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EMBA Management Revised: 4/6/99

To All Groups: The following comments are in addition to the comments that I made earlier located in the file (emba_ind.pdf).

Sprint PCS

Major Comments:

- Growth in Earnings Per Share: On page 5, your group discusses growth in terms of revenues. On page 4, you also note that operating cash flow margins may narrow to 20% to 30% from the golden days of 30% to 40%. This suggests that since both revenues and expenses are growing which expenses growing at a faster rate, you also need to discuss *expected* growth rates in earnings per share for your company and its competitors. THAT is what business is interested in. Please provide a table. Bloomberg reports expected EPS over the next five years. Also, in the annual reports, there is a section called "President's message to shareholders" which frequently gives management's assessment of future growth. Link this to the DuPont growth model that I've posted on the website.

- R&D as a percent of Sales: Please provide a table showing R&D expenses of Sprint vs. each of its Major Competitors that you list in your paper. Please calculate R&D expenses as a percent of sales and calculate this ratio for the last 3-5 years. Also provide some discussion/analysis. I need to get a sense of Sprint's spending on R&D relative to their major competitors since this is one measure of their growth potential.

- Cost of capital: On page 23, your group notes that Sprint has one of the lowest costs of capital of any publicly traded wireless carriers because it borrows from its parent at "two notches below investment grade". However, the number given, 8%, represents only the cost of debt. The cost of capital is a weighted average of debt AND equity. It is not clear, therefore whether this is the case. What needs to be done is to calculate the cost of capital for your firm as well as your competitors. Use my link to the **Bridge** website (see my Bloomberg handout) to figure out the cost of debt. Use bloomberg or **WSRN** to obtain the beta and figure out the cost of equity. Use market value weights in calculating the cost of capital.

- Strategy for financing growth: How is Sprint PCS financing growth? If you take your Statement of Cash Flows in the annual report (for several years) and reconfigure it, you can see to what extent growth is being financed by internal sources of funds, asset disposals, working capital, debt financing and equity financing.

- Free cash flows: On page 25, the Free Cash Flow reported appears to be Free Cash Flow to the firm rather than Free Cash Flow to Equity (FCFE) since I assume that Operating cash flow = EBIT. Am I right? If the answer is yes, please calculate FCFE as well since this is what you'll use to value Sprint PCS's equity.

Minor Comments:

- Please proofread your paper

Host Marriott: Lodging

Major Comments:

- Is Organizational Structure Suitable for Growth: Is the organizational structure e.g. REIT viable for the short run. In order to grow, several hotel/lodging REITs have taken very different organizational forms in order to grow. Starwood, for example, has decided to de-REIT and become a regular C-corporation. Your firm, in contrast, has decided to move from a C-corporation to a REIT. The major question is to what extent will this hinder growth in the long term. It works fine as a short term tax saving strategy but there are long term growth consequences that need to be addressed e.g. REITs are restricted to only certain activities. Please visit www.nareit.org for REIT restrictions. One reason that I broach this subject is that your group points out that Host Marriott may substitute retirement and assisted living properties for hotels.

- Comparison of Competitors: I would like to see more quantitative analysis done on Host Marriott versus its Key Competition. More specifically, some of the key ratios (such as debt to total capital ratio… see your reference on page 24) together with the growth in revenue and growth in "earnings" (FFO and FAD). Ratios and expected growth in FFO and FAD can be found on Bloomberg. Denote which of your competitors are REITs and which are operating companies. Also, your group needs to do a 5 year forecast of cash flows. Your group has done a qualitative analysis with the graph shown on page 14.

- Growth in FFO and FAD per Share: On page 7, your group discusses strategies to maximize RevPAR performance. This is akin to maximizing revenues rather than maximizing FFO or FAD. Maximization should focus first on FFO or FAD which you do note on page 22. This is because the deal-making orientation will quickly shift to an operations orientation as we move through the property market cycle.

Minor Comments:

- Please proofread your paper
- Please cite your sources of information using proper citation methods.

Amazon.com: Internet

Major Comments:

- Other Salient Ratios: For your type of company, the advertising expense ÷ sales ratio is one of the more important ratios in retailing. You need to analyze this not only on a cross-section basis e.g. across all firms at one point in time but also on a time-series basis e.g. across time. (to the extent possible)

- Can Amazon.com Maintain Cost Controls: One of the nice things about Amazon.com is that it doesn't warehouse its own inventory for the most part. How will Barnes and Noble's purchase of its major distributor impact on Amazon's bottom line? You need to do a little more research in this area.

- No Discussion of the Impact of Online Partners: For some companies such as Barnesandnoble.com, it uses an affiliates program to increase Web exposure. According to Reuters (April 5), as of April 1, Barnesandnoble.com increased its affiliates to 100,000 from 5,250 a year earlier. In fact, its affiliate program is growing by more than 2,000 members per week. Affiliates range from corporations to authors, publishers and personal home pages. Barnesandnoble.com affiliates sell books, magazines, and other products on their sites by linking to the online bookseller. Affiliates earn a 5 to 7 percent commission on each book, gift certificate, magazine subscription, software, music, or video sold through the program; there is no charge for participation. What impact, if any, does this have on Amazon.com?

- Users to Online Site: I would like a sense of the number of users who use each competitor's online shopping site and the average sales per customer. I understand from Reuters news articles, for example, that Barnesandnoble.com has around 1.5 million unique users while Amazon.com counts around 6.2 million for its online network. The barnesandnoble.com sales are given in Barnes and Noble's 10K for 1997. Going forward, what you really want is not only the growth rate in total sales but also, I suspect that a more meaningful statistic is growth rate in average sales per customer.

- Financing Growth: It appears that whatever Amazon.com does, it is for the long term, not for short-term profits. Recently, Amazon.com issued a $1.25 billion convertible bond offering. This offering including reasons for this offering and implications for equity holders (dilutive effects), needs to be incorporated into your discussion of strategy. The prospectus for this offering will give you a lot of insights into the company from a financial perspective. The question for the long term is how is growth going to be financed? If their bonds aren't effectively convertible, this would limit Amazon.com's ability to use this deferred equity financing technique in the future to obtain "cheap" debt.

- Facing the Future: 1) Are there any surveys of price competition on-line between various e-commerce vendors? A casual comparison of the same book on barnesandnoble.com versus Amazon.com reveals that barnesandnoble.com is cheaper. If this in fact holds for the majority of the titles, what does this portend for future sales growth? Although Amazon.com has momentum by being the first kid on the block, the other kids appear to be gaining ground given the ease of entry. 2) Given the tenor of your report and also the convertible bond offering prospectus, it appears that Amazon.com plans to grow via acquisitions and/or investments in other companies. I would like for your group to report the growth rate and margins for the types of businesses that Amazon.com is investing in such as drugstore.com to see whether these merger strategies make sense. Aswath Damodaran's website has some excellent material on mergers and acquisitions that you should look at.

Amgen: Biotech

Major Comments:

- Capital Structure: The debt÷equity ratios reported appear to be too high; is it based on book value or market value? If it is the former, please calculate leverage based on market value. Also, what's the capital structure of Amgen? The capital structure based on *market values* of its competitors? How is Amgen financing its growth? Also, on page 24, what do you mean by "pursue a policy of optimal capital structure"?

Minor Comments: I realize that some of the point below are in your in-class power point presentation but they also need to be incorporated into your paper.

- Tables: In addition to reporting statistics such as R&D as a percentage of sales for each firm, please provide a table(s) showing all firms with the relevant statistics to facilitate easier readability.

- Growth and Patents: One of the key drivers of growth is when patents come on-line and when patents go off-line since these patents represent a monopoly if only for a moment in time. They help to define the period of supernormal growth for a firm. As such, you need to provide a time line of various drugs starting from Phase I and ending with when patents go off-line so that the reader gets a better sense of revenue and earnings growth. Also, if you can obtain statistics for market potential of these drugs, this would enhance our understanding of growth prospects.

- Please proofread your paper

McDonalds: Fast Food

Major Comments:

- Cash Flow Forecasts: Your group needs to do a 5 year cash flow. On the last page of your project, you have some of the necessary ingredients to project free cash flow *to equity*.

- Where Does McDonald's Go From Here?: Look at the Statement of Cash Flows over time to obtain an idea of how they have financed their growth thus far. What are the implications of the fact that cash generated from operations totaled $2.8 billion, compared with capital expenditures of $1.9 billion? That McDonald's is repurchasing their stock?

Minor Comments:

- Please proofread your paper