

# [Interco case](https://assignbuster.com/interco-case/)

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Intercocase Introduction Interco is retail a company with essentially four major operating divisions: Apparel Manufacturing, General Retail Merchandising, Footwear Manufacturing and Retailing. The business climate in 1988 was questioned; cheap imports hurting the profitability of the Apparel group in the US, due to less consumer spending the retail group had to deal with decreasing profits. However, the furniture and home furnishing group experienced positive circumstances in demographic developments.

Still, the company is concerned that their stock is undervalued due the bad performance of the apparel group. As a response of this bad performance, the Interco’s board of directors had a meeting to discuss two alternatives for the future of Interco.

They discussed whether to accept a friendly merger or a restructuring plan. The restructuring plan would involve sale of apparel segment, special dividend, or-and stock repurchase. The takeover bid was based on an offer of $70 dollar per share. The task now is to evaluate whether this offer is reasonable or not.

First, the risk factors are discussed hereunder: ; gt; lower consuming spending ; gt; Imports from countries with lower labor costs ; gt; private-labelled goods at the expense of branded apparel Secondly, the true value of Interco is calculated with the following assumptions and partial spreadsheet (a few year are left out for readability purposes): The working capital investment starts from 1994 as described in exhibit 12.

This can be seen in the above income statement so that the free cash flows become slightly different from 1994.

Next the terminal value (TV) is calculated at different multiples (14, 15 and 16). This is shown in table x. The terminal value at different multiple is calculated by discounting at different discount factors (k). This value, together with the sum of the FCF’s (1989-1998) is the total value at multiples 14, 15 and 16.

This number is divided by the number of the outstanding shares (41. 356. 847). This gives us the implied stock prices at different discount factors k as shown in table x2. Discounted Cash Flow Valuation ?$62, 34 per share at 14, 0% discount rate and TV of 14 multiple ? 71, 27 per share at 13, 03% discount rate and TV of 16 multiple ? $88, 16 per share at 10. 0% discount rate and TV of 16 multiple Recommendations Based on our calculated stock prices, with the underlying assumptions, we advise to reject the offer since $71, 27 per share is simply higher than the offered $70, 00.

If we consider other discount factors k, the decision should be different. A discount rate of 14% would be positive towards the City Capital’s bid. However, any discount rate k lower than our calculated k, had a negative impact towards the offer.