optimistic view of Tiger's prospects.

Handout and Data Guide

Handout A:

Give when candidate asks for financial information.



Handout B:

Give when candidate specifically asks for cash flow information.



Handout C:

Give when candidate asks for ratios or comparables.



Re-routers

Questions to Keep Things on Track

- For Handout A, a good candidate should ask for cash flow info. If not, ask, "Is there any other information you need?"
- For Handout B, expect a good candidate to link A and B to calculate free cash flow. If not, prompt by saying, "Calculate Free Cash Flow."
- For Handout C, look for a good candidate to inquire about comparables. If not, ask, "How do you know whether Tiger is overvalued or undervalued?"

Additional Info

Likely question from candidate: "Do you have any comps information?"

Interviewer: "Here is a list of comps for you to evaluate" (GIVE HANDOUT C).

Say the following: "Walk me through how you will use each comp to evaluate this deal."

Tiger Comparables Analysis

- **Current Price:** The equity value of Tiger is 3x its EBITDA.
- **Precedent Transactions:** The equity values of other steel companies sold for 4x their EBITDA.
- **Current Comparables:** The equity values of other steel companies currently trade at 4x their EBITDA.
- **DCF Multiple:** The proposed equity value of Tiger, based on its intrinsic value.

Ask the candidate to discuss the implications of the different multiples for overall valuation.

Post Case Review

Case Insights & Takeaways

Your valuation should show Tiger with multiples for unproven technology (precedent transactions, trading comps) and proven technology (DCF).

The government contracts allow you to show your creativity as you discuss the benefits and costs of having them in the deal.

You should determine if the deal makes sense based on whether it is accretive or dilutive to earnings.

Math Tips

- Know how to calculate Free Cash Flow.
- Calculate your comps quickly so you can address the broader issues in valuation.
- Use “math lite” techniques to calculate terminal value in your head or on paper. In this example, the Perpetuity Growth Method fits the data available.

$$\text{Terminal Value} = \frac{\text{FCF}_n \times (1 + g)}{(r - g)}$$

What to Expect with Cases Like These

- Understand which assets in the company drive cash flow and profitability. They will appear indirectly through comps, but you can demonstrate them through a DCF.
- Understand why an acquirer wants to buy those key assets. What can it do with them to increase performance?
- Remember, understanding valuation is important, but *framing* valuation in the context of company strategy will help you structure your thought process and presentation.

My Takeaways

To build skills and improve, you must apply what you learned to future cases. Take a few moments and review the interviewer feedback and jot down some key insights about your performance in the space below.

Thinking Skills

My top 2 strengths are:

My top 2 soft spots are:

To address these problems I'll begin to:

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My Performance During the Case

Add up your points. → Total Score: _____ / 15

S	Strategy	A	Assets	V	Value	E	Expectations	D	Delivery
points	<ul style="list-style-type: none"> ③ Identifies acquirer's strategy and rationale ② Strategy but no rationale ① No strategy or rationale 	points	<ul style="list-style-type: none"> ③ Identifies all target's key assets ② At least one key asset ① No key assets 	points	<ul style="list-style-type: none"> ③ Links assets to value drivers and 4 valuation methods ② < 4 methods ① No value drivers or methods 	points	<ul style="list-style-type: none"> ③ Explains how valuation and value drivers work ② Some explanation ① No explanation 	points	<ul style="list-style-type: none"> ③ Identifies contradictions and next steps ② Contradictions but no next steps ① Nothing

Blaustahl, Tiger Steel - Partial Financial Snapshot

Company	LTM Financial Statistics							LTM Profitability Margins				
	Sales	Gross Profit	EBITDA	EBIT	EBT	Net Income	Gross Profit	EBITDA	EBIT	EBT	Net Income	
Blau	5,000	750	375	225	125	75	15.0%	7.5%	4.5%	2.5%	1.5%	
Tiger	1,000	200	100	70	70	42	20.0%	10.0%	7.0%	7.0%	4.2%	

Tiger Steel – Cash Flow Statement Data

	CY	LY
D&A	30.0	27.8
% of Sales	3.0%	3.0%
Cap Ex	30.0	30.0
% of Sales	3.0%	3.2%
WC	40.0	30

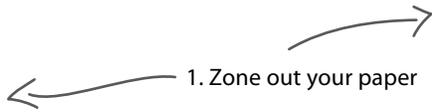
Tiger Steel – Comparables Analysis

	EBITDA multiple
Current price of Tiger	3x
Precedent transactions	4x
Current comparables of Tiger	4x

Today's date:

2. Be original with your data

4. Leave ample room for a structure and additional notes as the case progresses



3. Take clean and simple notes

BLAUSTAHL

Potential Plan and Output



WORKSHEET

Blaustahl
Frankfurt, Germany

Intro Facts

Blaustahl \$2B

- German construction
- Profits ↓

Buy Tiger?

- \$1B
- Tech → High quality steel
- Aircraft + US Govt

Blau: 2 yr contracts, low/med quality
Tiger: 4 yr, high quality

US Govt OK for Blau

Valuation

① Tiger

$$\begin{aligned} \text{Net income} &= 42 \\ &+ \text{D\&A} = 30 \\ &- \text{CapEx} = 30 \\ &- \Delta \text{WC} = 10 \end{aligned}$$

FCF = 32 Key

② $g = ?$
= Steel is stable, cyclical... But good tech + cust
 $g = 5\%$ estimated

③ $K_e = r_f + \beta(r_m - r_f)$
 $K_e = 5\% + 1(10\% - 5\%)$
 $K_e = 10\%$

$\beta = 1$ estimated
 $r = \text{WACC} = W_d * K_d(1 - \text{tax}) + W_e * K_e$

④ $r = \text{WACC} = K_e = 0.10$
 $r = 0.10$

⑤ $\text{Terminal Value} = \frac{\text{FCF} * (1+g)}{(r-g)}$

$$= \frac{32 * (1.05)}{(0.105)} = \frac{33.6}{0.095} = 672$$

⑥ **TV** 1400
EBITDA = 100 = 672x Key

Questions

- Will tech work?
- Will German cust pay for it?
- Competitor tech?
- Cost synergy?
- Valuation methods...

Strategy

Rev synergy
- new cust
- tech

Cost synergy
- consolidate

Assets

-relationships
-IP

-PPE

Value

Growth rate
 g

g

Expectations

Cust need diff grades of steel

IP works, transfers, and cust want it

Redundancies exist

Delivery

Identify any overlap in needs

Ensure IP has value/ is useful

Identify redundancies

Click or scan QR to see video.

Additional Study: For more questions to consider, review Section 13: Roadmaps.