Tiffany case essay sample

Question 1a:

Tiffany should go public since an IPO would be able to bring in fresh equity to fund growth, and to establish a relatively liquid and efficient market for the company's shares. Tiffany has a strong brand and would be able to attract investors during the IPO process. Tiffany option of IPO was favorable since it had positive operating results for the past months. Since the terms of renegotiating the terms of the GECC revolving credit were not encouraging , management of Tiffany consideration of getting funding via the IPO route made sense.

IPO would help the management of Tiffany to repay GECC completely and free the company to make alternative borrowing arrangements. Since the operating cash-flows where not steady, refinancing by additional debt was not the right choice. The right way was to go for equity and raising private equity was tough so IPO made more sense. The recommended issue size was 4 million shares at price range between 21-23 $ per share.

Question 1b:

When evaluating companies using comparable firms , the firms need to public companies. The firm should be from similar industry, business model, profitability, size, growth and geography. Since the operating margins for diversified retailers are very different from the Tiffany therefore it is not the right comparable. Thus, while Tiffany's revenue growth closely resembles that of other Jewellery Retailers, its margins are higher like Speciality Retailers. . For selecting the right comparables, I will be looking at companies with similar revenue growth rates, which is for the Jewellery Retailers.

Question 1c:

The average Enterprise value /operating income multiple of comparable jewelry retailers is around 7. 27x. We shall use this multiple of 7. 27x for valuation purposes. At 7. 27x, the enterprise value of Tiffany's is $ 157. 68 (21. 9 * 7. 27) million. Of this value, the value of debt is $ 49 million, giving us an equity value of $ 108 million. The multiple of EV to Operating income is commonly used in the retail industry for valuing. However, for the purpose of valuation by multiple, it is advisable to ignore Barry. Jewellers Inc. as these companies vary significantly in asset and sales structure from Tiffany. Enterprise value is arrived by adding net debt to market capitalization of the companies.

Question 1d:

The price range for Tiffany IPO is between $21-23 per share. This is much closer to the lower end of the price band and therefore further under pricing would not be advisable. Through book building, Tiffany is able to attract investors for 16 million compared to the actual issue of 4 million shares. Hence, it can be said that since the investors have expressed interest at the lower band of the price range, and no further under pricing is required. Hence, moderate under pricing in the range of 5% to 10%. is appropriate.

Question 2:

The lease option is better and cheaper because of the following reasons:- Tax Advantage. An operating lease is not considered to be a purchase, but rather a tax deductible overhead expense. Therefore, Amazon Mines can deduct 100% of their lease payments. Equipment purchased with a bank loan must be depreciated over a period of years, which often exceeds the useful life of the equipment. Lesser Liability. Because an operating lease is not considered a long-term debt or liability, it does not appear as debt on Amazon Mines financial statement, thus making it more attractive to traditional lenders when Amazon Mines need them by improving Amazon Mines financial ratios. All loans appear on Amazon Mines balance sheet. Fixed Rates.

Leases have rates that are fixed. Most term loans are adjustable. All equity-lines/line-of-credits are adjustable. Therefore more interest risk in case of loan. Lesser Down payment. With leasing, there is very little money down – perhaps only the first and last month’s payment is due at the time of the lease. Since a lease does not require a down payment, it is equivalent to 100% financing. That means that Amazon Mines will have more money to invest in revenue-generating activities. Most term loans require a 10-20% down payment. Personal Credit. Leases do not show up on Amazon Mines’s personal credit report.

Bank loans will show up on its credit report and may keep it from getting further credit . Improved Cash Forecasting. The lessee knows the amount and number of lease payments so they can accurately forecast the cash requirements for equipment. Upgraded technology. If the nature of Amazon

Mines industry demands that they have the latest technology, a short-term operating lease can help it get the equipment and keep their cash.

Amazon Mines risk of getting caught with obsolete equipment is lower because it can upgrade or add equipment to meet its ever-changing needs.. A lease provides the use of equipment for specific periods of time at fixed payments. The lessor assumes and manages the risk of equipment ownership. Flexibility. As Amazon Mines business grows and it needs change, it can add or upgrade at any point during the lease term through add-on or master leases.

Question 3:

A young firm NCI Corporation builds wind power driven energy systems. It is considering raising $400 million in debt capital for an expansion project and can issue bank debt at 16% or junk bonds at a yield of 14%. (a) Explain why bank debt is more expensive than public debt (b) Discuss the major pros and cons of each alternative for NCI.

Bank debt vs Public Debt:

Private debt comprises bank-loan type obligations. Public debt is a general definition covering all financial instruments that are freely tradable on a public exchange or over the counter. Bank debt is more expensive since the risk of default has to be borne by the bank itself while in the case of the public debt/bond , the risk of default will be divided among the various bond holders and therefore risk is minimized. Liquidity of bond is high whereas bank debt is low. The bonds can be freely traded on the market and are more liquid. Bonds below Baa/BBB (Moody's/S&P) are considered junk or high risk bonds.

Also, in issuing bonds, the company runs the risk of letting the issue undersubscribed which may severely hamper company's image in the market. The company also has cost involved in raising issue for bonds by the way of underwriting, advertising etc. The chances of under subscription in a bond issue is high as investor's response is dependent on macro-economic factors such as interest rate, market sentiment, rating etc. whereas such implications are not involved in applying for a bank debt.

Major pros and cons for NCI and Recommendation for NCI

NCI should go for bank debt although it is expensive, since it is a young firm and getting public debt will not be easy to obtain due to credibility issues.

Firms with a higher degree of information asymmetry will borrow privately, while firms with lower information asymmetry prefer public debt. Since NCI ha higher degree of information asymmetry it will prefer bank debt.

Firms with higher future growth opportunities will prefer bank debt so is the case with NCI.

Managers with high equity ownership stakes will be more likely to issue private debt for two reasons. First, their ownership stake gives them the incentive to choose the security that maximizes value. Since NCI is young firm high equity ownership will make it more likely to issue bank/private debt.

Question: 4a

The RES can be broken into a bond and a put option. If the Dell stock price is less than the strike price of 25. 72, ABN Amro would exercise the put option and sell 38. 88 shares of Dell to investors. In case the stock price is higher than 25. 72, ABN Amro will pay the principal of $ 1000 to the Investors.

Interest from bond considering Interest Rate 12. 00% per annum, payable semi-annually in arrears on December 19, 2002, June 19, 2003 and December 19, 2003 : $ 156. 33 The value of the security would be $1000-156. 33 – premium for the put option.

Question: 4b

Investors would be willing to buy the RES, if they feel that the Dell price will be higher than $25. 72 after 1. 5 years. Moreover investors would get the interest and also the premium from the put option.

Question: 4c

ABN Amro would use an RES to hedge against the risk due to fall in the price of the Dell Stock.. This would be needed if ABN Amro has a long exposure to the Dell Stock by going long on Dell stock or writing puts.