

**SLOAN SCHOOL OF MANAGEMENT
MASSACHUSETTS INSTITUTE OF TECHNOLOGY**

Jonathan Lewellen
15.414

Financial Management
Summer 2003

Assignment 6 – Due Monday, Aug. 17

Read ‘UST Inc.’ and answer the following questions. The information below about bond ratings and interest coverage ratios might be useful.

1. Describe the financial outlook and business risks for UST. Based on information in the case, do investors expect UST’s strong performance to continue? How can you tell?
2. Historically, UST has had low debt levels, declining to zero in 1992 (Exhibit 1). Briefly explain why you think it doesn’t have any long-term debt.
3. UST is considering raising the debt ratio to either 10%, 20%, or 30% of firm value.
 - a. Estimate UST’s bond rating and interest rate for each of the three debt ratios.
 - b. What are the benefits of debt to UST? Should it proceed with a leverage recapitalization, issuing debt and repurchasing shares with the proceeds? Which debt level would you choose?
 - c. If UST proceeds with the leverage recapitalization, how do you expect the stock market to react to the announcement? Why?
 - d. How would the leverage recapitalization affect EPS and the firm’s ability to continue paying dividends?

Additional information (from Standard and Poor’s, 1993)

Bond rating	Interest coverage ratio	Bond rating	Interest coverage ratio
AAA	13.8	BBB	3.0
AA	9.2	BB	2.0
A	5.1	B	1.2

Guidelines

- You may work on the case in groups of 3 or 4 students. Please hand-in one write-up per group. All members of the group should be prepared to discuss the case in class.
- State clearly any assumptions you make and provide enough information so that a reader can follow your analysis. I would expect the case write-up to be two to three pages plus supporting tables.
- The case is included in the course reading packet.