JAIPURIA INSTITUTE OF MANAGEMENT, NOIDA

PGDM / PGDM (M) / PGDM (SM)

5th TRIMESTER (Batch 2020-22)

End Term Examinations, January 2022.

SET - A

Course Name	Corporate Restructuring	Course Code	FIN502
Max. Time	2 Hrs	Max. Marks	40

Instructions: Attempt All Questions. Overall Permissible Plag. is 10%, **Penalty Clause: 11-20% - Minus 5 Marks, > 20% - Reappear**.

Q-1 (10 Marks) (CLO-1)

Although not exactly a household name, Berkshire Hathaway ("Berkshire") has long been a high flier on Wall Street. The firm's share price has outperformed the total return on the Standard and Poor's 500 stock index in 32 of the 36 years that Warren Buffet has managed the firm. Berkshire Hathaway's share price rose from $12 per share to $71,000 at the end of 2000, an annual rate of growth of 27%. With revenue in excess of $30 billion, Berkshire is among the top 50 of the Fortune 500 companies.

What makes the company unusual is that it is one of the few highly diversified companies to outperform consistently the S&P 500 over many years. As a conglomerate, Berkshire acquires or makes investments in a broad cross-section of companies. It owns operations in such diverse areas as insurance, furniture, flight services, vacuum cleaners, retailing, carpet manufacturing, paint, insulation and roofing products, newspapers, candy, shoes, steel warehousing, uniforms, and an electric utility. The firm also has "passive" investments in such major companies as Coca-Cola, American Express, Gillette, and the *Washington Post.*

Warren Buffet's investing philosophy is relatively simple. It consists of buying businesses that generate an attractive sustainable growth in earnings and leaving them alone. He is a long-term investor. Synergy among his holdings never seems to play an important role. He has shown a propensity to invest in relatively mundane businesses that have a preeminent position in their markets; he has assiduously avoided businesses he felt that he did not understand such as those in high technology industries. He also has shown a tendency to acquire businesses that were "out of favor" on Wall Street.

He has built a cash-generating machine, principally through his insurance operations that produce "float" (i.e., premium revenues that insurers invest in advance of paying claims). In 2000, Berkshire acquired eight firms. Usually flush with cash, Buffet has developed a reputation for being nimble. This most recently was demonstrated in his acquisition of Johns Manville in late 2000. Manville generated $2 billion in revenue from insulation and roofing products and more than $200 million in after-tax profits. Manville's controlling stockholder was a trust that had been set up to assume the firm's asbestos liabilities when Manville had emerged from bankruptcy in the late 1980s. After a buyout group that had offered to buy the company for $2.8 billion backed out of the transaction on December 8, 2000, Berkshire contacted the trust and acquired Manville for $2.2 billion in cash. By December 20, Manville and Berkshire reached an agreement.

Required:

a. To what do you attribute Warren Buffet's long-term success? (3 Marks)

b. In what ways might Warren Buffet use "financial synergy" to grow Berkshire Hathaway? Explain your answer. (3 Marks)

c. On theoretical ground, what are the primary differences between operating and financial synergy? Give examples to illustrate your answer. (4 Marks)

Q-2 (10 Marks) (CLO-2)

Suppose you are being approached by a privately-owned company which is engaged in electronic toy manufacturing business. The company's owners are recently in talks with a top branded toy manufacturing company that wants to acquire it. The owners of the company want you to evaluate its business and estimate the value. You are aware of the nature and challenges of the privately-owned businesses. Answer the following questions:

a. Why is it often more difficult to value privately owned companies than publicly traded firms? Give specific examples. (2.5 Marks)
b. Why is it important to restate financial statements provided to the acquirer by the target firm? Be specific. (2.5 Marks)
c. How could you determine if the target firm's cost and revenues are understated or overstated? Give specific examples. (2.5 Marks)

d. How would you adjust the firm value for Liquidity Risk, Value of Control, or Minority Risk? (2.5 Marks)

Q-3 (10 Marks) (CLO-3)

You have been asked to estimate the beta of a high-technology firm, which has three divisions with the following characteristics.

Division	Beta	Market Value
Personal Computers	1.6	$100 million
Software	2.00	$150 million
Computer Mainframes	1.2	$250 million

a. What is the beta of the equity of the firm? (2 Marks)
b. If the risk-free return is 5% and the spread between the return on all stocks is 5.5%, estimate the cost of equity for the software division? (2 Marks)
c. What is the cost of equity for the entire firm? (2 Marks)
d. Free cash flow to equity investors in the current year (FCFE) for the entire firm is $7.4 million and for the software division is $3.1 million. If the total firm and the software division are expected to grow at the same 8% rate into the foreseeable future, estimate the market value of the firm and of the software division. (2 Marks)
e. On theoretical ground, what are the primary differences between free cash flows to the equity (FCFE) and free cash flows to the firm (FCFF) approaches? Under what circumstances are these used? (2 Marks)

Q-4 (10 Marks) (CLO-4)

Divestitures, equity carve-outs, and spin-offs represent alternative restructuring strategies. Explain each one of these along with their primary advantages and disadvantages. Under what circumstances might senior management prefer (i) to divest a business unit rather than to spin-off the business, (ii) an equity carve-out to a spin-off? Support your answer with real life instances.