Case Study 1

1.5.1 Refinancing Debt in Teleware Exercise[1]

Unit:	Study Unit 3 – Strategic Treasury Solutions
Case:	Case Study 1 – Treasury opportunities
Date:	1 September 2016
Summary:	Questions looking at aspects of the cost/benefit playoff of refinancing (or retaining) Teleware's debt.
Key words:	refinance, debt, credit default swap, bond, risk management, funding, swap

In this exercise we will consider the implications for Victor, arising from the existence of Teleware's own borrowings, and Teleware's strategic decision to locate external debt in its subsidiaries rather than centrally. Use the background case material for Teleware, your text books, readings and any other resources you consider applicable. You will need the Teleware Acquisition Calculations spreadsheet for Question 1.

Question 1

Prepare a brief Board note on the amounts needed to refinance the Orion and MHBV bond issues at market value, if a decision is taken to do so.

Student Notes

- Base your response on the Teleware Acquisition Calculations spreadsheet and the Teleware Inc. Background Information document. Do NOT attempt a valuation from first principles.
- Present as a note to your Board in an appropriate house style.
- Schedule out the elements of each bond's valuation, starting at the par value and ending with the post-acquisition refinancing value (make sure these cross-check to the spreadsheet).
- Explain what gives rise to these valuation differences in layman's terms.
- Briefly consider the uncertainties around the valuation and means to mitigate.

Question 2

Teleware's policy on location of debt seems to be rather different from Victor's centralised approach, with debt being issued either in the operating unit itself or in its immediate holding company (or both).

a) Review Teleware's policies (summarised below) to identify and assess the risks inherent in Teleware's debt location.

[1] Post your responses to the various questions and discuss your thoughts and responses in the Case study 1 forum in light of the answers posted by fellow group members and the model answer released by the tutors. You are expected to post during the Case study 1 timeline – see course site U3/Case 1 for dates.

b) Why might Teleware have structured Mulberry's and Orion's debt in the way it has? What are the implications post acquisition for Victor?

Summary of Teleware's Debt	**Characteristics**
• MHBV $ Public Bond Senior Obligation	USD capital markets debt issued by Dutch intermediate holding company; senior obligation of issuer.
• Mulberry $ Bank debt senior obligation	USD bank debt borrowed locally by operating company; senior obligation of borrower.
• Orion EUR Bond Senior Obligation	EUR capital markets debt issued by local operating company; senior obligation of issuer.
• Orion EUR Bank loan Senior Obligation	EUR bank debt borrowed by local operating company; senior obligation of issuer.
• Orion EUR / CZK swap	Fixed rate EUR capital markets debt swapped into fixed rate CZK debt.
• No recourse to Teleware Inc	Each obligation is effectively ring-fenced to the issuer/borrower with no recourse (or support) from other group companies.

Student Notes

- Using the risk management framework again, use the characteristics of Teleware's debt to derive Teleware's policies regarding its debt funding; hence derive the risks that Teleware seems to be managing. Then apply these risks back to Victor on a bottom-up basis and assess their importance for Victor.
- Consider the following factors: country risk, FX risk, interest rate risk, control, recourse and tax. Note, however, that neither this exercise, nor the exam, is meant to be a test of tax issues around the world and only basic principles.
- To assess the importance of each risk, consider the probability of it occurring (high/medium/low) and its possible impact on Victor (high/medium/low). Enter your findings in a table as shown in the example below:

Teleware Policy	**Risk addressed in Teleware**	**Probability of risk happening**	**Impact of risk for Victor**
MHBV $ Public Bond Senior Obligation	Mismatch between currency of debt and currency of operations.	Low	Low
	Low tax deduction for Romanian debt.	High	High

- You are now in a position to comment on the risks that seem most important to Teleware, and hence why it has structured its funding in the way it has.
- And you can build on this understanding by assessing which of these risks are of importance to Victor, and hence which features of the funding structure should be retained (if possible) and which can be discarded.
- External factors not addressed above may also influence Victor's course of action. Briefly consider the implications for Victor of there being holders of credit default swaps on Mulberry or Orion debt.