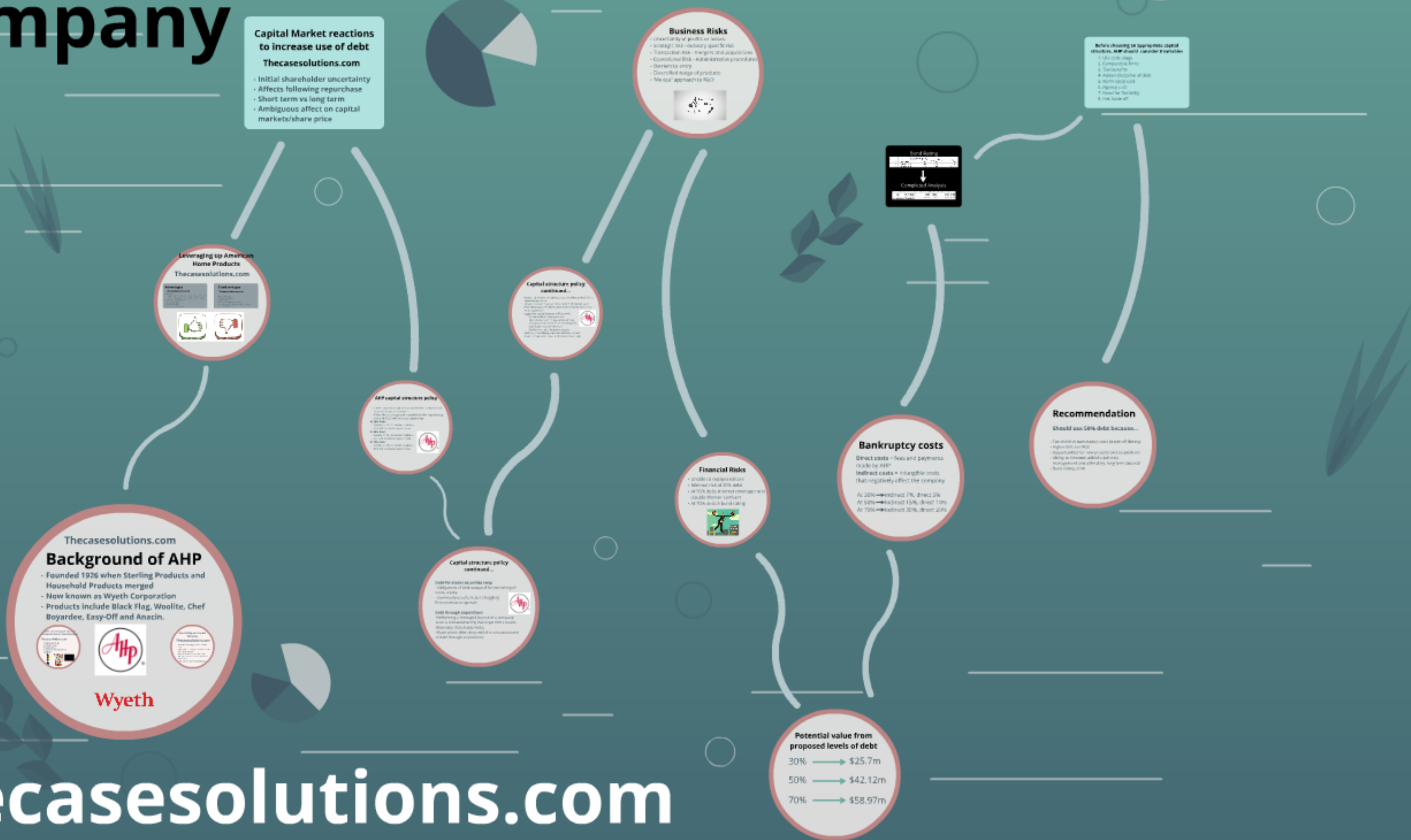
Sterling Household Products Company




Sterling Household Products Company
Capital Market reactions to increase use of debt
Thecasesolutions.com
- Initial shareholder uncertainty
- Affects following repurchase
- Short term vs long term
- Ambiguous affect on capital markets/share price
Business Risks
Leveraging up American Home Products
Thecasesolutions.com
AHP capital structure policy
Capital structure policy continued...
Financial Risks
Bankruptcy costs
Direct costs = fees and payments made by AHP
Indirect costs = intangible costs that negatively affect the company
Recommendation
Thecasesolutions.com
Background of AHP
- Founded 1926 when Sterling Products and Household Products merged
- Now known as Wyeth Corporation
- Products include Black Flag, Woolite, Chef Boyardee, Easy-Off and Anacin.
Wyeth
Potential value from proposed levels of debt
30% $25.7m
50% $42.12m
70% $58.97m
Thecasesolutions.com

Background of AHP

- Founded 1926 when Sterling Products and Household Products merged
- Now known as Wyeth Corporation
- Products include Black Flag, Woolite, Chef Boyardee, Easy-Off and Anacin.

1,500 consumer goods allocated among four distinct lines of business

- Prescription drugs
- Packaged drugs
- Food products
- Houseware and household products


Debt Policy and Capital Structure

- Low debt levels, high cash on balance sheet
- CEO, William F. Laporte had a conservative managerial approach
- Laporte's brand of centralized micro-management created a firm with a AAA bond rating

"we run this company for the shareholders"

1,500 consumer goods allocated among four distinct lines of business

Thecasesolutions.com

- Prescription drugs
- Packaged drugs
- Food products
- Houseware and household products

Debt Policy and Capital Structure

Thecasesolutions.com

- Low debt levels, high cash on balance sheet
- CEO, William F. Laporte had a conservative managerial approach
- Laporte's brand of centralized micro-management created a firm with a AAA bond rating

"we run this company for the shareholders"

Leveraging up American Home Products

Thecasesolutions.com

Advantages

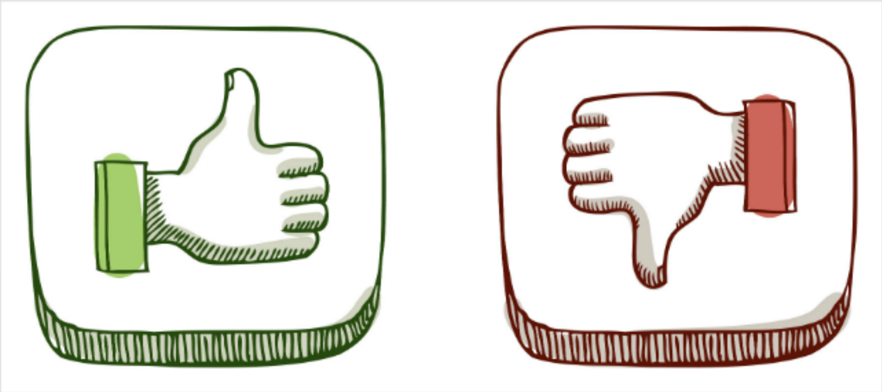
Thecasesolutions.com

- Tax Shield
  - -Hypothetical = 14% x 30% = 4.2%, 14% - 4.2% = 9.8%
  - -Actual = 14% x 48% = 6.72%, 14% - 6.72% = 7.28%
- Discipline to management
- Pecking order theory
- Higher EPS and ROE
- Increased room for growth

Disadvantages

Thecasesolutions.com

- Bankruptcy costs
- Increased risk (beta)
- Agency costs
- Loss of future financial flexibility
- Interest foregone on excess cash/ Opportunity cost of holding cash.



Advantages

Thecasesolutions.com

- Tax Shield
  - -Hypothetical = 14% x 30% = 4.2%, 14% - 4.2% = 9.8%
  - -Actual = 14% x 48% = 6.72%, 14% - 6.72% = 7.28%
- Discipline to management
- Pecking order theory
- Higher EPS and ROE
- Increased room for growth

Disadvantages

Thecasesolutions.com

- Bankruptcy costs
- Increased risk (beta)
- Agency costs
- Loss of future financial flexibility
- Interest foregone on excess cash/ Opportunity cost of holding cash.

Capital Market reactions to increase use of debt

Thecasesolutions.com

- Initial shareholder uncertainty
- Affects following repurchase
- Short term vs long term
- Ambiguous affect on capital markets/share price