

Case Study Questions

A New Financial Policy at Swedish Match

In early September 2005, Lars Dahlgren was weighing his options in his Stockholm office. He had recently been appointed CFO at Swedish Match, a producer of smokeless tobacco, cigar matches, and lighters. Its most important product was a type of smokeless tobacco called *snus* (see Exhibit 1). At the next meeting of Swedish Match's audit committee, Dahlgren was scheduled to present an annual review of the financial plan. Swedish Match had recently used bank loans to finance the acquisition of several cigar firms. However, these debts were being rapidly paid off, and if the firm maintained its traditional policies, its leverage—the ratio of debt to capital—would soon be very low again.

1. Assuming Swedish Match faces a 28% tax rate on income and can issue bonds at a fixed krona yield of 4.5%, how much will the company save in taxes from a SEK4 billion recapitalization? What is the value of this interest tax shield?
2. What will Swedish Match's book value balance sheet look like after it completes the debt issuance and share repurchase?
3. What will Swedish Match's market value balance sheet look like:
 - a. Right after it announces the leveraged recap?
 - b. When it completes the issuance of SEK4 billion in debt?
 - c. When it completes the share purchase?
4. Can Swedish Match afford to borrow this much money?
 - a. What are the risks?
 - b. Is it realistic to expect a BBB+ rating and does the rating matter?
5. Should the company go ahead with a leveraged recap?