Groupe Monceau Fleurs Case Study

Suggested answers

(Pascal Quiry – January 2011)

1. **Why has Groupe Monceau Fleurs decided to end its financial year on a date other than December 31? State your views.**

1 point

Groupe Monceau Fleurs has its year-end on September 30, probably in order to minimise the working capital that appears on its balance sheet. Because July and August are very slow months for business, inventories and receivables are likely to be at their lowest (credit cards only concern the last purchases in September which is one of the slowest months of the year). Stocks must then be built up again which means that working capital, and thus debts, increase.

2. **Carry out a financial analysis of Groupe Monceau Fleurs. State your views.**

4 points

It is difficult to assess the growth of the business because the accounting standard was changed during the course of the period in question, and also because major external growth operations were carried out, which modified the scope of the group.

We note that margins are low, and are even sometimes negative: EBITDA between -1.3% and 1.3% and EBIT from -4.5% to +0.4%.

In other words, this is a company with very few internal resources for financing through debt, given its low margins.

Unsurprisingly, working capital is very low, and drops suddenly into the red in 2009, although it is a bit difficult to draw conclusions from this, given the substantial change in the scope of consolidation that year.

The organisational structure of the group, made up of franchises, means that capital expenditures are minimal. Most investments are on external growth operations.

Monceau Fleurs, which does not generate very high operating cash flows, financed 40% of its external growth using equity and 60% by increasing debt.

At €25m, the company's debt is extremely high, given that its EBITDA is only €1.2bn. It is true that most of the debt is long term and the short-term debt is covered by cash and cash surpluses.

Returns on capital employed are very, very low, at around 0%, and given a negative leverage effect, they are negative for returns on equity.

3. What do you think about the amount of the brands recorded on the asset side of Groupe Monceau Fleurs balance sheet, given the earnings generated by the group? What impact does it have on the group's solvency? Why? An on its liquidity? Why?

1.5 point

It is difficult to understand how brands that are valued on the asset side of the balance sheet at their purchase price of €47m can be worth that much, for a company that is generating such a negligible ROCE as a result of such a low EBIT.

Given that intangibles are almost double the book equity capital (€47m vs €27m), questions could be raised about the real solvency of the company. Indeed, if the value of those intangible were written down by 50% because of their very low profitability, equity would drop from €27m to € 27m – 50% × € 47m = € 4m, i.e. close to 0, making Monceau Fleurs hardly solvent.

It has nothing to do with liquidity as liquidity is about cash and the carrying cost of brand on the balance sheet is completely unrelated with cash issues.

4. Carry out a market analysis of Groupe Monceau Fleurs. State your views.

2 points

It really is quite difficult to understand how this company can be worth so much.

The standard items used for analysis are not really available: the P/E ratio is insignificant, even negative, and there are no returns. Nevertheless, in 2009, Monceau Fleurs was worth more than double its book equity capital (€63m vs €27m) and in early 2010, it was worth still 66% more.

We can only assume that the market is expecting a strong recovery of its margins and its earnings, which, when looking at the historical financial statements, we have a bit of difficulty in understanding. Alternatively, it could be that the market is not efficient, which the small size of Monceau Fleurs could explain.

5. Given the characteristics of the convertible bond issued by Groupe Monceau Fleurs in 2007, what will the group's share price have to be in 2012 for these bonds to be converted into shares? What percentage will the share price have to increase by? State your views.

1 point

The 2007 convertible bond has a redemption price of €14.7 on November 29, 2012.

For it to be paid back in shares and not in cash, the share will thus have to rise from its current price of €7.9 to €14.7. This works out at an increase of 86% over two years and three months, if we put ourselves in July 2010, i.e., a yield to maturity of 32%.

Given what we see in the financial statements, this is an increase that seems a little high and could only be justified if the company succeeds in increasing its margins and its earnings very sharply, which we find hard to imagine.

6. **What will happen if the Groupe Monceau Fleurs share price does not rise above the price determined in the previous question in 2012? What will the consequences for the group be? What should it do?**

1 point

If the share does not rise above €14.7 on December 29, 2012, the bearers of the convertible bonds will request the redemption of their convertible bonds for an amount of €14.7 x 1,284m convertible bonds, which works out at €18.9m.

In these conditions, it is difficult to see how Groupe Monceau Fleurs will be able to repay the bonds, because if the share price has not risen, this will be because its economic situation has not improved. The company will thus be forced to carry out a capital increase that will be highly dilutive, and it will also have to find investors or it will have to negotiate a longer payment period with the convertible bondholders by restructuring the terms of the convertible bonds. Another option would be to sell off assets (Rapid'Flore?) or failing that, it could be forced into bankruptcy.

7. **If instead of issuing bonds in 2010, Groupe Monceau Fleurs had issued shares at €10 per share, what would the breakdown of the share capital have been, assuming that the founding family had not subscribed to this operation and that the convertible bonds issued in 2007:**

a) are not converted into shares;

1.5 point

b) are converted into shares.

1.5 point

If Groupe Monceau Fleurs had not issued a bond in 2010, and if it had issued shares at €10 per share, it would have issued 1.2 million new shares to raise €12m.

Assuming that the founding family had not subscribed to this operation and that:

a) the convertible bonds are not converted, the breakdown of shareholders would then be:

	In thousands of shares	**As a %**	**% voting rights (*)**
Laurent Amar – CEO – founder's grandson	3 788	54 %	70 %
Investment funds	394	6 %	4 %
Individual shareholders	1 623	23 %	15 %
New shareholders	1 200	17 %	11 %
Total	**5 805 + 1 200**	**100 %**	**100 %**

(*) The difference between the percentage in number of shares and the number of voting rights is explained by the fact that shares held by the same shareholder for more than 2 years are allocated double voting rights

b) If the convertible bonds were converted into shares (1,210,000 new shares, see appendix 6), we would have the following shareholder breakdown:

	In thousands of shares	As a %	% voting rights (*)
Laurent Amar – CEO – founder's grandson	3 788	46 %	63 %
Investment funds	394	5 %	3 %
Individual shareholders	1 623	20 %	14 %
New shareholders	2 410	29 %	20 %
Total	**5 805 + 2 410**	**100 %**	**100 %**

8. What are the advantages of the issue in mid 2010 of bonds by Groupe Monceau Fleurs, compared with a capital increase made at €10 per share? Why?

1 point

Issuing bonds has the advantage of not impacting on the structure of Groupe Monceau Fleur's capital, and accordingly, not threatening the family control over the firm.

Additionally, it would probably be easier to find investors prepared to subscribe bonds than investors prepared to subscribe shares in Monceau Fleurs, which carry more risk.

9. What are the drawbacks of the issue in mid 2010 of bonds by Groupe Monceau Fleurs, compared with a capital increase made at €10 per share? Why?

1 point

The main drawback is that more debt is being taken on by the company, when it has a sword of Damocles hanging over it in the form of the convertible bond when it has a disastrous debt / EBITDA ratio and a non-existent capacity to generate free cash flows.

10. If in mid 2010 you had been the Financial Director of Groupe Monceau Fleurs, would you have recommended a capital increase or a bond issue? Why?

1.5 point

As the financial director, without any doubt, I would have recommended a capital increase because the company's financial structure is such that taking out debt in 2010 was a real, highly risky upstream leak. Moreover, the bond was placed at a high rate of 8% which is a clear indications that the banks were not prepared to grant the group a bank loan. Instead, the company had to rely on the lack of awareness or the avidity of the public to place the bonds.

But is it possible to carry out a capital increase with a share price at a 12-month low?

An alternative would have been to cancel the external growth operations and work at improving the operations of existing company.

11. Would your recommendation have had an impact on the cost of equity, the cost of debt or the cost of capital of Groupe Monceau Fleurs? Why?

1 point

The recommendation would not have had an impact on the cost of capital as the cost of capital pre-dates the financial structure and depends on the risk of the capital employed and not on the financial structure itself.

However, a capital increase would have made it possible to reduce the cost of equity, as it would have made the equity capital less risky by lowering the level of the company's debt. It would also have reduced the cost of debt for the same reason (less risk to be born by lenders).

12. What do you think of the yield to maturity on the bonds issued in mid 2010 by Group Monceau Fleurs (8%) compared with 1.72% for Treasury Bonds over the same period and 4.3% for solid private companies? What is paying this rate?

1 point

The 8% rate includes a very high spread linked to the group's credit risk following this bond issue.

13. Would you personally have subscribed to Groupe Monceau Fleurs bonds if you had had the necessary cash? Why?

1 point

No, I wouldn't have subscribed the Group Monceau Fleurs bonds as the viability of this company, in a sector where margins are low and in which it is, however, a major player, does not appear to me to be certain over the short and medium term.

Furthermore, the repayment of the convertible bonds in cash in 2012 is a real risk, as they mature before the bonds issued in July 2010.

For your information, the last quoted share market price for Monceau Fleurs when this document was finalized (2011/1/7) was 4€ versus 8€ when the bond was issued.