Selected Case Studies in International Corporate Finance

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Over my career I have encountered quite a few interesting business situations that aren't typically described in textbooks. The following is the second case I am pleased to share.

Case 2: A Strategic Investment in a Leading Foreign Engineering and Construction Company

Soon after my work on Case 1 as a Director, Finance with a multinational company, my bosses developed a new strategic alliance, this time with the third largest engineering and construction company in the country. Again, the plan was to make a strategic investment in a prominent company that would lead to a series of new project and investment opportunities.

In view of my due diligence findings on Case 1, my bosses very reluctantly assigned me to do due diligence on this company, in anticipation of making a $25 to $50 million equity investment. I was overtly instructed by my boss to develop a more positive evaluation, this time.

The Company:

This company was also publicly traded on the local stock exchange, and was also controlled by a prominent family. They had an excellent reputation as an engineering company, and they had a fairly long-term alliance with a major U.S. engineering company, which outsourced engineering work to them. Over the past few years the company had aggressively entered the construction business, with emphasis on fixed-price EPC projects with the oil and gas and industrial segments.

By the time I was assigned to this project, I had known from the "street" that this company had issues financing the large projects it had won with the national oil company. When I arrived at the company I was told that employees had not been paid for over a month. The vast majority of the employees had continued to work in order to not jeopardize their statutory severance rights, but the mood throughout the company was very somber.

Two of the lead business developers (my bosses) gave a presentation to all the employees of the company and stated that we planned to invest in them and help turn around the company, financially and operationally. This occurred prior to conducting due diligence and prior to receiving corporate approvals.

A Brief Due-Diligence Review:

My main counterpart for this project was the CFO of the company. He was very professional, and he openly acknowledged the serious condition that the company was in. I had reviewed the company's financial statements and the trends were looking grim.

We started the due diligence process with the review of one of their larger projects, an EPC project for the construction of offshore platforms for the national oil company. This project was near completion but was in dispute. I noted that a $17 million "contingency reserve" remained in the forecasted results. This reserve was sufficient, if not required, to result in profits on the project.

I discussed this particular project with the Vice Chairman, a serious man who had an excellent reputation. I asked if he thought the $17 million contingency reserve would be needed and spent to complete the project. He became more serious, and said that the contingency actually was related to payments that had been already made, and contingent on which the contract was awarded. He added that this was simply required at the time to win contracts with the national oil company.

I understood what these payments really were, and then I asked to be directed to projects that would generate positive cash flow, to determine if there was the probability the overall company cash flow could be positive. I was directed to review two large projects in another country. It quickly became evident that those projects were also incurring overruns, were in dispute and significantly in arrears. Through the CFO of the company I later obtained his combined project forecasts for the company, and the near term cash drain was expected to be well-above the $50 million my employer was considering.

I also had noticed that the company's audited financial statements had a $120 million accumulated current tax liability, and I asked to speak with the Tax Manager. The CFO introduced me to him and instructed the Tax Manager to provide me with accurate information.

I asked two questions, and received two surprisingly honest answers:

Question: *"How did this tax liability arise, if the company is reporting low or no profits?"*
Answer: *"We withheld but did not pay employee federal and social security taxes for many months."*

Question: *"How is it that the tax authorities have not done anything about it?"*
Answer: *"They visit every two weeks, and we take care of them."*

By this time I knew that I would not recommend an investment in this company and I returned to Houston with my summary memo already written, in which I described the "contingency" and tax situations. We elected to not proceed with the equity investment.

Again, my developer-bosses were furious, and I was given an out-of-cycle performance review. The consensus of my three rating superiors was that I was good with numbers, but that I was negative, and a "non-team player". Fortunately, I had copied my summary to the group's CFO, to whom I had a dotted-line reporting relationship. The group attorneys addressed on the memo took particular interest. To my surprise, the CFO arranged for me to be his direct report and the group's "Deal Approval Manager ".

About three months later this potential alliance partner notoriously went bankrupt. About 9 months later my employer also plunged into its own notorious bankruptcy. There were other lingering projects and problems in the group, and I was lucky to be retained under a key employee retention program for more than four interesting years, to help unwind and liquidate the group's projects and assets.

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