University of Southern California

Marshall School of Business

FBE 532

Corporate Financial Strategy

Fall, 2010

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Office Hour: TBD

For the ones who had a notion
A notion deep inside
That it ain't no sin
To be glad you're alive

Bruce Springsteen
Badlands

TEXTS

[Required] Case and Readings Packet: at the Bookstore

Your textbook from your first-year corporate finance course. I assume you have all been through this, or a similar textbook before. Readings in this text are for background and to refresh your memory.

COURSE OBJECTIVES

This course will use cases to examine how the concepts and methods that you learned core can be applied to "real world" situations. We examine the linkages between the financing issues and the strategic objectives of the firm. It will be important to see what these linkages are and how the financial decisions reached must be consistent with the firm's objectives. By the end of the course, you should have become somewhat comfortable with taking raw financial data from the firm and applying different valuation approaches as a guide in decision-making. You should also have a deeper appreciation for the role of financial decisions in furthering corporate objectives and for the relations between the finance side of the firm and the operating side of the firm.

COURSE PROCEDURES:

In this class it is crucial that you spend time PRIOR to class going over the day's case. To the extent possible, I will not be lecturing. Thus, the only way the class works if the students have prepared the case. There are two mechanisms for ensuring this.

First, for each case I present a number of "study questions." I will highlight one or more of them in the syllabus. I expect you to hand in your response to these questions each class session (for cases that go over more than a single day, you should hand it in at the start of the case unless I indicate otherwise in the syllabus). These case assignments will be grades on a √, 0, - basis. These write-ups will count for 10% of the final grade.

The write-up should be written as a business memo directed to the decision maker in the case. Text is limited to at most two double spaced pages in a 12 point or larger font (this text is in 12 point type), with at most four pages of exhibits, graphs and figures. These must be easily readable and the entire document is to be on 8.5" x 11 inch paper with no cover page and margins of 1" at the top and bottom of the page and 1.25" at the left and right of the page. Penalties will be imposed for any violation of these rules (i.e., length, size of font, etc.)

Second, class participation will count for 25% of the final grade. In order to be sure that I know everyone in the class, I require (1) that you keep the same seat the entire semester [when enrollment stabilizes I will pass out a seating chart] and (2) that you have your name card in front of you at each class. I cold-call on a regular basis. Your attendance and participation are essential ingredients to a successful class. I expect you to inform me by email, prior to class, if you are going to miss class for any reason.

Cell phones and laptops are to be turned OFF during class.

The nature of the course

This is a case course. As you know, cases provide a rather unstructured and open-ended experience and you will have fairly little guidance, and rather larger uncertainty, about what the instructor wants and what the "right" answer is. This is intended, as this is the way the real world is.

This kind of teaching is often uncomfortable for students, as it requires you to learn by dealing with the inherent uncertainty of decision making with limited information. These are not simple textbook word problems. You will be tempted to look to the instructor in such a course for more guidance. However, it is inappropriate for me, or any other instructor in this kind of course, to give much detailed guidance. This would defeat the purpose and limit the learning that goes on. For this reason I will not discuss individual cases with any student prior to the class in which that case is discussed. As in the world outside the classroom, there is no single "right" analysis of a case. There are some approaches that are more "right" than others, and some that are clearly wrong in that they make unreasonable assumptions or proceed in an unreasonable manner. At some point in the discussion I will probably present my ideas of how one might analyze the situation, but mine is not the only valid approach and other reasonable approaches may be equally "right."

It is generally the case that students will ask for copies of my case notes and spreadsheets after we have discussed a given case in class. My policy, and that of ALL FBE instructors, is not to distribute these notes and spreadsheets. First, as stated earlier, given the inherent ambiguity of a case, there is no single "right" answer. There are, of course good and bad arguments and approaches. This course will help you distinguish between them. Handing out my solutions would reduce the ambiguity and defeat the purpose of the course. Moreover, it would render that case unusable in the future.

Because of the nature of this course (and the grading criteria), it is extremely important that you attend every class, arrive on time and be prepared to participate. To help me out, you should bring a name card and place it on the desk in front of you. I may not remember who said what without those cards. After the enrollment in the course has stabilized, I will pass around a seating chart. At that point, I ask that you remain in that seat for the entire term. This will help ensure that class participation is accurately recorded and rewarded. Note that good class participation does not mean simply speaking; it means participating and moving the discussion along in a productive manner.

FINAL EXAM

There will be an in class final exam. It will be given during the examination period stated in the Official Class Schedule for this class, which is Thursday, December 9, 2010 from 2:00 to 4:00.

GRADING

Grading will be based on: the case question write-ups (10%), class participation (25%) and the final exam (65%)

In evaluating class participation I will be considering the contributions that you have made to furthering the discussion of the topic at hand. Mere opening your mouth is not good class participation. I am looking for comments that are thoughtful and lead the discussion forward, not astray.

Note that I will cold-call. Thus, I expect everyone in the class to be able to discuss each case. However, I recognize that there are times when you will be unable to be prepared for a class. In that case, you must contact me BEFORE class and you may ask for a "cold-call" pass. Of course, I do not expect you to abuse this loophole. You may use this option no more than twice during the semester.

ELECTRONIC RESOURCES

I will maintain a website for this course on Blackboard. The website will contain an electronic version of this course syllabus, with hypertext links to 1) Excel spreadsheets for each case, 2) every handout as a PDF file, 3) any lecture notes this I write up as PowerPoint presentations. Each spreadsheet contains most of the exhibits in the case. This will make it easier for you to spend time on the analysis rather than punching in numbers. I will also monitor discussion threads on Blackboard. I would like you to post any questions that you have to the discussion board. I will leave them open for a bit so that other students may respond, then I will reply. This way all questions are available to all students. I will consider posting and replying to questions as an element of class participation in determining your grade. Of course, if you have a private question please contact me directly by e-mail, or at my office.

ACADEMIC DISHONESTY

The use of unauthorized materials, communications with fellow students during an examination, attempting to benefit from the work of another student, and similar behavior that defeats the intent of an examination, or other class work is unacceptable to the University. It is often difficult to distinguish between a culpable act and inadvertent behavior resulting from the nervous tensions accompanying examinations. Where a clear violation has occurred, however, the instructor may disqualify the students work as unacceptable and assign a failing

SECTION 1: INTRODUCTION AND REVIEW

Class 1: 8/24/2010

Introduction to course

Background reading for this lecture:

Review the sections in your first year text that covered capital structure and dividend policy

If the investment value of an enterprise as a whole is by definition the present worth of all its future distributions to security holders, whether on interest or dividend account, then this value in no wise depends n what the company's capitalization is. Clearly, if a single individual or a single institutional investor owned all of the bonds, stocks and warrants issued by the corporation, it would not matter to this investor what the company's capitalization was (except for details concerning the income tax). Any earnings collected as interest could not be collected as dividends. Thus such an individual it would be perfectly obvious that total interest- and dividend- paying power was in no wise dependent on the kind of securities issued to the company's owner. Furthermore no change in the investment value of the enterprise as a whole would result from a change in its capitalization. Bonds could be retired with stock issues, or two classes of junior securities could be combined into one, without changing the investment value of the company as a whole. Such constancy of investment value is analogous to the indestructibility of matter or energy: it leads us to speak of the Law of the Conservation of Investment Value, just as physicists speak of the Law of the Conservation of Matter, or the Law of the Conservation of Energy.[1]

John Burr Willams
The Theory of Investment Value
Harvard University Press, 1938

[1] More accurately, one should speak of the Law of Conservation of Matter and Energy, as we now know that matter can be converted into energy.

Class 2: 8/26/10

Reading: Is a Share Buyback Right for Your Company

Case: Blaine Kitchenware

Study Questions:

1. Do you believe Blaine's current capital structure and payout policies are appropriate? Why or why not?
2. **Should Dubinski recommend a large share repurchase to Blaine's board? What are the primary advantages and disadvantages of such a move?**
3. Consider the following share repurchase proposal: Blaine will use $209 million in cash from its balance sheet and $50 million in new debt bearing an interest rate of 6.75% to repurchase 14 million shares at a price of $18.50 per share. How would such a buyback affect Blaine? Consider the impact on, among other things, BKI's earnings per share and ROE, its interest coverage and debt rations, the family's ownership interest, and the company's cost of capital.
4. As a member of Blaine's controlling family, would you be in favor of this proposal? Would you be in favor of it as a non-family shareholder?
5. How does the proposal in question 3 differ from a special dividend of $4.39 per share?
6. Suppose that Mr. Dubinsky has obtained from Blaine's banker the quotes below for default spreads over 10 year Treasury bonds [note that these differ from the more general bond yields in case Exhibit 4]. What do these quotes imply about Blaine's cost of debt at the various debt levels and credit ratings? Compute BKI's weighted average cost of capital at each of the indicated debt levels. What do your calculations imply about Blaine's optimal capital structure? Based on these calculations, how many shares should Blaine repurchase and at what price?

10 year Treasury Yield 5.02%

Interest Coverage Ratio	**Debt Rating**	**Default Spread**
>13.0	AAA	0.65%
9.5 - 12.0	AA-	0.80%
7.0 - 9.5	A	0.85%
5.0 - 7.0	BBB+	1.83%
4.0 - 5.0	BBB+	2.98%
2.5 - 4.0	B+	4.10%

Debt Relationships	AAA	AA-	A	BBB+	BBB+	B+
FY2006 EBIT	73,860	73,860	73,860	73,860	73,860	73,860
Interest Expense	4,765	6,423	8,028	10,551	14,069	17,420
Coverage Ratio	15.5 x	11.5 x	9.2 x	7.0 x	5.2 x	4.2 x
Estimated Cost of Debt	?	?	?	?	?	?
Implied Debt	?	?	?	?	?	?

Class 3: 8/31/10

Case: MCI - 1983

Study Questions:

1. What is the likely level of MCI's external needs over the next several years? By how much could they reasonably be expected to vary? Why?
2. Critique MCI's past financial strategy, giving attention to the types of securities on which it has relied. Why did MCI finance itself in the manner it did?
3. **Based on your analysis of the outlook for MCI and the competitive and regulatory evolution of the industry, recommend a capital structure policy for MCI and defend you're a proposal against plausible alternatives.**
4. Assume that Mr. English, the MCI chief financial officer, has the following financial alternatives available to him in April 1983

    a) $500 million of 12½% 20-year subordinated debentures

    b) $400 million of common stock

    c) $600 million of 7⅝% 20-year convertible subordinated debentures with a conversion price of $54 per share (i.e., each $1,000 bond could be converted into 18.52 common shares).

    d) $1 billion of a unit package consisting of $1,000 7½% 10 year subordinated warrants, each entitling the holder to purchase one share of MCI common stock for $55. The warrants would be exercisable until 1988 and are callable. The exercise price of the warrants would be payable either in cash or by surrender of the debentures valued at their principal amount.

    Which, if any, of these alternatives would you recommend that Mr. English take? Why? In broad outline, what financing steps would you recommend he take over the next several years?

SECTION 2: CORPORATE VALUATION METHODS

Readings for this section of the course:

What's It Worth
Introduction to Cash Flow Valuation Methods
Corporate Valuation and Market Multiples
Note on Mergers and Acquisitions and Valuation
Technical Note on LBO Valuation (A) & (B)
Valuing Companies in Corporate Restructuring
Leverage, Betas and Taxes (on Blackboard under Course Documents)

Class 4: 9/2/10

First Lecture on Valuation: WACC, Asset and Equity Betas

Class 5: 9/7/10

Second Lecture on Valuation: Four DCF Valuation Approaches

Class 6: 9/9/10

No Class on 9/9/10

Class 7: 9/14/10

Case: Sampa Video, Inc.

Study *Questions*

1. What is the value of the project assuming the firm was entirely equity financed? What are the annual projected free cash flows? What discount rate is appropriate?
2. Value the project using the Adjusted Present Value (APV) approach assuming the firm raises $750 thousand if debt to fund the project and keeps the level of debt constant in perpetuity.
3. Value the project using the Weighted Average Cost of Capital (WACC) approach assuming the firm maintains a constant 25% debt-to-market value ratio in perpetuity.
4. What are the end-of-year debt balances implied by the 25% target debt-to-value ratio?
5. Using the debt balances from question 4, use the Capital Cash Flow (CCF) approach to value the project.
6. **How do the value from the APV, WACC and CCF approaches compare? How do the assumptions about financial policy differ across the three approaches?**
7. Given the assumptions behind the APV, WACC and CCF, when is one method more appropriate or easier to implement than the others

Class 8: 9/16/10

Third Lecture on Valuation: Valuation by Market Multiples, Marketability and Minority/Control Adjustements

Class 9:   9/21/10

Case: Kohler

Study Questions:

1. **What is the total enterprise value of Kohler Co. using a discounted cash flow approach? What is the total enterprise value using a multiples (market value of comparable companies) approach? What is the value of a share held by a minority shareholder of Kohler Co. that is implicit in your valuations?**
2. What assumptions can you use to arrive at the share price of $55,400 that was estimated by Kohler Co.? Show how these assumptions impact your valuation.
3. What assumptions can you use to arrive at the share price of $270,000 that was estimated by the dissenting shareholders? Show how these assumptions impact your valuation.

For the last two questions assume that (i) legal fees can be ignored; and (ii) Herbert Kohler, the dissenters, and the IRS all have the same cost of capital—i.e., that any interest charges are offset by the value for Herbert Kohler of paying late.

4. What is the maximum share price at which Herbert Kohler should be willing to settle with the dissenting shareholders in order to stop the trial on April 11, 2000. Assume that: (i) if the trial proceeds, it is expect to last less than a month and to result in one of two possible outcomes in terms of the price per share established in court: the $273,000 being claimed by the plaintiffs, or the $55,400 being defended by Herbert Kohler; (ii) Kohler estimates the probabilities of the two outcomes at 30% and 70% respectively.
5. How would your answer to (4) change if you also assume that (i) the inheritance tax owed on Frederic Kohler's estate was 50.2% of his holdings in Kohler Co. (equivalent to 489 shares out of the 975 he owned); (ii) the taxes paid by the estate amounted to $27 million (489 shares valued at $55,400 each); (iii) were the settlement or the trial to result in a revised share price in excess of $55,400, the IRS would likely demand a similar valuation for its claim on Frederic's estate; and (iv) Herbert Kohler estimates the probability of the IRS's demand at 100% if he proceeds to trial and 50% if he settles.

SECTION 3: RAISING MONEY

Class 10: 9/23/10

Case: JetBlue Airways IPO Valuation

Study Questions:

1. What are the advantages and disadvantages of going public?
2. What different approaches can be used to value JetBlue's Shares?
3. **At what price would you recommend that JetBlue offer its shares?**

Class 11: 9/28/10

Case: Philip Morris Companies and Kraft, Inc.

Page limits do not apply to this writeup. Provide a detailed analysis of the stated question, supported by spreadsheets. Make it clear what assumptions you have made in your analysis.

Study Questions

1. **How much is the proposed Kraft restructuring plan worth to Kraft shareholders? Contrast and compare the value given by different approaches including WACC, APV, CCF and FTE?**

Class 12:   9/30/10

Case: Philip Morris Companies and Kraft, Inc. (Day 2)

Study Questions

1. How did the stock market assess Philip Morris' $90 per share bid for Kraft?
2. **Can Philip Morris finance the Kraft acquisition?**
3. What is the value to shareholders of the restructuring plan proposed by Kraft? (see previous analyses of this case)
4. As Mr. Hamish Maxwell, chairman and CEO of Philip Morris, what should you do next? As Mr. John Richman, Chairman and CEO of Kraft, what should you do next?

Class 13:   10/5/10

Case: Bidding For Hertz: Leveraged Buyout (Day 1)

Study Questions

1. How does the dual-track process used by Ford to initiate "consideration of strategic alternatives" affect the bidding process for Hertz?
2. In what ways does Hertz conform or not conform to the definition of an "ideal LBO target"? Do you believe Hertz is an appropriate buyout target?
3. Strategically, what value-creating opportunities can the sponsors exploit in this transaction?
4. **How realistic are the key assumptions that underlie the Bidding Group's projections in case exhibits 8, 9, 10? Which assumptions are most likely to have**

Class 14: 10/7/10

Case: Bidding For Hertz: Leveraged Buyout (Day 2)

Study Questions

1. What is the market-required rate of return for this investment and why might it differ from the sponsors' target return?
2. What is the value of Hertz using the Flow to Equity method of valuation?
3. Assess the amount Ford is likely to receive if it pursues its IPO alternative versus sale to a private equity group?
4. **What factors would be considered in assessing whether the consortium's bid is likely to beat that of a rival group?**

Class 15: 10/12/10

Case: Investing in Sponsor Backed IPOs: The Case of Hertz

Study Questions

1. Why are the private equity sponsors pursuing an IPO of Hertz at this time – that is, what is the purpose of the IPO?
2. What are the differences between conventional IPOs and IPOs that arise from leveraged buyouts?
3. Should the sponsors have taken on additional debt and paid themselves a dividend from Hertz?
4. **What are the pros and cons of sponsor-backed IPOs for public shareholders?**
5. At the $15 offer price, does the Hertz IPO represent a good investment opportunity for Berg?
6. The sponsors invested $2.3 Billion in equity (divided equally among them) to finance the $15 Billion buyout of Hertz in December 2005. I the Hertz IPO is competed at the $15 offer price and the overallotment option is exercised, what is your estimate of the gross returns the sponsors will earn on their $2.3 Billion investment in Hertz (i.e., ignoring carried interest or management fees on the funds)?
7. Would you invest in the Hertz IPO?

Class 16: 10/14/10

Case: Corning Convertible Preferred Stock

Study Questions

1. Describe Corning's Business. How has the firm performed? What accounts for the changes in the value of Coring stock in Exhibit 2? Trying to avoid hindsight bias—and this is very hard to do—could one have forecasted Corning's troubles before 2001?
2. Evaluate Corning's financing strategy. How as the firm raised capital in the past?
3. **Why does Corning need to raise capital? Why might it be difficult or undesirable to raise equity, given its financial leverage and credit rating? Working through the exercise below will help you understand the "debt overhang" problem. Why might it be difficult or undesirable to raise equity even if its financial leverage were lower?**

    Debt and Incentives Exercise: Suppose that the face value of Corning debt is $4 billion and that the value of its assets will either be $10 billion (to creditors and shareowners) or $3 billion (to creditors in bankruptcy), with equal probability. Compute the market value of debt and the market value of equity per share, ignoring discounting. What happens to the market value of equity per share if Corning raises $400 million and invests in projects that deliver $500 in value for sure i.e., regardless of the value of Corning's assets?

4. Why is JP Morgan proposing this particular security? Who are the likely buyers?

Class 17: 10/19/10

Case: Corning Convertible Preferred Stock (continued)

Study Questions

1. **Draw a payoff diagram for the convertible security in Exhibit 10. Value the security as the sum of its parts. Would you buy the Corning preferred shares at par? If your answer is "yes" what other investments, if any, would you make concurrently?**
2. What are the risks of this offering for Corning?
3. What should Flaws do?

Class 18: 10/21/10

Case: AXA MONY

Study Questions

1. Why is AXA bidding for MONY? Does the deal make sense: (a) for AXA; (b) for MONY shareholders; (c) for management? AS a MONY shareholder, what concerns would you have about the deal?
2. How did AXA finance the takeover bid? Explain the structure that they used. Why did they use this structure? What effects, if any, do you think this method of financing has on the likelihood of the deal succeeding?
3. **How would you price the ORAN at issue? Is it fairly priced? What does the price of the ORAN on February 9, 2003, imply about the probability of the deal succeeding? What is the fair price for MONY stock?**
4. Suppose that you hold a position in the ORAN on February 9. Would you want to buy or sell MONY stock (a) at the "fair" price calculated in question 3 above or (b) at the market price of $31.55? How do you explain the price of MONY stock on February 9?

Class 19: 10/22/10

Case: AXA MONY (Continued)

1. **Suppose that you are the manager of a $2bn hedge fund with a significant stake in MONY and that on February 10 you receive a phone call asking to buy your stock at above the market price if you sign over the voting rights with the shares. What considerations would enter into you decision about whether to sell your MONY stock at $31.55 on February 9?**

SECTION 4: CORPORATE RESTRUCTURING INCLUDING BANKRUPTCY

Background Readings for this Section:

When does Restructuring Improve Economic Performance
Valuing Companies in Corporate Restructuring
Leveraging the Incumbent's Advantage

Class 20: 10/28/10

Case: Bankruptcy and Restructuring at Marvel Entertainment Group

Study Questions

1. Why did Marvel file for Chapter 11? Were the problems caused by bad luck, bad strategy, or bad execution?
2. Evaluate the proposed restructuring plan. Will it solve the problems that caused Marvel to file Chapter 11? As Carl Icahn, the largest unsecured debtholder, would you vote for the proposed restructuring plan? Why or why not?
3. How much is Marvel's equity worth per share under the proposed restructuring plan assuming it acquires Toy Biz as planned? What is your assessment of the pro forma financial projections and liquidation assumptions?
4. Will it be difficult for Marvel or other companies in the MacAndrews and Forbes holding company to issue debt in the future?
5. **Why did the price of Marvel's zero-coupon bonds drop on Tuesday, November 12, 1996? Why did portfolio managers at Fidelity and Putnam sell their bonds on Friday, November 8, 1996?**

Class 21: 11/2/10

Read Jensen "Free Cash Flow" article on Blackboard

Case: Sealed Air Leveraged Recapitalization (A)

Study Questions

1. **What if free cash flow? How can it create organizational problems?**
2. In their introductory textbook, Brealy and Myers define *financial slack* as having funds "so that financing is quickly available when good investment opportunities arise." What is the difference between free cash flow and financial slack?
3. What are the organizational advantages and disadvantages of leverage?

Class 22: 11/4/10

Case: Humana, Inc.

Study Questions

1. Do you think Humana's problems were serious enough to warrant some form of restructuring?
2. How much extra value would be created by separating the hospital and health plan segments through a spinoff? What are the sources of this added value, and how should the spinoff be structured for Humana to realize maximum benefits from the spinoff?
3. Kaiser Permanente has employed an integrated strategy of owning both hospitals and health plans for many years, some would argue with great apparent success. This suggests that Humana's problems are not the fault of its integrated strategy *per* se, and that breaking apart the hospital and health plan segments may not enhance shareholder value in the long run. Do you agree or disagree?
4. **Do any other options considered by management represent a more sensible solution to Humana's problems than the spinoff?**

Class 23: 11/9/10

Case: Seagate Technology Buyout

Study Questions

In analyzing these questions, assume that the transaction is expected to close on December 31, 2000

1. **Why is Seagate undertaking this transaction? Is it necessary to divest the Veritas shares in a separate transaction? Who are the winners and loser resulting from this transaction?**
2. What are the benefits of leveraged buyouts? Is the rigid disk drive industry conducive to a leveraged buyout?
3. Luczo and the buyout team plan to finance their acquisition of Seagate's operating assets using a combination of debt and equity. How much debt would you recommend that they use? Why?
4. Based on the scenarios presented in Exhibit 8, and on your assessment of the optimal amount of debt to be used in Seagate's capital structure, how much are Seagate's operating assets worth? For both of the assumptions listed below, estimate the value of Seagate's operating assets. Assume that of the $800 million in cash that the buyout team will acquire as part of the transaction, $500 million is required for net working capital and $300 million is excess cash.
    a) Assume that the buyout team plans to maintain its debt at a constant percentage of the firm's market value
    b) Assume that the buyout team plans to pay down its debt as cash flows permit until a terminal debt level of $700 million is reached.

Class 24: 11/11/10

Case: Seagate Technology Buyout (day 2)

Questions will be distributed

Section 5: Mergers and Acquisitions

Background Readings for this Section:

M&A Legal Context: Basic Framework for Corporate Governance

Note on Poison Pills

Class 25: 11/16/10

Case: Time Inc.'s Entry into the Entertainment Industry (A)

Study Questions

1. **How attractive is the merger of Time and Warner?**
   a) **What are the value enhancement opportunities?**
   b) **Is the proposed exchange ratio of .465 per Warner share attractive?**
2. What prompted Paramount's interest in Time?
3. What legal, financial, and restructuring options does Time have to combat the Paramount bid? To ensure that it is not a target in the future?
4. What would you do as Mr. Munro? How would you explain a decision to reject the Paramount offer at the annual shareholder's meeting?

Class 26: 11/18/10

Case: Vodphone AirTouch's Bid for Mannesmann

Study Questions

1. What was the strategic and economic rationale for Mannesmann's acquisition of Orange? Did Mannesmann overpay for Orange?
2. Vodafone AirTouch proposed that each Mannesmann share would receive 53.7 Vodafone AirTouch shares, so that in aggregate Mannesmann shareholders would own 47.2% of the equity of the new combined firm.
   a) Describe the stock swap. As of December 17, what was the market value of Mannesmann's contribution to the combined firm? As a Mannesmann shareholder, would you accept the current offer? As a Vodafone shareholder would you support the proposed transaction?
   b) On December 17, 1999, based on real sock prices of the two firms, what is the market's estimate of the implied synergies from the deal? Assume that if the bid fails both firms would trade at prices prevailing on Oct. 21, 1999.
   c) What is the present value of the expected synergies (in pounds) as shown in Exhibit 10 as of March 2000. (You may want to assume that the synergies related to revenues and costs would grow at 4% annually past 2006, but savings from capital expenditures would not extend beyond 2006, and that the merger will not affect the firm's level of working capital.) Use the average exchange rate of 1£=1.5789€ to convert pound synergies into Euros.
   d) UK equities return 7.7% (in pounds) over the UK risk-free rate for the period 1919 – 1993 and 6.8% over the UK risk-free rate for the period 1970 – 1996. How might this observation affect your decision?

Class 27: 11/23/10

Case: Vodphone AirTouch's Bid for Mannesmann (Continued)

Study Questions

1. What hurdles is Vodafone AirTouch going to face to complete its acquisition of Mannesmann? Who is going to be its most likely supporter? Who is going to resist? Why?
2. Why is Gent so eager to do the deal? Why is Esser fighting so hard?
3. **What role do hostile takeovers play? In their absence what mechanisms perform the same function? How is the German Corporate Governance system different from the Anglo-Saxon system?**

SECTION 6: AN APPLICATION: THE EVOLUTION OF BANKING AND THE CRISIS OF 2007/8

Class 28:   11/30/10

Case: Chase Manhattan: The Making of America's Largest Bank

Study Questions

1. Recently a growing number of U.S. companies have tried to cut their operating costs through various kinds of restructuring. Chemical and Chase are attempting to reduce their costs by merging. This approach ("bigger is better") represents a sharp contrast to the refocusing and downsizing which has characterized most U.S. manufacturing in recent years. Do you think the interests of the bank's shareholders and other constituencies would be better served by some alternative form of restructuring that emphasizes increased corporate focus?
2. What are the strategic benefits, in any, of combining Chase and Chemical? What is the most significant benefit that the banks will realize from this merger?
3. Should Chemical reconsider any of its other prospective merger partners?
4. **Assuming that all the anticipated benefits from the merger are realized, what is the likely dollar impact of the merger on the combined wealth of Chase and Chemical common stockholders? How will the merger affect the banks' financial performance (e.g., as measured by return on equity)? As a banking industry financial analyst, how would you measure the success of this transaction? (The equity beta for each bank's common stock at the time of the case was about 1.25)**
5. To what extent, if any, do the prospective financial gains of the banks' shareholders represent transfers of value from other claimholders, such as bank customers, employees, and communities in which the banks do business.
6. If you were the Chemical CEO, what exchange ratio would you seek for the merger? What if you were the Chase CEO?
7. Critically evaluate the analysis that Chase and Chemical performed for determining the level of employee layoffs and branch closings. How should a company determine what level of downsizing is appropriate for its circumstances? Over what time-period should the layoffs and branch closings be scheduled?
8. As a general matter, when a company undertakes a complex or controversial restructuring program, what issues should management be concerned about in designing the company's disclosure strategy? In the context of the Chemical-Chase merger, how much and what kind of information about this deal should management disclose to Wall Street and the media?

Class 29: 12/2/10

Case: Bear Stearns and the Seeds of Its Demise

Study Questions

1. Consider a commercial bank, circa 1973. What would each side of its balance sheet have looked like?
2. Consider an investment bank, circa 1973. What would each side of its balance sheet have looked like?
3. What activities did Bear Stearns undertake Was it a commercial bank or an investment bank?
4. What accounts for the financial turmoil that develop din summer 2007? Who or what do you believe was most responsible for the situation?
5. What forces contributed to the collapse of the two hedge funds?
6. Were the reasons for the collapse unique to Bear Sterns or more widespread?
7. In light of the collapse of the hedge funds, how serious were Bear,s credit problems? What steps did management take or could it have taken to address the problem?
8. Were the steps taken by Bear's management adequate in your opinion?
9. **More generally, what are the implications of the failure of independent investment banks, such as Bear Stearns, for the future business model of banking?**