

Comments for Arrowwood

Gaming Industry

Overall Assessment: Good financial analysis in general.

Major comments:

- What Business Are they In: On page 29, you appear to suggest that rather than be in the gaming business that Mandalay be in the entertainment business (broadly defined). If so, what synergies exist? Can we profit from these synergies? What is the incremental value added from each component? You also suggest that since the company has limited expertise in retail and non-event based entertainment, that they partner with a mall developer. Two contenders that you look at are The Mills and Simon Property Group. However, given your target audience, why didn't you consider Rouse?
- Centralized Management: One of your strategies is to centralize management. Out of curiosity, how are the other big 4 organizations run? Is it on a centralized or decentralized basis? Why? What's the rationale?
- Tier 4 Performance: On page 25, you mention that Mandalay Bay Hotel has performed under expectations. What were the expectations and what reasons are given for underperformance? Also, are payouts from gambling similar across Tier 4 competitors?
- Financing considerations: On page 14, what would the bond rating be from the combined MBG + HET entity? Would the debt on the merged company be downgraded? What is the optimal capital structure? Is the ROE > cost of equity? On page 16, why isn't CapEx = Depreciation in the stable growth period? Also, are your debt and equity weights associated with the current capital structure or the target capital structure? Ditto for the cost of equity.

Minor comments:

- Missing some scenarios/fill in the blanks: Just a reminder to be sure to model an EBITDA based growth argument (see page 13). Also, there is a lot of XXX which need to be filled in with the appropriate figures.

Beer Industry

Overall Assessment: Nice job. It is always a pleasant surprise to see that my “percent of sales” lecture has been incorporated into your report.

Major comments:

- Length of Brewing Contracts: There is never any mention in your paper on the length of the contract brewing contract. From the standpoint of Boston Beer, the length of brewing contracts should have an impact on COGs and should also affect the duration of cash flows.
- Buy vs. Lease: The decision to use contract brewers vs. acquiring a brewery is analogous to a buy vs. lease decision. After determining the length of the “lease” contract, e.g. brewing contract, when does it make sense to use contract brewing vs. acquiring a brewery? Please run the numbers. What is the incremental value on a per share basis? You’ve already done the brewery acquisition case. I don’t see the case for contract brewing *going forward*. (If you’ve already done it, please let me know what page it is on)
- Going Private Option: Why should Jim Koch spend money to take the company private when it is “as if” the company is already private? He’s got 100% of the voting stock and according to published reports, most of his net worth is already tied up in the business.
- Location and Distribution Costs: On page 167, you provide a map showing where Boston Beers brewing operations/contract brewing operations are. Does this map show where ALL of their contract brewers are located? Where are their other beverages such as their Ale and BoDean’s tea being brewed/bottled given that distribution costs are dependent on location? Also, since your target audience is the over 21 year old crowd, where is growth in this age group increasing the fastest from a geographical perspective. Present the map both with respect to relative and absolute growth in the over 21 year age group. If you need to also include over 21 + having an income of at least \$X, then plot this on a map. I’m trying to get a sense of where (location) you will need to have contract brewers or acquire breweries. Compare this against your current percentage of sales by region on page 167.
- Selling an Import Brand Domestically: On page 187, one strategy that you mention is to create a domestic pseudo-import with a catchy imported name like Coors has done. Has this strategy proven successful for Coor’s? What has it done in terms of their incremental sales and income on a per share basis?
- Marketing Problems: I receive the impression from reading your report that there have been several advertising mis-steps. Given this, I went to Lexis-Nexis as well as proquest and found that this is an important issue for Boston Beer. You might wish to elaborate on how their advertising has not resulted in the sales volume that other beer companies have had. Do a quick and dirty ratio of sales/advertising expenses per firm so that I can get a sense of what is their sales per \$1 of advertising for Boston Beer. Alternatively, you can graph this relationship or do a cross-sectional regression.

Beer Industry (continued)

Minor comments:

- Bond Rating: On page 162, you mention that “The company can take on \$52.8 million in debt at which point it would reach its optimal capital structure. The \$52.8 million debt threshold provides a ceiling for spending on projects.” At this level of debt, what would Boston Beer’s bond rating be?
- Taking a stake: There have been news reports that Lehman Brothers has been acquiring shares of Boston Beer on behalf of Miller Brewing. This is not mentioned in your report. Is there any truth to these news reports? Also, there have been reports that one concern of Jim Koch in selling his company is that the quality of the beer will be watered down just as Pillsbury has watered down the quality of Haagen Das ice cream (to use your analogy). You don’t mention this at all in your buyout scenario.
- Using the run and shoot offense: Doesn’t Boston Beer continue to change its product mix by allowing consumer demand to rationalize its line of core products?
- Alliances to Sell Sam Adams in other Countries: On page 207, there is no mention of whether Sam Adams is also sold in Canada.
- Other uses for Beer: Are there any other products that play to the strength of quality beer at a high price? For example, a Wharton student recently designed ice cream that uses high quality beer as one flavor.

Mass Retail/Department Stores

Overall Assessment: Your group has done a good job of exploring the issues and relating courses of action to financial/valuation considerations.

Major comments:

- Change in CEO: I'm sure that your group has heard since the submission of this report to me that the CEO of JCP, James Oesterreicher, has "retired". This news broke on May 4, 2000. What does this change in management portend? If Vanessa Castagna takes the helm and it appears likely given that she has been assembling her own management team, what directions will she likely take the company. Do some research in Nexis-Lexis on her when she was a Wal-Mart.
- More elaboration of JCP strategies is necessary: Simply stating that they will target 18-54 year old females isn't enough. It would be helpful to define other attributes of this target segment such as lines devoted to ethnic preferences, salary, etc since the profile of the American woman has changed over time. It is interesting that your report stresses JCP private lines such as Arizona jeans. Other stores such as Kmart appear to use a spokesperson/ celebrity lines such as Martha Stewart to create an image. Have you considered this course of action? In addition to this, it is not clear that you link trends to strategies. For example, there is a movement in the workplace to go from formal wear to business casual. What does this portend in terms of merchandise mix, targeting customers, and other strategies? Also, casual but chic seems to be the trend (or is it merely a fad?) these days e.g. business casual, active casual, urban/streetwear. Does JCP have the right inventory to take advantage of these trends? What should JCP do with inventory that doesn't move very quickly? Should they use a strategy similar to Neiman Marcus's and sell this inventory in a Last Call store? Is the recommendation to move to some free-standing stores a hedging strategy?
- Implementation plans: One implementation plan that is not mentioned is whether you plan to reduce the workforce or simply relocate existing workers. Recent articles have suggested that the net income of JCP per worker is \$1150 compared to \$4720 for Wal-Mart and \$6000 for Kohls. I'll leave it to you to find the appropriate references.
- There are shoppers and then there are shoppers: What is the profile of people who are shopping at the regional mall versus the profile of people who shop at JCP store within the mall? Is JCP doing a good job of capturing the majority of the mall traffic? Why or why not?
- Excess funds: On page 82, your group notes that "there will be an excess of funds available subsequent to the sales of the other two business units, which will ultimately be distributed to the equity holders in some manner, either through share repurchases or dividends." What is the rationale for distributing to the shareholders in this manner? You're making the implicit assumption that JCP can't invest it at a higher return than the shareholders can.
- Alignment of Management Compensation with Shareholder Interests: JCP has changed their management compensation from one with a low base salary and bonuses based on bottom line performance to a competitive base salary. As such, CEO James Oesterreicher despite having bad performance received a 78% increase in his base pay. Shouldn't you also have some courses of action which align management and shareholder interests?

Mass Retail/Department Stores (continued)

Minor comments:

- Link Between In-Store Merchandise and Catalog: Does the catalog carry the same number of items or more items than the in-store merchandise? Does JCP use the catalog sales as a barometer of their in-store merchandise mix?

Network Attached Storage

Overall Assessment: I continue to be disappointed with your paper given the talent and abilities of your group. The paper is very superficial in treating the relevant issues with not enough time devoted to strategic options and tying these options to financial considerations such as what does an option translate into in terms of incremental per share price, optimal debt structure, etc. I realize that it is only the final presentation that counts but if you don't do your homework, you may not be able to answer questions raised by the board of directors.

Major comments:

- Strategic Alliances: More discussion is necessary on defining exactly what you mean by strategic alliance. Is it merely a bundling of services? What happens if one of the parties becomes “weak”? Are you still committed to this party? If so, for how long? In this fast paced sector, new technology and new players appear on the scene rather quickly. In addition to this, your group needs to show the strategic alliances for your firm vs. the strategic alliances that your competitors have made. For example, there are news stories that NTAP has made strategic alliances with Quantum/ATL, Spectra Logic, Rulespace, and TrendMicro among others. Why? What businesses are the partners in? Also, if the principle of exclusivity is absent in any category of strategic partnership as in the case of Cisco (see page 15), doesn't this diminish the value of the strategic alliance? Once again, what is the nature of NTAPs strategic alliances? Is the principle of exclusivity present?
- Relating Suggested Courses of Action to Financial Considerations: Regardless whether you use strategic alliances, mergers, etc., you must translate your options into what this means with respect to sales and earnings growth. What is the NPV associated with a particular course of action e.g., does it add value to the firm? For example, what is the incremental value per share associated with the strategic alliance with Cisco? Ditto with CacheFlow. Also, how will NTAP finance future growth especially your recommendation that NTAP pursue a global expansion strategy with an eye toward supporting the delivery of wireless service? Should they use debt, equity or some combination? What has NTAP done in the past? What is their debt rating? Can they take on additional debt without a downgrade in their financial structure? What is their current financial health? What is their optimal capital structure? How much capital expenditures does a particular course of action require? Given your last sentence on page 28 that the “product life cycle is SHORT in the data storage market and NTAP should introduce a new product in a one year frame and improvements on existing ones in 3-6 months”, does this suggest high working capital needs as well as high levels of cash on hand?
- Linking Trends to Potential Courses of Action: You state that most in the industry feel that SANs are complementary to NAS technology and that ultimately, the SAN and NAS markets will converge. Yet there is no mention of strategic alliances or mergers in this regard. For example, there is a recent news story that Quantum/ATL has joined forces with NTAP and Vixel, a leading SAN provider to deliver an integrated backup/restore solution for NTAP filer customers. Does this suggest that this is the way to go or have you considered a merger between NTAP and Vixel?
- Size of Market and Potential Profits: I have no sense of the size of the markets that NTAP is in nor how “big” this market can become (please state in dollars and units/customers). Since NTAP currently counts 9 of the top 10 ISPs as its clients, how long will it be before market saturation (limited growth) occurs?

Network Attached Storage (continued)

- Relationship of R&D to Sales/Income: On page 29, you recommend increasing R&D as a percentage of sales. Yet I don't get a sense of how R&D is related to sales or earnings. If you do a cross sectional (across all firms) regression using R&D as the independent variable and earnings (or sales) as the dependent variable, I can get a sense of how \$1 R&D translates in sales or earnings. Also, provide a plot of R&D vs. Sales (or earnings).

Minor comments:

- Licensing Agreements: Please elaborate on how long the licensing agreements are good for e.g., "global system vendors, such as Dell and Fujitsu, which are NTAP current OEM partners and have the licensing agreements to distribute NTAP equipment with their product's suites, may be suitable alliance partners (page 12). This is useful in calculating the duration of cash flows to the firm.
- Strategic Analysis of Auspex: This section (starting on page 31) appears out of nowhere with no reason why it is stuck in here. It is not until page 38 that the reader know why you are discussing Auspex at all.
- Glossary: To facilitate easier readability, please put in a glossary at the back of your paper so that the reader can understand the terms used e.g. NAS, SAN, ISP, etc.

Toy Industry

Overall Impression: On average, a good report although more effort is required in linking various long term trends to your strategies.

Major Comments:

- Management: Who is their new CEO John Eyler and what do we know about him and his qualifications for getting the job done? Given that management is a key component of your strategy, should he buy management from Wal-Mart and other retailers who are the leaders? What about the management of Imaginarium? Does that management team have what it takes to turn around Toys R Us? Is ToyRUS using any performance metrics such as EVA? There was some discussion that they were thinking of implementing an EVA approach. Is management interest aligned with shareholder interest (see my comments on JC Penney)
- Should You Redefine Your Target Audience: You still haven't addressed a question that I posed in my previous review of your work, namely, should ToysRUS expand their target audience to include toys for people of all ages? This used to be the strategy of Tandy's Toys for Men, now known as Radio Shack dba Tandy Corporation. You need to relate the changing demographics and other important trends to your various strategies. For example, what are the forecasts of the age distribution that ToysRUS is trying to reach? Is it projected to increase at a fast rate, slow rate, or remain stagnant in the next couple of years?
- Financing Considerations/Analysis: How will CapEx be financed for your given strategies? Do you close stores and reinvest the proceeds in distribution facilities, use equity, or use debt? Do they gain on the sale of their real estate when they close a store or is it a total write-off? Your analysis is based on their *current* capital structure. What about the valuation analysis based on your *PROPOSED* capital structure?
- Location, Location, Location: Currently, ToysRUS has free standing stores that are not necessarily located near a major regional mall. Can you find statistics on whether store performance increases when they are located in or adjacent to a regional mall/power center? Does it make a difference in terms of capturing the target audience?

Minor Comments:

- Font Size: Please enlarge the font. I have a hard time reading your report with my reading glasses.
- Glossary: To facilitate easier readability, please put in a glossary at the back of your paper so that the reader can understand the terms used e.g. P.O.S, etc.