

LPS-FN209

Corporate Finance in a global world: challenges and chances

Moqi Groen-Xu



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Key Corporate Finance Issues

- **Financing Policy:** How should we finance the investment projects we choose to undertake?
- **Investment Policy:** How do we distinguish between good investment projects and bad ones?
- **Payout Policy:** How should we return money to shareholders?



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Your Lecturer

- Assistant Professor at the LSE Finance Department
- Research focus: M&A, Corporate Governance
- My research is empirical and I like collecting new sets of data
- PhD from INSEAD, France
- Worked at McKinsey before my PhD (in the Travel & Logistics sector)
- I'm German and speak little Chinese!
- Follow me on twitter: @moqixu



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Your Teaching Assistants

Jesús Gorrín

PhD student at the LSE Finance Department



Research focus: Managerial Economics, Empirical Corporate Finance and Applied Econometrics.

Teaching experience: Finance, Alternative Investments, Principles of Finance, Statistics for Business.



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Your Teaching Assistants

James Tengyu GUO

PhD student at the LSE Finance Department

Research focus: Financial Intermediation, Empirical asset pricing

Teaching experience: Finance, Alternative Investment



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Roadmap

Session	Lecture	Case	Tutorial
1	Introduction		Basic Math
2	Risk	Ngue An Tate & Lyle Sugar 1	Basic Accounting
3	Capital budgeting	Ngue An Tate & Lyle Sugar 2	Factor models
4	Ownership	YUKOS	Discounting
5	Capital structure	Petrolera Zuata 1	WACC
6	Project finance	Petrolera Zuata 2	APV
7	M&A	Felix	Valuation exercises
8	Dividends	Koito Manufacturing	Hedging
9	IPOs/ADRs	Petro China	Wrap up
10	Presentation		Exam



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Theory and Application

- Lectures: review and introduction of concepts and theory
- Case Studies: apply theory to real life questions
 - Case background and material will be provided on Moodle
 - You will be expected to discuss and defend your solutions in class
- Assignment: you assess the strategy of a real company
- Exam: 2 hours in class. It's a real case too



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Guidelines for Assignment



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The assignment

Write a report for the next AGM of an assigned company



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Separation of Ownership from Management

- Many companies separate management and ownership.
- This raises the possibility that ownership and management may not be perfectly aligned in their business and financial objectives
- Economists model this problem as a so-called *agency problem*
 - Owner = “Principal”
 - Manager = “Agent”
 - The owner hires the manager to manage the firm but does not observe all his actions
- In closely held firms, the owner can simply tell the manager what to do and fire him otherwise
- That is more difficult if there are many owners, as in firms with dispersed shareholders



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Voting at the AGM

- Listed companies are required to hold a meeting of shareholders on an annual basis (Annual General Meeting or AGM)
- At the AGM, the board proposes resolutions for shareholder to discuss and vote on
- Typical topics:
 - accept the annual report
 - elect directors
 - appoint auditors
 - approve executive compensation policies
- Shareholders can submit proposals to be put on vote: the shareholder resolution



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Example Apple 2014 – Management proposals

1. The election to the Company's Board of Directors (the "Board") of the eight nominees named in this Proxy Statement
2. The amendment of the Company's Restated Articles of Incorporation (the "Articles") to facilitate the implementation of majority voting for the election of directors in an uncontested election by eliminating Article VII, which relates to the term of directors and the transition from a classified board of directors to a declassified structure
3. The amendment of the Company's Articles to eliminate the "blank check" authority of the Board to issue preferred stock
4. The amendment of the Company's Articles to establish a par value for the Company's common stock of \$0.00001 per share
5. Ratification of the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for 2014
6. A non-binding advisory resolution to approve executive compensation
7. The approval of the Apple Inc. 2014 Employee Stock Plan



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Example Apple 2014 – Shareholder proposals

1. A shareholder proposal by John Harrington and Northstar Asset Management Inc. entitled “Board Committee on Human Rights” to amend the Company’s bylaws
2. A shareholder proposal by The National Center for Public Policy Research of a non-binding advisory resolution entitled “Report on Company Membership and Involvement with Certain Trade Associations and Business Organizations”
3. A shareholder proposal by Carl Icahn of a non-binding advisory resolution that the Company commit to completing not less than \$50 billion of share repurchases during its 2014 fiscal year (and increase the authorization under its capital return program accordingly)
4. A shareholder proposal by James McRitchie of a non-binding advisory resolution entitled “Proxy Access for Shareholders”



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Example Apple 2014 – Icahn proposal

“RESOLVED, that the shareholders hereby approve, on an advisory basis, High River’s proposal that Apple commit to completing not less than \$50 billion of share repurchases during Apple’s fiscal year ending September 27, 2014 (and increase the amount authorized for share repurchases under its Capital Return Program accordingly).”



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Example Apple 2014 – Icahn letter

"Dear Fellow Apple Shareholders,

Over the course of my long career as an investor and as Chairman of Icahn Enterprises, our best performing investments result from opportunities that we like to call "no brainers." Recent examples of such "no brainers" have been our investments in Netflix, Hain Celestial, Chesapeake, Forest Labs and Herbalife, just to name a few. In our opinion, a great example of a "no brainer" in today's market is Apple. The S&P 500's price to earnings multiple is 71% higher than Apple's, and if Apple were simply valued at the same multiple, its share price would be \$840, which is 52% higher than its current price. This is a dramatic valuation disconnect that simply makes no sense to us...."

www.shareholderssquaretable.com/apple_shareholder_letter



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Example Apple 2014 – Apple's response

"The Board recommends a vote AGAINST Proposal No. 10.

The Board and management team are thoughtfully considering options for returning additional cash to shareholders and are currently seeking input from shareholders as part of the Company's regular review.

...In March 2012, the Company announced a quarterly dividend and share repurchase program totaling \$45 billion. In April 2013, the Board authorized a dramatic increase, more than doubling the size of the program to \$100 billion, raising the dividend, and increasing the share buyback authorization to \$60 billion. "



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What happened?

Carl Icahn drops Apple buyback proposal

After Apple's move to repurchase \$14 billion in shares, the activist investor says it makes no sense to continue on with his buyback proposal.

Cnet, February 10, 2014



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Your assignment

- You will be assigned a company to write a report for potential investors
- Write a business case for an investor to buy shares of your company
 - It should be convincing and contain basic facts like the capital needed, the expected returns (if your recommendations are followed/not), the risks, the timeline
 - You should also outline the assumptions behind your valuation to make it credible
 - Be honest: if it's not a good deal don't recommend to buy it
- In the business case, assess the proposals for its coming AGM
 - Make a voting recommendation for each proposal (management and shareholders)
 - Describe your rationale in 2-3 bullet points
 - Choose one proposal and write an in-depth analysis backing up your recommendation
 - In particular, evaluate the proposal's potential impact on shareholder value
- Write a proposal yourself (included in the case)
 - Assess your company's current financial strategy
 - Make one suggestion how to improve its capital structure
 - Evaluate your suggestion's impact on shareholder value
 - Write a proposal and letter for the next AGM to convince your fellow shareholders to vote for it
- Report is due before last class
- Present your recommendations in the last class



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What do we look for?

- If you are convinced that your suggestion can create a lot of value, we will support you to search for an investor and/or submitting the proposal!
- Obviously, this depends on the company you are assigned to
- For grading, what matters is how you evaluate and discuss the current strategy and possible improvements
- Make sure to justify and discuss your assumptions and valuation method
- Point out potential differences in valuation that arise if you use another valuation method
- Discuss briefly the theoretical concepts behind your suggestion. In reality, proposals with references are more successful!
- Whether you want to go ahead with the proposal we decide AFTER you receive your grade.

