

FINC 423
Advanced Corporate Finance
Fall 2020

Group Homework #12

**Comprehensive Memorandum on the
Recapitalization of the Firm**

With this assignment your group will finish the cycle of homework projects on the effect of the proposed recapitalization on your firm. You must prepare a comprehensive but concise memorandum to the corporate CFO (by name) about the effect and feasibility of the proposed recapitalization. You need to determine the effect of releveraging on numerous firm characteristics, and use these results to recommend whether or not the firm should undertake the proposed recapitalization.

You clearly need the results from Group Homework #7, where you estimate the firm's current WACC, from Group Homework #9, where you estimate the balance sheets and income statement of as well as the beta and cost of equity capital, Group Homework #10 where you study the effect of the recapitalization on the firm's bond rating and required returns on equity, and Group Homework #11 where you estimate WACC for the recapitalized firm. Clearly, you should clean-up any problems with your estimates from these earlier assignments before proceeding.

Prepare a comprehensive memorandum to the CFO of the corporation summarizing your findings and providing your recommendations. Most importantly, you must give a clear recommendation on, and defense for, whether the firm should carry out the proposed recapitalization or leave the capital structure unchanged. If you do recommend that the firm relever, you must explain the best method to payout the funds raised, and what maturity of debt to issue. Even if you recommend that the firm not recapitalize, the corporate executives wish for a full report on the effects of the change, so they can judge for themselves. The effect of the recapitalization on shareholder wealth is obviously an important point to stress in your memorandum.

The management team has requested that you explain the effects of releveraging on the firm's WACC, its beta, bond rating, and its costs of equity and debt. [Remember that no one will understand the numeric rankings we used for the BLM regression.] Also, describe the impact on the debt-to-assets ratio (recall managers generally think of leverage in-terms of book-value ratios), coverage ratio, earnings per share (EPS), return on assets (ROA) and return on equity (ROE). Of course, you must compare all of these to the current levels. [A table might be an effective way to present some of your results.] Describe the differences between using the funds raised to pay a special dividend or repurchase shares. Of course, the effects of this decision on EPS will be of great interest to the managers. Explain the advantages and disadvantages of issuing the new bonds with ten- or thirty-year maturities (or some other maturity, or mix of maturities, if you feel it more appropriate).

Carefully consider the most effective organization for the memorandum. The document should be in proper memorandum format, which you studied in BUDN 280. You need to be as succinct as possible, but relay all of the relevant material. The writing must be acceptable, so you need to get the group members to proof-read the document. You need to provide supporting documentation to allow readers to easily understand where your figures come from. Be sure that any supporting documents are of sufficient quality to present to these important executives.