JAIPURIA INSTITUTE OF MANAGEMENT, NOIDA

PGDM / PGDM (M) / PGDM (SM)

5th TRIMESTER (Batch 2020-22)

Reappear End Term Examinations, February 2022.

SET - B

Course Name	Corporate Restructuring	Course Code	FIN502
Max. Time	2 Hrs	Max. Marks	40

Instructions: Attempt All Questions. Overall Permissible Plag. is 10%, **Penalty Clause: 11-20% - Minus 5 Marks, > 20% - Reappear**.

Q-1 (10 Marks) (CLO-1)

Under considerable profit pressure from escalating commodity prices and eroding market share, Wrigley Corporation, a U.S. based leader in gum and confectionery products, faced increasing competition from Cadbury Schweppes in the U.S. gum market. Wrigley had been losing market share to Cadbury since 2006. Mars Corporation, a privately-owned candy company with annual global sales of $22 billion, sensed an opportunity to achieve sales, marketing, and distribution synergies by acquiring Wrigley Corporation.

On April 28, 2008, Mars announced that it had reached an agreement to merge with Wrigley Corporation for $23 billion in cash. Under the terms of the agreement, unanimously approved by the boards of the two firms, shareholders of Wrigley would receive $80 in cash for each share of common stock outstanding. The purchase price represented a 28 percent premium to Wrigley's closing share price of $62.45 on the announcement date. The merged firms in 2008 would have a 14.4 percent share of the global confectionary market, annual revenue of $27 billion, and 64,000 employees worldwide. The merger of the two family-controlled firms represents a strategic blow to competitor Cadbury Schweppes's efforts to continue as the market leader in the global confectionary market with its gum and chocolate business. Prior to the announcement, Cadbury had a 10 percent worldwide market share.

Wrigley would become a separate stand-alone subsidiary of Mars, with $5.4 billion in sales. The deal would help Wrigley augment its sales, marketing, and distribution capabilities. To provide more focus to Mars' brands in an effort to stimulate growth, Mars would transfer its global nonchocolate confectionery sugar brands to Wrigley. Bill Wrigley, Jr., who controls 37 percent of the firm's outstanding shares, would remain executive chairman of Wrigley. The Wrigley management team also would remain in place after closing. The combined companies would have substantial brand

recognition and product diversity in six growth categories: chocolate, nonchocolate confectionary, gum, food, drinks, and pet-care products. The resulting confectionary powerhouse also would expect to achieve significant cost savings by combining manufacturing operations and have a substantial presence in emerging markets.

While mergers among competitors are not unusual, the deal's highly leveraged financial structure is atypical of transactions of this type. Almost 90 percent of the purchase price would be financed through borrowed funds, with the remainder financed largely by a third party equity investor. Mars's upfront costs would consist of paying for closing costs from its cash balances in excess of its operating needs. The debt financing for the transaction would consist of $11 billion and $5.5 billion provided by J.P. Morgan Chase and Goldman Sachs, respectively. An additional $4.4 billion in subordinated debt would come from Warren Buffet's investment company, Berkshire Hathaway, a nontraditional source of high-yield financing. Historically, such financing would have been provided by investment banks or hedge funds and subsequently repackaged into securities and sold to long-term investors, such as pension funds, insurance companies, and foreign investors. However, the meltdown in the global credit markets in 2008 forced investment banks and hedge funds to withdraw from the high-yield market in an effort to strengthen their balance sheets. Berkshire Hathaway completed the financing of the purchase price by providing $2.1 billion in equity financing for a 9.1 percent ownership stake in Wrigley.

Required:

a. Why was market share in the confectionery business an important factor in Mars’ decision to acquire Wrigley? (3 Marks)

b. In what way did the acquisition of Wrigley’s represent a strategic blow to Cadbury? (3 Marks)

c. How might the additional product and geographic diversity achieved by combining Mars and Wrigley benefit the combined firms? (4 Marks)

Q-2 (10 Marks) (CLO-2)

(a) What are some of the reasons a family-owned or privately-owned business may want to go public? What are some of the reasons that discourage such firms from going public? Why are family owned firms often attractive to private equity investors? (5 Marks)

(b) Rank from the highest to the lowest the liquidity discount you would apply if you as a business appraiser had been asked to value the following privately-owned businesses: a) a local, profitable hardware store, b) a money losing laundry, c) a large privately owned but marginally profitable firm with

significant excess cash balances and other liquid short-term investments, and d) a pool cleaning service whose primary tangible assets consist of a 2-year old truck and miscellaneous equipment. Explain your ranking. (5 Marks)

Q-3 (10 Marks) (CLO-3)

In the year in which it intends to go public, a firm has revenues of $20 million and net income after taxes of $2 million. The firm has no debt, and revenue is expected to grow at 20% annually for the next five years and 5% annually thereafter. Net profit margins are expected to remain constant throughout. Capital expenditures are expected to grow in line with depreciation and working capital requirements are minimal. The average beta of a publicly traded company in this industry is 1.50 and the average debt/equity ratio is 20%. The firm is managed very conservatively and does not intend to borrow through the foreseeable future. The Treasury bond rate is 6% and the tax rate is 40%. The normal spread between the return on stocks and the risk-free rate of return is believed to be 5.5%. Reflecting the slower growth rate in the sixth year and beyond, the firm's discount rate is expected to decline to the industry average cost of capital of 10.4%. Estimate the value of the firm's equity following the below-mentioned steps:

a. Calculate beta? (1.5 Marks)
b. Calculate cost of equity. (1.5 Marks)
c. Calculate discounted free cash flows to equity (FCFE). (3 Marks)
d. Calculate firm's equity value. (2 Marks)
e. On theoretical ground, which discounted cash flow valuation methods require the estimation of a terminal value? Why? (2 Marks)

Q-4 (10 Marks) (CLO-4)

How would you decide when to sell a business? What are the alternative strategies of restructuring? Briefly explain them. How the parent company uses tracking or target stocks? Critically evaluate the advantages and disadvantages of tracking or target stocks to investors and to the firm?