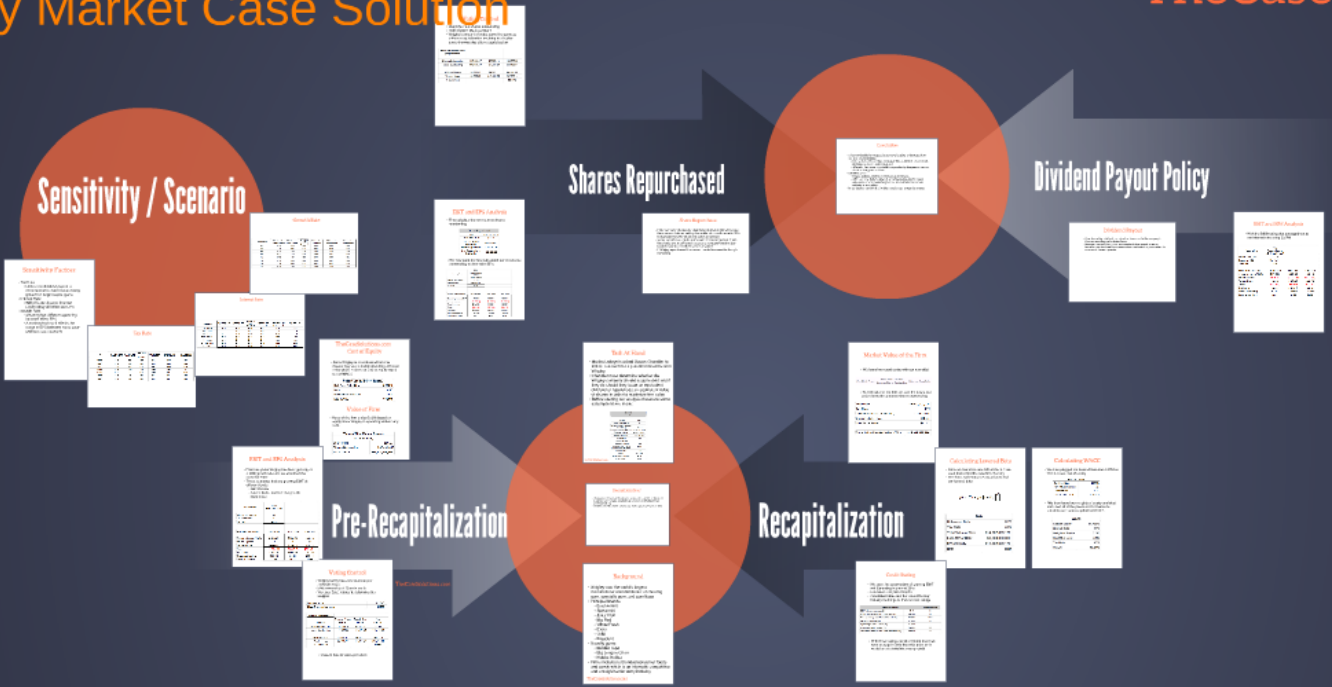


WM Wrigley JR. Company: Innovation in China's Confectionery Market Case Solution

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Wm. Wrigley Jr. Company: Capital Structure, Valuation, and Cost of Capital

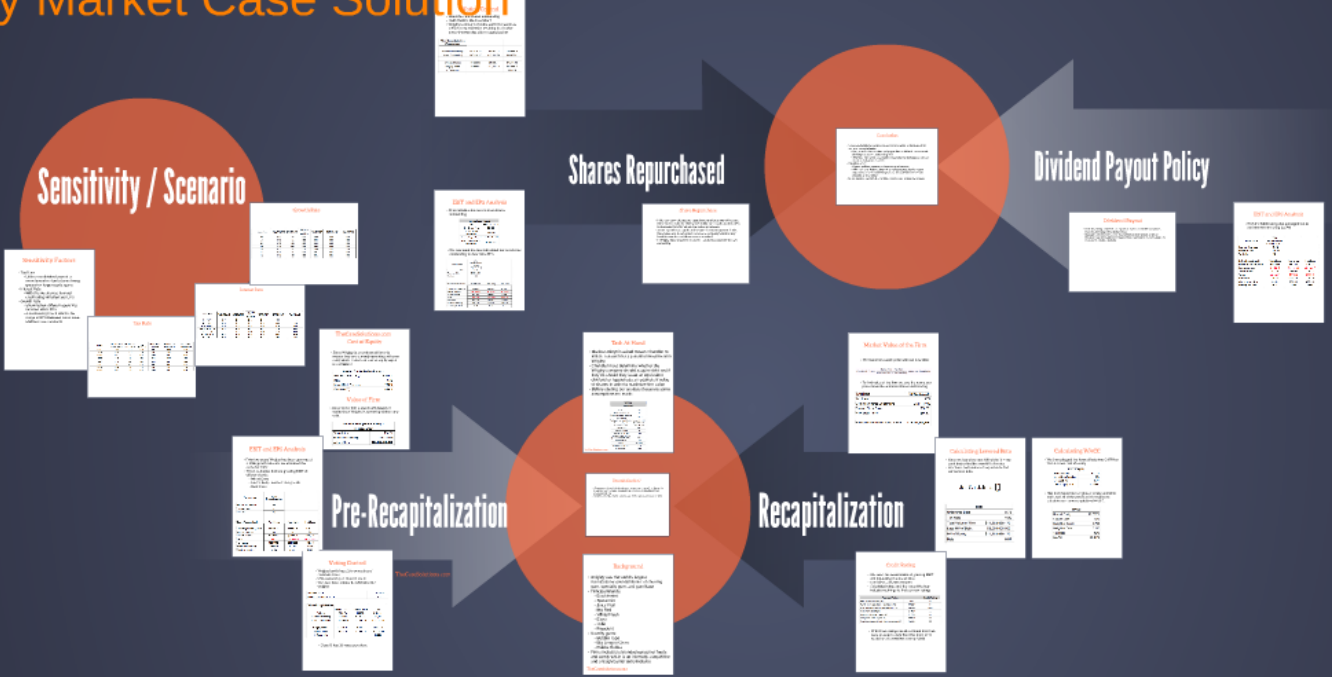
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Sensitivity Factors

- The main sensitivity factors to focus on when doing a DCF are:
 - WACC
 - Free Cash Flow
 - Terminal Value
 - Discount Rate

Free Cash Flow

Year	1	2	3	4	5	6	7	8	9	10
Operating Income	100	110	120	130	140	150	160	170	180	190
Depreciation	10	10	10	10	10	10	10	10	10	10
Change in Working Capital	0	0	0	0	0	0	0	0	0	0
Change in Debt	0	0	0	0	0	0	0	0	0	0
Change in Equity	0	0	0	0	0	0	0	0	0	0
Free Cash Flow	110	120	130	140	150	160	170	180	190	200

Market Data

Year	1	2	3	4	5	6	7	8	9	10
Market Value	1000	1100	1200	1300	1400	1500	1600	1700	1800	1900

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Cost of Equity

$Cost\ of\ Equity = R_f + \beta(R_M - R_f)$

$WACC = \frac{E}{E+D} \times Cost\ of\ Equity + \frac{D}{E+D} \times Cost\ of\ Debt$

EBIT and EPS Analysis

EBIT	100	110	120	130	140	150	160	170	180	190
Interest	0	0	0	0	0	0	0	0	0	0
EBT	100	110	120	130	140	150	160	170	180	190
Taxes	20	22	24	26	28	30	32	34	36	38
EBT - Taxes	80	88	96	104	112	120	128	136	144	152
Preferred Dividends	0	0	0	0	0	0	0	0	0	0
EBT - Taxes - Preferred Dividends	80	88	96	104	112	120	128	136	144	152
Number of Shares	100	100	100	100	100	100	100	100	100	100
EPS	0.80	0.88	0.96	1.04	1.12	1.20	1.28	1.36	1.44	1.52

Voting Control

Majority control is 50% ownership of shares.

Control is typically held by the majority.

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Pre-Recapitalization

Task At Hand

Calculate the value of the firm before the recapitalization. Use the WACC method. Use the market value of the firm as a benchmark. Compare the value of the firm before and after the recapitalization. Use the WACC method to calculate the value of the firm after the recapitalization.

Background

The firm is currently financed with 50% debt and 50% equity. The debt is at a 10% interest rate. The firm is considering a recapitalization to reduce its debt and increase its equity.

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Recapitalization

Market Value of the Firm

Market value is the value of the firm as determined by the market. It is the sum of the market value of the firm's equity and the value of its debt.

Market Value of the Firm

Component	Value
Equity	1000
Debt	1000
Total Market Value	2000

Credit Rating

The firm's credit rating is currently BBB. The firm is considering a recapitalization to improve its credit rating to AA.

Calculating Levered Beta

$\beta_L = \beta_U [1 + (1 - \tau_c) \frac{D}{E}]$

Calculating WACC

Component	Value	Weight	Cost
Equity	1000	50%	10%
Debt	1000	50%	10%
WACC	10%		

Discount Present

Discount present is the value of a future cash flow as of the present. It is calculated by dividing the future cash flow by the discount factor.

Discount Present

Year	1	2	3	4	5
Free Cash Flow	110	120	130	140	150
Discount Factor	0.909	0.818	0.733	0.658	0.583
Discounted FCF	100	98	95	92	87

Company: Capital Structure, Valuation

Jessica Holck
Megan Hayslett
Lu Wang

Background

- Wrigley was the world's largest manufacturer and distributor of chewing gum, specialty gum, and gum base
- Principal brands:
 - Doublemint
 - Spearmint
 - Juicy Fruit
 - Big Red
 - WinterFresh
 - Extra
 - Orbit
 - Freedent
- Novelty gums:
 - Bubble Tape
 - Big League Chew
 - Hubba Bubba
- Firms industry is branded consumer foods and candy which is an intensely competitive and a tough barrier entry industry

Task At Hand

- Blanka Dobrynin asked Susan Chandler to initiate research for a potential investment in Wrigley.
- Chandler must determine whether the Wrigley company should acquire debt and if they do should they issue an equivalent dividend or repurchase an equivalent value of shares in order to maximize firm value
- Before starting our analysis these are some assumptions we made:

Exhibit 6	
Assumptions	
Tax Rate	40%
Market Risk Premium	7%
Borrowing Debt @ (Assumed BB/B Rating)	13.71%
Rating prior to recapitalization	Between B and BB
Borrowing Capacity	\$3,000,000,000
Shares Outstanding	232,441,000
Growth Rate	10%
Earnings Growth	9%
Pre-tax Cost of Debt	13%
Actual Borrowed Debt @ (Assumed BBB/BB) Rating	11.82%
Common Stock	1 Vote
Class B	10 Votes
Wrigley Common Stock	21%
Wrigley Class B	58%

Exhibit 6**Assumptions**

Tax Rate	40%
Market Risk Premium	7%
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Common Stock	1 Vote
Class B	10 Votes
Wrigley Common Stock	21%
Wrigley Class B	58%

Share Price	\$56.37
Shares Outstanding	232,441,000
Value of Firm	\$13,102,699,170

Pre-Recapitalization

Voting Control

- Wrigley family has 21% ownership of common stock
- 58% ownership of Class B stock
- We used 2001 values to determine the weights

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\$0.93
\$0.83
\$0.74
\$0.65

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Cost of Equity

- Since Wrigley is an unlevered firm this means they are currently operating with zero debt, which makes our cost of equity equal to our WACC

Cost of Equity (Before Recap.)	
Risk Free Rate (20 yr)	5.650%
Beta	0.75
Market Risk Premium	7.00%
Ksu (WACC)	10.90%

Value of Firm

- Value of the firm is also 100% based on equity since Wrigley is operating without any debt.

Value of Firm (Before Recap.)	
(in thousands)	
Share Price	\$56.37
Shares Outstanding	232,441,000
Value of Firm	\$13,102,699,170