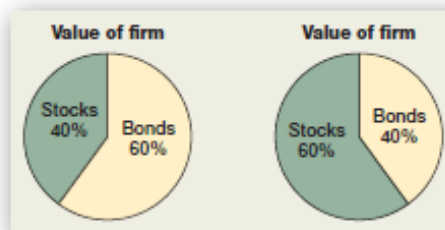


Definitions

- Financial structure** – broader term covers also non-debt obligations.
 - Which financing sources are to be used (short-term vs long-term) and in which proportions?
 - Stronger interlinkages with working capital management.
- Capital structure** - firm's mix of debt and equity financing.
 - What is the optimal capital structure for the firm?
 - What is the desired capital structure of the firm?

MM 1st proposition

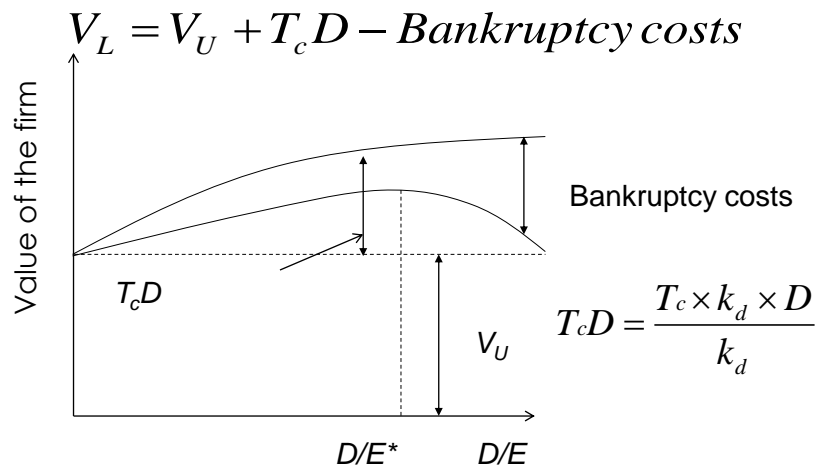
- Firm's value is determined by its real assets, not by securities it issues, i.e. capital structure is irrelevant.



- Capital structure affects the distribution of the pie not the size of the pie.

$$V_{Levered} = V_{Unlevered}$$

MM 1st proposition with taxes and bankruptcy costs



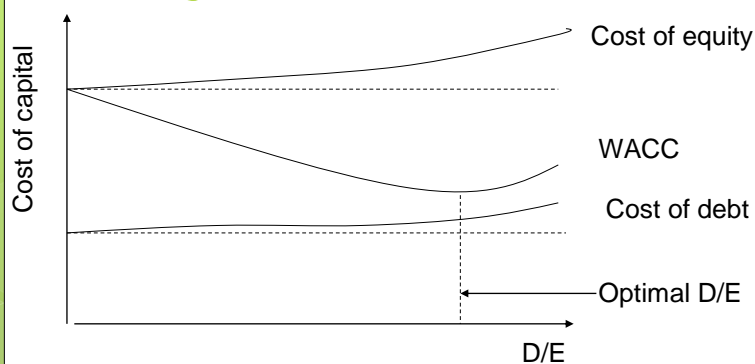
Bankruptcy costs

- **Direct bankruptcy costs** – costs related to redundancy payments, legal and administrative costs incurred during bankruptcy. Generally amount to 10-20% of firm pre-distress value.
- **Indirect bankruptcy costs include:**
 - Order cancellations (for fear they will not be honoured)
 - Less trade credit (because it may not be repaid)
 - Reduced productivity (strikes, underutilization of production capacity)
 - No more access to financing

Change in capital structure

- Replacing equity for loan is a signal that the company
 - has no profitable investment projects,
 - share is under-priced or
 - managers have positive expectations about the future earnings of the company.
- Impact on managers – resolving agency conflict.
- Impact on investors – may change their composition (similar result as in the case of a dividend policy decision).
- Affects the value of the firm, cost of capital, loan servicing ability, EPS and may affect voting rights (if shares are re-purchased).

Change in cost of capital



$$r_E = r + \frac{D}{E}(r - r_D)(1 - T_c) \quad \beta_{levered} = \beta_{unlevered} \left[1 + (1 - t) \frac{D}{E} \right]$$

Share re-purchase

- o **Carried out in order to:**

- o Keep them on the balance sheet - as treasury shares in order to fulfil the exercise of stock options held by employees.
- o Cancel them - par value is deducted from share capital and excess costs charged against distributable reserves.

- o **Alternatives for buying back shares:**

- o Open market.
- o Tender offer – offer to shareholders for buying their shares at a pre-determined price during a certain time period.
- o Targeted repurchase – shares of a specific shareholder are bought back.

Introduction (1)

- o Company – WM Wrigley Jr.
- o Owner – William Wrigley 21% of ordinary shares, 58% of Class B shares.
- o Activity - world's biggest chewing gum producer. Industry peers see page 4.
- o Financials
 - o Increasing sales and profits. Income statement on page 5.
 - o Financing based on equity, no loans. Balance sheet on page 6.
 - o Share price had an increasing trend. See page 7.

Introduction (2)

- Protagonist – Susan Chandler, working at hedge fund Aurora Borealis LLC managed by Blanka Dobrinin.
- Blanka Dobrinin's idea - Wrigley should take a 3 bio USD loan with interest corresponding to BB or B credit rating and either
 - Pay dividends.
 - Re-purchase shares.

Wrigley now

- In October 2008, the Company completed its merger transaction with Mars, Incorporated.
- As a result, Wrigley is now a subsidiary of Mars, Incorporated.
- Mars Inc. operates through its six business segments:
 - **Petcare** – brands PEDIGREE, ROYAL CANIN, WHISKAS, KITEKAT, BANFIELD Pet Hospital and NUTRO;
 - **Chocolate** – brands M&M'S, SNICKERS, DOVE, GALAXY, MARS, MILKY WAY and TWIX;
 - **Wrigley** – brands DOUBLEMINT, EXTRA, ORBIT and 5 chewing gums, SKITTLES and STARBURST candies, and ALToids AND LIFESAVERS mints;
 - **Food** – brands UNCLE BEN'S, DOLMIO, EBLy, MASTERFOODS, SEEDS OF CHANGE and ROYCO;
 - **Drinks** – brands ALTERRA COFFEE ROASTERS, THE BRIGHT TEA COMPANY, KLIX and FLAVIA;
 - **Symbioscience** – brands COCOAVIA, WISDOM PANEL and SERAMIS.
- The Company provides pet medicine, nutrition, and food products, ready-made meals, sauces, relishes, and cooking aids, chocolates, chewing gums, candies, and mints, and drinks, including hot chocolate drinks, teas, and coffees.

Source: Thomson Reuters Eikon