Other forms of restructuring

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Other forms of corporate restructuring

1. Leverage buy-out
2. Management buy-out
3. Management buy-in

M&A

4. Divestment
   - Equity carve-out
5. Spin-offs
   - Split-offs (the holding stays)
   - Split-up (The holding disappears)
6. Privatization
7. Buy-back
8. IPO - Initial Public Offer

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1. Leverage buy-out

- The acquisition of a company using high leve of debt
- Often, the acquired asset are used as collateral for the loans in addition to t assets of the acquiring company.

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2. Management buy-out

- The management team of a company purchases the shares of the company they are managing

the-centre-for-management-buy-out

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The MBO process

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3. Management buy-in

- A company is acquired by an outside manager or management team that replaces the existing management team:
  - The company is undervalued or
  - Has a poor management team

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Buy-outs in the United States

- Many cases (300 per year or more)
- High volume (US$ 40 thousand million)
- Many companies publicly traded
- Acess to a variety of funds
- Many dealmakers
- This is part of the "market for corporate control"

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Buy-outs in UK

- The start of the market in the 1970's
- Between 100 and 300 transactions per year
- Average transaction (£1,5 a 4 millions)
- Level of debt lower than in the USA

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Buy-outs in France

- Companies under control of “le patron”
- Law Delors (1984) created incentives for buying family businesses and divestiments in multinationals by employees *(Rachat d’Entreprise par ses Salaries)*
- Control <=50% requires a Dossier to the Minister of Finance. Law in 1987 eliminated the requirement of authorization
- Stock market not well developed
- Small buy-out (45% of them with sales < FF20 millions and less than 50 employees)

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World wide activity

- Nature and characteristics vary from country to country
- Function of industry, financial system entrepreneurship culture
- UK – begun buy-outs with bankruptcies and later development with group divestments
- France – has initiated with the need of family succession and use the tax benefits
- Germany - Buy-outs are more unusual as a result of the financial system
- Spain, Italy and Portugal – lack of entrepreneurial spirit and owner are not willing to sell

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Who are the target companies?

- Low business risk:
  - Low volatility of operational cash flow
  - Products in maturity /growth phase
  - Market niche
- To allow high financial risk after the acquisition

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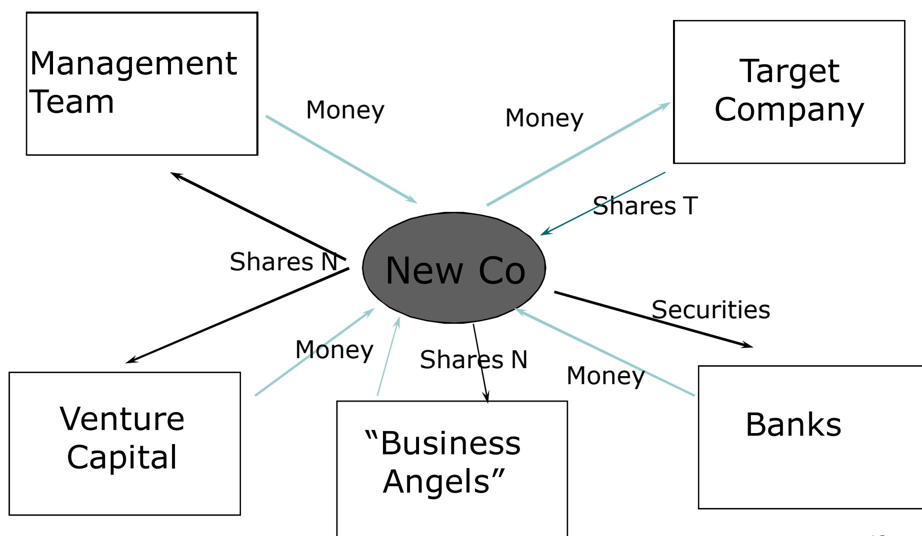
Actors of MBOs and MBIs



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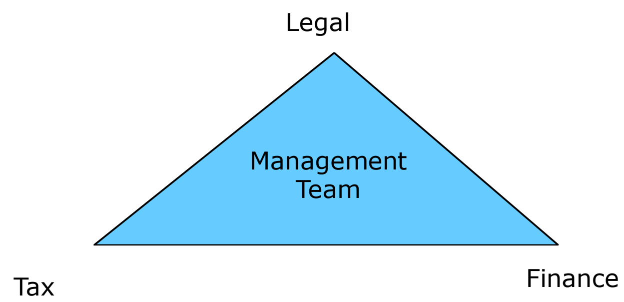
Major types of consultancy



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What to buy?

- Assets?
- Shares?

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Effects on the buyer

Acquisition of assets

- Depreciation based on the price of acquition
- Do not involve the acquisition of liabilities unless agreed
- Do not need to accept all personnel
- Need to register the assets
- Make sure no onus on the assets
- Costs: Registers and tax on real estate sale

Acquisition of shares

- Keep the same accounting policies
- Acquire the debt unless other agreement
- Keep all rights and obligations
- Change of money by the shares
- Requires legal audit, accounting audit and tax audit
- Costs: on the acquisition of shares or quotas

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Effects on the seller

Acquisition of assets

- May keep the rest of the assets
- Generates capital gains or capital losses
- Improves liquidity and financial structure

Acquisition of shares

- Elimina a sua participação
- Mais valias da participação isentas de imposto se detidas há mais de um ano
- Só assume os riscos que ficarem estabelecidos no contrato

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Financial Instruments

- Ordinary shares
  - High cost of capital
- Venture capital
  - Very high cost of capital
  - May not demand dividends. Is looking for capital gains
- Differed payments to the seller
- Loans
  - Low cost
  - Collaterals
- "Mezzanine finance"
  - Average risk and cost
  - Atractiness by its plasticity
- "Strip financing"

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Examples of mezzanine

- Loan (no collateral)
  - 12 years maturity
  - Convertible
  - Warrants
- Prefered shares
  - Participative in dividends
  - Right to vote in specific circumstances
  - Redeemable
- Characteristics:
  - Interest or dividend or both
  - Possibility to participate in the votes and in the dividends
  - Several option rights

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Financial approach to LMBOs

- Determine the maximum debt capacity using collateral, using the operational cash flows
- How much equity is available?
- The remainning is financed with “mezzanine”
  - What is the maximum level of equity to earn adequate return on equity?
  - What the highest amount of interest the operational cash flow can cover
- The company is able to cover service debt all the years?
- The price can be adjusted or difered?

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4. Divesture:

“breaking-up” the company is a value creation strategy?

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Why “breaking-up” ?

- Core business focus
- Market values better
- Generate money to reduce level of debt
- Afraid of being a target of a takeover bid
- Conflict of competition
- Low performance
- Pressure from authorities

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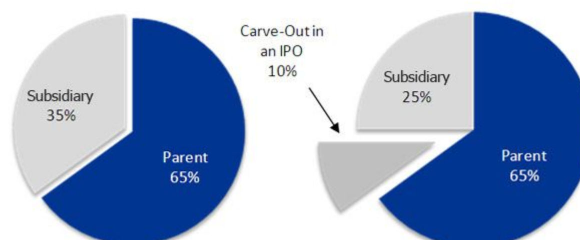
Equity carve-out

- Unlike divestures the parent retains control of the subsidiary in a carve-out transaction.
- Minority shareholders
- Provide na opportunity to generate cash to the parent
- Can be used as a prelude to a divestment



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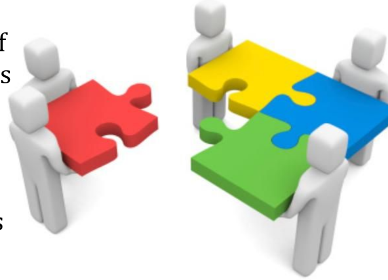
5. Spin-off

- The creation of a new company through the sale or distribution of new shares of an existing business or division of a parent company.
- A spinoff is a type of divestiture.
- Businesses wishing:
  - to streamline their operations often sell less productive or unrelated subsidiary businesses as spinoffs.
  - Create a partnership with other shareholders



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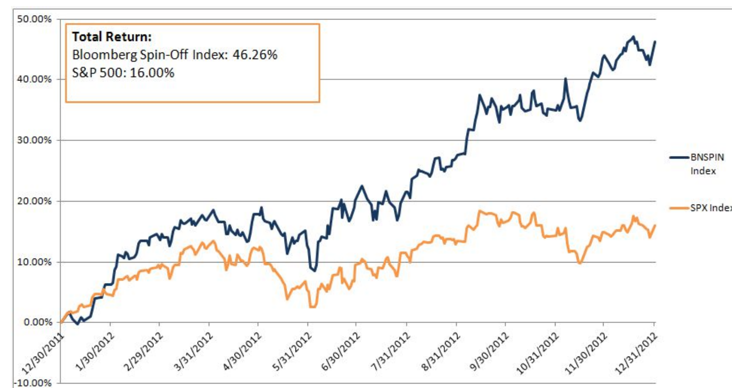
Spin-offs apparently create vale



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5.1 Split-off

- A business division, subsidiary or newly affiliated company is transferred to the shareholders of the parent company in exchange for their stock
- Split-offs often occur when the parent company wishes to draw a greater distinction between itself and the split-off business.

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5.2 Split-up

- A company splits into two or more separately companies. Shareholder of the original company exchange their shares with share of the new companies.
- This is an effective way to break up a company into several independent companies.
- After a split-up, the original company ceases to exist

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Why do spin-off occur?

- Information
  - Too much complexity hids the value of the corporation
  - Financial analysts tend to be speciallized per industry
- Efficiency
  - Difficult to manage companies that are too complex
- Incentives to managers
  - Better managed if there are smaller and homogeneous company
- Legal and tax system
  - Use the legal and tax system of the country

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(Cont.)

- Transfer of value from creditors
  - Creditors have lower coverage
- Environment change
  - Diferent opportunuties to the holding and the subsidiary
- Protection to shareholders
  - Spin-off generat options (option theory)
- Market if more complete
  - New opportunities to buy shares
  - Enlarges the number of shares in the market
- More focused M&A
  - Investors may be more interestred in companies with a clear

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6. Privatization
I has two meanings…

- The process of transferring ownership of a business from the public sector to the private sector
- The process of buying all outstanding shares of a publicly traded company by an entity making the company privately owned

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7. Buy-back shares or Shares repurchase

- The company buys back its own shares from the marketplace
- It is an indication that the company's management thinks the shares are undervalued.
- Shares can be bought directly from the market or the company can offer its shareholder the option to tender their shares at a fixed price.

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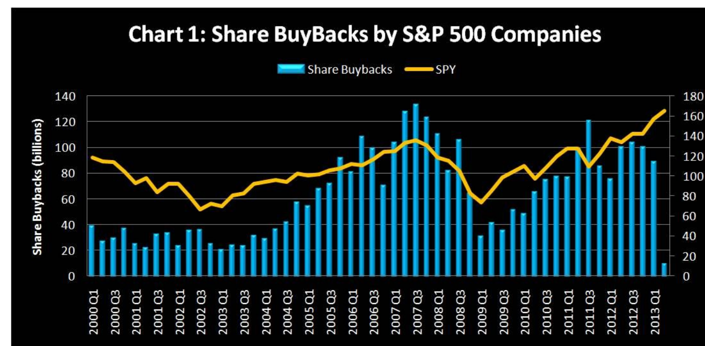
Market timing in share repurshase?

- Although buybacks are viewed as positive for stock prices, a lot of them happen at exactly the wrong timing and destroy value for shareholders.



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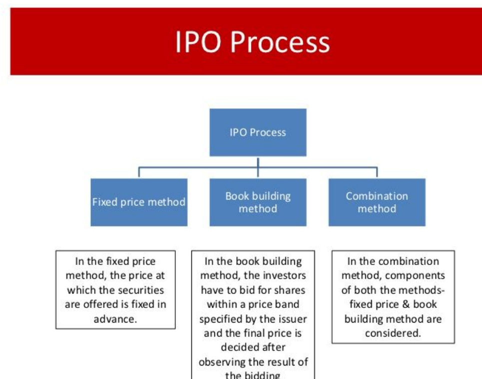
8. IPO Initial public offer

- If the company has never issued equity to the public, the first sale of stock to the public is known as an IPO.



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Case studies

- Each group identify a restructuring case in the world
- Write a short description of the restruturing and explain why it make sense
- Your work will be present in the class +/- 10 minutes

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Bibliography

DePamphilis (2014), Chapters 13, 14 and 16

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