Advanced Corporate Finance
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Blaine Kitchenware, Inc.: Capital Structure
Due Date: April 3 (midnight), 2018

1. List the main reasons why capital structure and payout policy might affect firm value
2. Do you believe Blaine's current capital structure and payout policies are appropriate? Why or why not? What is the maximum leverage ratios (e.g., based on D/V, interest/EBITDA, or similar) you think would be prudent for a company like Blaine?
3. Consider the following share repurchase proposal: Blaine will use $200 million of cash from its balance sheet and $100 million in new debt (with a cost of debt of 6%) to repurchase shares for $300 million.[1]
    a) Assume perfect capital markets: Draw the effects of this transaction on the "market value balance sheet" (*i.e.*, draw the main components of A=Cash+EnterpriseValue and L=Debt+Equity using market value), at four points in time: 1) before the announcement of the transaction, 2) after the announcement but before any debt issuance or repurchase is made, 3) after the debt issuance but before the repurchase, 4) after the repurchase.
    b) Now suppose a corporate tax rate of 30.76%: Repeat the exercise from part (a). Note: Consider that the share price will change immediately upon announcement of this policy to reflect future tax savings; the repurchase would take place at the post-announcement price—what share price is this?
4. Relative to Blaine's financial statements for 2006, analyze the impact of the transaction from part 3(b). Make two columns, one with Blaine's current 2006 numbers, and one that reflects what 2006 would have looked like if it had completed the transaction.
    a) Balance sheet and Income Statement[2]
    b) EPS, ROE, Market-to-Book
    c) Leverage: Interest coverage (relative to EBITDA), Debt/Equity (book)
    d) Founding family's ownership share (assuming the family did not sell any shares into the repurchase)
    e) Total cash flow available to all investors (the sum of net income and interest)
    f) (Market) Equity value and Share Price, Market-to-Book, Enterprise Value[3]
    g) Are Blaine's shareholders better or worse off given the cash flows and values in parts (e) and (f)?
5. Alternative transactions:
    a) How would the answer in parts 3. and 4. change if Blaine would instead pay a one-time dividend of $300 million, assuming the dividend were to be financed the same way (with $200 million cash and $100 million in new debt)? (For simplicity, you may ignore possible investor-level tax differences between repurchases and dividends)
    b) How would answers change if Blaine would repurchase 12 million shares at a price of $25?[4]
6. Should Dubinski recommend a large share repurchase to Blaine's board? What are the main advantages and disadvantages to such a move? If you were a member of Blaine's controlling family, would you be in favor?

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[1] The share repurchase would be conducted as an open-market repurchase.
[2] You can assume that the effective tax rate would remain the same (30.76%). You can also assume that "Other income" on Blaine's Income Statement is exclusively interest income from its position in cash+marketable securities, and that this income would decline proportionately as the firm decreases its position in cash+marketable securities (hint: also remember to consider the extra interest expense from any new debt on the income statement).
[3] Don't forget the present value of the associated tax savings! For simplicity, you can assume that Blaine's future corporate tax rate will be equal to the effective rate for 2006 (*i.e.*, ignore footnote *a* in Exhibit 1), and that the correct discount rate for these tax savings is 6%.
[4] The share repurchase would be conducted as a tender offer, where all current shareholders could choose whether (and how many shares) to sell to the company at the offered price. If more than 15 million shares are offered by shareholders (*i.e.*, the tender offer is "oversubscribed"), the company would buy them from each shareholder who offered to sell shares *"pro-rata"* (e.g., if all of the firm's 59.052 million shares were offered to the company for sale, the company would buy back a fraction 15/59.052 of each shareholder's shares).