Chapter 33
Corporate Restructuring

Multiple Choice Questions

1. The following are some of the ways by which changes in company structure are effected:
   (I) LBOs
   (II) Privatizations
   (III) Spin-offs and carve-outs
   (IV) Bankruptcies
   A) I and II only
   B) II only
   C) I and III only
   D) I, II, III, and IV
   Answer: D  Type: Medium  Page: 905

2. Leveraged buyouts (LBOs) almost always involve:
   (I) a large part of the purchase price is financed mostly by debt
   (II) most of the is below investment grade (junk)
   (III) the firm goes private and its shares are no longer traded on the open market
   A) I only
   B) II only
   C) III only
   D) I, II, and III
   Answer: D  Type: Medium  Page: 905

3. When a leveraged buyout transaction is led by the firm's management then the transaction is called:
   A) IPO
   B) MBO
   C) LBOM
   D) CFO
   Answer: B  Type: Easy  Page: 905

4. In 1988 LBOs were on average financed with 90% debt. In recent years the figure is:
   A) 80%
   B) 75%
   C) 60%
   D) 50%
   Answer: C  Type: Medium  Page: 905
5. The following are examples of LBOs except:
A) America Online and Time Warner
B) KKR and RJR Nabisco
C) KKR and Beatrice
D) Texas Pacific Group, Bain Capital, & Goldman Sachs and Burger King
Answer: A   Type: Easy   Page: 906

6. The following are examples of LBOs except:
A) KKR and Safeway
B) KKR and PanAmSat
C) Daimler-Benz and Chrysler
D) All of the above are LBOs
Answer: C   Type: Easy   Page: 906

7. The following are examples of LBOs that reverted to being public companies
A) Northwest Airlines
B) Safeway Stores
C) Kaiser Aluminum
D) all of the above
Answer: D   Type: Medium   Page: 907

8. Big gainers from LBOs were:
A) Junk bond holders
B) Raiders
C) Selling stockholders
D) Investment banking firms
Answer: C   Type: Medium   Page: 907

9. Junk bonds are bonds with:
A) AAA or Aaa ratings
B) BBB or Baa ratings
C) BB or Ba ratings or lower
D) D rated bonds
Answer: C   Type: Easy   Page: 908

10. The main characteristics of LBOs are:
A) High debt
B) Private ownership
C) Management incentives
D) All of the above
Answer: D   Type: Medium   Page: 908
11. The gains from LBOs are from:
   A) Tax savings because of high debt servicing
   B) Loss in the value to bondholders
   C) Improved performance because of incentives to managers and employees
   D) All of the above
   Answer: D   Type: Medium   Page: 908

12. The main characteristics of leveraged restructuring are:
   I) High debt
   II) Private ownership
   III) Management incentives
   A) I only
   B) I and II only
   C) I and III only
   D) I, II, and III
   Answer: C   Type: Medium   Page: 909

13. The following are examples of spin-offs except:
   A) Abbot Laboratories and Hospira
   B) AT&T and Lucent
   C) General Motors and EDS
   D) Exxon and Mobil
   Answer: D   Type: Medium   Page: 910

14. In case of spin-offs:
   A) Shares of the new company are given to shareholders of the parent company
   B) Shares of the new company are sold as a public offering
   C) Shares of the new company are bought by borrowing or issuing junk bonds
   D) None of the above
   Answer: A   Type: Difficult   Page: 910

15. Spin-offs are not taxed if the shareholders of the parent company are given at least:
   A) 90% of the shares in the new company
   B) 80% of the shares in the new company
   C) 70% of the shares in the new company
   D) 60% of the shares in the new company
   Answer: B   Type: Difficult   Page: 912

16. In case of carve-outs:
   A) Shares of the new company are given to the shareholders of the parent company
   B) Shares of the new company are sold in a public offering
   C) Shares of the new company are bought by borrowing or issuing junk bonds
   D) None of the above
   Answer: B   Type: Difficult   Page: 912
17. The following are examples of carve-outs except:
A) Northwest Airlines and Pinnacle Airlines
B) Sara Lee and Coach
C) Union Pacific and Overnite Corp.
D) All of the above are examples of carve-outs
Answer: D   Type: Medium   Page: 912

18. Which of the following statements regarding spin-offs and carve-outs is not true?
A) Spin-offs are not taxed if the shareholders of the parent company are given a majority of shares in
   the new company
B) Spin-offs are not taxed if the shareholders of the parent company are given at least 80% of the shares
   in the new company
C) Gains or losses from carve-outs are taxed at the corporate tax rate
D) In Carve-outs, parent company has the majority control
Answer: A   Type: Medium   Page: 912

19. Asset sales are:
(I) Good news for investors in the selling firm
(II) On average the assets are employed more productively after the sale
(III) Transfer business units to the companies that can manage them more efficiently
A) I only
B) I and II only
C) I, II, and III
D) III only
Answer: C   Type: Easy   Page: 914

20. A privatization is a:
A) Sale of a government-owned company to private investors
B) Sale of private companies to the government
C) Sale of a publicly traded company to private investors
D) None of the above
Answer: A   Type: Difficult   Page: 914

21. The following are examples of privatization except:
A) Thai Airways
B) Habib Bank
C) NTT (Nippon Telephone and Telegraph)
D) AT&T
Answer: D   Type: Easy   Page: 914
22. Privatizations transactions resemble:
   A) Carve-outs
   B) Spin-offs
   C) LBOs
   D) None of the above
   Answer: A   Type: Easy   Page: 914

23. The following are important motives for privatization except:
   A) Revenue for the government
   B) Increased efficiency
   C) Share ownership
   D) Economies of scale
   Answer: D   Type: Medium   Page: 914

24. Mergers and acquisitions in unrelated industries are called:
   A) Horizontal mergers
   B) Vertical mergers
   C) Conglomerate mergers
   D) Privatization
   Answer: C   Type: Easy   Page: 915

25. Conglomerate discount means:
   (I) The market value of the whole conglomerate is greater than the sum of the value of the parts
   (II) The market value of the whole conglomerate is less than the sum of the value of the parts
   (III) The book value of the whole conglomerate is greater than the sum of the value of the parts
   (IV) The book value of the whole conglomerate is less than the sum of the value of the parts
   A) I only
   B) II only
   C) III only
   D) IV only
   Answer: B   Type: Difficult   Page: 916

26. Which of the following statements is/are true of limited partnerships:
   A) Limited partners enjoy limited liability
   B) Generally limited partners put up most of the money
   C) Generally limited partners are institutional investors
   D) All of the above statements are true of limited partnerships
   Answer: D   Type: Medium   Page: 918

27. Two in-court options for dealing with financial distress of a firm are:
   A) Merger and acquisition
   B) Liquidation and reorganization
   C) Leasing and LBO
   D) Issue stocks and bonds
   Answer: B   Type: Easy   Page: 921
28. Flow-based insolvency occurs when:
   A) Current obligations are greater than operating cash flows
   B) Assets minus liabilities is less than zero
   C) There is no cash for dividend payments
   D) All of the above
   Answer: D   Type: Medium   Page: 921

29. Indirect costs of bankruptcy are borne principally by
   A) Bondholders
   B) Stockholders
   C) Managers
   D) The government
   Answer: B   Type: Medium   Page: 921

30. A bankrupt firm while being in the process of developing a reorganization plan is allowed to buy goods on credit and borrow money to finance needed working capital. Such an arrangement is called:
   A) Debtor-in-possession debt
   B) Junior creditors
   C) Workout
   D) Receiver
   Answer: A   Type: Difficult   Page: 924

True/False Questions

T  F  31. Leveraged buyouts are the same as acquisitions.
   Answer: False   Type: Medium   Page: 905

T  F  32. LBOs are financed with junk bonds.
   Answer: True   Type: Medium   Page: 905

T  F  33. A spin-off is a new, independent company created by detaching part of a parent company's assets.
   Answer: True   Type: Medium   Page: 910

T  F  34. Spin-offs are not taxed as long as shareholders of the parent company are given at least 80% of the shares in the new company.
   Answer: True   Type: Medium   Page: 910

T  F  35. Carve-outs are identical to spin-offs.
   Answer: False   Type: Medium   Page: 912
T  F  36. Privatization is the same as going private in a LBO.
Answer: False   Type: Difficult   Page: 914

T  F  37. A privatization is a sale of a government-owned company to private investors.
Answer: True   Type: Medium   Page: 914

T  F  38. A major beneficiary of privatization is the government that receives the revenues.
Answer: True   Type: Medium   Page: 914

T  F  39. There are only two types of bankruptcy procedures in the United States, which are set out
Chapter 7 and 11 of the 1978 Bankruptcy Reform Act.
Answer: True   Type: Medium   Page: 921

T  F  40. Securities and Exchange Commission (SEC) plays an important role in the
reorganization of, particularly for large, public companies by ensuring that all relevant and material
information is disclosed to the creditors before they vote on the proposed reorganization plan.
Answer: True   Type: Medium   Page: 922

Essay Questions

41. What is a leveraged buyout?
Type: Medium   Page: 905
Answer:
A leveraged buyout is the takeover of the firm by a group of investors using borrowed funds. Generally,
borrowed funds are obtained by issuing junk bonds. LBO goes private and its shares are no longer on
the open market.

42. What is a spin-off?
Type: Medium   Page: 910
Answer:
A spin-off is a new independent company created by detaching part of a parent company's assets and
operations. Shares of the new company are distributed to the parent company's stockholders.

43. Briefly explain the difference between a spin-off and a carve-out.
Type: Medium   Page: 912
Answer:
Carve-outs are similar to spin-offs, except that the shares in the new company are sold in a public offering.
The cash flows to the parent company are subject to taxes. In the case of spin-offs the shares of the new
company are distributed to the shareholders of the parent company and the transaction is not taxed as long
as the shareholders of the parent company receive 80% of the shares.
44. Briefly explain what is meant by privatization?
   Type: Medium   Page: 914
   Answer:
   A privatization is a sale of a government-owned company to private investors. A privatization is somewhat similar to a carve-out in that the shares of the company are sold to investors.

45. What are some of the benefits of privatization?
   Type: Medium   Page: 914
   Answer:
   Importantly, there are three benefits to privatization. First, the revenue for the government is enhanced. Second, widespread share ownership and lastly, increased efficiency of operations.

46. Under what circumstances would a conglomerate be effective?
   Type: Difficult   Page: 915
   Answer:
   Generally conglomerates perform well in less developed countries and also in countries where the legal system is based on civil-law systems.

47. Briefly explain bankruptcy costs.
   Type: Difficult   Page: 921
   Answer:
   There are direct and indirect costs to bankruptcy. Direct costs include legal and administrative costs of liquidation or reorganization. Indirect costs of financial distress include impaired ability to conduct business and increased agency costs. Agency costs associated with managerial actions under the threat of bankruptcy are: risk shifting, under-investment or refusal to invest more equity, and milking the property. These costs are borne by the shareholders.