

GROUP WORK ASSIGNMENT

FINANCIAL MARKETS AND MANAGEMENT

MiM

2020-2021

The Group Work Assignment of FFM is a practical case to determine the cost of capital and the capital structure of a large international company, for which we need to find relevant information. The script of this case study is presented next, but first read the rules of the game.

Rules of the Game:

- 1) **Important Dates: The Final Date to Hand In the Assignment is 21st December 2020.** The assignment must be submitted via Aquila.;
- 2) **Each group has an ideal and maximum number of 6 students.**
- 3) **The assignment involves the final delivery of the following 3 elements:**
 - a. A brief typed **Report** in pdf format, with a description of the procedures followed and of the results reached. (MAXIMUM 10 pages A4);
 - b. A **Spreadsheet** in Microsoft Office **excel**, supporting the written report;
 - c. A **Presentation** in Microsoft Office **powerpoint**, with a summary of the case analysis.

Disclaimer

Although based on a truly existing company and on what could be a real new project, the information that follows is purely fictional – nothing more appropriate for the New Year!

CASE DESCRIPTION:



When you think of sports and sports gear, NIKE always comes to mind. Who has never worn a pair of NIKE sneakers? No one I can think of... “everyone that matters” works out with NIKE. Mr. Mark Parker (NIKE’s Chairman and former Chief Executive) knows so. Himself a track and cross-country runner as a student of Political Science at Penn State University in the 1970s, Mr. Parker joined NIKE in 1979, in what was a surprisingly good decision. On November 23rd, 2020, Mark Parker is having a nice warm cup of coffee with his wife Kathy as they both recall that in 2019 he celebrated 40 years of a career dedicated to NIKE. Kathy reminds him of all the good times and extraordinary achievements, from the days when he designed footwear to being designated *Fortune’s* Businessperson of the Year 2015 and becoming Chairman in 2016 with an annual paycheck that year of \$47.6 million. Yet, Mark never fully recovered from his insomnias with the poor results of 2017 that led to a 71% personal pay cut and to the layout of 1000 employees. Sitting by his side in the living room, watching their Andy Warhol painting, Kathy suggests it is time to retire and spend more time together spending the fortune Mark made in the stuff they like, such as art, the movie industry, music and dance. Mark looks her in the eye, holds Kathy’s hand and smiles: “Alright”, he says, “but before I leave, there’s one last project I need to go after in 2021. It is my dream!” The project Mark Parker has in mind is to develop a totally revolutionary new pair of sneakers that are just perfect to dance, because they actually allow the dancer to jump (“fly”) higher and longer than with any other shoes. It is the JUMP NIKE 2021 project, that will require immediate investment in January 2021 so that the new sneakers are sold for the very first time on January 1st, 2022! To develop the final details of the new shoes and to make them a huge commercial success, Mark Parker is teaming up with the famous Shoe Designer Christian Louboutin, which means he is moving to Comporta (Alentejo, Portugal) for the first couple of months of 2021. Mr. Parker asked ISEG’s Dean, Prof. Clara Raposo, to find him a solid group of financial analysts to assess the potential of this new project. This is where you, students of the Masters in Management, join the game!!! Mr. Parker has already asked his designers and engineers to provide us with some numbers and technical estimates to help you with your analysis.

For the project to go through, the company will make an immediate investment in fixed assets with a useful life of 15 years. This investment should be approximately 1/3 of the total investment of the company (in property, plant and equipment and in intangible assets) during the last fiscal year for which you have data (possibly it's data for 2019). The new JUMP NIKE 2021 sneakers alone are expected to generate revenues at the end of 1 year (when launched in January 2022) of approximately 17% of the company's total revenues in the last year for which annual accounts have been published. Over time, sales of this new product are expected to increase at a rate of 3.5% per year for the next 5 years of the project, and, after that, the sales should decrease at a 1.5% rate per year. Production will be completely stopped 10 years after the launch of the project. The structure of operating costs (as a percentage of total revenues) is expected to be similar to what it has been for the last 3 fiscal years. With the launch of the new dancing sneakers, NKE should experience, as a side effect, a small reduction of 3% in the sale of its other footwear products. As a newly hired financial expert consultant you have been asked to evaluate the new project. You will compute the appropriate costs of capital and the net present value using different valuation methods. You must seek out the information necessary to value the free cash flows. But you'll be given some directions to follow.

1. Go to <http://finance.yahoo.com>. Under "Market Data", you will find the yield to maturity for Treasury notes/bonds with maturity of 10 years listed as "x Yr Bond (%)." Collect this number as your risk-free rate. Comment. Note: You are free to get this information from a different source (such as Bloomberg, for example) and justify it. Identify your sources always.
2. In the search box "Quotes Lookup", type Nike Inc. (NKE) and press enter. Once you see the basic information for NKE, find "Statistics". From section "statistics" collect NKE's market capitalization (its market value of equity), enterprise value and beta. Comment. Note: You are free to get this information from a different source (such as Morningstar, for example) and justify it. Identify your sources always.
3. Use the information from point 2. above to compute the weights for NKE's equity and debt for the WACC rate.
4. Calculate NKE's equity cost of capital using the CAPM, and a market risk premium of your choice. Justify your choice and comment.
5. To get NKE's cost of debt and the market value of its long-term debt, you will need the yield to maturity of the firm's existing long-term bonds. Try <http://finra-markets.morningstar.com/BondCenter/Default.jsp>.
6. Under "Market data Center Bond n Guides", choose "Search" and select Bond Type "Corporate". Type NIKE INC. as the bond issuer (or use "NKE" in the symbol/cusip). A list of NKE's outstanding bond issues will appear. Assume that NKE's policy is to use the expected return on fifteen-year obligations as its cost of debt. Try to identify a bond issue that is as close to 15 years from maturity as

possible. (Sometimes you have insufficient information about some bonds – in this case, simply ignore those for which you have no data; it might be the case that the company already called those bonds.) *(Note: if possible, select a bond that is not “Callable” – if you can’t find one, just use the callable bond information).* Find the credit rating and yield to maturity for your chosen bond issue (it is in the column with the heading “Yield”). You can get detailed information about your bond by selecting it with a tick and then opening the information in a new window.

7. Based on the bond you selected in 5., estimate NKE’s cost of debt (based on the yield to maturity).
8. Get the Income Statement and the Balance sheet from Yahoo Finance, section “Financials” (or another source, such as the company’s website <http://investors.nike.com>). Place your cursor in the Income Statement or the Balance sheet and right-click. Select “Export to Microsoft Excel” (the last few years available, maybe 3-4 years). Remember to consider the consolidated statements.
9. Compare NKE’s market value to its book value and make a short comment.
10. Calculate the average corporate tax rate for NKE over the last three years, by dividing “Income Tax Expense” by “Income Before Tax”. Use the average corporate tax rate for your project.
11. Calculate NKE’s WACC rate based on its current market value and the costs of equity and debt that you computed above. Note: Do not forget the tax effect in that rate. Justify your choice.
12. Create a timeline in Excel with the free cash flows for the 15 years of the project.
13. Compute the NPV of the new project given the free cash flows you calculated, using the WACC method of valuation, assuming the company will keep a target ratio of capital structure similar to the current one. Comment.
14. Make an investment recommendation regarding this project. Justify your choice.
15. Perform some robustness analysis on your valuation. Clearly explain all your steps and assumptions.
16. Determine the NPV of the project using the Adjusted Present Value method, and also using the Flow to Equity method. In both cases assume that NKE maintains the target leverage ratio you computed before. Comment.
17. Compare the results under the three methods.

18. What is your opinion about this company's capital structure? Would you choose to increase or reduce its leverage, and by how much? How would the value of your project change? Explain.

19. Surprisingly, NKE's Chairman Mark Parker persuades the board to abandon the new JUMP NIKE 2021 project with Louboutin, and instead proposes a totally different joint venture with singer Taylor Swift: developing a new NIKE-SWIFT Music Hotel chain in Asia, which would constitute a dramatic diversification strategy for NKE. To keep things simple, assume that the free cash flows estimated for this new project would be the same numbers that you estimated for the previous questions. How much would this project be worth now? Explain, stating all assumptions and showing all the steps in your computations.