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Overview

- M&M Pizza: Profitable, mature pizza company in Francostan
- Annual profits: F$125 million; stock price flat at F$25/share
- Issue F$500 million in debt at 4%
- Moe Miller, new managing director, proposes recapitalization:
- Issue F$500 million in debt at 4%
- Use proceeds to repurchase shares
- Goal: Increase shareholder value and reduce cost of capital

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Financial Statement Variations and Dividend Per Share Impact

Before Repurchase (All Equity & W/Tax):

- Shares Outstanding: 62.5 million
- Dividends: $125M (no tax) or $100M (with tax)
- **DPS**: $2.00 (no tax) or $1.60 (with tax)

After Repurchase (All Equity & W/Tax):

- Shares Outstanding: 42.5 million (no tax) or 39.4 million (with tax)
- Dividends: $105M (no tax) or $84M (with tax)
- **DPS**: $2.47 (no tax) or **$2.13** (with tax)

The repurchase **reduces the number of shares**, and even though total dividends decline, the **dividends per share increase** in both scenarios. The policy **does improve expected DPS** for remaining shareholders.

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Impact on Weighted-Average Cost of Capital (WACC)

Before Recap:

- WACC = 8.00%

After Recap:

- WACC (No Tax) = 6.72%
- WACC (With Tax) = **6.40%**

The share repurchase funded by debt **lowers M&M's WACC**, especially under the tax scenario due to the **tax shield on interest payments**. This improves capital efficiency and increases firm value theoretically, though in your case the firm value is held constant.

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Value of Debt and Equity Claims Formula: PV = Expected Cash Flow / Required Return

Scenario	Firm Value	Debt Value	Equity Value
Before Recap (All Equity)	$1,562.50M	$0.00M	$1,562.50M
Before Recap (With Tax)	$1,250.00M	$0.00M	$1,250.00M
After Recap (No Tax)	$1,562.50M	$500.00M	$1,062.50M
After Recap (With Tax)	$1,562.50M	$500.00M	$1,062.50M

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Best Proposal for Investors & Recommendation

The **repurchase plan is best for investors** because:

- **DPS increases** (beneficial for income investors).
- **PPS increases** (\$20 → \$26.97 under the tax scenario)
- **WACC decreases**, improving the firm's valuation efficiency.
- **Tax shields** from debt are captured in the lower WACC.

Recommendation: **Miller should proceed with the share repurchase plan**, particularly under the tax-inclusive scenario. It creates a better capital structure, boosts per-share returns, and aligns with shareholder interests.

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Impact of New Tax Law and Adjusted Debt-to-Equity Ratio

With the new tax law:

- Debt-to-Equity ratio = 0.588
- Shares outstanding = 39.4 million
- Assumes corporate taxes continue to allow interest deductibility

WACC Analysis:

- The **tax shield on debt** becomes even more valuable with a higher D/E ratio.
- This would likely reduce the WACC slightly below 6.40% (depending on exact debt cost).

Equity & Debt Valuation:

- Higher leverage (D/E = 0.588) increases financial risk, but also the value of the tax shield.
- With shares down to 39.4M and stable dividend payout, **DPS increases further**.

Recommendation Revisited:

- **Still recommend the repurchase plan**.
- New tax law makes it even more favorable due to an enhanced tax shield and stronger per-share metrics.
- Miller should monitor debt servicing risk, but as long as operating cash flows are stable, the plan is sound.

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The End

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