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 HBSP website

https://cb.hbsp.harvard.edu/cbmp/access/27423433

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 examines how the finance theory that developed in your prior finance class(es) can be applied in “real world” situations. More importantly, we will be concerned with the implementation of a financial strategy. We will take is as given that the past 50 years of research in the academic discipline of Financial Economics (which has resulted in at least 9 Nobel prizes in Economics) has had a significant impact on the practice of finance, and thus should inform our analysis. All you need to do is consider that 50 years ago investment banks and money managers had no use for Ph.D. financial economists, and now they line up to hire them.

Finally, it is useful to consider what we mean by the term “Financial Strategy.” In your first finance class, while you learned a set of skills, you really only considered two financial decisions (the capital structure and dividend payout decisions) and, by and large, evaluated these in the context of an entity that had already made its operating and investment decisions. In this class we expand the analysis in two ways. First, we consider the more realistic situation where today’s financing decision may have an effect on future operating and investment decisions; and thus (unless markets do not work at all) on current value. Second, we broaden the definition of a “financial” decision to include thinks like corporate structure, ownership structure, and the like. We also consider how these decisions are affected by the legal and regulatory environment, capital markets, and general societal structures.

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 [in bold]. I expect you to hand in your response to these highlighted questions each class session. For cases that go over more than a single day, I have indicated which questions are due on which day. No written assignments are due until after the add/drop date, which is September 12, 2014. Grading will be on a 0,1,2 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 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 a portion 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. **Note that I will cold-call and even though you are not required to hand in a write-up of the case, you are still responsible for being able to discuss the case in a meaningful manner.** In evaluating class participation I will be considering the contributions that you have made to advancing 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.

**Cell phones and laptops are to be turned OFF during class unless otherwise directed.**

**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.

As the cases are all examples of real world decisions, it is possible for you to find out what decision was actually made before we discuss the case in class. While this may be of interest, it is really not a good idea. First off, I will, in general, end the class by going over what actually happened. More importantly, the decisions made by the actual people involved in the case may not have been the right decision. In many of the cases the decision did not work out well for the firm, and, more importantly, some understanding of finance theory and empirical results, could have avoided the mistake. You should make no presumption that CEO’s always make the right decision.

**FINAL EXAM:**

There will be a final exam. It will be given during the examination period stated in the Official Class Schedule for this class, which is **Wednesday, December 11, 2013 from 4:30 to 6:30.**

**GRADING**

Grading will be based on: the case question write-ups (10%), class participation (20%) and the final exam (70%)

Again, note that I will cold-call. Thus, I expect everyone in the class to be able to discuss each case.

**ELECTRONIC RESOURCES**

I will maintain a website for this course on Blackboard. The website will contain information on each case, some questions to get you thinking about the case, some suggested readings described in more detail below, and this course syllabus. The readings packet referenced above also contains exhibit spreadsheets for each case that you can download.

I have created a separate bulletin board forum for each case in Blackboard. I will monitor these. 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. Please inform me by email anytime you post a question. Of course, if you have a private question please contact me directly by e-mail, or at my office, however, I will not answer any question about a case or class procedures privately so that everyone can see any information I provide to anyone. I will not be handing out any paper in the class, all is on Blackboard.
SUPPLEMENTAL READINGS

In addition to the cases there are three types of readings in this course:

**Required Readings:** These are readings that I expect you to read either before or after the case. Most of these will be found as part of the course packet on the HBS website. I have marked these as “optional” on the website as it is possible you may have already read these notes and articles for another class.

**Docs:** These are various articles from the media or from “experts” that relate to the case. They may be newspaper reports about the event or may provide background information that may be use. In a few cases I have included legal decisions that had a bearing on the case. Unless I state otherwise, these are for edification but are not required. These may include papers from practitioner oriented, as opposed to academic oriented journals. All should be readily accessible to you.

**Academic:** These are academic papers that relate to the case. In general they are aimed at an academic audience, and may be rather technical in nature. You may, however, find it interesting to look at the introductory and concluding sections, which are usually not difficult to understand. These papers are *not required* at all, but you may find them interesting as the results in these papers are often of use in analyzing the case. These show how, in Finance, academic research and actual practice inform, and are informed by, each other.

Sometimes a reading that I especially want you to read after a case will not appear on either the Harvard Reading Packet site, or on Blackboard, until the case discussion is finished.

**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 grade.

**Class Notes Policy**

Notes or recordings made by students based on a university class or lecture may only be made for purposes of individual or group study, or for other non-commercial purposes that reasonably arise from the student’s membership in the class or attendance at the university. This restriction also applies to any information distributed, disseminated or in any way displayed for use in relationship to the class, whether obtained in class, via email or otherwise on the Internet, or via any other medium. Actions in violation of this policy constitute a violation of the Student Conduct Code, and may subject an individual or entity to university discipline and/or legal proceedings.

**Policy on electronics in the classroom**
Laptop and Internet usage is not permitted during academic or professional sessions unless otherwise stated by the respective professor and/or staff. Use of other personal communication devices, such as cell phones, is considered unprofessional and is not permitted during academic or professional sessions. ANY e-devices (cell phones, PDAs, i-Phones, Blackberries, other texting devices, laptops, i-pods) must be completely turned off during class time. Upon request, you must comply and put your device on the table in off mode and FACE DOWN. You might also be asked to deposit your devices in a designated area in the classroom. Videotaping or audiotaping of a class session is not permitted except by my arrangement. Use of any recorded or distributed material is reserved exclusively for the USC students registered in this class.

“Know something? The entire dialectic of Marxist revisionism can be reduced to one simple formula: Money talks.”
Course Introduction

Class 2: 8/27/2014

Case: Texas High Speed Rail

This case is here to:
2) Examine the unique problems associated with financing of large infrastructure projects

Class 3: 9/3/2014

Case: Interco

This case is here to:
1) To help you become both critical consumers and competent practitioners of valuation analysis.
2) To compare and contrast various approaches to valuation analysis.
3) To ask how a reasonable discount rate, or overall cost of capital, can be determined for valuation purposes.
4) To provide the basis for a discussion of the roles of the various parties in a hostile takeover situation.

Class 4: 9/8/2014
Class 5: 9/10/2014

Case: Fleetwood Enterprises

This case is here to:
1) Provide a vehicle for reviewing basic capital structure theory and distribution/payout policies.
This case is here to:

1) Show how project finance can reduce the opportunity costs associated with leverage-induced under-investment in positive net present value projects. This “debt overhang motivation” is one of the primary motivations for using project finance.
2) Describe what project finance is and how it differs from corporate finance.
3) Illustrate the importance of adapting a company’s financial strategy to support a new competitive strategy designed to capture fleeting profit opportunities.
4) Illustrate how a financial institution can lead the credit markets by developing an innovative financial structure to support a client’s evolving financial need.

This case is here to:

1) Provide another opportunity to practice using equity cash flow valuation and compare this approach to APV and CCF.
2) Provide an example of an LBO that was successful.
3) Examine how you finance a company’s growth after an LBO

**NOTE: CLASS WILL NOT MEET ON 9/24/2014**

Your assignment for 9/24 is to reflect upon your behavior toward your fellow man during the past year, and consider how your behavior can improve during the next year.
**Class 9: 9/29/2014**

Case: L’Occitane de Provence

This case is here to:

1) Examine the varied implications of being a public firm (reporting, governance, compliance), from the perspective of a consumer goods firm
2) Examine the choice of where to list, based on an assessment of the differences between a few key global stock exchanges.

**Class 10: 10/1/2014  
Class 11: 10/6/2014**

Case: ISS Buyout

This case is here to

1) Get practice forecasting cash flows, with and without acquisitions — making suitable assumptions about the likely cost (CAPX) associated with acquisitions and, if desired, forecasting the goodwill tax shield resulting from these acquisitions. Decide, on the basis of these forecasts, whether continuing the acquisition strategy makes sense.
2) Forecast the firm’s balance sheet and, in particular, work out a viable debt schedule for the firm in an LBO purchase.
3) Employ advanced valuation techniques in an LBO setting, particularly the Capital Cash Flows and Equity Cash Flows methods.
4) Consider whether the way of sharing returns between the general partners (GPs) and the limited partners (LPs) creates any conflict of interest between them — for example, in the GP’s choice between continuing and terminating the acquisition strategy.
5) Discuss what makes a firm an attractive target for a buyout in general, and what factors might make this deal particularly attractive or unattractive.
6) Consider the various ways in which private equity firms might make money from their investments (including more aggressive leverage, improving operations, and extracting value from other stakeholders).
7) Consider the obligations of the private equity holders to existing bondholders, who have no covenant to prevent the new buyers issuing LBO debt that is senior to their own securities. Assess the likely losses to these bondholders resulting from the expected downgrade of their debt.
Class 12: 10/8/2014

Case: Nextel Partners

This case is here to

1) Discuss the concept of “fair market value” and how it should be estimated.
2) Discuss the various premia and discounts, use of auction vs. negotiated prices, dcf vs. market multiples and how to use comparable transactions data in the context of valuation disputes.
3) See how the structure of a financial claim can hinder, or engender, cooperation between antagonistic parties.

Note: For this case I will ask that you engage in some role-playing. Students seated between the window and the aisle will take the perspective of Morgan-Stanley (the appraiser selected by Nextel Partners). Those in the middle section will take the perspective of Lazard Freres (the appraiser selected by Sprint Nextel). Those in the middle section will take the role of the as-yet unnamed third appraiser.

Class 13: 10/13/2014

Case: Dow – Rohm & Haas

This case is here to:

1) Expose you to the legal side of M&A transactions. By exploring detailed contractual provisions (e.g., consideration, ticking fees, termination fees, “no talk” clauses, etc.), you are exposed to how a merger agreement identifies, mitigates, and allocates important deal risks. It also exposes you to legal theories of enforcement such as “specific performance” and to a lesser extent theories of damages in the event of a breach.
2) Provide another opportunity to value an acquisition target as well as potential synergies using discounted cash flow (DCF) analysis.
3) Analyze the impact the global economic and financial crises had on the M&A market from the fall of 2008 through 2009. In addition to reducing the value of target firms, the crisis severely limited the internal and extern financing options available to acquirers.
4) Help you understand and use information contained in capital markets to assess the dynamics of merger transactions. In particular the case presents data on the arbitrage discount and the pricing of credit default swap (CDS) spreads as ways to understand the likelihood of consummation and the probability of bankruptcy, respectively. Interestingly, these securities provided somewhat mixed signals regarding the likely outcome of the deal.
Case: MCI Takeover Battle: Verizon Versus Qwest

This case is here to:

1) Focus on the possible role of inefficient markets in M&A.
2) Examine the use and valuation of collared offers
3) Explore the potential conflicts between shareholders with different horizons
4) Examine the fiduciary responsibilities of the target firm’s board in choosing between competing offers.

Case: Kerr-McGee

This case is here to:

1) Examine the possible underpricing of a firm in the oil patch.
2) Evaluate a specific restructuring proposal
3) Determine whether the board should adopt the proposal made by Carl Icahn
4) Examine the role of activist investors such as Icahn.

Case: Magna International (A)

This case is here to:

1) Provide a vehicle to assess the costs and benefits of the dual-class ownership structure and analyze how these costs and benefits change as the firm evolves through its business life cycle.
2) Illustrate the agency problem associated with controlling shareholders and its real impact on firm value, especially when there is a large divergence between the dominant shareholders’ control rights and cash-flow rights (“control-ownership divergence”), and highlight the importance of establishing effective governance mechanisms to protect minority shareholders.
3) Provide an opportunity to quantify the potential benefits of unwinding an ownership structure that eliminates the control-ownership divergence, and to consider how the value created should be divided between two classes of shareholders.
Case: Mylan Labs’ Proposed Merger with King Pharmaceuticals

This case is here to:

1) Attempt to value the stated synergies from the deal using a DCF or multiples based approach.
2) Consider whether Mylan’s offer for King is too generous, looking at the control premium and using a multiples analysis to value King; and to discuss why pharmaceutical companies may be difficult to value without access to detailed information (because of expiring patents on particular drugs making the forecasting of revenues uncertain).
3) Infer from the market reaction to the announcement of the Mylan-King merger the expected value of the combined companies and the market’s view of the winner and loser from the deal.
4) Use the subsequent trading prices of the two companies to back out a probability with which the market expects the merger to be consummated, and to discuss merger arbitrage strategies.
5) Consider why a hedge fund might have incentives to engage in so-called “empty voting” around a controversial merger, and think about the mechanics about how acquiring a voting stake without accompanying economic interest can be achieved.
6) Consider whether and how such “empty-voting” should be regulated or curtailed.
Case: TELUS

This case is here to:

1) Delve more into the “empty voting” issue.
2) Provide an opportunity to discuss the mechanics and economics of short selling as implemented by an event-driven hedge fund.
3) Raise several fundamental questions about corporate governance: why do shareholders (rather than employees or debtholders) have voting rights? Are those rights valuable? Assuming they are valuable, how valuable are they, and why?
4) Examine some other issues such as: the value of liquidity, the nature of proxy contests, the roles played by activist shareholders, and the existence of and motivations for dual class ownership structures. Also analyzes important governance institutions including the roles played by special committees (of directors) and by proxy advisors (“proxy firms”) like Institutional Shareholder Services (ISS) and Glass, Lewis & Co. (GL).

Case: AXA MONY

This case is here to:

1) Explore the difficulties that stand in the way of an efficient transaction.
2) Assessing the difficulties facing shareholders in exercising voice in a poorly performing company, and the free rider problem associated with this.
3) Understand management’s general reluctance to entertain such transactions, and change in control compensation as a means to alleviate this reluctance and facilitate value-enhancing transactions. Understand that excessive change in control compensation might lead management to recommend deals that are not in the best interests of shareholders.
4) Consider the various options for financing a take-over bid, including debt, equity, or the more exotic convertible bond used by AXA in this case.
5) Analyze the ORAN bond used by AXA to finance the acquisition of MONY including how it is priced initially, how its value evolves, and how it affects the incentives of the various parties to acquire MONY stock and to vote on the transaction.
6) Understand why the MONY stock price trades above the offer price in a situation where there does not appear to be any competing acquirer.
Case: Shenzhen Bank

Why this case is here:

1) Start a series of three cases examining the role of commercial banking
2) Provide an opportunity to assess the investment thesis and risk factors for a private equity investment by foreign investors in an emerging market setting. Examine the potential political and regulatory risks that are present in most emerging markets, and discuss the strategies that may be used to mitigate them.
3) Illustrate the importance of managing relationships for private equity investing, especially in emerging markets where formal market mechanisms are under-developed, and where relationships with relevant local and central government entities play a crucial part in determining deal success.
4) Highlight the importance of effective control rights in turnaround deals, especially in situations where conflicts of interests among powerful stakeholders could derail restructuring efforts, e.g., at state-owned companies with politically connected managers.

Class 23: 11/17/2014

Case: Barclays Bank, 2008

This case is here to:

1) Discuss why banks need to be regulated.
2) Compare the instruments that Barclays is actually issuing (preference shares and/or subordinated debt instruments, and debt that converts to equity) against what one might expect capital instruments to look like (i.e., straight common equity). Consider the reasons for, and implications of, this difference.
3) Forecast the interest payments on the preference shares and debt instruments (the latter after tax) and discount back to arrive at a cost of finance. (This issue would normally be moot in a well-functioning capital market [think M&M] but here it is important because the UK Government deal may be subsidized; or - on the contrary - both funding offers might exploit the scarcity of capital during the financial crisis to provide new investors with some monopoly rents.)
4) Value the warrants that will be issued to the private investors in the deal, using standard option pricing techniques adjusting for the dilution effect of the new equity that will be created if the warrants are exercised.
5) Discuss the constraints associated with (UK) Government ownership - in general and in this particular case - as well as any possible benefits.
Case: Barclays Bank, 2012

This case is here to:

1) Continue our discussion of why bank capital needs to be regulated, what regulators would ideally like bank capital to look like; and what banks would prefer to issue. Consider whether co-cos (contingent capital bonds) form a reasonable compromise between the two.
2) Consider how capital regulation has evolved (tightened) between 2008 and 2012, so that Barclays is now in danger of falling short of regulatory standards — despite having issued new capital in 2008, and having generated profits since then, and having sold risky assets.
3) Consider how co-cos work by writing down the bond and/or converting it into equity when a trigger is reached. Consider whether it would be useful for firms to issue such securities, were a liquid market to develop, or whether these securities are of interest only to banks.
4) Consider the importance of the contractual details of co-cos. These are a new kind of security and the details are evolving. This gives us a chance to examine some issues associated with the design of new corporate securities.
5) Discuss the merits of the co-cos that Barclays actually ends up issuing.

Class: Roche-Genentech

This case is here to:

1) Overall: Review a lot of what we have done this term
2) Explore the differences between a majority-owned, publicly listed company and a wholly owned subsidiary.
3) To practice DCF valuation based on financial forecasts and to consider how the source of the forecasts (bidder’s vs. target’s financial advisors) may bias them.
4) To discuss the fiduciary duties of the target’s board of directors when faced with an unsolicited merger offer, as well as the duties of a majority owner seeking to buy out a minority. What are the U.S. and Delaware rules? Who speaks for Genentech’s minority shareholders?
5) To discuss the tactics of a hostile tender offer, including the initial bid, reservation price, and contingencies.
6) To reflect on the influence of the financial crisis on corporate finance decisions. Should the price change? Does lack of funding make the merger impossible?
"Hi, Dad. Investment banking wasn't that great after all."