CASES IN STRATEGIC FINANCIAL MANAGEMENT
SYLLABUS

FIN 522                                                              Professor Jim Gentry
Cases in Strategic Financial Management          108 Wohlers Hall
Spring Semester 2013                                         333-7995
3007 BIF                                                             j-gentry@illinois.edu
Office Hours: 11 a.m. to 12:00 p.m.
Tues. /Thurs., or an open door policy

I. Teaching Objectives

Financial decision making cases are used to…
• Create a highly interactive learning environment;
• Learn about the practice of financial management and analysis of credit;
• Help prepare financial forecasts and estimate short-term financing needs;
• Discover what you do not understand and what you have learned;
• Interpret credit rating processes and why they are necessary;
• Highlight the relationships between strategic goals and the creation of firm value;
• Develop techniques for interpreting financial data and strategic corporate plans;
• Enhance your critical thinking and problem solving skills;
• Expand your understanding of financial theory and its application;
• Improve your listening and cooperative learning skills.

II. Learning Promises

At the end of this course your will be able to…
• Think like a progressive corporate financial manager;
• Learn how to prepare and interpret cash flow accounts;
• Interpret a company’s financial health;
• Create financial forecasts with different scenarios;
• Justify the acceptance or rejection of a loan based on credit analysis:
• Learn to interpret loan covenants and the underlying collateral;
• Discover metrics that Moody’s measures credit risk, default and recovery rates;
• Explain how target capital structure is determined;
• Learn to estimate the components of a firm’s cost of capital;
• Use Credit Risk Spreads to estimate risk adjusted interest rates;
• Explain why ROIC is a cost of capital proxy;
• Discover issues that cause changes in a firm’s target capital structure;
• Estimate the intrinsic value of a stock and the enterprise value of a firm and explain the strengths and shortcomings of your analyses.
• Learn best practices and invaluable insights from Visiting Executives.
III. Cases and Readings

Cases:

Readings:-
  Refer to this manuscript as “The Cash Flow Story”.
- E-Reserve link http://www.library.illinois.edu/ereserves/showURLs.asp?id=2776&cID=4121

IV. SYLLABUS FOR FIN 522    Spring 2013
A. Exhibits related to assignments:
- Exhibit 1. Cash Flow Statement
- Exhibit 2. The Cash Flow Cycle
- Exhibit 3. The Cash Conversion Cycle
- Exhibit 4. Dupont System
- Exhibit 5  Gentry’s Key Financial Ratios
- Exhibit 7  Porter’s Five Competitive Forces
- Exhibit 9. Dell’s Pro-forma Balance Sheet
- Exhibit 10. Dell’s Pro-forma Income Statement
- Exhibit 11. BBC 2005: A Live Case
- Exhibit 12. Credit Risk Spreads
- Exhibit 13. Equity Premiums
- Exhibit 14. The Public EDF Model, Fall 2009
- Exhibit 15. CreditEdge Challenge Assignment
- Exhibit 17. Moody’s SGL Components: Frequently Asked Questions
- Exhibit 18. Flash Memory, Inc. Spreadsheet
- Exhibit 20. Analysis of MCI Convertible Bond Financing
- Exhibit 21. Financial Structure
- Exhibit 22  Polaroid Financial Flexibility
- Exhibit 23. Estimating the Intrinsic Value… (IFMS) (text)
• Exhibit 24. Centene Corporation Case
• Exhibit 25. IFMS Exhibits
• Exhibit 26. Monmouth Corporation. Spreadsheet
• Exhibit 27. Calaveras Vineyard Exhibit

B. Exhibits Related To Valuation

• Exhibit 1. Generalized Cash Flow Valuation Model
• Exhibit 2. Dividend Valuation Model
• Exhibit 3. Capital Investment Valuation Model
• Exhibit 4. Dividend Valuation of a Stock
• Exhibit 5. Valuation of a Stock—FCFE Approach
• Exhibit 6. Valuation of a Firm—FCFF Approach

C. Case Exams: You will purchase a package of two tickets at the TIS Bookstore, one for each case. The tickets will be used to pick up each case and instructions for the case at the Department of Finance, 340 Wohlers Hall for the designated time period. Do not purchase tickets until February 19, 2013.

D. Grading Policies:

There are three components to your grade. First, each student will complete two written case examinations during the semester, February 20-25 (noon) and final exam period. The second component is a case team’s valuation of a live case. Each case exam and the valuation project are worth 20 percent of your total grade, for a total of 60 percent. Third, participation in case discussions will contribute 40 percent of each student’s total grade. There are two ways to earn participation points. They are: (1) contributions to class discussions and/or (2) submitting case briefs, an optional approach discussed below.

The examination cases will be made available in the Department of Finance at appropriate times during the semester. A completed case analysis shall be no more than five double-spaced typewritten pages. Exhibits are not included in the five-page limit. You will have nine (9) hours to complete the case analysis over a two day period. The clock starts running when you pick up the exam in the Department of Finance and ends when you submit your completed case exam to the Finance Dept.

Upon completing the case exam, you will print the following pledge on the back of your case analysis, “On my honor as a University of Illinois graduate student I have neither given nor received unauthorized aid on this exam, and I have limited the time spent on this case to nine hours.” Please carefully sign your name below the pledge, date the pledge and print your name below the pledge. Your name should NOT appear elsewhere on the paper. Please do not miss other classes when you are writing the exam.
Valuation of Centene Corporation (CNC). The assignments for each case team are (1) to prepare a financial forecast and (2) to estimate and interpret the intrinsic value of Monsanto. Each valuation team will consist of three of four Fin 522 students. On April 9, Bill Scheffel, CFO at Centene Corporation will present background information on Centene and answer questions that will be valuable in preparing the financial forecast. On April 25 Bill Scheffel will listen to and comment each team’s case team’s assumptions, analysis and interpretations of CNC’s intrinsic valuation. The highlight of this special class will be a natural learning experience during the exchange of ideas between the Finance 522 students and Bill Scheffel, CFO at Centene Corporation.

Participation grades. A maximum of 40 percent of your course grade is based on participation in class discussions. The quality of your class participation will be graded each day on a scale of zero to three points. The participation points will be based on the following criterion:

- **0 points**  No participation or observations
- **½ point**  Contributing relevant information and/or facts, asks critical questions concerning the discussion in class and/or the reading assignments, and responses to comments made by your classmates.
- **1 point**  Providing interpretations of relevant information and/or facts that are based on analysis and, in turn, advances the discussion to other related topics;
- **2 points**  Developing well supported interpretation of relevant information that is associated with good financial practices in financial management; or provides contributions that leads a discussion to a significantly higher level of thought.
- **3 points**  Presenting a superior analysis and interpretation of the relevant information used in solving the case.

You are encouraged to work independently in the initial preparation of a case. After you have completed your initial analysis, you should meet with your case team in order to have your ideas challenged and thereby improve your interpretation of the case. Finally, discussions within your study group will help you to be prepared to more effectively participate in the class discussions.

Case Briefs. Case briefs are optional. Historically, I have observed that between 80 and 90 percent of the students in Finance 522 submit case briefs on each scheduled class day. When a brief is submitted to Professor Gentry by 1 p.m. on a class day, it can contribute between ½ and 1 point to your daily participation grade Professor Gentry will read between a few to all of the case briefs submitted before class and will return the graded briefs the next class period.
The text of the case briefs should be no longer than two double-spaced pages and address the following: (1) what is the primary problem(s) in the case; (2) what is your analytical interpretation of the case that may be presented in the exhibits, and (3) what are your recommendations to management. If Exhibits are attached, please cite them in the text of the brief. Each brief must reflect your work and judgment. The case briefs will greatly help you be a more effective participant in class discussions. Simply answering the questions presented in the syllabus is not considered a case brief. The case questions are designed for discussion purposes.

SCHEDULE OF CLASSES

C = Cases in Strategic Financial Management
E-Reserve for selected readings
R = Selected Readings for Case Problems in Finance by Gentry
H = Analysis for Financial Management, 9th edition by Higgins

I. Extending Bank Credit vis-à-vis Measuring Credit Risk

Jan. 15 Organization Day—Learning if you will return on Thursday, January 17.

• What do you expect to learn in Finance 522?
• Why do we use cases as a primary learning tool in Finance 522?
• How do you prepare a case?
• Participating in the discussion of the Case of Unidentified Industries (C). The Case will be distributed in class.


Please prepare a two page case brief based the following questions on what you learned from the assigned reading and submit it to j-gentry@illinois.edu by 1 p.m. on January 17.

• What were the important ideas you learned from The Cash Flow Story?
• Identify the Exhibits that added value to your learning experience?
• What were the five most important Exhibits in the reading? Why?
• Why are we discussing this reading on the second day of class?
Jan. 22 CASE: Butler Lumber Company (C); Reading: *Linkages between S&P Bond Ratings and the Cash Flow Accounts of Industrial Companies, 1990-2011*, found in Exhibit 8; The Exhibits for the assignments are in the Fin.522 WEB--Cash Flow Statement (Exhibit 1), Cash Flow Cycle (Exhibit 2), Cash Conversion Cycle in Exhibit 3.

Organize Case Teams and submit names of Case Team members to Professor Gentry before class on January 24.

**Suggested Analysis (Below)**
- Prepare Butler Lumber cash flow statements for 1989 and 1990 by using Exhibit 1 in (WEB). Please use cash flow accounts in Exhibit 1 to identify and interpret the cash flow problems at Butler Lumber. Also use the cash conversion cycle in Exhibit 3 to interpret problems in the case. Optional: Porter’s Five Competitive Forces in Exhibit 7 WEB will help assess Butler’s market position.

Jan. 24 Butler Lumber Company (C) (continued); Readings: Financial Statement Forecasting: The Percent of Sales Method (H) [E-Reserve], 90-102. Note on Bank Loans (E-Reserve) with focus on covenants. DuPont Analysis (Exhibit 4). Also refer to Exhibit 5 for Gentry’s Key Ratios and Moody’s Financial Ratios in Exhibit 6. Optional Readings in Chap. 2 in (H)|E-Reserve

**Suggested Analysis**
- Prepare and interpret the proforma income statement and balance sheet for 1991 using information cited above.
- Would you extend credit to Butler Lumber? Why?

Jan. 29 Hampton Machine Company (C); Note on Bank Loans (E-Reserve)
- Why can’t a profitable firm like Hampton repay its loan on time and why does it need more bank financing?

**Suggested Analysis**
- Prepare a cash flow statement for the 9 month period 11/30/78 to 8/31/79. (Exhibit 1 WEB). Interpret the results.
- Optional: Based on the information in the case, prepare monthly cash budgets for September through December 1979, Higgins (H) [E-Reserve], pp. 107-110, a monthly pro forma income statement and a year end balance sheet .
- Evaluate the assumptions underlying your forecasts. What developments could alter your results?
- Should the bank approve Mr. Cowin’s loan request?
- What is the effect of the share repurchase on Hampton’s financial performance?
Jan. 31 Dell’s Working Capital (C)

- How Dell’s working capital policy created a competitive advantage?
- How did Dell fund its 52 percent growth in 1996?
- Assuming Dell sales grow 50 percent in 1997, how might the company fund this growth internally?
- How would your answers to the preceding question change, if Dell also repurchased $500 million of common stock in 1997 and repaid its long-term debt?

Suggested Analysis

- Prepare a pro forma income statement and balance sheet for January 1997 based on 50 percent growth in sales. See Exhibits 9 and 10 WEB.
- Prepare cash flow statements for January 1996 (actual) and January 1997 (proforma) and interpret the results.

Current Reading

Dead Money, The Economist, November 3-9, 2012, 4 pages. “Why companies are sitting on cash” Foundation for discussion of a current topic. [E-Reserve]

Feb. 5 Flash Memory, Inc.(C) CASE TEAM ASSIGNMENT

- Initially, assume Flash Memory, Inc. does not invest in the new product line. Prepare forecasts for income statement and balance sheets at year-end 2010, 2011 and 2012, (Exhibit 18 WEB Flash Memory. Inc. Spreadsheet). The challenge is to solve for the notes payable in 2010, 2011 and 2012. A few iterations will be required to estimate (1) interest expense and (2) notes payable in each year.
- Go to Flash Memory, Inc. Spreadsheet (Exhibit 18) and prepare income statement and balance sheet for 2010.
- 2010 Sales, current assets and 2011-2014 Sales are under, “Growth Projections” on p. 3 of the case. For the remaining income statement and balance sheet inputs use Case Exhibit 3. These inputs are also discussed in the Case p. 3.
- For annual estimates of Accounts Receivable, Inventory and Accounts Payable assume 365 days in a year. Finally, on bottom of p. 3 the forecast for capital expenditures and depreciation expense are presented.
- After the initial inputs for the 2010 income statement and balance sheet items are completed, you will discover you do not have estimates for interest expense or notes payable. (1) The trick in estimating the Notes Payable is make a rough estimate of notes payable, e.g., if the growth of sales is 10 percent annually, assume the notes payable will also increase by 10 percent. (2) The next step is determine the interest rate, see top of page 3, and estimate the interest expense, i.e., (Interest Rate x Notes Payable). The first iteration of the financial forecast is now complete. Does the Total Liabilities + Equity = Total Assets. If not, go to the second iteration.
- Second iteration: Use the Excel Goal Seek function to discover notes payable that will make [(Total Liabilities + Equity) = Total Assets]
• Do the forecast results appear to be reasonable? If not, make changes in the inputs until you are satisfied. Repeat the above process for 2011 and then 2012.
• After completing Inc. Stat. and Bal. Sheets for 2010 -2012, can the loan balance be financed with Flash’s existing loan agreement? Why?
• The next step is to calculate the WACC that will be used for the second day’s assignment.
• Go to Case Exhibit 4 and calculate an Asset Beta for each of the three companies. That is, assuming the debt beta is 0.20 and estimates a relevered equity beta for each company. Finally, calculate an average asset beta for each of the three companies, i.e., an industry average beta.
• Use the Asset Beta in conjunction with the revised target D/V and E/V and estimated cost of equity and cost of debt to calculate the WACC for Flash Memory. Refer to Financing Alternatives information (bottom of p. 4 and top p. 5) includes the revised target D/V and E/V, estimated cost of equity and cost of debt.

Feb. 7 Flash Memory, Inc. (C) (continued) CASE TEAM ASSIGNMENT

• Prepare an NPV analysis for the new product line by determining the free cash flow and discounting it at the WACC is calculated above. Use the Spreadsheet provided in Exhibit 18 WEB.
• Calculate the net present value (NPV) of the above New Product Line for 2010-2012 by assuming no sale of common stock and all borrowings cost being 9.25%. Should the company accept or reject the proposed investment in the new product line presented on p. 4 of Case?
• What do you discover?
• Prepare another financial forecast for the New Product Line in 2010, 2011 and 2012, assuming sale of 300,000 shares of common stock and interest rate at 7.25%. What did you discover? What is your financing recommendation?

Feb. 12 BBC 2005: A Live Case. A Bank Lending Case wrote by Andy Roethe, Vice President, Commercial Lending Officer, Harris Bank, Madison, WI. Andy will be a Visiting Guest Banker and lead the discussion of the BBC 2005: A Live Case.

Case: BBC 2005: A Live Case Exhibit 11 WEB
• In preparing the case, focus on assumptions related to strategic decisions presented in the case.

Feb. 14 U.S. Bank of Washington (C); Note on Bank Loans (E-Reserve); SGL Grid (Exhibit 17.
Visiting Guests from Busey Bank are Chip Jorstad, Lending Officer, and Joshua Hinds, Credit Analyst.

• Case Teams will be assigned to play the roles of.....
• **CFO and Credit Staff of Redhook Ale.**
The objective of your presentation is to develop a strong case to justify the approval of the $7 million loan request. Use your qualitative and quantitative skills to highlight Redhook’s strong strategic business and financing plans, plus stressing its past financial performance. *Please be prepared to defend your recommendations.*

• **Credit Analysts for U. S. Bank Washington’s Loan Committee.** You should rigorously challenge the assumptions and analysis of the CFO and Credit staff of Redhook Ale. Develop solid recommendations to the Bank Loan committee to either **accept** or **reject** the $7 million loan. *Please be prepared to defend your analysis and recommendations.*

• **European Brewery Executives** expected to invest $5 million in equity. Develop strong strategies to justify or reject the $5 million equity investment in Redhook. *Please be prepared to defend your recommendations.*

• **Loan Committee**
The Loan Committee will be the case teams that are not presenting their recommendations to the class. Use your qualitative and quantitative financial analysis skills to challenge the presentation of the CFO and Credit Staff of Redhook Ale. The loan committee will have an opportunity to ask questions. *After the questions are answered, the members of Loan Committee will vote individually as to accept or reject the $7 million loan.*

**Assignment for U.S. Bank of Washington**

• **Each Team will submit their case analysis and recommendations to Professor Gentry by 2 p.m. on February 13. All teams will be notified by 5 p.m. on 2/13 as to which Teams will be making presentations**
• **on February 14 to the Loan Committee at U. S. Bank of Washington.**

**Suggested Analysis**

• Study the pages in the case entitled “Financing the Redhook Ale Brewery, the Appendix, and Exhibit A1 Through Exhibit A2 (concluded)”
• For each of the four roles presented above use suggestions provided.
• Review the *Noted on Bank Loan* (pp. 1—11) to provide insightful questions for each of the four roles cited above.
• Use the *SGL Grid* to rate the liquidity of Red Hook for 1990-1992.

• **Readings on Liquidity.**
• “*SGL Components: Frequently Asked Questions*” Exhibit 17 WEB
Appendix: The SGL Grid. Using the SGL GRID, interpret the words used to explain the differences in liquidity that exists between companies rated a 1 and a 4.

Feb. 19 Calaveras Vineyards (C)

Visiting Guest: Willard Bunn III, Managing Director, Colonnade Advisors, LLC.

OVERVIEW OF THE ASSIGNMENT

Your primary task for the Calaveras Vineyards Case is to assess the CREDITWORTHINESS of their business. Along with the case, Exhibit 27 presents useful financial ratios that will abbreviate the “number crunching” required and will help you focus on the interpretive tasks associated with the credit analysis. DO NOT FOCUS YOUR ANALYSIS ON THE VALUATION OF CALAVERAS VINEYARDS.

Suggested Analysis

- Would Calaveras be a creditworthy borrower?
- What are the principal risk factors in this prospective credit?
- Can Calaveras adequately service the proposed amount of debt?
- What other considerations might influence your evaluation of Calaveras as a prospective borrower?
- What should Anne Clemens do?
- Prepare a recommendation for action by Goldengate Capital
- If you are inclined to participate in the loan, identify any issues that will warrant careful continued monitoring terms outlined in the case.
- If you are not inclined to participate on the terms as outlined in the case, prepare a counterproposal to NationsBank indicating the terms on which you would be willing to participate.

February 20-25 Case Examination 1 begins on Feb. 20 and ends Feb 25 at noon.

Cases and instructions may be picked up in the Department of Finance, 340 Wohlers Hall, on the day you plan to start the case exam. However, if you plan to start the case on Saturday or Sunday, you may pick up the case and instructions in the p.m. on Friday, February 22. You are on your honor to complete this case exam without any outside assistance.

The case exams and instruction will be available on Wednesday, Feb. 20 between at 8 a.m. and 5 p.m. You have 9 hours, spread over two days, to complete the case exam. You are responsible for keeping track of the time used in each day. Please return the completed case exam with attached exhibits to 340 Wohlers Hall during regular business hours 8 a.m. to 5 p.m. All completed case analyses must be returned by 12:00 p.m. Monday, February 25.

Feb. 25 Case Examination 1 ends at 12:00 p.m. (noon)
II. The Linkages between Capital Structure and Credit Risk

Feb. 26  Reading (1): “Note on the Theory of Optimal Capital Structure” (R)
• What are the important assumptions used in creating Case Exhibit 1?
• What is the significance of lines 9, 10, and 13 in Case Exhibit 1?
• What is the significance of lines 20 and 27 in Case Exhibit 1?
• Why does line 13 equal line 27 in Case Exhibit 1? Why is this possible?

Reading (2): “Credit Risk Spreads”, Exhibit 12 WEB
• How do you measure Credit Risk Spreads (CRS)?
• How stable are credit risk spreads (CRS)?
• What causes changes in the CRS?

Handout: Fresh Insights into Economic Conditions based on Historical Yield Curves

Introduction to DuPont Case

Feb. 28 Case Assignment: E. I. du Pont de Nemours and Company (1983) (C);
• Why should a company have a target debt ratio?
• Why did Du Pont abandon its AAA debt-rating policy? What were the consequences? What is the role of bond ratings?
• What bond rating would you assign Du Pont each alternative in Case Exhibit 8 in 1987? How would Du Pont’s financial performance, financing needs, access to capital and financial risk differ under the two alternative debt policies?
• What capital structure policy should Du Pont adopt? What are the key issues?
• How should a company determine its appropriate capital structure?
  a. What impact does leverage have on a firm’s prospects and performance?
  b. What problems arise from employing too much debt? too little debt?
  c. What indications do a firm have that its leverage is too high? Too low?
  d. What competitive strategy issues arise in establishing capital structure policy?
  e. Do industry differences affect capital structure policy?
Mar. 5. Videoconference with John Rogers, Moody’s Senior Credit Analyst.

Readings

“Moody’s Corporate Default and Recovery Rates, 1920-2012” Exhibit 16 WEB. Assignments for the 2012 publication will be provided when it is released in late February or early March 2013. Exhibit Number Assignments will be provided.

Given your existing credit risk knowledge and the above readings, each team should prepare a few questions concerning how a credit rating team works. Please send your team’s questions to Professor Gentry by 4 p.m. on March 4. He will forward them to John Rogers, a senior credit analyst for the chemical industry.

Mar. 7  CreditEdge Presentation in Market Information Lab, 1029C BIF

- A CreditEdge Presentation by Lab Staff.

Readings:
- Challenge Assignment Exhibit 14 WEB
- The Public EDF Model Exhibit 15 WEB

Mar. 12 MCI Communications Corporation (1983) (C)

- How did MCI choose to finance itself as shown in Case Exhibit 6?
- What is the likely level of MCI’s financing needs during the next few years?

Suggested Analysis

- Calculate the book and market value of MCI capital structure components in Exhibit 19 WEB. Interpret the patterns you observe in Exhibit 19.
- Interpret the Analysis of MCI Convertible Financing Decisions in Exhibit 20.

Mar. 14 MCI Communications Corporation (1983) (C) [continued]

- Based upon your interpretation of the outlook for MCI and the competitive and regulatory evolution of the industry, recommend a capital structure policy for MCI and defend your proposal.
- Professor Gentry will provide four financial alternatives. Which alternatives would you recommend to MCI?

Mar. 16-24 Spring Break

Mar. 26 Polaroid Corporation 1996

1. What are the main objectives of the debt policy that Ralph Norwood must recommend to Polaroid’s board of directors?
2. What financing requirements do you foresee for the firm in the coming years? What are the risks associated with Polaroid’s business and strategy? In your view, what firms are Polaroid’s peer firms?
3. Drawing on the case’s financial ratios in case Exhibit 9, how much debt could Polaroid borrows at each rating level? What EBIT coverage ratios would result from the borrowings implied in each rating category?
4. Using Hudson Guaranty’s estimates of the costs of debt and equity in case Exhibit 11, which rating category has the lowest overall cost of funds? Do you agree with Hudson Guaranty’s view that equity investors are indifferent to the increases in financial risk across investment grade debt categories?
5. Is Polaroid’s current maturity structure of debt appropriate? Why?
6. What should Ralph Norwood recommend regarding:
   - The target bond rating?
   - The level of flexibility or reserves? (Exhibit 22 WEB)
   - The mix of debt and equity?
   - The maturity structure of debt?
   - Any other issues you believe are important.

III. A Live Case Valuation Experience


Reading Assignment:

- The first objective is to read the IFMS manuscript pages 2-15 and study the structure of the Integrated Financial Management System (IFMS) in Figure 1 Boxes 1-6.
- The second objective is to read the Centene Corporation (CNC) case in Exhibit 24 WEB.
- Third, focus on the strategic plans for CNC by reading key pages throughout the 2011 Centene Corporation 10K. Professor Gentry will provide key pages in CNC’s 10K report.

Financial Forecast Assignment

- The fourth objective is to prepare the initial inputs for a five year forecast of Centene’s income statements and balance sheets in Exhibit 23 WEB.
- Refer to the top of IFMS Exhibit 1 as a guide for forecasting inputs. Also refer to IFMS Appendix 2 for additional guidance in preparing the IFMS inputs.
- Initially make simplistic assumptions for the forecasted inputs for the 2013-2017 income statements and balance sheets, e.g., inputs that are similar to the 2012 performance results.
- Please limit your work to preparing proforma statements for the next five years and interpreting the results presented in IFMS Exhibit 1.
- Interpret the key forecasted items in case Exhibit 1 and the working capital and capital investment in IFMS Exhibit 3.
- Prepare questions and muddy thoughts for class discussion.
April 2  Financial Structure

- *Structuring Corporate Financial Policy: Diagnosis of Problems and Evaluation of Strategies* by Robert F. Bruner (C)
- What are the components of financial structure? Why are they important?

**Suggested Analysis**

- Using Bruner’s methods for diagnosing a firm’s financial policy, what are critical insights concerning financial structure? Financial structure of Centene Corporation (CNC) is presented in its 2012 Form 10K.
- Use Exhibit 21 WEB as a framework for analyzing Centene’s (CNC) financial structure.
- Use Bruner’s FRICT model to analyze CNC’s financial structure.
- Use Exhibit 6 WEB to compare CNC to its competitors or
- Use competitive companies provided by Centene’s staff, or
- Professor Gentry will provide additional information on CNC.

**Guest Librarian: Carissa Phillips “Available Data Sources”**

Apr. 4  Integrated Financial Management System (IFMS) [Session 2]]

**Reading Assignment:**
- IFMS Manuscript pages 15-19
- An objective of the IFMS is to estimate the intrinsic value of Centene Corp. (CNC). The valuation of the free cash flow for the equity (FCFE) and free cash flow to firm (FCFF) are presented in IFMS Exhibit 3. Prepare the inputs for the valuation.
- **Reading:** “The Equity Premium in 150 Textbooks” by Pablo Fernandez, Exhibit 13 WEB, p. 1 through Figure 2 on p. 4
  - How do you measure the equity premium or market risk premium (MRP)?
  - How stable is the equity premium over time?
  - What are most important conclusions associated with equity premiums?
  - Is there any relationship between credit risk premiums and equity premiums?
- **TARGET CAPITAL STRUCTURE.** At the bottom of IFMS Exhibit 4, insert your estimated target book D/V, the forecasted interest rate ($k_d$), (1-tax rate) and a CAPM cost of equity ($k_s$). At the top of IFMS Exhibit 4 insert an estimated terminal growth rate of FCFF. At the bottom of IFMS Exhibit 5, insert your estimated interest rate and interest earned on marketable securities. You are ready to run Exhibits 4 and 5.
- Compare IFMS Exhibit 4 (target) results to Exhibit 5 (market) results and interpret the differences.
• Why is the valuation of the firm \((V_f)\) in IFMS Exhibit 5 equal to the \(V_f\) in IFMS 4?

• Why does the terminal growth rate in IFMS Exhibit 5 differ from the terminal growth rate in IFMS Exhibit 4? How is the adjusted FCFE determined? Refer to IFMS Appendix 4. Explain/Interpret.

• **MARKET CAPITAL STRUCTURE.** In the right hand corner of IFMS Exhibit 6 insert either End of Year Value or the Current Market Value of Centene’s Equity (E) or Debt (D) and either EOY or current value of CNC price per share and number of shares outstanding. The market capital structure will be automatically calculated. Also the \(k_d\), \(k_e\), \(T\), and TV growth rate of FCFF in IFMS Exhibit 6 are identical to IFMS Exhibit 4. Why?

• You are ready to run Exhibits 6 and 7.

• Compare IFMS Exhibit 6 (market) results to IFMS Exhibit 7 (market) and interpret the results.

• Why is the valuation of firm \((V_f)\) in IFMS Exhibit 7 equal to value of firm in IFMS Exhibit 6?

• Why does the terminal growth rate in IFMS Exhibit 7 differ from the terminal growth rate in IFMS Exhibit 6? How is the adjusted FCFE calculated? Refer to IFMS Appendix 4.

• Prepare questions and muddy thoughts on what you do not understand.

• *Each case study group should develop thoughtful questions* for William (Bill) Scheffel. Your questions should focus on the preparation of the financial forecast of Centene Corporation and questions concerning strategic plans or changes at CNC. Please submit your questions to Professor Gentry via email no later than 4 p.m. on April 4. Professor Gentry will forward the questions to Bill Scheffel on the evening of April 4.

• You may wish to meet with Professor Gentry on April 6 or 7 to discuss your forecast and other questions. Make an appointment with your Prof.

**Apr. 9** Presentations by Bill Scheffel, Chief Financial Officer at Centene Corp.

• **Bill Scheffel** will present a 20-30 minute strategic overview of **Centene.** Following the overview, he will answer the questions you have submitted and new questions asked by each team. Your questions will provide background information that is useful in preparing inputs for your revised financial forecast of Centene Corporation.

• For comparative ratios refer to **Exhibit 6 WEB.**
April 11 Monmouth, Inc. (C) and Monmouth, Inc. Spreadsheet (Exhibit 26)

- If you were Mr. Vincent, Executive Vice President at Monmouth, Inc., would you try to gain control of Robertson Tool in May 2003?

- What is the maximum price that Monmouth can afford to pay, based on a DCF valuation? Based on market multiples of EBIAT?

- Why is Simmons eager to sell its position to Monmouth for $50 per share? What are the concerns of and alternatives for each of the other groups of Robertson shareholders?

- What offer would you make in an effort to gain the support of the Robertson family and the great majority of the stockholders, while improving the long-term trend on Monmouth’s earnings per share over the next five years?

Apr. 16 The Wm. Wrigley Jr. Company: Capital Structure, Valuation and Cost of Capital (C);

- What does Blanka Dobrynin hope to accomplish through her active-investor strategy?

- What is the nature of Wrigley’s business? Is this a healthy, growing company? What should a major recapitalization of Wrigley signal to investors?

- What will be the effect of issuing $3 billion in new debt and using the proceeds to pay a dividend or to repurchase shares on:
  1. Wrigley’s market value per share?
  2. Wrigley’s number of outstanding shares?
  3. Wrigley’s book value and market value of equity?

- What are the relative merits of the dividend or share repurchase?

- Would book value and market value weights change as a result of recapitalization?

Apr. 18 The Wm. Wrigley Jr. Company, Capital Structure, Valuation and Cost Capital (C) (continued).

- What is Wrigley’s WACC before the repurchase?

- What will be the new WACC if the repurchase is undertaken?

- Is there anything missing from the WACC estimates? Is the reduction in WACC a sufficient motive for the recapitalization?

- What will be the effect on earnings per share (EPS) of issuing $3 billion of new debt and using the proceeds to repurchase shares or pay a dividend?

- Should Blanka Dobrynin pursue the recapitalization proposal with Wrigley’s directors?

Guest Financial Executive: Anthony Gedeller, Vice President & Treasurer at Wrigley. (continue to next page)
Please submit your questions for Tony Gedeller on April `18 by 4 p.m., e.g., the management of capital structure and WACC; the financing of the acquisition of Wrigley by Mars Incorporated on October 8, 2008; what has he learned since the Mars acquisition; and to discuss interesting segments of his professional life as financial officer at Wrigley.

**Apr 19** Each Case Team will meet with Professor Gentry to Review its forecast and valuation of Centene Corporation’s in 343M wohlers Hall: This session will address questions related to each case team’s financial forecast in IFMS Exhibit 1-2, its forecast results related to working capital and capital investment in IFMS Exhibits 3, and valuation results in Exhibits 4-7.

- We shall discuss inputs for the capital structure and costs of capital, plus questions you have concerning the valuation of Centene Corporation.

- Please submit Exhibits 1-7 by 8 a.m. on April 19 or sooner if possible.

**April 22** An electronic draft of Centene’s intrinsic valuation analysis will be submitted to Professor Gentry by 11 a.m. on April 22. Also each case team should plan an electronic presentation that can be further refined if your valuation paper is selected for presentation on April 25. On April 22 I will select one or two case teams to present their intrinsic valuation analysis to the class on April 23.

**Apr. 23** Warm-Up Presentations of Centene Corporation’s Intrinsic Valuation.
Each group should be prepared to make a summary presentation of your financial forecast inputs, capital structure, WACC components, implied terminal value growth rates and Valuation estimates. Please do the following....

- Prepare solid justifications for each of the assumptions used in the proforma income statements and the balance sheets.
- Interpret the credibility of the FCFF and FCFE listed in IFMS Exhibits 4 & 6 and 5 & 7.
- Review the stability and credibility of the \( w_d \) and \( w_s \) in IFMS Exhibits 4 and 6.
- Justify the assumed target \( w_d \) and \( w_s \), and \( k_d \) and \( k_e \) in IFMS Exhibits 4 & 6.
- What are the WACC estimates in IFMS Exhibits 4 and 6? Are they justifiable?
- What is the enterprise value of MON, and its debt and equity? Are they justifiable?
- Compare TV implied growth rates in IFMS Exhibits 5 and 7. What do you discover?

**April 24** The presenting case team(s) will be notified in the early afternoon of April 24, in order to allow each team adequate time to develop their Power Point Presentation.
Apr. 25 Team Presentations of its Financial Forecast and Valuation of Centene Corporation (CNC).

- **Case Team Presentations**: Each presenting case team should prepare its financial forecast and interpretation of Centene Corporation valuation, based on its most likely case scenario. A worst case scenario may be used to support your most likely case.

- Bill Scheffel, Chief Financial Officer at Centene Corporation will listen and comment on the assumptions, analysis, and interpretations of your forecast and valuation of Centene Corporation.

Examples of questions you should be prepared to discuss.
- Are the growth rate of sales, cost of sales/sales and SGA/Sales too optimistic for 2013-2017 period?
- Can CNC increase its net operating cash inflow or reduce its operating costs during the period 2013-2017?
- What capital investment strategies appear to add the most value in 2013-2017?
- What strategies were implemented to reduce the size of CNC’s goodwill?
- Should CNC management pursue a strategy of repurchasing its common stock shares?
- How realistic are the assumptions for a target and market capital structures [Wd and Ws] and costs of debt and equity capital?
- Is the implied terminal growth rate realistic?
- How realistic are your estimates of the intrinsic value of Centene?
- What big item(s) did you not include in the financial forecast?

April 30 An **Overview of Finance 522 and a Look into the Future**

May 2 **Reading Day**

May 3-10 **Final Case Examination occurs during this period.**
Cases for the final examination and instructions may be picked up the day you plan to start the case final and returned to 340 Wohlers Hall no later than nine (9) hours that are spread over two days. All exams must be returned before 5:00 p.m., Friday, May 10, 2013.