

# [Cf report assignment](https://assignbuster.com/cf-report-assignment/)

This case examines the April 2007 decision of British music company MME to suspend Its annual dividend as the company struggled to respond to the effect of digital audio distribution on Its core business. The MME case Is Intended to serve as an engaging introduction to corporate financial policy and themes in managing the right side of the balance sheet. The case contrasts MI’S storied success with artists such as the Battles, the Beach Boys, Pink Floyd, and North Jones with its recent inability to succeed in financial markets.

In light of takeover threats and restructuring sots, MI’S SCOFF Martin Stewart must recommend MI’S dividend policy. Objectives The case serves to accomplish the following teaching objectives: ; Introduce the topics of financial policy, such as dividend policy and debt policy. ; Motivate the tension between investment policy and financial policy with respect to the sources and uses of cash. ; Prompt the Modeling-Miller intuition of financial policy irrelevance and homemade demands. ; Discuss the ways In which Scoffs add value to firms. ; Review the mechanics of corporate dividends.

Advance Assignment Questions Students may consider the following study questions: 1 . What are the central challenges facing the MME management team? 2. As SCOFF, how can Martin Stewart contribute to successfully managing MME? 3. What do you learn from the sources-and-uses statement provided In case Exhibit 7? What are the Implications for MI’S dividend policy? Supplementary Material An Excel spreadsheet (Case\_27. XSL) is available for students. Hypothetical Teaching Plan 1 . How is MME doing? What are your concerns? What does MME have going for itself? 2. It seems like this dividend decision is a big deal.

Do shareholders generally prefer firms that pay dividends? Do you think MME shareholders would pay more if MME promised a up dividend? 3. Why should the dividend policy matter much at all? Why is this dividend decision so important to MME? 4. What should Stewart do? Case Analysis 1. How is MME doing? What are your concerns? What does MME have going for itself? In April 2007, MME management faces an important challenge as it searches for a new business model in a digital music world. Annual revenue is down 16% for the [ear and 19% since 2003. Investors are reeling from a series of negative-earnings- audience surprises.

Earnings per share for the year will be announced at -36. Up per share, the company’s worst profit figures. The industry continues to look for a bottom in the effect of digital audio distribution among the major companies (Warner Music, Sony BMW, and Universal Music). MME is attracting takeover interest from rivals, Including the recent IPPP offer from its U. S. Rival, Warner Music. The company is currently involved in a GOBI 25 million to GOBI 50 million (British pounds) restructuring effort that is taxing its financial resources. Still, MME has much to celebrate.

It maintains one of the strongest catalogs of music and artists in the industry. MI’S music-publishing division is stable and profitable, and its restructuring efforts appear to be gaining traction. MI’S digital sales are expanding aggressively and now represent 10% of group revenue. The offer its digital catalog using the new format that maintains better sound quality and fewer rights’ restrictions. Given that backdrop, MI’S SCOFF Martin Stewart must recommend a dividend policy for MME. Maintaining the up-per-share end-of-year annual dividend would require BEBOP million of MI’S cash resources.

Omitting the dividend may further disappoint Investors and lead to greater softening of MME share values in the market. Students will generally claim that dividends are valuable to shareholders, and that this decision is a big deal for MME. This discussion motivates an introduction to the Modeling-Miller intuition of financial policy irrelevance and homemade dividends. One way to do this is with the following example. Suppose you are walking into the bank and you notice an advertisement for a new concept in retail banking called the " Free Money Checking Account. Since you are always interested in advertisements for free money, you inquire further with the bank representative. The representative is delighted with your interest and explains that the mechanics of the free money account are simple. Each month the bank looks at the average balance in your account and sends you a check for 10% of the balance. ‘ Great! ” you exclaim, " you mean the bank will send me free checks in the mail! ” " Well, not exactly,” explains the representative, " you see the amount of the check will first be deducted from your checking account. Registering your disappointment, the bank preventative counters, " But the Free Money Checking Account only costs a mere $20 per month! ” The instructor can ask how many of the students are interested in signing up for a ‘ Free Money Checking Account” (FMC). The students should express reluctance to sign up for the account (if not, the instructor is provided with an obvious arbitrage opportunity). The instructor can encourage the students to discuss how they could mimic all the features of the FMC by " home cooking” their own monthly payments Introit paying $20 per month.

The instructor can then ask how the story applies to shareholders of MME stock. Quickly, the students will recognize the Modeling-Miller proposition that corporate dividends are wealth-irrelevant. [l] The shareholder of the dividend-paying stock is doing nothing more than taking money out of one pocket and putting it in the other. Recognizing this fact, the rational shareholder should not be willing to pay any premium for firms that pay dividends over those that do not because the shareholder can “ home cook” any dividend policy desired without paying any premium.

The students should be somewhat primed for this discussion based on the introduction . Why should the dividend policy matter much at all? Why is this dividend decision so important to MME? One exercise worth spending time on is a detailed review of case Exhibit 7. The students should appreciate that the sources and uses of capital must equal each other. In this regard, investment policy is linked to financial policy. MME must fund the dividend either through additional borrowing or through a reduction in investment spending. The discussion invites a survey of the principles of financial policy relevancy.

Points of discussion can include the following: Information signaling: There is some evidence that the market is being overly critical of MME prospects. Dividends can be used as a way of credibly signaling the private information of management of the future profits. [2] There is[2]bstantial evidence in the case that information signaling plays an important role in the MME dividend. Tax treatment: In many countries, there is a difference between the tax treatment of dividend income and capital gains income. [3] At the t[3] of the case, there was little difference in the two tax rates for individuals in the United Kingdom.

Still, UAPITA gains do afford the investor the flexibility to postpone the recognition of taxes and thus gain the time value of the tax recognition. Management monitoring: Dividend payments provide a mechanism for bonding manager performance. By requiring managers to return to the capital markets to fund future investment, managers are required to accept the additional scrutiny of the primary market for capital. [4] More bro[4]y, this question provides an opportunity for the instructor to introduce students to the world of financial policy and the themes in managing the right side of he balance sheet.

One fundamental distinction to make from this discussion is that Scoffs are involved in two important activities: investment policy (managing the left side of the balance sheet) and financial policy (managing the right side of the balance sheet). Financial policy includes decisions regarding the appropriate securities to fund firm assets, including how much debt to have in the capital structure, the appropriate level of dividends to pay shareholders, and how to manage firm risk exposure to foreign exchange rates and commodity prices. 4. What should

Stewart do? To wrap up the discussion, the instructor may choose to poll the class on its recommendation for MI’S dividend policy. There is likely to be some disagreement, and each group may be allowed ample time to summarize its arguments. The As you will see in the epilogue, MME chose to suspend the dividend; the company Nas subsequently purchased by a private equity firm, and MME senior management Nas dismissed. The discussion of the epilogue can be followed by a discussion about Neither MME management made a mistake to suspend the dividend.

Ultimately, the lass is likely to conclude that the operating failure of MME management played a larger role than any aspects of the financial policy (including the dividend decision). A closing statement for the case might emphasize the lesson that business value is created primarily by the operations of the business and that financial policy maintains a primary role of supporting rather than superseding the operating decisions. Exhibit TIN Epilogue In addition to preliminary results for the 2007 fiscal year, MI’S April 18 press release included the company’s decision to suspend dividend payments for a time.

Regarding its dividend, MME noted “ in view of the Company’s funding requirements, the Board has decided to suspend dividend payments until the benefits of the restructuring process have been fully realized (the interim dividend of up per share has already been paid [on April 2][on April 2] will keep the situation under review. ” Ninth heavy trading, MME shares actually gained nearly 5% following the announcement. Two weeks later, MME confirmed that a number of parties had contacted management regarding an acquisition of MME. Shortly after, on May 21, MME announced the Board had accepted a IPPP offer from private equity firm, Terra

Firma. While acknowledging there were numerous offers, MME Chair John Silversides stated, “ Terra Firm’s offer delivers cash now, without regulatory uncertainty and with the minimum of operational risk to the company. ” Investors clearly expected a bidding war to break out for MME. MI’S shares rose to 271 p that same day, surpassing the Terra Firma offer. While other private equity firms were mentioned as possible bidders, most bets were on Warner Music to be the principal dueling bidder. Sole Media Metrics analyst Laura Martin remarked, “ It’s the beginning, not the end…

We think it’s a good thing for Warner, because it gives them a clear price for them now to beat. ” Warner confirmed in mid June that it was actively considering a possible counter offer. Multiple times as shareholders held out hope for a higher bid from Warner Music. Manner Music ended intense speculation on July 18 and stated it would not make another bid for MME given the current situation. With all obstacles removed, Terra Firma completed its acquisition of MME and the shares were delimited on September 18, 2007. Prior to officially taking over MME, Terra Firma announced in late August that both

Eric Nicolle and Martin Stewart had agreed to step down. But Roger Fagan, head of MME Music Publishing, remained with the new leadership team. Most in the city agreed the departure of Nicolle and Stewart came down to numbers and MI’S dismal performance. Speaking with a Royal Television Society convention audience in late September, rarer Firma CEO Guy Hands described how his firm looked “ for the worst business we can find in the most challenged sector and we get really happy if it’s really, really bad. ” He explained, “ MME, our most recent investment, is a classic example.