

El Corte Inglés feud heads for court. Financial Times

A feud at El Corte Inglés, the family-owned department stores chain that is Spain's largest retailer, will be aired in court next week in a civil action brought by a branch of the family that wants to sell out.

Lawyers for the plaintiffs said that for the first time a court is being asked to establish a fair value for the business, which reported sales of €15.9bn (\$20.9bn) and a net profit of €653m in the year to February 2006.

By Leslie Crawford

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History of the firm¹

El Corte Inglés, S.A. is a private company that forms the core of the El Corte Inglés Group and was incorporated on January 2, 1952, from the limited liability company El Corte Inglés S.L., itself incorporated on June 28, 1940. The company runs Spain's largest chain of department stores, with about 55 stores under the Corte Inglés name, and the Hipercor hypermarket chain, through a subsidiary operation. It also operates, through additional subsidiaries, a wide range of services, including travel agencies, insurance, computer services, and the publication of university texts. El Corte Inglés is by far the largest privately held company in Spain, is the third largest company overall in that country (behind Telefónica and Repsol), and is the nation's largest retailer.

El Corte Inglés has become a model for the Spanish business world, owing to the efforts of its founder, Ramón Areces Rodríguez, and the firm's directors. The history of El Corte Inglés is closely linked with the life of Areces. Born in 1905 in Asturias, he emigrated to Cuba in 1919 aboard the ship *Alfonso XII*, following his brother, who had emigrated a few years earlier. With help from his uncle, César Rodríguez, Areces was able to find work in the department store El Encanto, owned by a Spanish family. At El Encanto he worked alongside José (Pepín) Fernández Rodríguez, his uncle's cousin, who would later become Areces's business rival in Spain.

El Encanto employed some of the retail management techniques that had been developed in the United States, based in particular on diversification and aggressiveness. Wishing to improve his understanding of business administration, Areces left Cuba in 1924 to go to New York and Montreal with César Rodríguez. For a year and a half he worked in a New York export firm, learning about international trade.

In 1928 at the age of 23, Areces returned to work in Cuba for six years before deciding to return to Spain to set up his own business. Spain was on the verge of civil war, but Areces launched directly into business nonetheless. He established himself in Madrid and invested his Cuban savings in the acquisition of a tailor's shop. This shop was strategically located in the center of Madrid, and had

¹ Case prepared by professor Oriol Amat, Departament d'Economia i Empresa, Universitat Pompeu Fabra, March 2007.

exits onto three streets, Preciados, Rompelanzas, and Carmen. Areces bought for the tailor's shop and changed everything except the store's name, El Corte Inglés.

The business started out with seven employees and was an immediate success, causing the company to expand quickly. In 1940, shortly after the end of the Spanish civil war, the business was moved to a location on Preciados Street, where Areces bought the department store El Aguila. The store would be converted, after several extensions, into the firm's first commercial shopping center. Areces's cousin, José Fernández, bought the original shop on Rompelanzas Street from him; it became the first store of the Galerías Preciados department store chain after it had been expanded several times.

On June 28, 1940, Ramón Areces Rodríguez formed El Corte Inglés, S.L., a limited liability company, with his younger brothers Luis and Celestino. In July 1949 the company formed Industrias y Confecciones, S.A. (Induyco) as an independent company. It became a joint stock company in December 1955. Induyco was established to make clothes, as part of the founder's clear vision of vertical expansion and integration for El Corte Inglés. The aim of the new company was to ensure the supply of manufactured clothes to meet the demand at the shop in Preciados Street. This decision was made because during the civil war the Spanish clothing industry found itself facing great difficulties owing to the shortage of raw materials and capital to buy machinery and other basic items.

To ensure the company's continued development, it was changed into a joint-stock venture, being incorporated as El Corte Inglés, S.A. on January 2, 1952. At first Induyco manufactured clothes exclusively for El Corte Inglés, but later it began trading with clients outside the group. Induyco is not part of the El Corte Inglés Group, although El Corte Inglés S.A.'s president is also president of Induyco.

Ramón Areces Rodríguez did not have any children. He brought his 18-year-old nephew, Isidoro Alvarez, onto the staff of El Corte Inglés in 1953. Alvarez continued to study economics and business at the Complutense University, and in 1957 graduated with special distinction. Areces dedicated his time to training Alvarez. Alvarez was made a member of the board of directors of El Corte Inglés in 1959, having started in the company's warehouse and then worked in many of the firm's departments.

Ramón Areces Rodríguez's rival, Pepín Fernández, managing Galerías Preciados, had taken a great lead over him, with Galerías Preciados having a merchandise turnover 20 times greater than El Corte Inglés in 1960. Ramón Areces Rodríguez had to develop a strategy that would distinguish him from his competitor. He decided to change his shop's image to that of a store offering luxury goods. If Galerías Preciados worked on the principle of making huge sales of a wide range of products at cheap prices, El Corte Inglés would concentrate on offering personalized service and specialized articles. Areces's business strategy and his decision to start up business in Barcelona in 1962 were prompted by an external factor, a managerial crisis at Galerías Preciados, which affected that company's image and permitted Areces to achieve supremacy in the large department store sector.

The time from 1965 to 1975 was a boom period for El Corte Inglés. The opening of the El Corte Inglés department store in Barcelona was the first step in a policy of expansion that led to the opening of 20 shopping centers that were still open into the 1990s. This evolution was the result not only of the particular activities El Corte Inglés had developed in its department stores, but also of its strategy of vertical expansion and integration and its development of diversified services and activities.

In May 1966 El Corte Inglés shareholders formed the company Móstoles Industrial S.A. This company, arose from the consolidation of the group's divisions dealing with window displays and wooden kitchen furniture. (Móstoles Industrial is not included in the El Corte Inglés Group.) In November 1969 the travel agency company Viajes El Corte Inglés, S.A. was formed as a fully

owned subsidiary of El Corte Inglés. It grew out of the company department that had previously organized staff vacations. At the beginning of the 1990s it was the second-largest of El Corte Inglés's subsidiaries by turnover, having established itself as the largest travel agency in Spain.

To help ensure the growth of the group, Induyco was strengthened by the creation of two additional companies, Confecciones Teruel, S.A., incorporated in May 1975, and Industrias del Vestido, S.A., incorporated in June 1976. Both were set up as fully owned subsidiaries of El Corte Inglés. A further fully owned subsidiary, Construcción, Promociones e Instalaciones, S.A., was formed in May 1976 to meet the construction needs of the firms within the group.

The Ramón Areces Foundation was formed in 1976. Its purpose, apart from arranging a secure future for the company in the case of Ramón Areces Rodríguez's death, was to encourage scientific research, award grants, and support training programs, publications, and cultural activities in general.

Hipercor, S.A., another of El Corte Inglés's fully owned subsidiaries, was founded in 1979. Hipercor, operating in the hypermarket sector, based its strategy on combining the traditional hypermarket concept of low prices with the range of products and the customer care of a large department store. Hypermarkets typically combined grocery stores, nonfood retailing, and service businesses. The Hipercor centers covered a large surface area like a hypermarket. Within Tiendas Cortty, little shops gave the impression of independent franchise operations and sold products exclusive to El Corte Inglés under the Cortty trademark. Hipercor grew spectacularly during the 1980s making it the group's largest subsidiary.

Induyco created two important new companies in the 1980s. Investrónica S.A. was incorporated in 1980 and was involved in the electronics and computer sector, in particular in the manufacture of microcomputers and hi-fi equipment and the design of software. The second, Invesgen S.A., was incorporated in 1985 and was geared toward the use of advanced technologies in biochemistry and genetics.

El Corte Inglés also created two new subsidiaries in the early 1980s. In 1982 it created Centro de Seguros, Correduría de Seguros, S.A., an insurance broker and assessor also offering family policies. In 1984, it created Videcor S.A., dedicated to the development of video clubs in El Corte Inglés's and Hipercor's shopping centers. Centro de Seguros developed successfully. Videcor ceased to exist as a public limited company in August 1988 and its activities were transferred to El Corte Inglés.

In 1983, branching out onto the international market, El Corte Inglés bought The Harris Company in the United States, which ran a chain of medium-sized stores in California and also owned various shopping centers.

In February 1988 Informática El Corte Inglés was formed to sell computer products and services to large firms and public institutions using computer centers and data processing.

The year 1988 also saw the foundation of the publishing company Editorial Centro de Estudios Ramón Areces, S.A. Its aim was to become a publisher of texts for universities, and in particular of works needed for courses at the Ramón Areces Center for University Studies.

In December 1989 El Corte Inglés formed two insurance companies. The first, Seguros El Corte Inglés, Vida, Pensiones y Reaseguros S.A., covered life assurance and underwriting. The second, Seguros El Corte Inglés, Ramos Generales y Reaseguros S.A., covered accident, health, and travel insurance, as well as damages. El Corte Inglés had a 99.9 percent holding in these two companies; their accounts were separate from El Corte Inglés since their activities differed from those of other firms in the group.

El Corte Inglés also developed into a major competitor of the Spanish banks. It offered consumer credit in the manner of a bank or savings society. It held accounts for its employees, where they could cash or deposit their paychecks and take care of the expenses and purchases that they made within the company. El Corte Inglés introduced personal credit cards for its stores in 1967, and in 1991 it was the largest issuer of personal credit cards in Spain, with around 1.8 million in issue.

Ramón Areces Rodríguez died on July 30, 1989, leaving all his capital inheritance to the Ramón Areces Foundation. This effectively meant that the Ramón Areces Foundation controlled the business group, holding practically all the shares in the group's companies except for the insignificant number owned by the administrative board.

After Ramón Areces Rodríguez's death, the administrative board agreed unanimously to appoint Isidoro Alvarez as the new president of El Corte Inglés on August 1, 1989. Thus Alvarez took the position of patron and president for life of the Ramón Areces Foundation board of patrons.

Alvarez inherited a paternalistic style of management from Areces and rigorously followed the latter's stated principles of prudent investment, careful reinvestment of profits, and the avoidance of incurring unnecessary debts with banks. His initial aims were to compete successfully with the great retail multinationals, to increase the group's international ventures, and to raise profit margins. From his numerous trips and connections abroad he had an excellent knowledge of retailing outside of Spain. He was also intimately involved with Areces in El Corte Inglés's expansion, including the development of the Hipercor network and its expansion into new areas of business.

The most significant event of the 1990s for El Corte Inglés was its June 1995 acquisition of its great rival, Galerías Preciados. Galerías had fallen on hard times, having run up huge debts in the 1970s, then being taken over by its main creditor in 1977. Over the next 17 years, it had six different owners before applying for bankruptcy protection at the end of 1994. El Corte Inglés won the bidding for Galerías with an offer of US\$245 million, thereby adding the chain's 30 large department stores to its own 33. The purchase added an additional 13 cities to the company's market penetration, as well as giving it a total of 12 stores in Madrid and five in Barcelona. Acquiring Galerías also solidified El Corte Inglés's position as the top retailer in Spain and also propelled it to the number three position overall among all Spanish companies, trailing only telecommunications giant Telefónica and petrochemical concern Repsol.

El Corte Inglés spent another US\$410 million to transform most of the Galerías units into Corte Inglés stores, reopening them in time for the Christmas buying season of 1995. Several of the acquired stores that were close to existing Corte Inglés stores were not converted, but were slated to be used in experimenting with new formats. Of particular interest were the development of "category killer" formats, the large specialty stores that were the hot retailing concept of the 1990s in the United States. As usual, El Corte Inglés was well aware of this trend and in August 1995 opened three new large format stores in Madrid: one selling records, videos, audio equipment, televisions, and musical instruments; one selling books; and one selling toys and video games.

In June 1997 El Corte Inglés entered into a 50-50 joint venture with Repsol to develop a chain of supermarket-style service stations. The stores were operated under the Supercor name and sold food, produce, and other supermarket products at service stations.

El Corte Inglés's 1983 expansion into the United States ran into difficulty in the 1990s when the Harris chain consistently lost money because of declining sales. In July 1998 Fresno, California-based Gottschalks Inc. reached an agreement with El Corte Inglés to acquire the assets of Harris. In return, El Corte Inglés gained a 20 percent stake in privately held Gottschalks, operator of 37 Gottschalks department stores and 22 Village East specialty stores in California, Nevada, Oregon, and Washington.

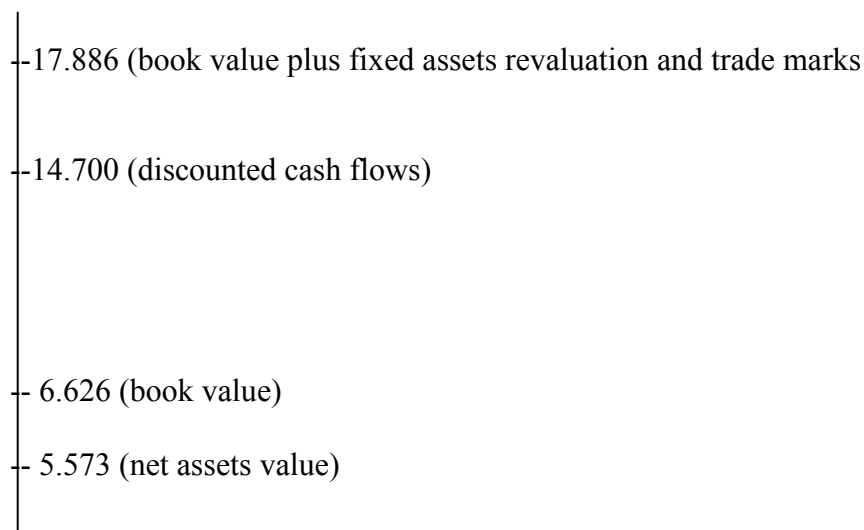
The issue

In March 2007, El Corte Ingles is embroiled in a feud to be aired in court brought by a branch of the Areces's family that wants to sell out his 2,5% of El Corte Inglés share capital. According to the statutes, the company must buy these shares agreeing a price with the shareholders interested in selling the shares. The sellers want to receive between 367 and 447 million euros. These amounts are the 2,5% of a valuation between 14.700 (discounted cash flow method) and 17.886 (adding to the book value the trade marks –1760 million euros- and the increase of the value of buildings – 9500 million euros). These valuations have prepared by a consultant hired by the sellers. Isidoro Alvarez, chairman of the firm who owns more than 60% of the company shares, thinks this price is high. Because of the disagreement Mr.Alvarez has decided to hire another consultant who has valued the firm at 5.573 million euros (net assets value which means deducting fictitious assets to the book value). The board controlled by Mr.Alvarez has done an interpretation of the statues which says that in case of disagreement the board will hire an independent expert to value the firm. After this decision, the board has decided to value the firm at 5.573 million euros.

If the civil action brought by members of the Areces Fuentes family is successful, other branches of the extended family are expected to sell out, which might eventually force Chairman Isidoro Alvarez to float the company. As the court case gets underway it has been revealed that the value of El Corte Inglés brand, and other intangibles like know-how and customer networks, have been put at zero in the company balance sheet.

The question

What is the most appropriate method to value the shares of El Corte Inglés?



EL CORTE INGLES S.A.					
	28/02/2006	28/02/2005	28/02/2004	28/02/2003	28/02/2002
	Unqualif.	Unqualif.	Unqualif.	Unqualif.	Unqualif.
	thousands €	thousands €	thousands €	thousands €	thousands €
BALANCE SHEET					
Fixed Assets	8.729.640	7.873.108	7.224.442	6.556.724	5.739.545
Intangible fixed assets	712.557	673.783	597.308	588.875	516.717
Tangible fixed assets (historical cost)	7.313.754	6.566.945	6.128.718	5.554.099	4.768.899
Other fixed assets	703.329	632.380	498.416	413.750	453.929
Current assets	3.199.987	3.043.549	3.108.410	2.877.244	2.758.135
Stocks	2.039.480	1.849.747	1.751.458	1.605.377	1.533.726
Debtors	849.824	804.835	1.056.578	1.095.170	1.023.638
Other current assets	310.683	388.967	300.374	176.697	200.771
Cash & cash equivalent	260.163	345.499	258.236	129.302	147.132
Total assets	11.929.627	10.916.657	10.332.852	9.433.968	8.497.680
Shareholders funds	6.626.054	6.046.647	5.496.781	4.892.701	4.398.010
Capital	446.292	432.768	419.244	405.720	392.196
Other shareholders funds	6.179.762	5.613.879	5.077.537	4.486.981	4.005.814
Non current liabilities	1.213.680	1.252.390	1.263.264	1.234.535	1.132.248
Long-term debt	1.211.146	1.246.326	1.225.194	1.215.186	1.097.808
Other non-current liabilities	2.534	6.064	38.070	19.349	34.440
Current liabilities	4.089.893	3.617.620	3.572.807	3.306.732	2.967.422
Loans	240.167	130.975	166.210	126.501	176.331
Creditors	2.576.671	2.482.750	2.347.229	2.126.506	1.979.716
Other current liabilities	1.273.055	1.003.895	1.059.368	1.053.725	811.375
Total shareh. funds & liab.	11.929.627	10.916.657	10.332.852	9.433.968	8.497.680
Working capital	312.633	171.832	460.807	574.041	577.648
Number of employees	92.481	87.610	84.465	79.631	74.314
INCOME STATEMENT					
	28/02/2006	28/02/2005	28/02/2004	28/02/2003	28/02/2002
Operating revenue / turnover	16.310.394	15.022.322	14.034.971	12.974.743	11.866.414
Cost of goods sold	10.964.373	10.096.093	9.388.918	8.700.753	7.934.073
Gross profit	5.346.021	4.926.229	4.646.053	4.273.990	3.932.341
Other operating expenses	4.456.448	4.086.025	3.867.975	3.536.393	3.213.722
EBIT	889.573	840.204	778.078	737.597	718.619
Financial revenue	28.022	11.787	10.261	12.509	11.025
Financial expenses	78.900	74.159	44.091	82.378	90.690
Financial P/L	-50.878	-62.372	-33.830	-69.869	-79.665
P/L before tax	838.695	777.832	744.248	667.728	638.954
Taxation	267.446	246.673	231.894	199.957	174.785
P/L after tax	571.249	531.159	512.354	467.771	464.169
Extraordinary revenue	99.073	99.965	90.550	83.393	73.402
Extraordinary expenses	17.180	19.662	26.850	18.587	55.640
Extraordinary P/L	81.893	80.303	63.700	64.806	17.762
P/L for period	653.142	611.462	576.054	532.577	481.931
Depreciation	518.212	503.168	480.930	422.933	373.504
Cash flow	1.171.354	1.114.630	1.056.984	955.510	855.435
EUROPEAN RATIOS					
Return on Shareholders Funds (%)	12,66	12,86	13,54	13,65	14,53
Return on Total Assets (%)	7,03	7,13	7,2	7,08	7,52
Profit Margin (%)	5,14	5,18	5,3	5,15	5,38
Stock Turnover	8	8,12	8,01	8,08	7,74
Collection period (days)	19	19	27	30	31
Credit Period (days)	57	59	60	59	60