Richard Ivey School of Business

The University of Western Ontario

COURSE OUTLINE

Fall 2000

Financial Markets
(Strategic Financial Planning)

Business 423/623

Robert W. White

2N48

661-3293

A. COURSE PURPOSE

The focus of the course is on strategic planning with respect to corporate decisions that interface with the financial markets. The objective of this course is to develop a detailed understanding of the process of **deal making**; Origination, Structuring and Placement.

B. COURSE CONTENT

A key framework is shareholder value enhancement; identifying value gaps and strategies to close the value gaps. The positioning of the course is to review first year; to extend in terms of depth, complexity, implementation and entrepreneurial. The course delivers the key skills, concepts for valuing corporations, valuation of emerging businesses, sourcing of capital, financing high growth start-ups, structured notes, commodity swaps, vulture funds, restructuring corporations (including divestitures, mergers and acquisitions), tracking stock, hedging interest rate and foreign exchange exposure, share buy-backs/dividend policy and the designing and pricing of securities.

C. TARGET GROUP

The course is designed for individuals seeking careers in the financial services industry, financial management and consulting.

D. COURSE MATERIAL

1. REQUIRED

Casebook for 423/623.

2. SUGGESTED TEXTBOOK

The textbook is to provide a reference, to stimulate you and to provide a path for further intellectual development during the course and in your subsequent careers. **A textbook is not explicitly used (exercises, etc.) in the course.**

Mark Grinblatt and Sheridan Titman, *Financial Markets and Corporate Strategy*, Irwin/McGraw-Hill, 1998. **(GT) — Excellent reference book**; **"In depth."**

OR

James C. Van Horne, *Financial Management and Policy*, Prentice-Hall, Eleventh Edition, 1998. **(VH) — Very readable intermediate level book; "Overview."**

3. REFERENCE BOOKS

The following books are excellent, each one takes a different perspective:

1. J. Fred Weston, Kwang S. Chung and Juan A. Siu, *Takeovers, Restructuring, and Corporate Governance,* Second Edition, Prentice-Hall 1998.
2. Simon Z. Benninga and Oded H. Sarig, *Corporate Finance: a Valuation Approach*, McGraw-Hill, 1997.
3. John Y. Campbell, Andrew W. Lo, A. Craig MacKinlay, *The Econometrics of Financial Markets*, Princeton University Press, 1997.
4. John Hull, *Introduction to Futures and Options Markets*, Third Edition, Prentice Hall, 1998.
5. William L. Megginson, *Corporate Finance Theory*, Addison-Wesley, 1997.

E. GRADE ALLOCATION

The components of the overall course grade and the weighting of each component are as follows:

Participation	15 %
Group hand-in exercises ("bridge" first year); 7, 5% each	35%
Final Exam – Case; Individual	50 %

F. CLASSROOM CONTRIBUTION

The daily classroom discussion represents a unique opportunity for you to develop and enhance your confidence and skill in articulating a personal position, reacting "on the spot" to new ideas and receiving and providing critical feedback from a group of assertive and demanding colleagues. This is an opportunity that I would encourage all of you to seize.

The grade I assign for your classroom contribution is a careful, subjective (on my part) assessment of the value of your input to the classroom learning. That contribution can take many forms including a good assessment of the problem, identification of imaginative yet realistic alternative solutions to the problem, a carefully thought out analysis of the alternatives or an effective strategy for implementation of the alternative chosen. A contribution can also be achieved through a level of questioning that causes the class to rethink its analysis and position. Emphasis will be placed on the quality of contribution as opposed to quantity and frequency.

G. OFFICE HOURS

Please feel free to contact me at any time. I have an open door policy. If you wish to make an appointment, catch me after class, drop by my office, Room 2N48, or call me at 661-3293. My secretary is Pat Avery. Her office is 2N55 and her phone number is 661-3762.

H. COURSE SCHEDULE

	Date	Day	Session	Hand-in exercises; due prior to class
1	Sept. 5	Tues	Intro	
2	6	Wed	Gillette -Duracell	#1
3	11	Mon	Peerless	
4	12	Tue	Peerless	
5	18	Mon	ED TEL	#2
6	19	Tue	JDS Uniphase	#3
7	25	Mon	Canadian National Railways	
8	26	Tue.	Canadian National Railways	
9	Oct 2	Mon	Rogers Communications Inc.	
10	3	Tue	Citibank-Oil Monetization	#4
11	10	Tue	PPL	#5
12	11	Wed.	Cadillac	
Exam Week; Oct 16-20				
Break Week; Oct 23-27				
13	Oct. 30	Mon	4SN	#6
14	31	Tue	Torstar	
15	Nov. 6	Mon	HealthVISION	
16	7	Tue	Legacy	
17	13	Mon	LM&E	
18	14	Tue	RCI - MHL	
19	20	Mon	RCI - MHL	
20	21	Tue	ATS	
21	27	Mon	BC Sugar	
22	28	Tue	Sun Media	#7
23	Dec. 4	Mon	Clearnet	
24	5	Tue	Clearnet; Wrap-up	

IV. ASSIGNMENT SHEETS

The Windows Option Pricing Software (WinOPA), *.ppt and *.xls files referenced in the assignment sheets below will be distributed via e-mail. **The items listed under reference in the assignment sheets are primarily lecture/discussion (ld*) notes for a first year course.**

1. Tuesday, September 5

Topic: Course Introduction
Reading: 1. GT, Chapter 1
2. VH, Chapter 1

2. Wednesday, September 6

Topic: Risk assessment; Cost of capital – concepts and measurement
Case: **The Gillette Company's Acquisition of Duracell International Inc. - Cost of Capital**
Readings: 1. GT, Chapters 4, 5, 6, 10
2. VH, Chapters 3, 4 and 8
Reference: **ldcofc.ppt**
ldcapm.ppt
ldsecval.ppt and secval.xls
Questions:
1. In principle, which entity's cost of capital is relevant? Why?
2. Has Duracell's risk profile changed over the period 1988 to 1996? Historical versus future? Implications for risk measurement?
3. What industry is Duracell in?
4. What is your estimate of Duracell's cost of capital as of September 15, 1996? Note, assume that Gillette's target capital structure does not include preferred stock (vehicle for ESOP)**.**

Group Hand-in Exercise # 1:

1. A firm has excess cash $50 million; current assets of $100 million and current liabilities of $50 million. The firm issued 400,000 bonds which are currently trading at 105. The firm has 5,000,000 shares outstanding and the most recent trading price was $110.00 per share. What is firm's net debt? What is the firm's total enterprise value (TEV)? Construct the firm's market value balance sheet.
2. With respect to the pending acquisition of Duracell by Gillette, in principle, which entity's cost of capital is relevant? Why?
3. In a present value calculation, why is a discount rate called the cost of capital?
4. A member, X, of your study group recently purchased a BMW for $45,000. The purchase was financed by cashing $20,000 of stock and borrowing $25,000 from a bank; the bank holds a lien

on the car. Assuming that the individual has fallen on financial hard times and wants to sell, that you want to buy the car and are willing to purchase it based on fair market, the balance owing on the loan is $25,000 and that the fair market value is $40,000, how much cash would change hands between you and X? Explain.

5. Why do the multiplier (for example, TEV/EBITDA) and the discounted cash flow (for example, PV (FCF_t, k)) approaches to valuation generate "comparable" values?

3. Monday, September 11

Topic: Cross border valuation; Drill on valuation
Case: **Ventra Group Inc. - Peerless-Cascade**

The case discussion will span two classes.

Readings:
1. GT, Chapters 11
2. VH, Chapters 2 and 6

Reference: **ldval.ppt**
ldcapstruc.ppt

Questions:
1. Why does Ventra Group Inc. want to acquire Peerless Cascade? Why are the Owners of Peerless Cascade willing to sell?
2. What valuation methods can be used? What are the advantages and disadvantages of each method?
3. Is the asking price of $26 million reasonable?
3. What recommendation would you make with respect to the acquisition?

4. Tuesday, September 12

Topic: Long-term financing decision; Bought deals, Special warrants and notes; Financial flexibility
Case: **Ventra Group Inc. – Peerless-Cascade**
Readings:
1. GT, Chapters 15, 16
2. VH, Chapter 9
3. Canadian Listing of Securities

Questions:

For the purposes of this class assume that Ventra has decided to purchase Peerless-Cascade.

1. What are special warrants? Special notes? What precipitated (i.e., the reason for the existence of) the development of these products?
4. What criteria would you use to decide how to finance the purchase?

5. What recommendation would you make?

5. Monday, September 18

Topic: Initial public offerings; Creating price tension; Techniques for valuing new and emerging businesses; Sum-of-parts valuation

Case: **Edmonton Telephones Corporation**

Spreadsheet: 1. edtel.xls

Readings: 1. GT, Chapters 3 and 11

Questions:
1. Why was Scott so enthusiastic about the directive?
2. What is your estimate of ED TEL's 1994 book equity?
3. What was the market value of ED TEL?
4. As Mr. Scott what would you recommend?

Group Hand-in Exercise # 2:

1. What does the expression to "capitalize an item" mean? What are the two commonly used approaches? Use the information in the ED TEL case to illustrate the application of the concepts.
2. What is the difference between a primary and a secondary offering of common equity?
3. In the ED TEL case reference is made to an "IPO discount." What does this mean? Is a discount typical for an IPO? Explain.
4. In the ED TEL case reference is made to a "road show." What is it? What does the firm/investment dealer expect to gain from the road show?

5. Tuesday, September 19

Topic: Introduction to Option Pricing, Hedging

Lecture: **JDS Uniphase Corporation**

Reference:

Software: 1. Windows Option Pricing Software, WinOPA

Readings:
1. VH, Chapters 5.
2. GT, Chapters 8 and 11
3. "The Real Power of Real Options," *Corporate Finance*, January 1998, 13-20
4. Thomas E. Copland and Phillip T. Keenan, "Making Real Options Real," *The McKinsey Quarterly*, 1998 Number 3, 129-141.
5. Timothy A. Luehrman, "Investment opportunities as Real Options: Getting Started on the Numbers," *Harvard Business Review*, July-August 1998.
6. Timothy A. Luehrman, "Strategy as a Portfolio of Real Options," *Harvard Business Review*, September-October 1998.

Questions:

1. Assuming you own 100,000 shares of JDS, how would hedge your position to lock in a price of $210 over the next five weeks?
2. Assuming the volume at the market is sufficient to create the hedge, what would it cost you?
3. Is there a strategy that would enable you to hedge your position with no up-front cash outlay?
4. Is there an enhanced strategy that will lessen your potential opportunity cost?
5. How would you hedge your position over a longer period, say 2 years?

Group Hand-in Exercise # 3:

1. VH, pages 124-5; Problems 1, 2, 3, 7 and 9.

7. Monday, September 25

Topic: Strategic Options
Case: **Canadian National Railways Company**

The case discussion will span two classes.

Spreadsheet:
Readings:

1. GT, Chapter 11
2. "The Real Power of Real Options," *Corporate Finance*, January 1998, 13-20
3. Thomas E. Copland and Phillip T. Keenan, "Making Real Options Real," *The McKinsey Quarterly*, 1998 Number 3, 129-141.
4. Timothy A. Luehrman, "Investment opportunities as Real Options: Getting Started on the Numbers," *Harvard Business Review*, July-August 1998.
5. Timothy A. Luehrman, "Strategy as a Portfolio of Real Options," *Harvard Business Review*, September-October 1998.

Questions:

1. What is your assessment of the value of Illinois Central to CN?
2. How does the Kansas City Southern Railway factor into your analysis?
3. Within the context of this deal, illustrate the concept that "strategy is a portfolio of real options?
4. What price would you bid for Illinois Central?
5. How would you structure the deal?

8. Tuesday, September 26

Topic: Strategic Options
Case: **Canadian National Railways Company** (continued)

Spreadsheet:

Readings:
1. GT, Chapter 11
2. "The Real Power of Real Options," *Corporate Finance*, January 1998, 13-20
3. Thomas E. Copland and Phillip T. Keenan, "Making Real Options Real," *The McKinsey Quarterly*, 1998 Number 3, 129-141.
4. Timothy A. Luehrman, "Investment opportunities as Real Options: Getting Started on the Numbers," *Harvard Business Review*, July-August 1998.
5. Timothy A. Luehrman, "Strategy as a Portfolio of Real Options," *Harvard Business Review*, September-October 1998.

Questions:
1. What is your assessment of the value of Illinois Central to CN?
2. How does the Kansas City Southern Railway factor into your analysis?
3. Within the context of this deal, illustrate the concept that "strategy is a portfolio of real options?
4. What price would you bid for Illinois Central?
5. How would you structure the deal?

9. Monday, October 2

Topic: Securities as Bundles of Characteristics; Convertible, callable debentures, etc.

Case: **Rogers Communications Inc.**

Readings:
1. GT, Chapter 3
6. VH, Chapter 20

Current Events: "Worlds apart: the convertible markets of the US and Europe," *Corporate Finance*, February 2000.

Questions:
1. What is Rogers Communications Inc.'s business risk? Given that Rogers is regulated by DOC and CRTC, is there any upside potential for Rogers' share price?
2. Is Rogers' credit investment grade? What is the appropriate measure to determine Rogers' ability to service its debt?
3. What is Rogers' tax status and what implications does this have on its preferred method of financing?
4. What is your assessment of Rogers? What is the assessment of the Canadian financial markets?
5. Does the MJDS provide an opportunity for Rogers? Why?
6. As Graham Savage, what recommendation would you make? Why?

10. Tuesday, October 3

Topic: Structured financing; Targeting a deal; Commodity SWAPS

Case: **Citibank Canada Ltd. – Monetization of Future Oil Production**

Readings:
1. GT, Chapter 7.1, 20, 21

2. VH, Chapters 15 and 21

Questions:
1. Why does Petrolia want to monetize oil production? Why oil?
2. What is the primary risk in managing the special purpose trust (SPT)? How can this be managed?
3. What are the benefits of monetization to Petrolia?
4. What are the major risks in the structure?
5. Who would you target to place the paper with? Would you adjust the structure?
6. What are the benefits of the deal over a straight loan?

Group Hand-in Exercise # 4:

Reference: **ldhedgederv.ppt**
ldinterestr.ppt

1. VH, pages 583; Problems 4, 5 and 9.

11. Tuesday, October 10

Topic: Timing; Financial restructuring
Case: **PPL Forest Products Inc.**
Readings:
1. GT, Chapters 15 and16
2. VH, Chapter 10

Spreadsheet:
1. ppl.xls

Questions:
1. What are the primary factors generating PPL's business risk?
2. What are the funding requirements?
3. What debt policy would you recommend?
4. How would you structure the financing?

Group Hand-in Exercise # 5:

1. What is the significance of the phrase "the product is a global commodity?"
2. What are the supply/demand, price dynamics of the pulp industry, in turn, what are the primary factors generating PPL's business risk?
3. In arriving at the optimal capital structure, does a bond rating play a role? How? Illustrate with respect to Cadillac Fairview (case for class 12, October 11).

12. Wednesday, October 11

Topic: Establishing a capital structure; Structuring a deal; Bankruptcy; Vulture funds
Case: **Cadillac Fairview Inc.**

Readings: 1. GT, Chapters 15 and16
2. VH, Chapter 9

Spreadsheet: 1. cadillac.xls

Questions:
1. Is Cadillac Fairview a viable company?
2. What is the bargaining position of each of the stakeholders?
3. What trade-offs are possible to reach a deal?
4. What strategy would you recommend?

13. Monday, October 30

Topic: Selecting an investment banker; Global offering; Signalling - Capital structure

Case: **Four Seasons Hotels and Resorts**

Readings:
1. GT, Chapters 15, 16
2. VH, Chapter 16

Questions:
1. Characterize Four Seasons' positioning relative to Doubletree, Renaissance and Marriott; prospects, bond rating, etc.
2. As of January 2, 1997, what are Four Seasons' near term funding requirements?
3. What advantages do the financial markets outside Canada offer Four Seasons? Do the alternatives present any disadvantages?
4. What are the critical factors in selecting an investment banker to complete an offering(s) for Four Seasons in January 1997?
5. Evaluate the financing alternatives facing Four Seasons in 1997 with respect to shareholder value and future ability to raise funds?
6. As Doug Ludwig what proposal would you put forward to Four Seasons' board of directors?

Group Hand-in Exercise # 6:

1. Is it possible for Four Seasons to signal paradigm shifts via financial execution? How? What is the potential benefit?
2. What is the logic underlying the conjectures that information is conveyed, i.e, signalling, via dividend policy, share repurchases and stock splits (Torstar case, October 31)?

14. Tuesday, October 31

Topic: Signalling - Dividend policy, splits and share buybacks

Case: **Torstar Corporation**

Readings:
1. GT, Chapters 14 and 18
2. VH, Chapter 11

Questions:
1. Why do firms pay dividends? What is dividend policy? Are dividends irrelevant?
2. What is the logic underlying the conjectures that information is conveyed, i.e, signalling via dividend policy, share repurchases and stock splits? Evidence?

3. As a Torstar shareholder would you prefer regular dividends, special dividends or irregular share repurchases as a means of realizing a return on your investment?
4. As Robert Steacy, what recommendation would you make?

15. Monday, November 6

Topic: Restructuring (Spin-off, Split-off, Private Placement; IPO, Targeted/Tracking Shares); Pure Play versus Conglomerate Discount; Merchant Banking; Mezzanine Financing

Case: **HealthVISION**

Spreadsheet:
1. health.xls

Readings:
1. GT, Chapter 11
2. VH, Chapter 23

Current Events:
1. Information Statement: Spin-off of Agilent Technologies, Inc. Through the Distribution by Hewlett-Packard Company.
2. TD Waterhouse Corporate Action Notice, April 20, 2000.
3. AT&T Wireless tracking stock (excerpts of AT&T's web page).

Questions:
1. Should Biomira sell its 75% interest in HealthVISION? If so, why?
2. Assume Biomira should sell its interest in HealthVISION. How should Biomira accomplish this divestment?
3. What are the likely proceeds to Biomira from such a divestment?

16. Tuesday, November 7

Topic: Securitization; Trust units; Instalment receipts; REITS;

Case: **Legacy Hotels Real Estate Investment Trust**

Readings:
1. GT, Chapter 17

Current Events: "Europe's corporates find the way to a secure future," *Corporate Finance*, March 2000.

Spreadsheet:
1. legacy.xls

Questions:
1. What was the impetus for the creation of REITs?
3. What are the risks involved in holding a REIT unit?
4. Why would Canadian Pacific want to divest the hotels included in the Initial Hotel Portfolio?
5. At the time of the Legacy IPO, what is your assessment of the hotel industry market environment?
6. Why installment receipts? How are the parameters set?
7. As Wayne Adlam, what price range would you recommend for the Legacy REIT unit?

17. **Monday, November 13**

Topic: Taxes; Leveraged buyout; Trust units; Structuring a deal

Case: **Labrador Mining and Exploration Company Limited**

Readings:
1. GT, Chapter 13

Questions:
1. Based on the cash distribution presented in the case, what is the market value of a Royalty Trust Unit ? Income Fund Unit?
2. Can the market value of the Income Fund be increased? How?
3. What risks are involved in owning Trust Units?
4. What conditions are necessary for the continued acceptance of Trust Units?
5. Are current market conditions favorable or unfavorable with respect to issuing Trust Units?
6. As a member of the Scotia Capital Markets' team, what recommendation would you make with respect to the divestiture of Labrador Mining and Exploration Company Limited? Why?

18. **Tuesday, November 14**

Topic: Determining the terms and financing of a merger/acquisition; Leveraged buyout; Preventing price tension

Case: **Rogers Communications Inc. – Maclean Hunter Limited**

The case discussion will span two classes.

Readings:
1. Canadian Merger and Acquisition Regulation
2. GT, Chapter 19
3. VH, Chapter 22

Questions:
1. If you were Ted Rogers, would you try to gain control of MHL in February 1994?
2. What is the maximum price that RCI can afford to pay for MHL and still keep the acquisition attractive from the standpoint of RCI?
3. What are the concerns and what is the bargaining position of each "player." What must RCI offer each player in order to acquire their support?
4. On the assumption that RCI management wants to acquire all the shares of MHL, what offer must RCI management make? What strategy would you propose?
5. What would you recommend that the management of RCI do?

19. **Monday, November 20**

Topic: Determining the terms and financing of a merger/acquisition; Leveraged buyout;

	Preventing price tension
Case:	**Rogers Communications Inc. – Maclean Hunter Limited** (continued)
Readings:	1. Canadian Merger and Acquisition Regulation 2. GT, Chapter 19 3. VH, Chapter 22
Questions:	1. If you were Ted Rogers, would you try to gain control of MHL in February 1994? 2. What is the maximum price that RCI can afford to pay for MHL and still keep the acquisition attractive from the standpoint of RCI? 3. What are the concerns and what is the bargaining position of each "player." What must RCI offer each player in order to acquire their support? 4. On the assumption that RCI management wants to acquire all the shares of MHL, what offer must RCI management make? What strategy would you propose? 5. What would you recommend that the management of RCI do?

20.	**Tuesday, November 21**
Topic:	Management Buyout; Merchant Banking
Case:	**ATS Inc.**
Spreadsheet:	1. ATS financial model.xls 2. ATS exit strategy.xls.
Readings:	1. GT, Chapter 19 2. VH, Chapter 22.
Questions:	1. Is the offer price reasonable? 2. How strong is the bargaining position of management buyout team? 3. How should the expansion be financed? Are there implications for the provider of the current financial needs? 4. As Lay and Metcalf, would you modify the proposed deal? Why? 5. As Lay and Metcalf, what would you recommend?

21.	**Monday, November 27**
Topic:	Review case; Shareholder value enhancement (Value Investing) - Acquirer
Case:	**BC Sugar Refineries, Limited**
Readings:	1. GT, Chapter 19 2. VH, Chapter 22
Questions:	1. Why was BC Sugar in play? 2. How much is BC Sugar worth to Onex? 3. With what strategy would you as Seth Mersky and Onex approach the current situation?

22. **Tuesday, November 28**

Topic: Review case; Shareholder value enhancement - Target
Case: **Sun Media Corporation**
Readings:
1. GT, Chapter 19
2. VH, Chapter 22

Questions:
1. Why was Sun Media in play? Implications for enhancement of shareholder value?
2. What was Sun Media's core business? Implications?
3. Is there potential to create price tension? If so, how?
4. As a member of the CIBC World Markets' team, what course of action would you recommend?

Group Hand-in Exercise # 7:

1. VH, pages 464; Problems 5, 6, 7 and 8.

23. **Monday, December 4**

Topic: Review case - Corporate Financing
Case: **Clearnet Communications Inc.**

The case discussion is expected to span two classes.

Readings:
1. VH, Chapter 16 and 20
2. GT, Chapter 16

Questions:
1. How did Clearnet finance its growth from 1994 through 1997? What is the logic for using units?
2. When will Clearnet exhaust its current funding resources?
3. What is your assessment of Clearnet's prospects? What is your forecast of Clearnet's price one year hence, December 1998/January 1999?
4. What was Clearnet's capacity to service interest on debt as of July 18, 1997? 2001?
5. As Robert McFarlane, what recommendation would you make with respect funding Clearnet?

24. **Tuesday, December 5**

Topic: Review case - Corporate Financing
Case: **Clearnet Communications Inc.** (continued)
Readings:
1. VH, Chapter 16 and 20
2. GT, Chapter 16

Questions:

1. How did Clearnet finance its growth from 1994 through 1997? What is the logic for using units?
2. When will Clearnet exhaust its current funding resources?
3. What is your assessment of Clearnet's prospects? What is your forecast of Clearnet's price one year hence, December 1998/January 1999?
4. What was Clearnet's capacity to service interest on debt as of July 18, 1997? 2001?
5. As Robert McFarlane, what recommendation would you make with respect funding Clearnet?

Topic: Wrap-up