In bidding for the privatization of Telco Sur (to be renamed Telefónica de Argentina), Citibank won by offering USD114 m cash and USD 2.72 b Argentine Debt Instruments (ADIs) for 60% ownership of the company. The bank subsequently created Cointel as a holding company for Telefónica and now plans to capitalize Cointel by offering Cointel stock in exchange for the ADI’s of other banks. Put differently, Citibank is raising USD 2.72 b in ADI’s that it promised the Argentine government by offering stock in the new company in exchange. Citibank will also trade some of its own ADI’s for 20% of Cointel, two other institutions will trade their ADI’s for 18% of Cointel, and the remaining 62% of Cointel will be offered to other financial institutions. The other institutions will have the option of swapping their ADI’s for common stock or preferred stock (see case exhibits 4a and 4b).

Ms. Jane Gorham of First International Bank has received the offering memorandum, and must decide if FIB should participate by swapping some of its own USD 1 b in ADI’s for Cointel stock. Your assignment is to act as Ms. Gorham, and to come up with a recommendation which will be passed on to the Board of Directors. As such you have to recommend that FIB either swap its ADI’s for preferred shares, swap them for common shares, or not participate in the transaction at all. To obtain a clear understanding of FIB’s decision problem please discuss the following questions and issues in your group:

1. What issues do you think are relevant for analysis of a swap of sovereign Argentine Debt Instruments (ADI’s) for securities of a "to be privatized" Argentine company?

2. In light of the case facts, would you consider such a swap? What factors should feature in your analysis? How would you evaluate the incidence of the other partners in the Cointel venture on the likelihood of a successful restructuring of Telefónica?

3. Carry out a full-fledged valuation exercise on the basis of the information provided in the case. In particular, examine three scenarios for the Argentine economy: economic collapse, muddling-through, and miraculous recovery. What incidence, if any, would each of the scenarios have on Telefónica?

   (a) Which one do you consider most likely? How would you expect each scenario to affect the numbers?

   (b) What would your judgement be concerning the future profitability and market value of Telefónica?

   (c) How does the valuation affect your decision regarding the ADI for Cointel equity swap?
4. Given your valuation of Telefónica and, hence, Cointel determine the value of the various instruments proposed (either by scenario or what you consider the most likely outcome).

(a) Would you swap your ADI’s for the preferred stock offered in this case? Would you negotiate to swap ADI’s for common stock?
(b) Which swap opportunity looks most promising?

5. Using modern information sources, find out what happened, especially to Telefónica’s stock price. With hindsight, what economic scenario came about? How was Telefónica affected? How did the ADIs perform subsequently? Given your swap decision, how did your firm (FIB) do?

For your calculations, assume that Cointel issues USD 306m of Series A Preferred Stock and USD 163m of Series B Preferred Stock. The case notes that 6-month LIBOR was 8-3/16% at the time of decision. Assume that the receipt of 1-year LIBOR could be swapped into a fixed rate of 10.20% at the time of the case. Also, you need to be careful with the treatment of accrued interest which is effectively capitalized.

Please note the following ground rules for the case write-ups:

- the maximal group size is 5; every group member gets the same grade
- at most 2 pages of analysis and 6 pages of technical appendices;
- show your work, staple the pages together and be professional;
- late write-ups will not be accepted for any reason; they are due at the beginning of class for which the discussion is scheduled;
- graded write-ups will be available a week later.