**MLM**

**Masters in Law and Management**

Corporate Restructuring

Final Exam

21/11/2019

Suggestion: Max of 10 lines per answer

Company XYZ has been in operation for more than 20 years. It generates annual profits of €1 million, out of an Ebitda of €4 million. Its assets amount to €8 million (at book value) and the total outstanding debt is €€10 million. A financial information site reports that comparable firms are trading between 8 to 10 times ebitda.

1. (20%) The firm has more debt than assets (at book values). Should this be considered a problem in the context of the information above?
2. (10%) Provide an estimate of the market value of this firm's equity.
3. (20%) If a potential buyer, negotiating the acquisition of the XYZ, is somewhat worried about a possible decline of the company's ebitda in the near future, how can she make an offer for XYZ that could accommodate such potential deviations in future performance? Provide a numerical example.
4. (20%) What is the **main** purpose of the due diligence in company's mergers and acquisitions? What key areas should buyers look at (just present a maximum of 5)
5. (30%) Two years later, the company's ebitda fell to €2 million, profits are negative and total outstanding debt is €20 million, of which 6 million is secured by the company's assets and €10 million are subordinated loans. How could this company recover through a bankruptcy reorganization?

**Resolution Topics**

1. Indeed, the firm has a negative book value of equity. However, the firm seems to be profitable, generating and Ebitda of €4 million, meaning that it seems to generate substantial positive cash-flow, which should be sufficient to repay debt as convenient. As we'll see in the next answer, while the book value of equity is negative its true market value is clearly positive, having no reason to question this firm's solvency.
2. If comparable firms trade at an average 9× ebitda, then: EV = 9×4 = €36 million and Market Value of Equity = EV – Net Debt = 36 – 10 = €26 million.
3. In this case, if the buyer is worried about a potential decline in future ebitda, she may make an initial partial payment followed by future contingent payments usually designated as earnouts. In the above example, a buyer valuing the company's equity as €26 million, could make an initial payment of €17 million, followed by 3 annual payments of €3 million, each of them contingent upon that year's ebitda exceeding €4 million.
4. The main purposes of due diligence are to identify any material aspects that may affect the value of the firm (i.e., future cash-flows) as well as identify sources of risk. So, anything thay may influence future cashflows and / or undisclosed liabilities and /or contingent future claims must be examined. Besides analising the firm's financial and tax situation, we must examine conduct an analysis of the firm's strategic and market situation (products, clients, regulation competition, patents, brands, imtelectual property, etc), operations (including personnel, facilities, etc) and any other issue that may impact future cash flows.
5. In this new context the value of the firm has declined, possibly to 8× ebitda, in which case the firm will be worth 8× 2 = €16 million, clearly below its €20 million in debt. A bankruptcy reorganization could help by allowing a reduction of the firm's debt burden. In this case it seems that if we write-off the existing equity and cancel the subordinated debt (the other most senior debtholders amount to €10 million and are unlikely to accept any losses due to the fact the company is worth €16 million) the new market value of equity would become MVE = €16 – 10 = €6 million, leaving the company in a solvent state. Most likely, the subordinated debtholders would only agree to lose their creditor status if their loans / bonds are converted into the new equity of this firm (thus becoming *de facto* the new owners).