

## Copyright

### **A New Financial Policy at Swedish Match**

Harvard Business School Case 9-212-017

Courseware 9-212-705

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Particulars	SEK millions
<b>Interest Payment</b>	<b>180</b>
<b>Saving each year</b>	<b>50.4</b>
<b>Tax Shield(assuming 10 year bond</b>	<b>398.80</b>

Post-Recap, Swedish Match will have an additional SEK 4 billion in debt and have The pre and post recap balance sheets as of 2004:-

<b>Balance Sheet</b>	<b>Pre</b>	<b>Post</b>
<b>Cash and Short-term Investments</b>	<b>3002</b>	<b>3002</b>
<b>Current Assets<sup>b</sup></b>	<b>4884</b>	<b>4884</b>
<b>PP&amp;E</b>	<b>2712</b>	<b>2712</b>
<b>Other Assets<sup>c</sup></b>	<b>4300</b>	<b>4300</b>
<b>Total Assets</b>	<b>14898</b>	<b>14898</b>
<b>Current Liabilities<sup>d</sup></b>	<b>3776</b>	<b>3776</b>
<b>Total Interest-Bearing Debt</b>	<b>3529</b>	<b>7529</b>
<b>Of which: Long-term Debt</b>	<b>2559</b>	<b>6559</b>
<b>Other Liabilities<sup>e</sup></b>	<b>2533</b>	<b>2533</b>
<b>Equity, including minority interes</b>	<b>5060</b>	<b>1060</b>
<b>Total Liabilities and Equity</b>	<b>14898</b>	<b>14898</b>

SEK 4.5 billion less in book value equity.

Total Debt/EBITDA	
<b>7529</b>	
<b>2344</b>	<b>3.21203</b>

**Part A**

Immediately after announcing the leverage recap, Swedish Match's market value of equity assuming that the book values of all tangible assets are equal to their market values

<b>Balance Sheet</b>	<b>Pre</b>	<b>Post</b>
Cash & Short Term Investments	3002.00	\$3,002
Current Assets	4884.00	\$4,884
PP&E	2712.00	\$2,712
Other Assets	4300.00	\$4,300
Intangible Assets	23394.00	\$23,393
<b>Total Assets</b>	<b>38292.00</b>	<b>\$38,292</b>
Current Liabilities	\$3,776	\$3,776
Total Interest Bearing Debt	\$3,529	\$3,529
<i>Of Which: Long-Term Debt</i>	\$2,559	\$2,559
Other Liabilities	\$2,533	\$2,533
Equity & Minority Interests	\$28,454	\$28,454
<b>Total Liabilities &amp; Equity</b>	<b>\$38,292</b>	<b>\$38,292</b>

**Part B**

After it completes the debt issuance, the total interest bearing debt figure will increase by SEK 4 billion

<b>Balance Sheet</b>	<b>Pre</b>	<b>Post</b>
Cash & Short Term Investments	\$3,002	\$7,002
Current Assets	\$4,884	\$4,884
PP&E	\$2,712	\$2,712
Other Assets	\$4,300	\$4,300
Intangible Assets	\$23,793	\$23,793
<b>Total Assets</b>	<b>\$38,691</b>	<b>\$42,691</b>
Current Liabilities	\$3,776	\$3,776
Total Interest Bearing Debt	\$3,529	\$7,529
<i>Of Which: Long-Term Debt</i>	\$2,559	\$6,559
Other Liabilities	\$2,533	\$2,533
Equity & Minority Interests	\$28,853	\$28,853
<b>Total Liabilities &amp; Equity</b>	<b>\$38,691</b>	<b>\$38,691</b>

**Part C**

After it completes the share repurchase, the cash figure will decrease by SEK 4 billion and

<b>Balance Sheet</b>	<b>Pre</b>	<b>Post</b>
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Cash & Short Term Investments	\$7,002	\$3,0
Current Assets	\$4,884	\$4,8
PP&E	\$2,712	\$2,7
Other Assets	\$4,300	\$4,3
Intangible Assets	\$23,793	\$23,7
<b>Total Assets</b>	<b>\$42,691</b>	<b>\$38,</b>
Current Liabilities	\$3,776	\$3,7
Total Interest Bearing Debt	\$7,529	\$7,5
<i>Of Which: Long-Term Debt</i>	\$6,559	\$6,5
Other Liabilities	\$2,533	\$2,5
Equity including Minority Interests	\$28,853	\$24,8
<b>Total Liabilities &amp; Equity</b>	<b>\$42,691</b>	<b>\$38,</b>

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From Exhibit 7 and Exhibit 5:

<b>Firm</b>	<b>EBIT Interest Coverage</b>	<b>EBITDA Interest Coverage</b>
<b>Altadis</b>	5.4	6.4
<b>BAT</b>	6.8	7.7
<b>Imperial Tobacco</b>	4.4	5.8
<b>Gallaher</b>	3.9	4.5
<b>Average BBB firm</b>	4.7	6.5
<b>Average BB firm</b>	2.5	3.5
<b>Swedish Match</b>	4.18	5.26

Thus the credit rating of Swedish Match will fall from A Swedish Match may take this new policy. However, it should and retain some flexibility at the same time rather than

<b>Total Debt/EBITDA</b>	<b>Leverage @ Market Values</b>	<b>Rating</b>
2.9	24%	A-
2.5	28%	BBB+
3.2	28%	BBB
4.3	36%	BBB
2.2	24.50%	BBB
3.5	35.50%	BB
3.21	23.30%	BBB

A- to BBB which will increase further costs in the future.  
 should not raise more debt to maintain a BBB rating at least  
 in becoming cash-strapped due to interest payments alone.

**Exhibit 2** Swedish Match, Selected Financial Data, 1995–2004 (in SEK millions, except where noted)

	1995	1996	1997	1998	1999	2000	2001
<b>Summary Operating Data</b>							
Revenue	7,435	7,416	7,465	8,194	9,420	11,533	13,635
– Cost of Goods Sold	3,900	3,653	3,615	4,096	5,138	6,647	7,627
– Other Operating Expenses	2,062	2,179	2,281	2,620	2,639	3,035	3,843
<b>EBITDA</b>	<b>1,473</b>	<b>1,584</b>	<b>1,569</b>	<b>1,478</b>	<b>1,643</b>	<b>1,851</b>	<b>2,165</b>
– Depreciation and Amortization	294	270	268	332	381	543	670
<b>EBIT</b>	<b>1,179</b>	<b>1,314</b>	<b>1,301</b>	<b>1,146</b>	<b>1,262</b>	<b>1,308</b>	<b>1,495</b>
– Interest Expense	107	178	65	182	323	427	407
+ Other Items <sup>a</sup>	504	394	322	234	4,341	829	752
<b>EBT</b>	<b>1,576</b>	<b>1,530</b>	<b>1,558</b>	<b>1,198</b>	<b>5,280</b>	<b>1,710</b>	<b>1,840</b>
– Income Tax Expense	473	439	512	482	638	556	589
<b>Net Income</b>	<b>1,103</b>	<b>1,091</b>	<b>1,046</b>	<b>716</b>	<b>4,642</b>	<b>1,154</b>	<b>1,251</b>
<b>Balance Sheet</b>							
Cash and Short-term Investments	804	942	563	2,876	7,296	2,960	1,606
Current Assets <sup>b</sup>	3,099	3,108	3,278	4,089	3,808	5,730	6,587
PP&E	2,002	1,939	2,050	2,239	1,866	2,576	2,970
Other Assets <sup>c</sup>	741	888	1,241	1,358	3,700	5,015	5,460
<b>Total Assets</b>	<b>6,646</b>	<b>6,877</b>	<b>7,132</b>	<b>10,562</b>	<b>16,670</b>	<b>16,281</b>	<b>16,623</b>
Current Liabilities <sup>d</sup>	4,566	2,798	3,248	2,732	3,290	3,253	3,879
Total Interest-Bearing Debt	129	1,019	209	4,331	5,873	5,699	5,483
<i>Of which: Long-term Debt</i>	9	4	209	2,098	5,093	4,638	5,072
Other Liabilities <sup>e</sup>	289	692	683	1,191	1,405	2,125	2,389
Equity, including minority interest	1,662	2,368	2,992	2,308	6,102	5,204	4,872
<b>Total Liabilities and Equity</b>	<b>6,646</b>	<b>6,877</b>	<b>7,132</b>	<b>10,562</b>	<b>16,670</b>	<b>16,281</b>	<b>16,623</b>
<b>Cash Flow Data and Stock Price</b>							
Capital Expenditures	302	217	292	393	452	331	633
Cash Acquisitions, net <sup>f</sup>	0	0	60	157	-2,259	1,660	962
Dividends Paid	1,072	300	510	510	474	539	490
Share Repurchases	0	0	0	1,147	0	1,967	1,169
Shares Outstanding, M	431	464	464	431	431	375	350
Year End Share Price (krona/share)	29.7	26.6	26.28	25.52	28.62	42.52	69
Market Value of Equity	12,801	12,331	12,192	10,999	12,336	15,944	24,150
<b>Selected Growth Rates and Ratios</b>							
EBITDA Margin	19.8%	21.4%	21.0%	18.0%	17.4%	16.0%	15.9%
EBIT Margin	15.9%	17.7%	17.4%	14.0%	13.4%	11.3%	11.0%
Book Leverage (debt/debt plus equity) (%)	7.2%	30.1%	6.5%	65.2%	49.0%	52.3%	53.0%
Market Leverage (debt/debt plus market capitalization) (%)	1.0%	7.6%	1.7%	28.3%	32.3%	26.3%	18.5%
Book Equity / Assets	25.0%	34.4%	42.0%	21.9%	36.6%	32.0%	29.3%

Source: Capital IQ, accessed September 2011, and annual reports.

<sup>a</sup> Other items include Investment Income, Income from Affiliates, Currency Exchange Gains, Restructuring Charges, Gain on Sale of Assets, Asset Write-downs,

<sup>b</sup> "Current Assets" includes Accounts Receivable, Inventory, and Prepaid Expenses.

<sup>c</sup> "Other Assets" includes Long-term Investments, Goodwill, Other Intangibles, and Other Long-Term Assets.

<sup>d</sup> "Current Liabilities" includes Accounts Payable, Accrued Expenses, Current Income Taxes Payable, Deferred Tax Liabilities, and Other Current Liabilities.

<sup>e</sup> "Other Liabilities" includes Pension and Other Post-Retirement Benefits, Deferred Tax Liabilities, Non-Current, and Other Non-Current Liabilities.

<sup>f</sup> Cash used for purchasing businesses and subsidiaries, minus net proceeds from the divestiture and sale of businesses and subsidiaries.

2002	2003	2004	2005
13,643	13,036	13,007	
7,451	7,103	7,027	
3,842	3,722	3,636	
<b>2,350</b>	<b>2,211</b>	<b>2,344</b>	<b>2344 5.255605</b>
651	665	479	
<b>1,699</b>	<b>1,546</b>	<b>1,865</b>	<b>1865</b>
337	283	266	<b>446 4.181614</b>
764	911	1,829	
<b>2,126</b>	<b>2,174</b>	<b>3,428</b>	
648	572	1,345	
<b>1,478</b>	<b>1,602</b>	<b>2,083</b>	
2,016	2,666	3,002	
5,742	5,310	4,884	
2,938	2,862	2,712	
4,751	4,264	4,300	
<b>15,447</b>	<b>15,102</b>	<b>14,898</b>	
3,093	2,929	3,776	
5,283	5,381	3,529	
4,518	4,535	2,559	
2,378	2,185	2,533	
4,693	4,607	5,060	
<b>15,447</b>	<b>15,102</b>	<b>14,898</b>	
751	551	486	
53	78	-64	
508	535	558	
499	1,012	658	
334	328.5	322.1	
61.95	78.71	88.34	
20,691	25,856	<b>28,454</b>	
17.2%	17.0%	18.2%	
12.5%	11.9%	14.3%	
53.0%	53.9%	41.1%	
20.3%	17.2%	11.0%	
30.4%	30.5%	34.0%	

and Other Unusual Items.

**Exhibit 7** Comparable Company Data, 12/31/2004 (in SEK millions,<sup>a</sup> except as noted)

	<b>Swedish Match</b>	<b>UST</b>	<b>Imperial Tobacco</b>	<b>BAT</b>
<b>Summary Operating Data</b>				
Net Sales	13,007	11,888	36,447	137,096
EBITDA	2,344	6,377	15,915	36,528
EBIT	1,865	6,060	12,189	31,982
Interest Expense	266	551	2,741	4,723
Net Income	2,083	3,527	5,349	35,993
Dividend Payout Ratio (%)	28%	65%	73%	30%
<b>Balance Sheet and Cash Flow Data</b>				
Cash and Short-term Investments	3,002	3,390	4,010	24,662
Total Assets	14,898	11,027	77,282	226,308
Total Debt	3,529	8,238	50,549	91,353
Non-Interest Bearing Liabilities	6,309	2,726	23,664	57,074
Total Equity	5,060	64	3,069	77,881
<b>Stock Price Data</b>				
Price/Earnings Ratio	14.2x	15.0x	23.4x	17.6x
Equity Market Value	28,454	52,823	131,484	233,667
<b>Select Ratios</b>				
Sales Growth	-0.2%	5.3%	-5.3%	1.8%
EBITDA Margin	18%	54%	44%	27%
Leverage at Book Values (debt/debt plus equity cap), (%)	41%	99%	94%	54%
Leverage at Market Values (debt/debt plus market cap), (%)	11%	13%	28%	28%
EBIT Interest Coverage (x)	7.0	11.0	4.4	6.8
EBITDA Interest Coverage (x)	8.8	11.6	5.8	7.7
Total Debt/EBITDA (x)	1.5	1.3	3.2	2.5
<b>Credit Rating</b>	<b>A-</b>	<b>A</b>	<b>BBB</b>	<b>BBB+</b>

Source: Thomson Reuters, except credit rating data from Standard & Poor's Ratings Direct; accessed September

<sup>a</sup> The year-end exchange rate was 6.645 SEK per US\$.

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<b>Gallaher</b>	<b>Altadis</b>
32,428	86,469
8,811	9,624
7,677	8,112
1,974	1,496
4,558	4,852
55%	45%
9,689	9,954
55,154	96,446
37,831	27,720
18,087	55,893
-764	12,833
17.9x	23.1x
65,865	86,425
-1.5%	2.5%
27%	11%
102%	68%
36%	24%
3.9	5.4
4.5	6.4
4.3	2.9
<b>BBB</b>	<b>A-</b>

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**Exhibit 5** U.S. Industrial Firms, Aggregate Average Financial Ratios by Credit Rating, 2002-200

	<b>Credit Rating</b>				
	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>BB</b>
EBIT interest coverage (x)	23.8	19.5	8	4.7	2.5
EBITDA interest coverage (x)	25.5	24.6	10.2	6.5	3.5
Total debt/EBITDA (x)	0.4	0.9	1.6	2.2	3.5
Market leverage (debt/debt plus market capitalization) (%)	3.1	7.2	16.1	24.5	35.5

Source: Compiled from Standard & Poor's RatingsDirect, "CreditStats Adjusted Key U.S. Industrial Finan 2005, pp. 3-4, accessed September 2011.

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<b>B</b>	<b>CCC</b>
1.2	0.4
1.9	0.9
5.3	7.9
53.5	78.2

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cial Ratios," August 11,

**Exhibit 4** European Corporate Bonds, Constant Maturity Yields by Credit Rating, Janu

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	<b>Maturity</b>				
	<b>3-month</b>	<b>6-month</b>	<b>1-year</b>	<b>5-year</b>	<b>10-year</b>
<b>Credit</b>					
AAA	2.179	2.218	2.348	3.15	3.762
AA	2.246	2.262	2.389	3.269	3.918
A	2.284	2.336	2.474	3.349	4.024
BBB	2.463	2.484	2.688	3.819	4.541
Benchmark <sup>a</sup>	2.065	2.119	2.225	3.028	3.695

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Source: Bloomberg, accessed September 2011.

<sup>a</sup> Benchmark interest rate refers to the average of euro-area AAA-rated government debt (sovereign Germany).

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<b>20-year</b>	<b>30-year</b>
4.394	N/A
4.612	4.539
4.624	4.97
5.151	5.077
4.293	4.383

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sign bonds issued by France and