FNCE20005 CORPORATE FINANCIAL DECISION MAKING

TUTORIAL 10: Corporate Takeovers & Restructuring - Part 4 & Real Options

SECTION A

Question 1
Briefly describe each of these methods of corporate restructuring:

Divestitures; Spin-offs; Equity carve-outs; LBO

Answer 1
(a) DIVESTITURES: The sale of assets (segment of the business) to a third party – often via a "trade sale" to another company that is already involved in that industry. They are "voluntary" decisions by management and the expectation is that it is a positive net present value strategy.

(b) SPIN-OFFS: Another company is established as a separate listed entity. In aa full spin-off all of the shares owned by the parent are distributed pro-rata to their shareholders. In a partial spin-off, shares are distributed to parent shareholders but some shares are also retained by the parent company in its own right. For companies with multiple lines of business it will mitigate cross-subsidization concerns.

(c) EQUITY CARVE-OUTS: IPO of part of a parent company assets and operations. A minority stake is sold in the new company to the public with the funds received being retained by the parent company.

(d) LBO: When a small group of investors, typically a private equity firm led partnership, purchase a company using a high proportion of debt and delist the company and run it via private ownership ("going private")

Question 2

Explain how the notion of real options may explain why we observe that exporters are slow to cease supplying overseas markets following adverse changes in exchange rates.

Answer 2:
By removing yourself from a market, you are giving up the option to continue operations if economic circumstances change. It could have meant the irreversible loss of tangible and intangible assets that you used to build your operation in that export market if you decide to withdraw too early from that export market.