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. Over the next weeks, I will share a few of them. Here is the first.

Case 1: A Strategic Investment in a Leading Foreign Construction Company

In the late 1990's I was hired by a multinational company that invested in a wide range of domestic and foreign companies and projects. My job was to evaluate the financial viability of these new projects and of our potential investments in them. This was an ideal opportunity for me to broaden my corporate finance and international business experience. Initially I was assigned to be my employer's financial point-person within a strategic alliance with the second largest construction company in a key Latin American country.

The Initial investment Transaction:

My employer had already invested $30 million of "bridge equity" into the company, and the plan was to jointly develop a stream of new investment and construction projects in the country. The initial $30 million investment was actually in the form of a demand loan, 100% backed by a credit bond issued by the largest insurance company in the country. The insurance company was rated A-minus by a major U.S. credit rating agency, due to its "market leadership and its seasoned management". According to written representations made by the insurance company at the time they issued the credit bond, the bond was 96% re-insured by highly-rated European insurance companies.

Attached to the transaction were significant options to purchase stock in the partner at a fixed price. The deal appeared to offer substantial upside, and very low risk. No serious due-diligence had been conducted by my employer, however, due to the partner's size and prominence, and due to the backing of a 100% credit bond.

The Alliance Partner's Business:

The alliance partner was publicly-traded on the country's stock exchange, but it was controlled by a prominent family. Over the previous three years the partner had won several large government concessions to build, own and operate toll roads in the country, and t. Most of these projects were under construction or had been recently completed and were in operation. Toll roads had become the company's primary source of revenues.

My initial effort upon my arrival with the alliance partner was to understand the toll-road concession business and to get acquainted with the overall company and its financial health. Under the toll road concession framework in the country, alternative free highway routes were required to remain open and in operation. I coordinated with very professional counterparts at the partner-company, and together we methodically reviewed and forecasted the cash flows of each of the partner's projects.

The tolls negotiated for the concessions were quite high, and as might have been anticipated, most people chose to take the longer, bumpier free routes. Toll road traffic was much less than had been forecast, and the concessions generated far less than their originally forecasted cash flow.

It soon became clear that the partner was facing major cost overruns on its construction projects and continuing cash drains on the operating concession projects. The company's financial situation was rapidly becoming dire.

The Next Steps:

Upon my return to Houston I provided my bosses with a two-page summary of my findings and I briefed a small group of my bosses and an in house attorney. The summary was soon "leaked" by the attorney to my employer's Vice Chairman, who was furious that the deal might be in trouble. My direct bosses (who had recently originated the deal) were furious that my due diligence findings had been documented and leaked. We concluded that even if the partner was in bad financial condition and had depleted the $30 million we invested, we still had a solid 100% credit bond backing our exposure.

I returned to the country, met with the insurance/bonding company, and asked for documentary evidence that the credit bond had been 96% re-insured, as they had represented. They refused to provide evidence of re-insurance, stating that it was confidential. This was disconcerting, but I didn't know if this was a standard insurance industry practice.

I reviewed the regulations governing insurance companies in the country and obtained the latest public, monthly financial reports the company was required to issue to the banking authorities. It was not difficult to determine from the reports that the insurance company had about $6 billion in bonds backing the credit or performance of construction companies in the country. Payments under about 50% of those bonds had been demanded, remained unpaid and were tied up in the country's arbitration process. I also determined that the insurance/bonding company had exceeded the leverage and credit exposure limitations imposed by the regulators, and that its' net worth was then only USD $27 million.

I met again with the insurance/bonding company and demanded to be shown the 96% re-insurance commitments. After some further discussion (in which I mentioned my determination that the insurance company had violated the country's regulations) I was reluctantly shown all of the official re-insurance commitments, which then totaled only 24% of our exposure.

A Fortuitous Outcome:

By a major stroke of luck, a large U.S. insurance company had very recently closed on the acquisition of the insurance/bonding company. Apparently the U.S. acquirer had also not performed serious due diligence, perhaps because the size of its transaction was relatively small, and the U.S. credit agency had given it an A-minus rating. With my employer's approval, I contacted a senior officer of the U.S. insurance company and advised him that we were going to demand payment of the bond issued by their newly acquired company. The $30 million claim by multinational company could have caused much visibility and scandal within the market, and the U.S. parent quickly proposed and guaranteed a payout scheme of $2 million per month, which we accepted.

Within a few months the alliance partner went bankrupt and its chairman and majority owner fled to Spain to avoid pursuit by the local country authorities. The insurance company survived with the support of its new owner, and my employer was paid out as agreed by the U.S insurance company.

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