

## Built Up Betas and the Cost of Equity

**Objective:** The objective of this assignment is to introduce students to how to calculate beta when a firm is either a private company or a publicly traded company that has been trading only a short time or only infrequently. A secondary goal is to show the impact that leverage (the use of debt) has on risk (beta).

**Company:** GLOBAL BRANDS INC (Formerly Swiss Natural Brands)

"Global Brands (formerly Swiss Natural Brands<sup>1</sup>) believes a little financial juice will allow it to spill into new markets. Global Brands markets a variety of naturally flavored, vitamin-fortified fruit drinks and teas under the Swiss Natural label as well as under third-party labels. Its drinks include Icy Melonade, Peach Icy Tea, and Icy Berry. The company also makes 100% orange and apple juices. Global Brands drinks are sold through the Sbarro pizza chain in the US and abroad, and through some Dunkin' Donuts stores and a variety of independent outlets, mostly in the New York City area. CEO Ralph Ferrante will retain nearly 26% of the firm after its planned IPO. It plans to use the proceeds to market nationally" (source: <http://www.hoovers.com/>)



Filing Date: August 20, 1999

Expected IPO Date: Postponed 10/11/00

Proposed Ticker: GLBR

Proposed Exchange: NASDAQ

Proposed offer price: \$5.25

Shares offered (mil): 1.3

Offering amount (mil.): \$6.8

Post-offering shares (mil.): 6.5

Underwriters: Somerset Financial Group, Seaboard Securities Inc.

**Competitors (Publicly Traded)<sup>2</sup>:** [Coca-Cola](#) (KO), [Cott Corporation](#) (COTT), [Hansen Natural Corporation](#) (HANS), [National Beverage Corporation](#) (FIZ), [Odwalla](#) (ODWA), and [PepsiCo](#) (PEP)

**Competitors (Private):** [Ferolito, Vultaggio & Sons](#), [Nantucket Allserve](#), [Ocean Spray Cranberries](#) (Cooperative), [Saratoga Beverage Group](#), and [Tree Top](#) (Cooperative)

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<sup>1</sup>Company changed its name on May 24, 2000. For a review of their products, go to <http://www.bevnet.com/reviews/swissnatural/>.

<sup>2</sup>There is no recent 10Q information on [Cadbury Schweppes](#) (CSG) and [Clearly Canadian](#) (CCBC). As such, these firms are excluded from our analysis.

**Risk Factors:** According to their revised prospectus dated 8/29/2000, risks of investing in Global Brands includes but is not limited to the fact that

- Red ink since inception: the company has incurred losses from inception and may never generate substantial profits.
- One year burn rate: The proceeds from their proposed IPO offering together with their current cash balances and anticipated cash to be generated from operations will be sufficient to meet expected operating and capital requirements for at least one year.
- One customer accounts for a large portion of revenue: The loss of SBARRO, inc. as a customer would have a material adverse effect on their business since they currently sell the majority of their private label beverages to them
- Manufacturing isn't done in-house: The loss of their third-party suppliers or service providers could have a material adverse effect on their operations since they rely on third parties to produce their beverages, glass bottles and to bottle their beverages.
- Management entrenchment: It may be difficult to effect a change in control of the firm without current management's consent. Upon consummation of this offering, Dr. Ralph M. Ferrante, the Chairman and CEO, and Herbert Paul, the President and CFO, will hold approximately 38% and 10%, respectively, of our outstanding voting stock.

**Assumptions:**

Item	Assumption
Marginal tax rate	32%. Note: Global Brands has generated net losses for each fiscal year since its inception in April 1993.
Capital Structure for GLBR	See last page for capitalization of GLBR
Debt	Use most recent debt outstanding for each firm
Equity	Use market value of equity for each firm
Risk premium ( $R_M - r_F$ )	4.5%
NA	Set NA = 0 in the Financial Statements (Disclosure spreadsheet)

**Assignment:** Download the GLBR data from my website and use the downloaded spreadsheet to answer the following questions (all work should be done on this spreadsheet). Please highlight your answers in **yellow**:

1. Firm Betas (20 points): Calculate the betas for the comparable firms using either the Regression option under Data Analysis in the Excel menu or the slope command.
2. Average Levered Beta and Average Debt/Equity Ratio (20 points): Calculate the average levered beta ( $\beta_L$ ) for the comparable firms. Also calculate the corresponding average debt/equity ratio for the comparable firms. In calculating the debt for each comparable company, use the *most recent* figure given in the spreadsheet for each firm. Assume that the book value of debt equals the market value of debt. Use the market value of equity.
3. Average Unlevered Beta (20 points): Calculate the average unlevered beta ( $\beta_U$ ) given your answer in question 2 above.
4. Estimate the Beta for GLBR (20 points): Calculate the levered beta for GLBR, the private firm that has recently postponed their initial public offering (IPO), using their pro-forma numbers. (**Hint:** Ask yourself what is the correct numbers to use in GLBR's pro-forma statement for debt and equity?)
5. Estimate the Cost of Equity for GLBR (20 points): Calculate the cost of equity for GLBR e.g., the discount rate that shareholders use to discount back the cashflows they receive (dividends, stock buybacks, etc.). Use the 10 year Treasury bond for the riskfree rate.

Please turn in a hard copy of your solutions together with your disk which shows all work on your spreadsheet. Since this is an individual effort, any student caught cheating will be given an F on this assignment.

### Capitalization OF Global Brands

CAPITALIZATION The following table sets forth the capitalization of Global Brands as of May 31, 2000: (1) on an actual basis, and (2) as adjusted to reflect the receipt by Global Brands of the estimated net proceeds from the sale of our 1,300,000 shares of common stock offered hereby (after deducting the estimated offering expenses and underwriter' compensation). The information described in the following table assumes that none of the convertible subordinated debentures of Global Brands have been converted. This table should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and related notes thereto included elsewhere in this prospectus.



	MAY 31, 2000	
	<u>Actual</u>	<u>As Adjusted To Reflect Net Proceeds Of Offering</u>
Convertible Subordinated Debentures.....	757,500	757,500
Compensation Payable.....	101,092	101,092
Preferred Stock, \$.01 par value, 3,000,000 shares authorized; Series A Convertible Preferred Stock, 1,206,000 shares issued and outstanding (actual and as adjusted).....	12,060	12,060
Common Stock, \$.01 par value, 20,000,000 shares authorized, 2,591,708 shares issued and outstanding actual; 3,891,708 shares outstanding, as adjusted.....	25,917	38,917
Additional paid in capital.....	2,014,833	8,467,458
Accumulated Deficit.....	<u>(2,726,895)</u>	<u>(2,726,895)</u>
Stockholders' equity (deficiency).....	<u>(674,085)</u>	<u>5,791,540</u>
Total capitalization.....	184,507	6,650,132