Indian Institute of Management Kozhikode

Case Study

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Project Chariot – Hyperlinked Live Case (HLC)

Deepak Dhayanithy[1]

[1]Associate Professor, Strategic Management at the Indian Institute of Management Kozhikode, Kozhikode, India. IIMK Campus P.O., Kozhikode, Kerala 673570, India; Email: deepak@iimk.ac.in; Phone Number (+91) 495- 2809433

HLC *adapted from HBS case by Prof. Lynn Sharp Paine & Charles A Nicholas III, 2006 – Deepak Dhayanithy, Indian Institute of Management (IIMK)*

<u>Exhibit 1:</u> Hyperlinked Live Case (HLC) – projection slide

Project Chariot (HHLC *adapted from HBS case by Prof. Lynn Sharp Paine & Charles A Nicholas III, 2006 – Deepak Dhayanithy*)

- Stephen Bollenbach had built his reputation in the 1980s through a serious of financial engineering initiatives involving corporate and capital restructuring. His ingenuity had helped save many businesses including Donald Trump's. In 1992, as CFO of Marriott Corporation (MC), his team has made a compelling case for spinning out two entities – a) Host Marriott Corporation and b) Marriott International Incorporated (paid for via a stock dividend to MC shareholders). Host Marriott Corporation (HMC) would hold most of the assets and liabilities, and represented an option on future rises in hotel real estate valuations. Marriott International Incorporated (MII) was asset light and profitable. As in earlier restructuring exercises, such spinning out created value for shareholders by allowing the equity markets to value the cash rich, asset light entity (MII) 'pureplay' without any encumbrance from the debt heavy (HMC). However, when Bollenbach announced Project Chariot, in 1992, it was not met with universal support. MC bond holders were particularly unhappy and made themselves quite clear. Marriott managers, leadership and HR committee of the board were quite enthused by the spin out that would create a number of career growth opportunities. MH board perceived his initiative as driving shareholder value as well as employee morale. **However, in the face of the unexpected criticism, they had to reconsider.**

<u>Exhibit 2:</u> Marriott Corporation (MC) – financial summary

Marriott Corporation

	MC
EBIT	419
Interest	246
EBT	173
Tax (45%)	77.85
Net Income	95.15
EPS (95 million shares)	1.001579
Share price	16
PE ratio	16X
Business risk	Moderate
Financial risk	Moderate/ High
Total risk	Moderate/ High
Growth potential	Low
Times Interest earned	1.7
Bond rating	Baa3

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Exhibit 3: Marriott International Incorporated (MII)

Marriott International Incorporated (MII)

	MII
EBIT	250
Interest	22
EBT	228
Tax (45%)	102.6
Net Income	125.4
EPS (95 million shares)	1.32
Share price	?
PE ratio	?
Business risk	Low
Financial risk	Low
Total risk	Low
Growth potential	High
Times Interest earned	11.4
Bond rating	A

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Exhibit 4: Host Marriott Corporation (HMC)

Host Marriott Corporation (HMC)

	HMC
EBIT	169
Interest	224
EBT	-55
Tax (45%)	-24.75
Net Income	-30.25
EPS (95 million shares)	-0.31842
Share price	2 - 3
PE ratio	N/ A
Business risk	High
Financial risk	High
Total risk	High
Growth potential	Low
Times Interest earned	0.75
Bond rating	CCC/B

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<u>Exhibit 5:</u> Shareholders' View

Financial effects of Project Chariot (Exhibit 1)				
	MC	MII	HMC	
EBIT	419	250	169	
Interest	246	22	224	
EBT	173	228	-55	
Tax (45%)	77.85	102.6	-24.75	
Net Income	95.15	125.4	-30.25	
EPS (95 million shares)	1.001579	1.32	-0.31842	
Share price	16	?	2 - 3	why is the share price not $0?
PE ratio	16X	?	N/ A	
Business risk	Moderate	Low	High	
Financial risk	Moderate/	Low	High	
Total risk	Moderate/	Low	High	
Growth potential	Low	High	Low	
Times Interest earned	1.7	11.4	0.75	
Bond rating	Baa3	A	CCC/B	
Assuming same multiple (16x), given appreciation in Net Income, share price of MII would be				
0.317919075	21.08671	483.237	$M	
But 'Pure play' is likely to get a better valuation…lets say 20x				
26.3583815	984.0462	$M		
But market is not doing that well…to maintain a conservative stance…				
$575M				
95 million shares outstanding				

Value for shareholders

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<u>Exhibit 6:</u> Bollenbach's announcement

Bollenbach announcement of Project Chariot

- It would add shareholder value, free as MII would be from diversification discounts
- This enhanced valuation would aid MII to seek growth opportunities in related businesses as well as free up it ability to acquire businesses as such opportunities may open up
- The growth opportunities as well as the spin out into two companies would open up a number interesting growth opportunities for Marriott managers

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<u>Exhibit 7:</u> Bond holders' View

MC Bond holders

	Current date	Jan-92			
Type	Rate	1990 ($M)	1991 (SM)	Maturity	YTM
Secured notes	8.60%	175	527	2010	19
Unsecured senior notes	9.30%	1198	1323	2001	10
Unsecured debentures	9.40%	250	250	2007	16
Revolving loans	5.30%	1780	676	1995	4
Other notes	7.80%	209	193	2015	24
WA interest rate		7.22%	8.18%		
WA duration (years)		8.704595792	11.64668238		

Table B: Prices of 10yr and 20yr bonds		
Market Interest Rate	10 Years	20 Years
7%	114	124
8%	109	115
9%	104	107
10%	100	100
11%	96	94
12%	92	88
13%	88	82
14%	85	78
15%	82	73

A1 - Comparison of Bond ratings			
	Moody's	S & P	Yields
High Quality	Aaa	AAA	7.80%
	Aa	AA	8.07%
Investment Grade	A	A	8.26%
	Baa	BBB	8.72%
Junk bonds substandard	Ba	BB	9.04%
	B	B	10.81%
Speculative	Caa	CCC	
	C	D	

A2 - Bond ratings of industrial corporations (1987 - '89 medians)							
	AAA	AA	A	BBB	BB	B	CCC
Times interest earned	12	9.1	5.5	3.6	2.3	1	0.8
Long-term debt as % of capital	12	19	30	38	51	66	62

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Project Chariot, Hyperlinked Live Case (HLC) teaching note are in page 1, page 2 here. PowerPoint slides of the HLC are available on request from the author of this note, Deepak Dhayanithy. Please email deepak@iimk.ac.in