CASE:

ALMACENES LOPEZ

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Guide for case preparation

1.- Do you recommend the acquisition at a price of 19 million euros?

Hypothesis:

- The company operates for 7 years and in the year 8 enters into liquidation.

- In 2008, 5 million euros of stock is obsolete and has no market value.

- The company must invest 300,000 euros in fixed assets annually.

2.- What would happen if things turn worse that forecast and the company must liquidate after two years?

Suppose the following profit and loss accounts:

	2.002	**2.003**
Turnover	40,916	36,825
Cost of sales	25,784	22,426
Personnel expenses	3,151	2,836
Depreciation	812	842
Other operating expenses	10,352	10,714
Operating profit	818	8
Financial incomes	342	359
Earning before taxes	1,161	367
Taxes	406	128
Net income	754	239

In both cases suppose a discount rate of 12%.

ALMACENES LOPEZ[1]

Alejandro Herrero, consultant for the Sahuir Group, was still debating whether to buy "Almacenes López", a Majorcan company listed on the Valencia stock exchange.

I. The company

Almacenes López was founded at the beginning of the 20th century by Evaristo López, a Majorcan entrepreneur with a clear vision of the future.

Before the arrival of El Corte Inglés or Galerías Preciados, Evaristo López had already introduced the idea of the department store into Spain.

He believed that small shops would tend to disappear and that what was needed were large scale retail stores where the customer could find everything he or she wanted, or at least most things.

He bought a six-storey building in the Calle Jaime I in Palma de Mallorca, and set up his business.

His star product was women's clothing which took up nearly half the building, but there were also departments for menswear, children's clothing, shoes, cosmetics, and haberdashery.

In spite of protests from the small shopkeepers in the area who went as far as breaking a shop window or two, it was a resounding success. Sales and profits grew year after year at a rate that not even Mr. López had dared to hope for when he first opened up his store. He expanded his business to Menorca where he bought a four-storey building near the port of Mahón.

One of the highlights of his career was in 1956 when he decided to float the company on the Valencia stock exchange. Although he continued to control 80% of the share capital, the heightened status among the financial community that listing on the stock market gave him flattered his vanity. He died on April 12, 1960.

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[1] Professors María Luisa Garayalde and María José López prepared this case as the basis for class discussion rather than to illustrate either the effective or ineffective handling of an administrative situation. No part of this case may be reproduced, stored in a retrieval system, used in a spreadsheet or transmitted in any form or by any means without the written permission of the authors.

His four children, all male, inherited the company and carried on the business. The tourist boom gave another boost to the company which was able to stave off the threat posed by the arrival on the scene of other major department store chains, especially the opening of an El Corte Inglés store in Palma de Mallorca.

The situation today

In 2002, however, the situation was different, or at least that was what Alejandro Herrero thought. Sales continued to grow but now at a very moderate rate. The management style of the four brothers had been very conservative. They had not dared to take the plunge and open up on the mainland, nor had they increased the number of stores on the islands. This left the company in a very healthy financial situation, with no debts and an excess of cash amounting to around 6 million euros, but with no clear outlook for the future. By now the brothers were getting on in years and were thinking about their retirement. None of their children had become involved in the management and most of them were no longer living on the islands.

The way Alejandro Herrero saw it, the business projected a stale image. Its customer base had grown old and the company had failed to attract the younger generations.

But Alejandro Herrero was firmly convinced that, with a good facelift, more attractive window dressing, and an injection of younger blood in the company's buying department, the company could continue to be highly profitable for at least the next seven years until the new franchises came on the scene. These franchises with their very aggressive pricing policies could signal the end for Almacenes López.

Alejandro Herrero had prepared some forecasts which, while conservative, were a reflection of how the business might perform until 2008 when he believed the company would need to be wound up.

From his conversations with the four brothers, he had reached the conclusion that they would be wiling to sell up provided that the sale was made at a 30% premium over the company's market cap which, in their opinion, did not reflect the company's true value.

The real estate company, Basamar, had sent Herrero a report on the market value of the two buildings owned by the company, with a forecast of the trend over the next ten years. This report put the present value at 13.1 million euros, which in two years could increase to 14 million, and by the end of 2008 would, if their projections were correct, be worth 17.084 million euros.

Herrero was concerned about the drag that a staff with an average of fifteen years' service and a total redundancy cost of 3,490,000 euros could have on any plans to wind up the company.

He would have to take all this into consideration before recommending the operation.

Exhibit 1

Almacenes López Stock Exchange data

	Average Price	Annual Volume	Market cap. At December, 31st
1999	14.45€	80,863 €	18,660,000 €
2000	9.54€	68,733 €	10,885,000 €
2001	5.95€	75,606 €	9,361,100 €

Last price (2001-12-02): 9.40 €

Number of shares : 1.555.000

Exhibit 2

Almacenes López Balance sheet

BALANCE SHEET	2001			
Assets			**Equity & Liabilities**	
Intangible assets	33		Common stock	1,555
Fixed assets	8,402		Retained earnings	25,927
Total fixed assets	8,435		Total equity	27,482
Inventories	16,340		Trade accounts payable	5,373
Accounts receivable	1,234		Others accounts payable	1,135
Short-term investments	6,002		Total short–term liabilities	6,508
Cash	1,979			
Total current assets	25,555			
Total Assets	33,990		Total Equity & Liabilities	33,990

(thousand euros)

Exhibit 3

Income statement

Profit and loss account	2000	2001
Turnover	43,505	45,463
Cost of sales	28,278	29,551
Personnel expenses	3,350	3,501
Depreciation	771	782
Other operating expenses	9,781	10,002
Operating profit	1,325	1,628
Financial incomes	312	326
Earning before taxes	1,637	1,954
Taxes	573	684
Net income	1,064	1,270

(thousand euros)

Exhibit 4

Income statement Forecast

	2002	2003	2004	2005	2006	2007	2008
Turnover	49.100	51.555	52.586	52.586	52.586	47.327	40.228
Cost of sales	31.915	33.511	34.181	34.181	34.181	30.763	26.148
Personnel expenses	3.781	3.970	4.049	4.049	4.049	3.644	3.098
Depreciation	812	842	872	902	932	962	992
Other operating expenses	10.352	10.714	11.089	11.477	12.051	11.449	9.731
Operating profit	2.240	2.518	2.395	1.977	1.373	510	259
Financial incomes	342	359	377	396	416	437	459
Earning before taxes	2.583	2.878	2.772	2.373	1.789	947	718
Taxes	904	1.007	970	831	626	331	251
Net income	1.679	1.870	1.802	1.542	1.163	615	466

(Thousand euros)