CHAPTER 18

CORPORATE RESTRUCTURING

1. (B) initial evaluation.

Explanation

The first step in evaluation of an announced corporate transaction is initial evaluation. Within this step, analysts seek to answer four questions: what, why, when, and is it material.

(Module 18.1, LOS 18.b)

Related Material

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2. (A) The approach does not assume that the market's valuation of the comparable companies is fair.

Explanation

One disadvantage of comparable company analysis is that it implicitly assumes that the market's valuation of the comparable companies is fair.

(Module 18.2, LOS 18.c)

Related Material

SchweserNotes - Book 2

3. (C) Estimates of value are derived directly from recent prices for actual deals completed in the marketplace.

Explanation

Comparable transaction analysis uses market prices of actual transactions; this is an advantage, not a disadvantage (compared to DCF analysis, which is based on several estimated inputs).

(Module 18.2, LOS 18.c)

Related Material

SchweserNotes - Book 2

4. (A) Divestment.

Explanation

Motivations for divestment actions include liquidity needs, fetching an attractive price, and compliance with regulatory requirements.

(Module 18.1, LOS 18.a)

Related Material

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Simon Gracier follows Company P. On December 31, 20x2, Company P made an offer to acquire 100% of Company S's outstanding shares for a purchase price of €175 million—€122 million is financed by senior unsecured debentures with a yield of 6.5%, and the remaining is in stock based on the €52 per share current market price of Company P. Pre-acquisition financial statements are presented in Financial Statements (€ thousands) for the Year Ended December 31, 20X2.

Financial Statements (€ thousands) for the Year Ended December 31, 20X2

Balance Sheet

	Company P	Company S
Working capital	€25,098	€3,692
Fixed assets	€1,807,088	€265,800
Total assets	**€1,832,186**	**€269,492**
Debt	€24,460	€9,262
Equity	€1,807,726	€260,230
	€1,832,186	**€269,492**

Income Statement

	Company P	Company S
Sales	€225,886	€33,225
COGS	€166,026	€19,603
Gross Profit	€59,860	€13,622
SG & A	€24,845	€3,987
Depreciation	€8,422	€2,269
Interest expense	€1,223	€741
Income from continuing operations	€25,350	€6,625

Gracier is concerned about the impact of the acquisition on Company P's WACC.

Peer Comparable Company Analysis for Company S (€ '000s) shows data about Company S's peers.

Peer Comparable Company Analysis for Company S (€ '000s)

Company	Enterprise Value	Revenues	EV/Rev
Alpha	1,312	298	4.40
Beta	569	115	4.95
Gamma	1,994	391	5.10
Zeta	812	167	4.86

5. (A) increase.

Explanation

Company P's EBITDA = gross profit — SG&A = 35,015

Company S's EBITDA = 9,635

Consolidated EBITDA = 35,015 + 9,635 = 44,650

Company P's debt (after new issue) = 24,460 + 122,000 = 146,460

Consolidated debt = 146,640 + 9,262 = 155,722

Debt/EBITDA (Company P) = 24,460 / 35,015 = 0.70

Debt/EBITDA (consolidated) = 155,722 / 44,650 = 3.49.

(Module 18.2, LOS 18.d)

Related Material

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6. (C) Several factors influence the cost of debt: profitability, volatility of EBITDA, leverage, collateral, and so on.

Explanation

Several factors influence cost of debt: profitability (EBITDA to sales, or EBIT to sales), volatility of revenues or EBITDA, leverage (debt to EBITDA), collateral (asset specificity, liquidity, existence of an active market), and prevailing interest rates. Weights of debt and equity are calculated using market values, and include any financing raised or additional equity issued.

(Module 18.2, LOS 18.d)

Related Material

SchweserNotes - Book 2

7. (B) €151,153,000.

Explanation

Average EV/sales = (4.40 + 4.95 + 5.10 + 4.86) / 4 = 4.83

Company S's EV = 4.83 x 33,225,000 = 160,476,750

Company S's equity = EV — debt = 160,476,750 — 9,262,000 = 151,153,000.

(Module 18.3, LOS 18.e)

Related Material

SchweserNotes - Book 2

8. (B) **Both companies would report the investment using the equity method.**

Explanation

The accounting for a joint venture is similar to that of equity investments. The two partners in the joint venture will report their stake in the venture using the equity method, reporting their share of income from the venture in their respective income statements. Any capital raised by the two partners will be accounted for in their own financial statements.

(Module 18.3, LOS 18.e)

Related Material

SchweserNotes - Book 2

9. (A) **Both statements are correct.**

Explanation

Both statements are correct.

(Module 18.3, LOS 18.f)

Related Material

SchweserNotes - Book 2

10. (B) **Statement 1 only.**

Explanation

Statement 2 is incorrect. Moderate-to large-sized business units sought by several potential acquirers might be expected to fetch a high sale price; therefore, they are more likely to be sold than spun off.

(Module 18.1, LOS 18.a)

Related Material

SchweserNotes - Book 2

11. (C) **The divestment of an unrelated business for a company that had previously been diversifying into such businesses is immaterial.**

Explanation

The divestment of an unrelated business for a company that had previously been diversifying into such businesses is material because it may be an indication of a change in strategy, or that the strategy is not working.

(Module 18.1, LOS 18.b)

Related Material

SchweserNotes - Book 2

12. (B) **35%.**

Explanation

Deal price (DP) = \$65. Unaffected price (UP) = \$48.

Premium = (DP — UP) / UP = 17 / 65 = 35.4%.

(Module 18.2, LOS 18.c)

Related Material

SchweserNotes - Book 2

13. (A) **Statement 2 only.**

Explanation

Statement 1 is incorrect. Empirical studies suggest that corporate transactions taken during weaker economic times tend to create more value.

(Module 18.1, LOS 18.a)

Related Material

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