QUICK CHECKLIST

International Corporate Finance

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Why and how to pursue international business?

Why?

- Comperative advantage
- Imperfect markets
- International product life cycle

How?

- International trade
- Licencing to Franchising
- Joint ventures
- Acquistion or establishment of new sub

Agency problem

- Discrepancy between management and shareholders interest
- Reasons
  - personal motivations
  - wrongly set KPIs
  - corporate governance
  - misleading information
- How can MCN manage agency problems?
- Centralised or de-centralised management?

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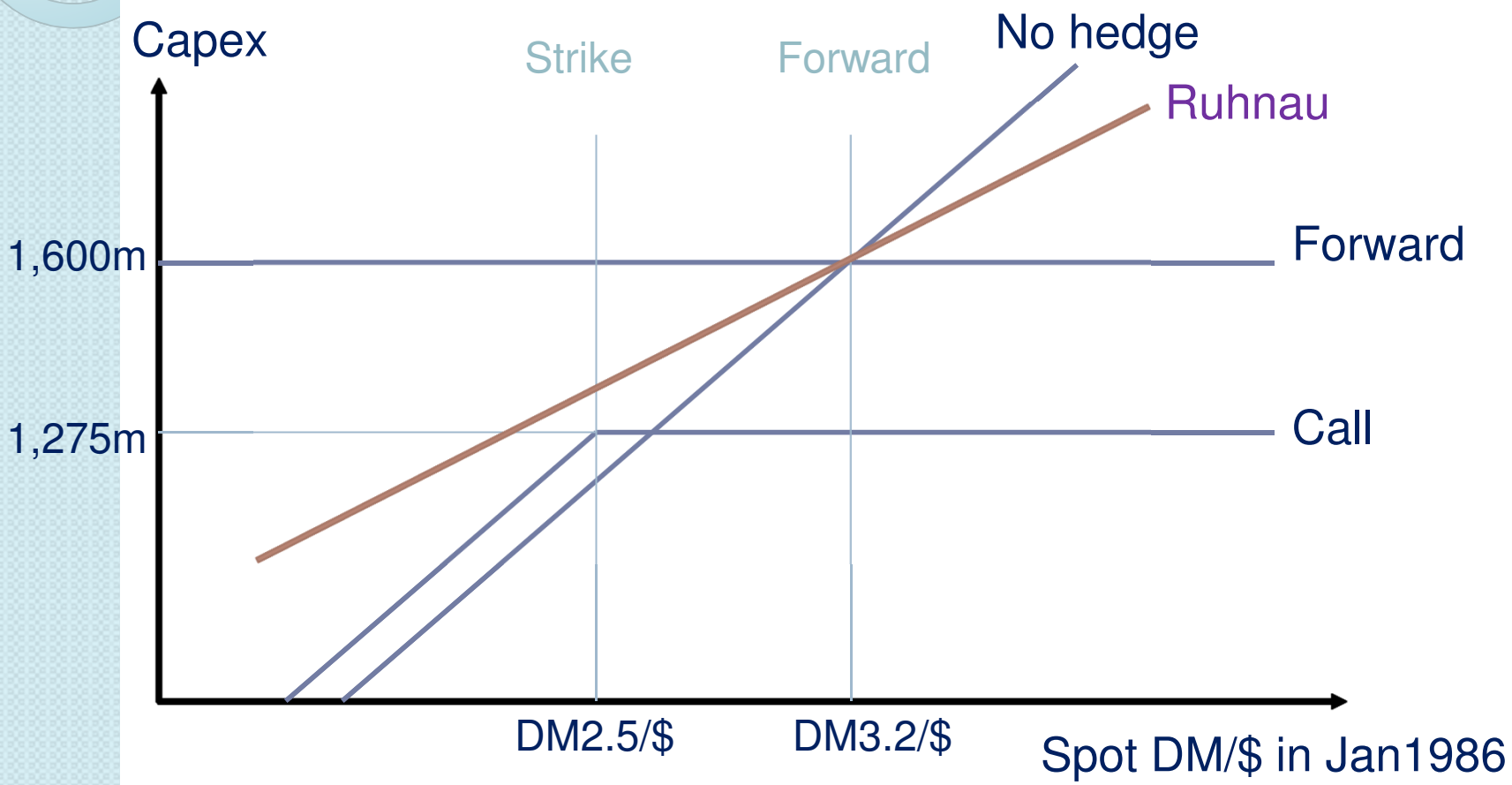
CURRENCY EXPOSURE

- Long position
  - Assets in foreign currency → gives profits if FX rate of foreign currency goes up
- Short position
  - Liabilities in foreign currency → gives profits if FX rate goes down
- Balance position
  - Assets or liabilities on the current value date
- Off-balance / cash flow position
  - Settlement of FX cash flows will be done in the future
- Indirect FX exposure
  - FX changes affects competitiveness or volumes

How to hedge FX Exposure

- Natural hedge
- FX Forward
- Options

Hedging strategies



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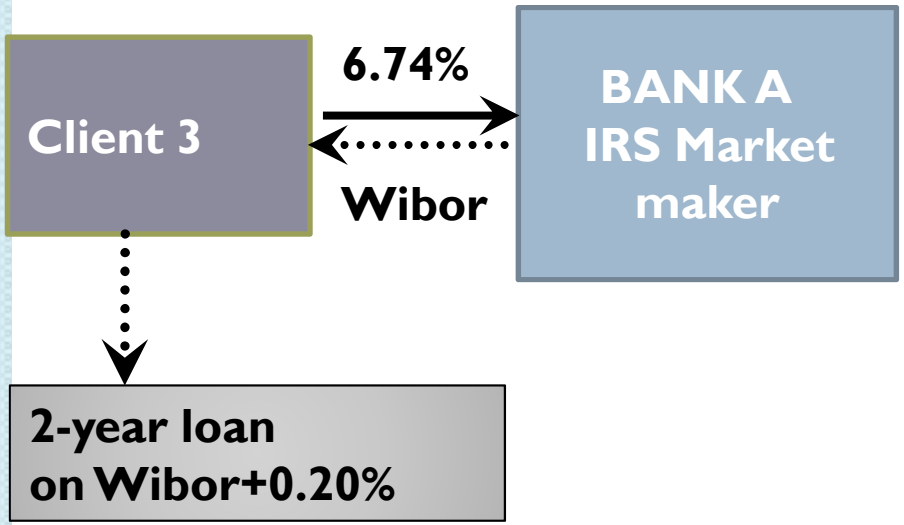
Interest rate exposure

- Situation where company faces profits or losses on the interest rate fluctuations
- Long position in interest rate is when Company benefits from interest rate increases
  - Company has significant liquid interest bearing assets
- Short position in interest rate is when Company benefits from interest rate decreases
  - Company has loans with interest calculated based on variable interest benchmark (e.g. LIBOR)

Application of interest rate swap



Maturity	bid	offer
1	6.83	6.93
2	6.64	6.74
3	6.60	6.66
4	6.56	6.62
5	6.53	6.59
6	6.49	6.55
7	6.45	6.51
8	6.41	6.47
9	6.36	6.42
10	6.30	6.36

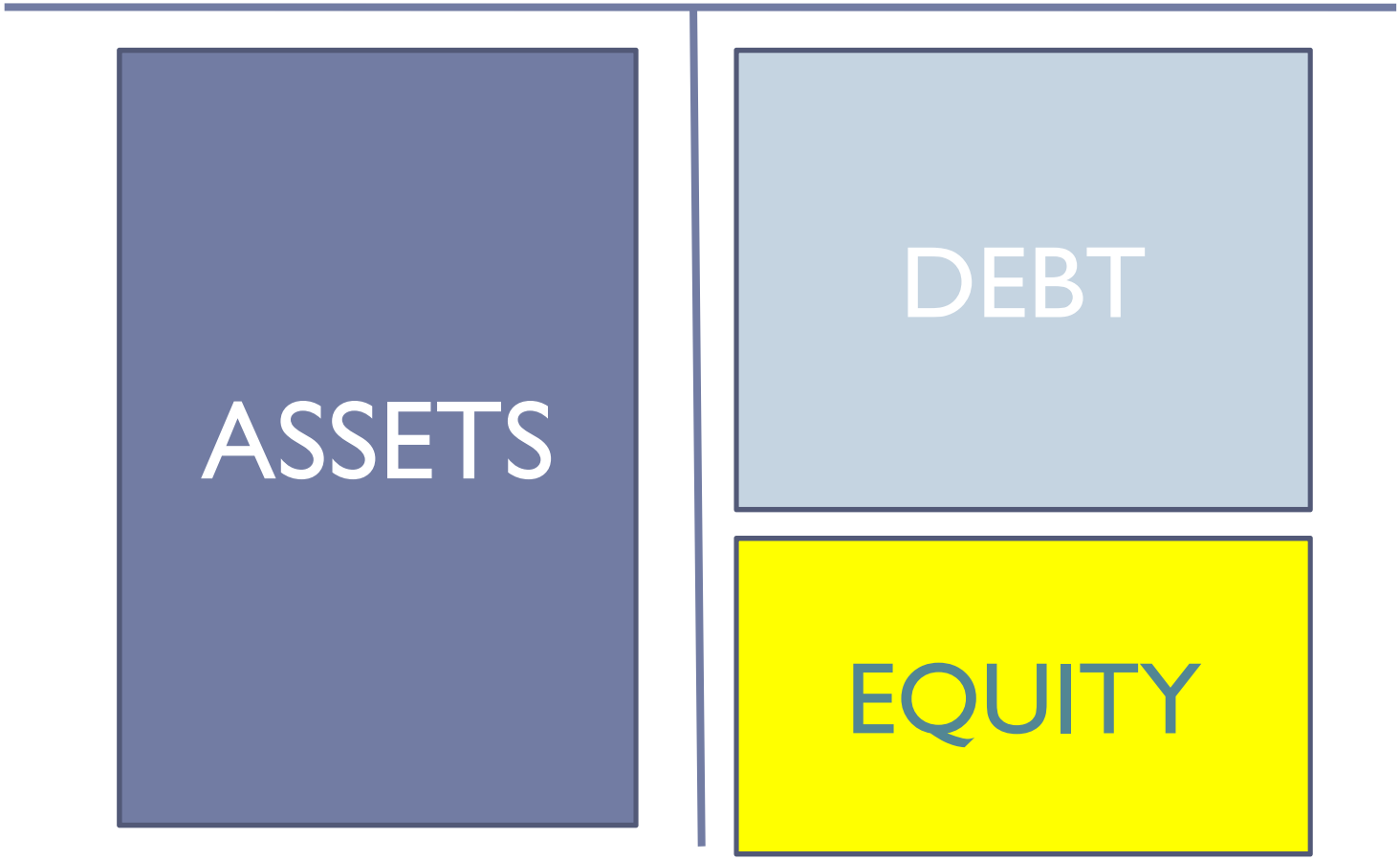
Effective rate?

Client pays: (Wibor+0.20%) i 6.74%

Client receives: Wibor

So it pays net **6.94%**

Company's Balance Sheet



WACC

The **weighted average cost of capital (WACC)** is the marginal cost of raising additional capital and is affected by the costs of capital and the proportion of each source of capital:

$$\text{WACC} = \left[\frac{D}{V} r_d (1 - t)\right] + \left[\frac{E}{V} r_e\right]$$

where

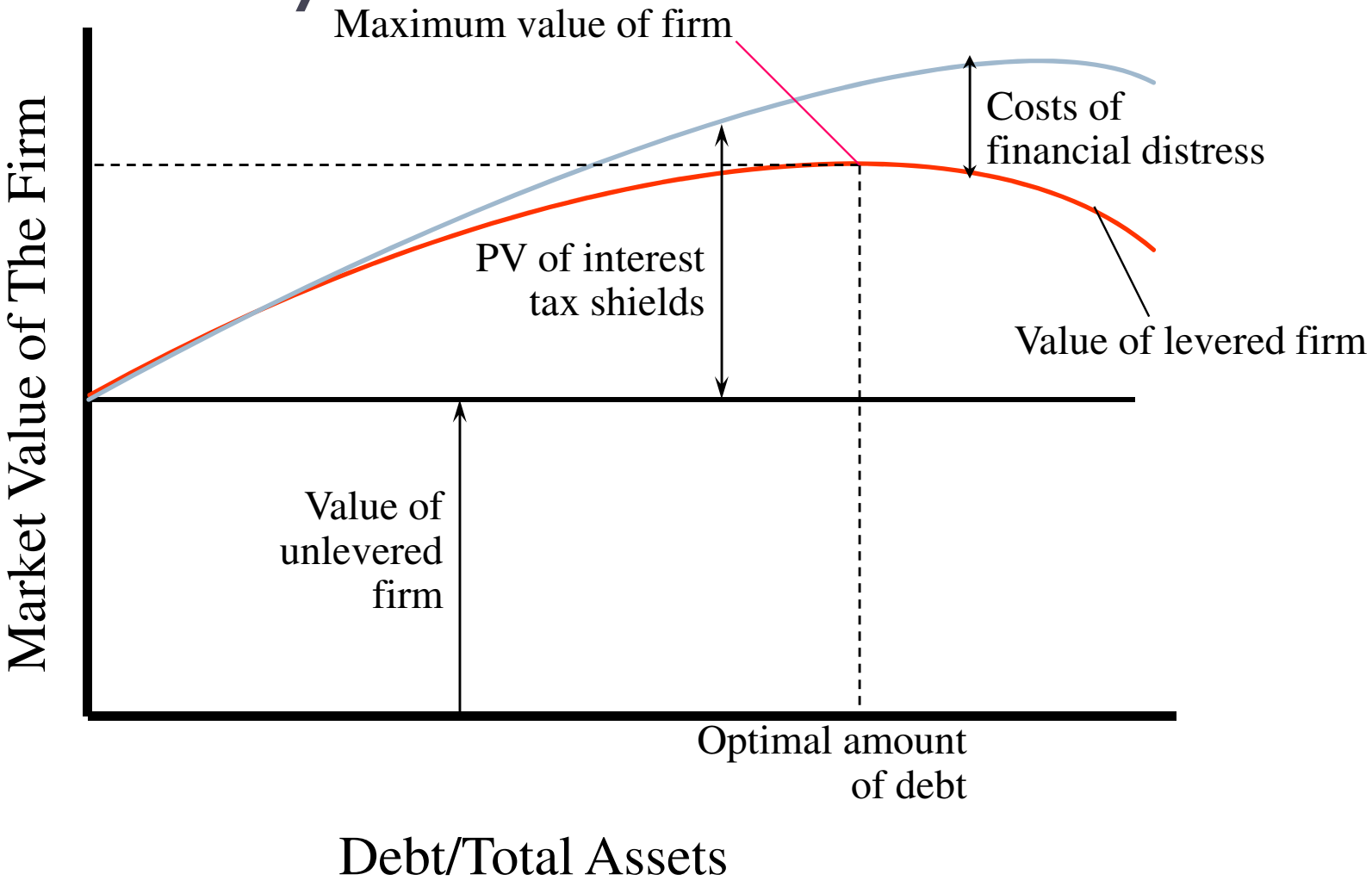
r_d is the before-tax marginal cost of debt
r_e is the marginal cost of equity
t is the marginal tax rate
D is the market value of debt
E is the market value of equity
$V = D + E$

Capital Structure Irrelevance

- Franco Modigliani and Merton Miller (MM) theory that helps us understand how taxes and financial distress affect a company's capital structure decision.

- Unrealistic assumptions, but helpful conclusions:
  1. Homogeneous expectations
  2. Bonds and stocks are perfectly traded
  3. Borrowing rate = lending rate
  4. No agency costs.
  5. Investment and financing decisions are independent

Modified corporate structure theory



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No Optimal Capital Structure

Taxes	Costs to Financial Distress	Optimal Capital Structure?
No	No	No
Yes	No	Yes, 99.99% debt
Yes	Yes	Yes, benefits of interest deductibility are offset by the expected costs of financial distress

Optimal capital structure for a given company depends:

- business risk
- tax situation
- tangibility of company's assets
- corporate governance.
- transparency

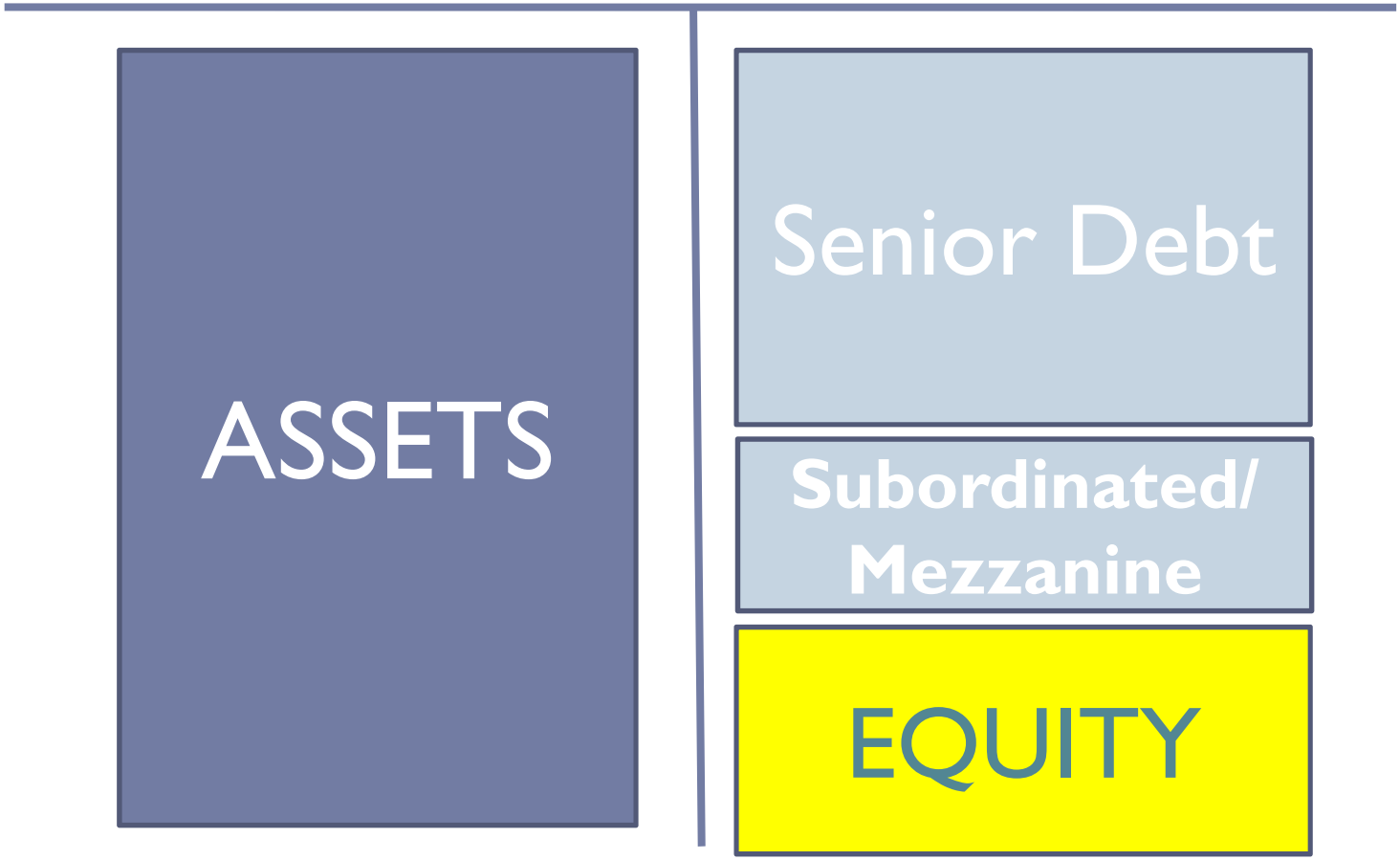
Leverage impact on IRR

- Unlevered investment of $1mio yields 4.8% p.a.
- 70% levered investment yields 12.2% p.a.
- Exit after 2 years, selling price $ 1 100 000, Prepayment fee 1%

- Unlevered example
  - 2 years profits add to $96k
  - Sales revenues were $1100k, therefore tax is 20k
  - Total inflows for equity is 96k + 1100k - 20k = 1176k
  - Therefore return on equity investment is 76 000 /1 000 000 = 17.6%

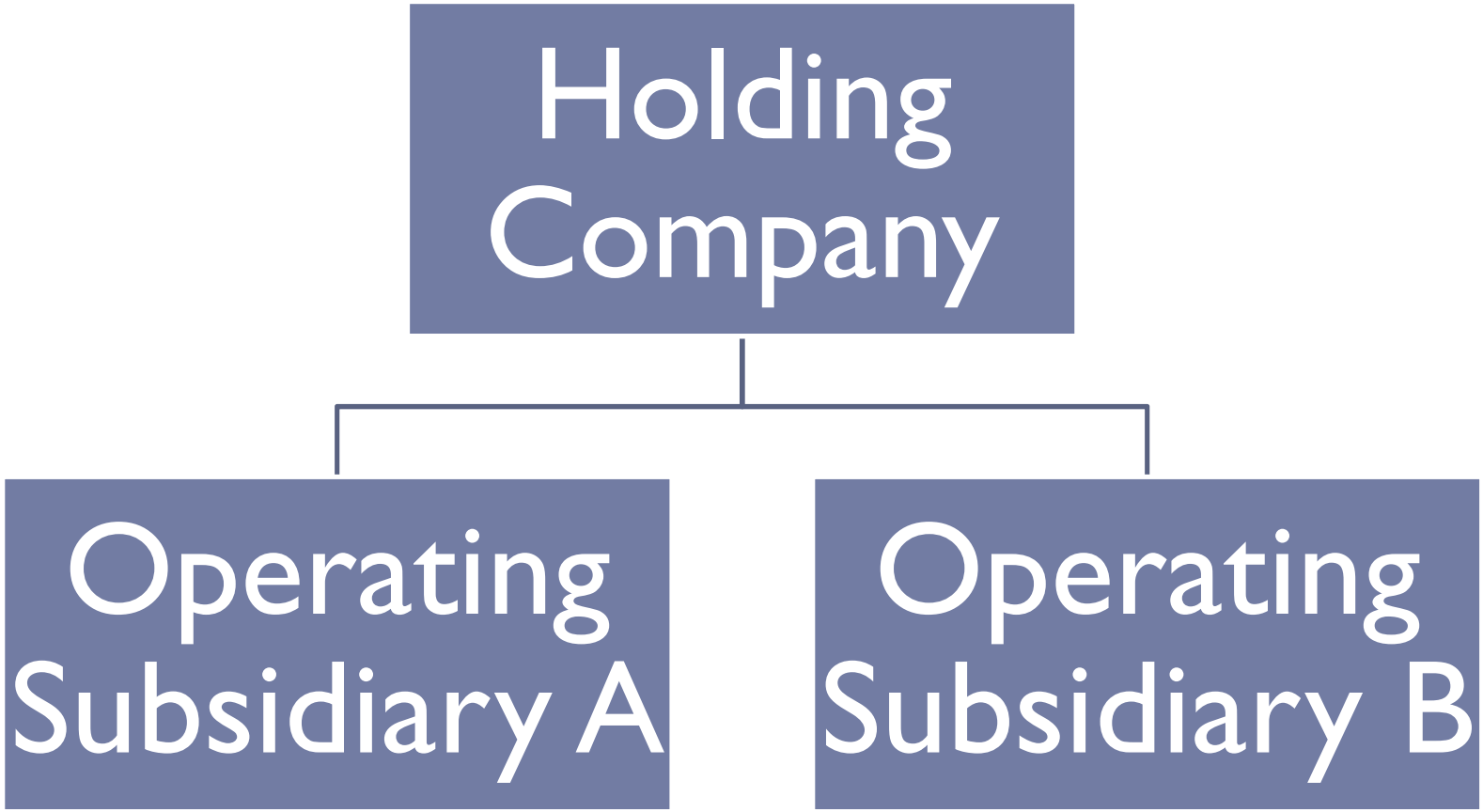
- Levered example
  - 2 years profits add to $3.6k
  - Sales revenues were $1.1mio, therefore capital gain tax is $20k
  - Loan remaining to be repaid $630k , prepayment fee $6.3 mio
  - Therefore all inflows for equity is (3.6k + 1100k -20k- 636.3) = 447.3
  - in return is $ 147 300 / 300 000 = 49.1%

Structure of Indebtness



Seniority and subordination

Structural Subordination



Covenants - examples

- Negative pledge
- Pari-passu
- Cross default
- Change of control
- Material Adverse Clause

Other requirements

- Debt Service Reserve Account
- Cash Sweep Mechanism

Financial Covenants

- Debt service coverage ratio
- Interest coverage ratio
- Debt to EBITDA
- Current ratio
- Leverage ratio
- Tangible net worth

Private equity or public equity?

- Know the co-investor
- Choose the co-investors
- Pre-agreed shareholders agreement
- Better protection of sensitive information
- Lower costs
- Typically lower price

- Access to broad investor base
- Publicity/ Prestige
- Stock exchange rules apply
- Access to capital in the future
- Limited influence on the choice of investors
- High costs but higher proceeds
- Motivation for employees
- Market Valuation

Shareholders Agreement – main areas of decisions

- Core business / Strategy of the Company and majority needed to change it
- Management and its appointment
- Supervisory Board composition
- Scope of decisions made at Shareholders and Supervisory Board Meetings (and majority needed)
- Anti dilution – decisions on capital increases
- EXIT (especially for the minority investors)

Exit – special provisions

- Put option
- Call option
- Right of First Refusal
- Drag-along rights
- Tag-along rights

Contrasting a buyout with an acquisition

	PE acquirer	Corporate acquirer
Use of a Newco	Newco must be created to hold the shares	Target can be taken as a subsidiary of the acquirer
Impact of debt	Acquisition debt is held in the Newco and does not gear up the PE fund	Debt relating to the acquisition is not ring-fenced and affects the acquirer's capital structure
Conditional payments	Ratchets can be used change shareholdings, dependent on performance	Earn-outs can be used to give the sellers further proceeds, dependent on performance
Changes to target business operations	Part of the acquisition plan agreed with management	Generally plans for synergies to be created
Management incentives	Linked completely to the eventual exit from the investment	Will depend on the corporate objectives
Purpose and timescale of acquisition	The acquisition is made with an ultimate profitable disposal in mind	Probably made for strategic reasons with no expectation of selling on
Funding the acquisition	A relatively high level of debt	To meet the corporate financial structure

Pre- and Post- Money Valuation

- Pre-money valuation
  - Takes into account situation before the new proceeds
  - Assumes new proceeds will generate similar IRR
- Post-money valuation
  - Takes into account new proceeds for the valuation of the Company
  - % holding is determined based on share in valuation

Pre- vs. Post-Money
Does it matter?

If the Company is worth 100m and needs 100m investment, which is expected to boost it to 300m (as new project is more promising than existing business).

Than PE approach would be to get 50% stake,

…. Perhaps VC could accept 33%

Term Sheet : typical areas

- Offer
- Use of proceeds
- Return/Dividends
- Other options: conversion, drag along, tag along, right of first refusal
- Voting rights
- Exit
- Other undertakings

Country Risk

POLITICAL ASPECTS

- Attitude of consumers in the host country
- Actions of host government
- Blockage of fund transfers
- Currency inconvertibility
- War
- Inefficient bureaucracy
- Corruption

FINANCIAL ASPECTS

- Economic growth
- Interest rates
- Exchange rate
- Public debt
- Inflation

Country risk ratings Rating Agencies

Issuer Ratings Scales

S&P	Moody's	Fitch
	Investment grade	
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-
A+	A1	A+
A	A2	A
A-	A3	A-
BBB+	Baa1	BBB+
BBB	Baa2	BBB
BBB-	Baa3	BBB-
	Speculative grade	
BB+	Ba1	BB+
BB	Ba2	BB
BB-	Ba3	BB-
B+	B1	B+
B	B2	B
B-	B3	B-
CCC+	Caa1	CCC+
CCC	Caa2	CCC
CCC-	Caa3	CCC-
CC	--	CC
C	--	C