

# Notes

## 1 Restructuring: A General Overview

1. Defined as ROE ( $ROE = \text{Net Earnings}/\text{Equity}$ ).
2. For a more in-depth analysis of internal and external actions, see Francisco J. López Lubián (2010), 'Some Comments on Financial Restructuring', *Harvard Deusto Finanzas y Contabilidad*, December.

## 3 Operating Restructuring

1. See, for example, some classic book like Tom Peters (1999), *The Circle of Innovation*, Vintage Books).
2. See [www.cfo.com](http://www.cfo.com).
3. Assuming two years of remaining depreciation (€ 250,000 per year) and a discount rate of 10%, the PV of tax savings associated with the differential depreciation would be € 130,165, at a tax rate of 30%.

## 4 Financial Restructuring

1. Proposition I in Modigliani and Miller (1954) concludes that the value of the company is independent of its capital structure and therefore separates investment and financing decisions based upon no arbitrage arguments and the absence of transaction costs (including taxes).
2. Although absurd business practices do sometimes occur, this is not usually very common. This is consistent with Modigliani–Miller Proposition II which provides a linear relationship between the cost of the unlevered assets, financial leverage and cost of risky debt under the assumption of absence of leverage or bankruptcy costs.
3. It is well known that passengers of airlines in financial difficulties always wonder if the aircraft are being properly maintained. This kind of mistrust can have a significant impact on the revenues of the businesses affected.
4. This is the so-called 'pecking order theory' arising under conditions of information asymmetry.
5. Examples of indirect costs of bankruptcy are shorter supplier payment deadlines during times of financial crisis, the inability to meet service commitments to customers, a drop in revenues due to managers' time being devoted to internal issues, etc. Examples of direct costs include legal costs, payments the company has to make to consultants advising on the bankruptcy process, etc.
6. This is one of the main reasons why business projects with a high level of initial leverage, such as project finance, leveraged buyouts (LBOs) or management buyouts (MBOs), have been carried out. To the extent that the operating risk is relatively

low and remains constant, with proper management of the risks affecting free cash flow, the project allows a greater degree of financial risk and generates more economic value, as the costs of debt do not rocket.

7. There are different ways to estimate these bankruptcy costs. Some authors use the formula:

$$bc = \text{probability of bankruptcy} \times \text{cost of bankruptcy.}$$

The probability of bankruptcy can be approximated using a synthetic rating estimated for the company, based on historical data for the percentage of companies with a similar debt rating that went bankrupt over a given period of time. The cost of bankruptcy can also be estimated based on various studies published on the subject. As an indication, it is possible to talk of 5% of direct costs and up to 15% including indirect costs, according to various studies basing estimates on proxy variables. Appendix 4.1 includes a list of main bibliographical references in relation to the optimal capital structure.

8. In order to generate cash flow, it was essential to catalogue, value and sell off Cortefiel's real-estate assets as quickly as possible. Although the company's managers believed these assets to be worth around 300 million Euros, a recent independent valuation situated the value of this real estate at 150 million Euros. They expected to materialize the sale at the end of the first year.

## 5 Valuation in Distress

1. Total net assets are considered to be the sum of net current assets and net fixed assets. Net current assets are equivalent to the operating working capital, excluding short-term debt.
2. Also known as relative value or market value.
3. Also known as fundamental value.
4. In many cases it might be useful also to discount equity cash flows including in the cash flow calculations the details of all operating and financial restructuring measures. Cash flow to equity holders will show if the company is viable and profitable if and when the restructuring has been implemented.
5. Equivalent to the present value of a perpetuity for the last FCF, growing at 3.5%.
6. Average ROE of the restructured company is 13%.

## 6 Some Examples of Restructuring (I)

1. Fiscal year ending in April.
2. Fábricas Agrupadas de Muñecas de Onil, Sociedad Anónima (FAMOSA).
3. For more information on the company's business, see the website <http://www.famosa.es/>.
4. According to the initial business plan, in the event of breach of this condition in any given year, a reserve fund would be set aside equal to the amount of cash flow necessary. This fund would be created with additional capital from shareholders.
5. These theoretical returns are based on the assumption of no legal restriction. This means that all the positive FCF to shareholders will be freely distributed, in the

form of dividends or any other way to compensate the shareholders (e.g. shares buy back, issue of free new capital, etc.). In Spain there was a legal restriction regarding maintaining a capital reserve ratio that had to be considered. According to this legal restriction, the accumulated losses must not be more than two thirds of the capital over two years. If this happens, the shareholders' FCF may not be freely distributed and will be modified by possible capital infusions to ensure the ratio is maintained. For more information, see: <http://www.bde.es/webbde/es/estadis/infoest/a1901.pdf>.

## 7 Some Examples of Restructuring (II)

1. Figures in A\$ million.
2. See details in Appendix 7.1.
3. Similar to the PV of a perpetuation of the last FCF with no growth ( $g=0$ ).
4. <http://www.sabmiller.com>.
5. <http://www.businessweek.com/news/2011-03-29/sabmiller-s-mackay-predicts-further-beer-industry-consolidation.html>.
6. [http://www.brewersofeurope.org/docs/flipping\\_books/contribution\\_report\\_2011/index.html#/8/zoomed](http://www.brewersofeurope.org/docs/flipping_books/contribution_report_2011/index.html#/8/zoomed).
7. <http://ezinearticles.com/?Beer-Industry-Analysis&id=2977137>.
8. [http://www.sabmiller.com/files/presentations/2011/210911/210911\\_fosters.pdf](http://www.sabmiller.com/files/presentations/2011/210911/210911_fosters.pdf).
9. Note on the goodwill implied in the transaction (A\$ 9.9bn–A\$ 0.4bn = A\$ 9.5bn): Foster's equity was negatively affected in 2011 to the amount of almost A\$ 2.2bn due to the demerger of its wine business. In any case, the relevance of this goodwill relates to the capacity of Foster's business to generate enough cash flows to provide for a reasonable return for SABMiller's investment.

## 8 Life after Restructuring

1. Of course, in relative terms.
2. See Chapter 4.
3. Appendix 8.1 develops a detailed explanation of the expected future for the company, following the assumptions of the restructuring plan.
4. See Appendix 8.2 for details of the valuation.
5. Copeland, T., Koller, T. and Murrin, J. (2002) *Valuation*. John Wiley & Sons, Inc.
6. In fact, these paragraphs come from the Message of Pope Benedict XVI, called 'Fighting Poverty to Build Peace' and published for the celebration of the World Day of Peace (1 January 2009). I believe this is a very interesting document. And surprising (kind of...).

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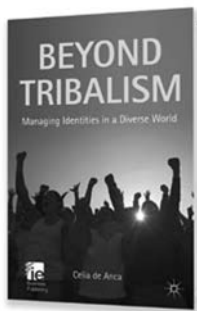
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