

3 The transactions and their financial consequences

Background

3.1. In this chapter we first describe the sale by Stora of its CP Division to Swedish Match NV. A statement based on information provided by Stora, setting out the major events in the sale process, is given in Appendix 3.1. We then summarise the contents of the principal agreements that were entered into between Swedish Match NV, Gillette and others in connection with that sale so far as we consider them relevant to our inquiry. We next outline the sale by Swedish Match NV of its Wilkinson Sword non-EC wet-shaving business to Gillette and the repurchase of the US part of that business following action by the US competition authorities. Following this, we describe the agreement for the sale by Swedish Match NV of its matches and lighters businesses, leaving the Wilkinson Sword wet-shaving business in the EC and the US as the company's only business of any significance. Finally, we set out the salient features of financial projections made by Swedish Match NV and its advisers.

3.2. As explained in Chapter 2, in mid-1989 Stora decided to dispose of the CP Division, which principally consisted of its subsidiary, Swedish Match AB, and certain other Stora subsidiaries. The CP Division's businesses fell into three broad categories:

- (a) shaving products and toiletries, being mainly the manufacture and sale of razors and razor blades under the Wilkinson Sword trade mark;
- (b) matches, which were manufactured in various countries around the world, including in the United Kingdom under various Bryant & May and J John Masters brand names; and
- (c) disposable lighters, including the Cricket and Feudor brands.

3.3. Stora decided to proceed with the sale by way of a controlled competitive auction. In conjunction with its financial adviser, MSI, it therefore drew up an information memorandum and invited tenders from a number of potentially interested parties, including Gillette. Among the conditions set by Stora in inviting tenders were that the CP Division was to be sold in a single transaction and not in a piecemeal fashion (any subsequent disposals were therefore to be the responsibility of the purchaser), and that those invited to tender were to maintain confidentiality throughout the tender process.

3.4. Gillette approached the senior management of Swedish Match AB to see if they would be interested in the possibility of a management or leveraged buy-out. Through its merchant bankers, Lazard Brothers & Co Ltd (Lazards), Gillette learnt that Procuritas A/S (Procuritas), a Danish company specialising in financing management buy-outs, and a number of other Scandinavian investors were interested in taking part in the financing of a transaction if it could be arranged.

3.5. Lazards, on behalf of Gillette, brought together various potential investors and lenders for discussions about the possibility of a leveraged buy-out of the CP Division in which some of the existing management would be involved in order to ensure continuity. Lazards was also instrumental in the preparation of the original financial projections for the business and in arranging the financing. It found that the US banking group, J P Morgan & Co Incorporated (Morgan), was interested in participating. Morgan included Morgan Guaranty Trust Company of New York (MGTC), Morgan Capital Corporation (MCC) and J P Morgan & Co Ltd. Morgan, however, had no connection with Stora's adviser, MSI.

3.6. As described in paragraph 2.30, the plan which was developed involved the establishment of a buy-out vehicle, incorporated in the Netherlands, which Lazards told us it regarded itself as advising by late November 1989. This company was then called Eemland but subsequently changed its name to Swedish Match NV in April 1990. (We have been advised of its intention to change the name again, to Wilkinson Sword NV, but we refer to it in this report as Swedish Match NV except where the use of its former name is unavoidable.) The intention was that Swedish Match NV would make an offer for the CP Division in its entirety. Agreements between the parties would provide for the sale of the non-EC shaving products businesses to Gillette. It was also envisaged that the matches and lighters businesses would be sold over a two-year period to third parties.

3.7. It was also the intention that Swedish Match NV should use the proceeds of the sales of the matches and lighters businesses to repay the greater part of the debt with which it financed the acquisition. During the second half of 1989 discussions took place between the various potential providers of equity and debt finance and commitments in principle were obtained from a number of investors and banking institutions prepared to back the buy-out plan and provide the necessary finance. Gillette was to provide quasi-equity capital in the form of loan stock on a completely subordinated basis. Negotiations with Stora then commenced.

3.8. By early December 1989 the negotiations with Stora were still continuing, but by now were influenced by certain time constraints imposed by Stora. Details of the financing had still to be finalised. Leveraged buy-outs were at that time being viewed more cautiously by banking institutions and, as the year end was approaching, many potential lenders had already closed their books. Certain potential investors and lenders were reconsidering the finance they were prepared to provide. One of them, Intermediate Capital Group (ICG), was threatening to withdraw because of what it regarded as an inadequate return on its investment. Also, the purchase price appeared likely to exceed the amount originally envisaged because the assets of the businesses were proving to be higher than had been expected. Gillette therefore came under pressure to participate in the debt financing of Swedish Match NV to a greater extent than it had originally contemplated.

3.9. To help to overcome some of these difficulties, and to enable the transaction to proceed, Stora agreed to accept part of the consideration for the sale in the form of a junior subordinated interest-free loan note from Swedish Match NV for SEK 300 million, repayable on 31 December 1995 or after repayment in full of the debt to be used for the acquisition, if earlier. In order to obtain Stora's agreement to this, Gillette agreed to pay Stora up to \$11 million over the period until the end of 1997 (of which \$4 million related to periods after the end of 1995, it being then thought that the loan note might remain outstanding beyond 1995) to reflect the fact that its loan note carried no right to interest. Gillette also ceded to ICG 2 per cent of the equity that it would otherwise have received. These actions by Gillette enabled the transaction to proceed. They were over and above the other financial support that it had undertaken to provide.

The agreements of December 1989

3.10. Agreement was ultimately reached that Swedish Match NV would pay Stora for the CP Division a total of SEK 3,930 million, of which, as noted above, SEK 300 million (equivalent to some US \$48 million) would remain outstanding as a loan note. The transaction took the form of a highly leveraged buy-out, financed by a number of banks and finance houses and Gillette, together with certain members of the CP Division senior management. The relevant agreements were executed on 20 December 1989 and the financing arrangements were put in place the following day. The transfer of the business took place in stages and has, we were told, now been completed.

3.11. Eemland (later to be renamed Swedish Match NV), the company used for the purchase of the CP Division, had been formed as a BV¹ in the Netherlands on 5 February 1988 with an authorised share capital of Dfl 200,000 divided into 200 shares of Dfl 1,000 of which 40 were issued. The main events concerning Eemland leading up to 20 December 1989 were given to us by Swedish Match NV as follows. On 7 November 1989, Amaco (Netherlands) BV (Amaco), a company specialising in the provision of shelf companies and of company secretarial, trust and other corporate services, purchased the entire issued share

¹BV is a Netherlands private limited liability company and NV is a Netherlands public limited liability company.

capital of Eemland from the two existing Netherlands shareholders for Dfl 48,713 and assumed the role of Managing Director. Then on 18 December 1989 Amaco, as holder of the entire share capital of Eemland, passed a resolution to amend the statutes of the company by increasing its authorised share capital of Dfl 11,200,000, divided into shares of Dfl 1 each, and, at the moment of the passing of a notarial deed of amendment, to issue 2,246,256 shares in Eemland to the proposed equityholders and the four members of the management. On 20 December 1989 the notarial deed of amendment was passed, thereby giving effect to the shareholders' resolution, and Amaco sold its 40 Dfl 1,000 shares in Eemland to the purchasing group. Directors and other officers were appointed and the senior management of the company from then onwards consisted of four former senior managers of the CP Division, who had been closely involved in setting up the transaction. A general meeting of the company's shareholders was held and the purchase from Stora and other arrangements were agreed. Further details as given by Gillette on the events of 20 and 21 December are given in paragraph 5.19.

3.12. The acquisition and the continuing financial requirements of the businesses bought by Swedish Match NV from Stora are funded by a mixture of equity and loan capital as follows:

(a) *Equity capital.* This consists of some 2.25 million voting ordinary shares of Dfl 1 each and Dfl 8.17 million of non-voting quasi-equity, the latter comprising four classes ('A', 'B', 'C' and 'D') of convertible subordinated unsecured loan stock. (The non-voting equity took this form because non-voting shares are not permissible under Dutch law.) 96.2 per cent of the voting ordinary shares are owned by a group of Scandinavian investors. Gillette holds Dfl 2.29 million of non-voting loan stock, being all the 'B' class, which represents some 22 per cent of the total issued equity and quasi-equity capital. (It was to have been 24 per cent but, as noted in paragraph 3.9, Gillette ceded 2 per cent to ICG.)

(b) *Loan capital.* There are two debt facilities and a loan note from Stora:

(i) *Senior debt (\$409 million).* This comprises an asset sale facility of \$300 million repayable by 31 December 1991, which is expected to be repaid out of the proceeds of the sale of the matches and disposable lighters businesses, and also a revolving credit facility of \$109 million repayable by 31 December 1994. The senior debt may be drawn down in different currencies. The currency of each tranche may be swapped between US dollars, Deutschmarks or Sterling on the expiry of each interest period. The senior debt carries interest at 2 per cent over LIBOR.¹ Syndication, which was underwritten by MGTC, took place in February 1990.

(ii) *Mezzanine debt (\$138 million).* This is in two parts. It comprises, first, an institutional mezzanine debt of \$69 million. This is subordinated to the senior debt and only repayable once the senior debt has been repaid. It carries interest at 4 per cent over LIBOR and may be drawn down in Sterling or Deutschmarks and changed between those currencies at the end of the first interest period. Its final maturity date is 31 December 1997. There is also a subordinated Gillette debt of \$69 million. This may be drawn down in US dollars, Deutschmarks or Sterling, but in only one currency at a time, and Swedish Match NV may specify the currency prior to each interest period. It carries interest at 6 per cent over LIBOR. This interest, however, is to be capitalised and is not payable until repayment of the principal. The subordinated Gillette debt is not repayable until the institutional mezzanine debt has been paid in full (which cannot be until after the senior debt has been repaid in full). It is then repayable in 12 equal six-monthly instalments beginning six months after the repayment in full of the institutional mezzanine debt, the last instalment being due on 31 December 2003 at the latest. If the institutional mezzanine debt is repaid before that date Swedish Match NV would be entitled to repay all or part of the Gillette mezzanine debt without needing Gillette's consent.

¹As the senior and mezzanine debt may be in different currencies, the LIBOR rates will be those applicable to the currency in question. LIBOR stands for the London Interbank Offering Rate.

- (iii) *Stora loan note (SEK 300 million, equivalent to \$48 million)*. As noted above, Stora accepted a subordinated non-interest-bearing loan note as part consideration for the sale of the CP Division. The maturity of this loan is on 31 December 1995 or on such earlier date as all of the senior and mezzanine debts are fully repaid. It is therefore repayable after the institutional mezzanine debt but before the Gillette mezzanine debt. Gillette has agreed to make certain payments to Stora to compensate it for the loan note being non-interest-bearing.

Particulars of Swedish Match NV's equity capital structure, together with the names of the holders and the amounts subscribed, are set out in Appendix 3.2. Particulars of its loan capital structure, loan creditors, terms and maturity dates are given in Appendix 3.3.

3.13. The order of priority for the repayment of the various loans on a winding up of Swedish Match NV would be as follows:

The senior debt of US \$409 million (comprising an asset sale facility of US \$300 million and a revolving credit facility of US \$109 million).

The institutional mezzanine debt of US \$69 million.

The Gillette mezzanine debt of US \$69 million.

The Stora loan note of SEK 300 million.

The convertible loan stock (quasi-equity) of Dfl 8.17 million.

The amount of US \$6.4 million payable to Gillette for the reacquisition of the US business (see paragraph 3.27).

Any balance remaining would be distributed to the holders of the 2.25 million ordinary shares.

Gillette's involvement in Swedish Match NV

3.14. A large part of the negotiations for the acquisition of the CP Division, and for the financing of the transaction, was carried out by Gillette, mainly through directors and staff of Gillette Industries with Board approval from The Gillette Company. In addition, Gillette was financially involved in Swedish Match NV, by virtue of:

- (a) its holding of non-voting convertible loan stock of Dfl 2.29 million, representing 22 per cent of the equity capital;
- (b) the Gillette mezzanine debt of \$69 million, representing between 11 and 12 per cent of the total loan capital; and
- (c) its commitment to make payments to Stora to compensate for the latter's loan note being non-interest-bearing.

Gillette has no right, however, to Board representation or to receive from Swedish Match NV the financial and other information provided to the other investors.

3.15. Gillette also has certain pre-emption rights exercisable in the event of an investor wishing to dispose of its shares in Swedish Match NV or of Wilkinson Sword wishing to dispose of any major assets. These rights are more fully described in the following paragraphs which summarise the various agreements that have been entered into.

The Equityholders' Agreement

3.16. The Equityholders' Agreement sets out the terms on which the equityholders subscribed for equity in Swedish Match NV, and their continuing rights and obligations. 'Equity' in this case includes both ordinary shares and the convertible loan stock. The ordinary shares are the only form of equity which carries voting rights: 96.2 per cent of these shares are held by the Scandinavian investors group-Procuritas through its subsidiary Procuritas MBO Invest AB, Aktieselskabet Kjobenhavns Handelsbank (Copenhagen Handelsbank), Försäkringsbolaget SPP, Ömsesidigt (SPP Insurance), Livsförsäkringsaktiebolaget Skandia (Skandia Insurance) and Spira Invest AB (Spira Invest)-the remainder being a nominal shareholding by MCC and the management shares (see Appendix 3.2). There are four separate classes of equity loan stock ('A', 'B', 'C' and 'D') created by the four loan stock instruments referred to below. Gillette's equity interest is in the form of 'B' stock.

3.17. The provisions of the Equityholders' Agreement (as amended by certain side letters executed at the same time as the agreement itself) relating to disposals of ordinary shares and convertible loan stock are summarised below:

- (a) Except in special circumstances, such as intra-group transfers and certain options granted to Procuritas by two of the other Scandinavian investors, no equityholder may dispose of ordinary shares or equity loan stock before 1 January 1993, by which time it was envisaged that the disposal programme for the lighters and matches businesses would have been completed. The proceeds of those sales are intended to be applied in reducing gearing by paying off the senior debt. Disposals by equityholders after 1 January 1993 are subject to the pre-emption and other rights referred to below.
- (b) No Scandinavian investor is to dispose of any ordinary shares or equity loan stock to a third party unless the other Scandinavian investors have been given the opportunity to purchase the equity concerned for the same price and on the same terms pro rata to their existing holdings. The other Scandinavian investors will have 30 days in which to accept such an offer.
- (c) Subject to this, equityholders may sell ordinary shares or equity loan stock to a third party provided that the other equityholders have been given the opportunity to purchase the equity concerned for the same price and on the same terms pro rata to their existing holdings. They will have 30 days in which to accept such an offer. Gillette is entitled, if it chooses, to nominate a non-associated third party (who has to be approved by 75 per cent of the ordinary shareholders except, for reasons of US banking regulations, MCC) to take up its entitlement.
- (d) Any equityholder wishing to dispose of more than 10 per cent of the total equity of Swedish Match NV must procure that the other equityholders are given the opportunity to dispose of a similar proportion of their holdings in excess of 10 per cent on the same terms.
- (e) If the holders of 26 per cent or more of the equity, excluding Gillette, notify the other equityholders that they wish to obtain a stock exchange listing for the ordinary shares, Gillette is to have an option to buy, or to find a non-associated third party purchaser for, that equity at the price at which it is proposed to obtain the listing. Gillette would have seven days to exercise such an option or implement procedures to agree a price. If Gillette exercises the option, it must ensure that an identical offer is made to all the other equityholders. In the event of a listing, the Equityholders' Agreement will terminate and Gillette will be entitled to convert its 'B' convertible loan stock into ordinary shares.
- (f) If the holders of either 75 per cent or more of the equity, excluding Gillette, or 64 per cent including a majority of the management and again excluding Gillette, notify the other equityholders that they wish to sell all their equity to a third party, Gillette has the option to buy, or to find a non-associated third party purchaser for, that equity for the same price and on the same terms. Gillette would have ten days to exercise such an option. If it were to do so, it would have to ensure that an identical offer be made to all the other equityholders. Similarly, if it were to decline the option, the selling group would have to ensure that an identical offer be made enabling the other equityholders (including Gillette) to sell their equity. In the event of any such sale of equity to a third party, the

Equityholders' Agreement would terminate and Gillette would be entitled to convert its 'B' convertible loan stock into ordinary shares.

3.18. The Equityholders' Agreement, as amended by the side letters, also contains provisions relating to any proposal by Swedish Match NV to sell the whole or any substantial part of its business or assets to a third party. In summary:

- (a) Swedish Match NV may not sell the whole or any part of its European match business or assets to a third party unless it has first offered the business or assets to Procuritas at the same price and on the same terms. Procuritas has 45 days in which to accept such an offer, failing which Swedish Match NV is free to sell the business or assets. There are no other restrictions on Swedish Match NV regarding any of the planned disposals of the matches and lighters businesses.
- (b) Swedish Match NV may not sell to a third party any other business or assets which amount to the whole or any substantial part of its wet-shaving business or assets unless it has first offered the business or assets to Gillette at the same price and on the same terms. Gillette would have 30 days to accept such an offer or find an alternative non-associated third party purchaser willing to buy the business or assets on those terms, failing which Swedish Match NV would be free to sell the business or assets.

3.19. The rights described in paragraphs 3.17(e) and (f) and 3.18(b) were in the Equityholders' Agreement itself given to all equityholders other than MCC but, with the exception of Gillette, they waived these rights in the side letters. Furthermore, the Equityholders' Agreement requires Swedish Match NV to supply MCC and the Scandinavian investors, but not Gillette, with financial information, Board minutes and other information regarding its financial condition and operations. The Scandinavian investors, MCC and the management have also agreed not to make any such information available to Gillette.

The Voting and Management Agreement

3.20. The Voting and Management Agreement contains the following provisions:

- (a) The four members of senior management are restricted from selling their equity before 1 January 1995, except in acceptance of an offer of the type described in paragraphs 3.17(e) or (f).
- (b) There are bonus plans for those members of the management team related to the disposal of the matches and lighters businesses, and for them to receive cash and equity in amounts linked to the profitability of the shaving business.
- (c) They undertake to devote their efforts to Swedish Match NV and not to other businesses. They have also entered into service contracts with Swedish Match NV.

3.21. The Voting and Management Agreement also prescribes the Board structure of Swedish Match NV. In summary:

- (a) There are to be six directors, of whom four ('A' directors) are nominated by the ordinary shareholders and two ('B' directors) are nominated by the management. The 'A' directors make up the 'Supervisory Board'; Swedish Match NV's 'Board' means a combined meeting of both the Supervisory Board and the Managing Board.
- (b) Gillette is never to be entitled to nominate a director and covenants with Swedish Match NV, the management and the Scandinavian investors that it will not exert or attempt to exert any influence over the Board or any member of the Board.

The Loan Stock Instruments

3.22. The four Loan Stock Instruments create four separate classes of convertible loan stock, 'A', 'B', 'C' and 'D' stock, all of which are subordinated to all other debt of Swedish Match NV, carry rights to interest at levels corresponding to the dividend which would have been receivable had it been converted into ordinary share capital immediately prior to the dividend payment date, and carry no voting rights. All four classes of stock are repayable on 1 January 2100 (together with accrued interest). The conversion rights of the different classes of stock are as follows:

- (a) The 'A' stock is convertible into ordinary shares at any time. The initial holders of 'A' stock are MCC, SPP Insurance and Skandia Insurance.
- (b) The 'B' stock is convertible into ordinary shares only in the event of a winding up of Swedish Match NV, a listing of Swedish Match NV shares, or a sale of the majority of the Swedish Match NV equity in the circumstances described in paragraph 3.17(f). The 'B' stock is held by Gillette UK.
- (c) Both the 'C' and 'D' stock are convertible in the same circumstances as the 'B' stock but also during a period of 28 days from the eighth anniversary of the Loan Stock Instrument. ICG was the initial holder of the 'C' stock. The initial holders of the 'D' stock were ICG and Copenhagen Handelsbank.

The Senior Facility Agreement

3.23. Under the Senior Facility Agreement MGTC made available to Swedish Match NV senior loan facilities totalling \$409 million, carrying interest at the rate of 2 per cent over LIBOR. This senior debt is repayable by Swedish Match NV over a period of up to five years, although the greater part of it is due to be repaid by the second anniversary of the agreement, and is expected to be repaid out of the proceeds of the disposal of the matches and lighters businesses. Syndication of the senior debt took place in February 1990, prior to which it was underwritten by MGTC. As will be seen from Appendix 3.3, over 50 per cent continues to be held by MGTC.

The Mezzanine Facility Agreement

3.24. Under the Mezzanine Facility Agreement some \$138 million of additional loan facilities, subordinated to the senior loan facilities, were made available to Swedish Match NV. Of this:

- (a) \$69 million was the institutional mezzanine debt, ranking after the senior debt and made available by MGTC, Copenhagen Handelsbank and ICG. As noted in paragraph 3.12(b)(ii), this may be drawn in Deutschmarks or Sterling and carries interest of 4 per cent over LIBOR; and
- (b) \$69 million was the Gillette mezzanine debt, ranking after both the senior debt and the institutional mezzanine debt and made available by Lustrasilk, a member of the Gillette group which is no longer trading but which was used as the vehicle for this loan. It may also be drawn in different currencies (US dollars, Deutschmarks or Sterling, in this case) and carries interest at 6 per cent over LIBOR, which is capitalised and not payable until the principal debt is repaid. (For this reason the loan is known as the 'payment in kind' (PIK) loan.) It is repayable by 12 equal six-monthly instalments beginning six months after the institutional mezzanine debt has been repaid in full, the final instalment being repayable after 14 years (by 31 December 2003) at the latest, although Swedish Match NV may repay all or part of the loan earlier if it wishes.

3.25. The Mezzanine Facility Agreement contains a number of provisions limiting Gillette's rights as a creditor. In particular, it does not confer on Gillette any right to be represented on any Board, committee or other body of creditors of Swedish Match NV. Certain representations and warranties by Swedish Match NV, and undertakings to furnish financial and other information, are given to ICG, MGTC and Copenhagen Handelsbank only.

The sale by Swedish Match NV of the non-EC/US shaving businesses to Gillette

3.26. As explained earlier, the arrangements included the sale of the non-EC shaving businesses to Gillette. This part of the transaction was covered by the non-EC Sale Agreement and the Intellectual Property, Manufacturing and Distribution Agreement (IP Agreement), under which Swedish Match NV agreed to sell to Gillette for US \$72.3 million the Wilkinson Sword wet-shaving businesses outside the EC which it had acquired from Stora.

3.27. Following the initiation of anti-trust proceedings in the USA, more fully described below, Gillette and Swedish Match NV entered into a further agreement which provided for Swedish Match NV to reacquire the US business for US \$6.4 million. The net cost to Gillette of the non-EC/US businesses was therefore US \$65.9 million.

3.28. The transaction was effected by the sale of shares in certain non-EC/US companies and the sale of non-EC/US assets, as well as by the assignment or, where necessary, sub-licence of non-EC/US trade marks, know-how and other intellectual property. The agreements did not, however, give Gillette any right or interest in the Wilkinson Sword wet-shaving business in the United Kingdom (or other EC countries). To reinforce the separation of the ownership of the Wilkinson Sword trade marks, Gillette undertook not to use them in any EC member state (including the United Kingdom) or in the USA, and Swedish Match NV undertook not to use them outside the EC or USA.

3.29. The IP Agreement also provides that Wilkinson Sword shall supply Gillette with Wilkinson Sword branded products for a period of two years, expiring at the end of 1991: this is set out in detail in the Supply Agreement dated 20 July 1990.

3.30. Although Wilkinson Sword will no longer be able to supply shaving products and toiletries outside the EC and USA under the Wilkinson Sword trade marks, it remains free to supply shaving products and toiletries outside the EC and USA as own-label products or under new brands:

- (a) to any country to which it supplied own-label products in 1988 or 1989;
- (b) to any country to which it did not supply products in 1989;
- (c) to any country in respect of which the transitional supply arrangements with Gillette are terminated;
or
- (d) to any country for which Gillette's purchases from Wilkinson Sword under the transitional supply arrangements are less than Wilkinson Sword's sales to that country in 1989.

3.31. To enable Wilkinson Sword to sell shaving products and toiletries outside the EC and USA in the circumstances envisaged above Gillette has granted back to Wilkinson Sword a non-exclusive, royalty-free, perpetual licence to use all the know-how it purchased from Wilkinson Sword, excluding the trade marks. The arrangements also enable Wilkinson Sword to continue to sell outside the EC and USA its range of ceremonial swords and the like.

Undertakings given to the US Department of Justice

3.32. As mentioned above, it was originally envisaged that Gillette's acquisition of the Wilkinson Sword businesses outside the EC would include the US business, namely Wilkinson Sword Inc (the US distribution and packaging company) and the Wilkinson Sword US intellectual property rights. In January 1990, however, the US Department of Justice filed a complaint in the United States District Court for the District of Columbia against The Gillette Company, Swedish Match NV, Wilkinson Sword Inc, Stora and Eemland in respect of this US acquisition. Gillette re-sold the US business to Swedish Match NV on 24 January 1990. Following this, an agreement was reached between the Department of Justice, Gillette and Swedish Match NV which led to a Consent Order being entered by the US Court. As part of this settlement of the legal proceedings, certain restrictions were imposed on Gillette and Swedish Match NV. These are contained in the Final Judgment by the Court, which is reproduced in Appendix 2.3.

Source and application of the funds for the purchase of the CP Division

3.33. The funds available for the purchase of the CP Division and the application of these funds are broadly as shown in Table 3.1.

TABLE 3.1 Source and application of funds for the purchase of the CP Division

			<i>\$ million</i>
<i>Source</i>			
Equity (including the convertible loan stocks)			56
Senior debt		409	
Mezzanine debt:			
Institutions	69		
Gillette (PIK loan)	<u>69</u>	138	
Stora loan note		<u>48</u>	<u>595</u>
			651
Sale to Gillette of the non-EC shaving business			<u>72</u>
			<u>723</u>
<i>Application</i>			
Purchase of the CP Division			627
Reacquisition of the US shaving business			6
Available for purchase price adjustments, working capital, settlement of inter-company indebtedness, fees etc			<u>90</u>
			<u>723</u>

Source: MMC from MGTC and Swedish Match NV data.

The sale of the matches and lighters businesses

3.34. The arrangements made in connection with the purchase of the CP Division from Stora also contemplated the disposal of the matches and lighters businesses over a two-year period. This was achieved ahead of time. On 8 October 1990 Swedish Match NV announced that it had agreed, subject to certain conditions (including there being no reference of that transaction to the MMC), the sale of the major part of those businesses world-wide for \$277.5 million to Nederlight NV, a company specially formed for the purpose by a consortium of financial and industrial investors. Swedish Match NV added that it had by then already sold its match businesses in Chile, Thailand and the Dominican Republic for \$30.5 million and had signed contracts to sell those in Colombia and India for \$10.8 million. It also announced that negotiations were in progress for the sale of its only remaining match business, namely that in the Philippines.

3.35. The consideration of \$277.5 million was equivalent, at an assumed exchange rate at December 1990 of SEK 5.74=\$1, to SEK 1,593 million, to which was added interest for the three months September to December 1990 of SEK 30 million, making SEK 1,623 million in all. Of this, SEK 1,172 million was to be payable in December 1990 and the balance of SEK 451 million was to remain outstanding on a loan note, repayable by instalments ending in March 1992. The note carries interest at 10.5 per cent which in part is to be capitalised. Deductions from the principal of the note were to be made of SEK 63 million on the sale in November of the India and Colombia businesses, and of SEK 86 million on the sale in December of the businesses in Argentina, Australia and New Zealand, leaving a balance outstanding on the note at the end of December 1990 of SEK 302 million.

3.36. Swedish Match NV also then announced its intention to change its name to Wilkinson Sword NV to reflect the fact that its remaining business would, on completion of the above transactions, consist mainly of Wilkinson Sword's shaving and related products in the EC and the US.

3.37. The total amounts received or expected to be received for the matches and lighters businesses are shown in Table 3.2.

TABLE 3.2 Swedish Match NV expected proceeds of sales of matches and lighters businesses

	<i>\$ million</i>
Conditional sale to Nederlight NV	277.5
Chile, Thailand and Dominican Republic	30.5
Colombia and India	10.8
Philippines	<u>33.0</u>
	351.8

Source: MMC from Swedish Match NV data.

Note: The above amounts are net of any taxes payable.

Financial projections

3.38. During the negotiations preceding the agreement of 20 December 1989 the management of the CP Division and Lazards were involved in the preparation of financial projections for the venture to see whether it would be sufficiently attractive to potential investors. These projections were largely based on the management's assumptions of turnover, margins and the amounts expected to be realised for the matches and lighters businesses.

The MGTC projections

3.39. When MGTC became involved in the financing of the transaction it revised these projections using more conservative assumptions, both of operating cash flows of the Wilkinson Sword wet-shaving business and the realisable values of the matches and lighters businesses. A third set of projections was prepared for the purpose of setting financial covenants.

3.40. An invitation letter issued by MGTC in connection with the syndication of the senior debt therefore included three projections for the business for the period from 1990 to 2000:

- (a) the management case, as developed by the management, and the most optimistic;
- (b) the base case, as developed by MGTC and agreed with the management; and
- (c) the downside case, being the least optimistic, and used to set financial covenants.

These were all expressed in US dollars.

3.41. All three sets of projections were in nominal terms (ie they ignored inflation) and relied on a number of assumptions, the most significant being:

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Details omitted.
See note on page iv.

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*Details omitted.
See note on page iv.*

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- (c) A 5.2 per cent expected growth in margins from rationalising production throughout Europe, harmonising prices across European markets and moving to higher margin products. In the management case (but not the other two cases) a 5 per cent saving is also expected to arise from marketing economies following the concentration on European markets; marketing costs have accounted for 26 per cent of sales revenue. There are also to be savings from restructuring production and reducing overheads following the move of the Wilkinson Sword headquarters to Germany, and royalty income is expected from the use of the Wilkinson Sword name for home and garden tools in Europe.
- (d) The amortisation over 40 years of the goodwill of \$194 million then calculated to arise on the transaction. (Goodwill was subsequently recalculated at \$249.5 million following the sale of the matches and lighters businesses-see Table 3.8.)
- (e) The disposal, in the management case, of the matches and lighters businesses for \$352 million net of taxes by the end of 1991. (As noted in Table 3.2, the amounts now received or expected to be received total US \$351.8 million.) The base case assumed that 85 per cent of this amount would be realised by the end of 1991, and the downside case 80 per cent.
- (f) Interest being payable on borrowings at 11.5 per cent on the senior debt, 13 per cent on the institutional mezzanine debt and 15 per cent on the Gillette mezzanine debt.

3.42. None of the three cases took into account the refinancing exercise which Swedish Match NV contemplates will take place in due course.

3.43. Table 3.3 sets out the loan repayments that, subject to refinancing, were, according to the MGTC projections, expected to be made during the first ten years.

TABLE 3.3 Projections of loan repayments

	<i>Management case</i>	<i>Base case</i>	<i>Downside case</i>
<i>Finance wholly repaid during ten years</i>			
	<i>Repaid by end of</i>		
Bridging finance (\$300 million)	1991	1991	1992
Revolving credit (\$109 million)	1991	1995	1997
Mezzanine-institutions (\$69 million)	1994	1997	1999
	<i>\$ million</i>		
<i>Wholly or partly outstanding at end of year 2000</i>			
	<i>Amount outstanding</i>		
Mezzanine-Gillette PIK (originally \$69 million)*	9	197	256
Stora loan note	48	48	48

Source: MMC from MGTC data.

*Increases because interest (at LIBOR plus 6 per cent) is rolled up.

3.44 In Table 3.4 we show Swedish Match NV's balance sheet positions according to the three cases at the end of 1994 (when the last of the senior debt becomes repayable) and the end of the year 2000, which is as far as the MGTC projections go.

TABLE 3.4 Projected Swedish Match NV balance sheets at 31 December 1994 and 2000

\$ million

	Management case		Base case		Downside case	
	1994	2000	1994	2000	1994	2000
Fixed assets	29	26	30	26	30	26
Net working capital	29	39	28	39	28	39
Provisions etc	(9)	(9)	(9)	(9)	(9)	(9)
Goodwill*	<u>170</u>	<u>141</u>	<u>216</u>	<u>179</u>	<u>232</u>	<u>192</u>
	219	197	265	235	281	248
Equity capital	55	55	55	55	55	55
Reserves/(losses)	(17)	<u>85</u>	(65)	(65)	(85)	(111)
	38	140	(10)	(10)	(30)	(56)
Senior debt	-	-	16	-	52	-
Institutional mezzanine	-	-	69	-	69	-
Stora loan note	48	48	48	48	48	48
Gillette mezzanine	<u>133</u>	<u>9</u>	<u>142</u>	<u>197</u>	<u>142</u>	<u>256</u>
	219	197	265	235	281	248

Source: MMC from MGTC data.

*Higher in the base and downside cases because the lower proceeds for disposal of the matches and lighters businesses would increase the net premium payable for the shaving business.

1.1. If the figures in Table 3.4 are expressed in another way, as shown in Table 3.5, it will be seen that in all three cases capital gearing would be infinite at the end of the year 2000 and that only in the management case would there then have been tangible assets sufficient (almost) to cover the PIK loan. In the base and downside cases there would be a substantial deficit of tangible assets. In the absence of some form of refinancing or a sale of the business it appeared unlikely in these cases that there would be sufficient tangible assets to cover repayment of the PIK loan by its final maturity date of 31 December 2003. None of these projections, however, takes account of the value of the Wilkinson Sword trade marks and goodwill and, moreover, forecasts extending so far ahead must inevitably be regarded with caution.

TABLE 3.5 Alternative presentation of projected Swedish Match NV balance sheets at 31 December 1994 and 2000

\$ million

	Management case		Base case		Downside case	
	1994	2000	1994	2000	1994	2000
Fixed assets	29	26	30	26	30	26
Working capital	29	39	28	39	28	39
Provisions	(9)	(9)	(9)	(9)	(9)	(9)
Senior debt	-	-	(16)	-	(52)	-
Institutional mezzanine	-	-	(69)	-	(69)	-
Gillette mezzanine	(133)	(9)	(142)	(197)	(142)	(256)
Stora loan note	<u>(48)</u>	<u>(48)</u>	<u>(48)</u>	<u>(48)</u>	<u>(48)</u>	<u>(48)</u>
Net tangible (deficit)	<u>(132)</u>	<u>(1)</u>	<u>(226)</u>	<u>(189)</u>	<u>(262)</u>	<u>(248)</u>
Equity	55	55	55	55	55	55
Reserves/(losses)	(17)	85	(65)	(65)	(85)	(111)
Goodwill	<u>(170)</u>	<u>(141)</u>	<u>(216)</u>	<u>(179)</u>	<u>(232)</u>	<u>(192)</u>
	(132)	(1)	(226)	(189)	(262)	(248)

Source: MMC from MGTC data.

1.2. Swedish Match NV's profit and loss projections for the years 1994 and 2000 according to the three cases are as shown in Table 3.6.

TABLE 3.6 Profit and loss projections of Swedish Match NV for the years 1994 and 2000

\$ million

	Management case		Base case		Downside case	
	1994	2000	1994	2000	1994	2000
Sales revenue	172	231	172	231	172	231
Depreciation	(9)	(9)	(9)	(9)	(9)	(9)
Other costs	(120)	(164)	(129)	(176)	(128)	(176)
Operating profit	43	58	34	46	35	46
Loan interest	(20)	(3)	(31)	(30)	(35)	(39)
Goodwill amortisation	(5)	(5)	(6)	(6)	(7)	(7)
Profit before tax	18	50	(3)	10	(7)	-
Tax	(9)	(26)	(1)	(6)	-	(2)
Retained profit/loss	9	24	(4)	4	(7)	(2)

Source: MMC from MGTC data.

The low projected profits (in the base case) or loss (in the downside case) are largely attributable to the PIK loan interest. The object of a refinancing exercise would no doubt be to substitute a less costly form of finance for this debt.

The updated projections following the sales of the matches and lighters businesses

3.47. J Henry Schroder Wagg & Co Ltd (Schroders) was appointed as financial adviser to Swedish Match NV following the acquisition of the CP Division from Stora. In conjunction with the management, it too made a number of financial projections during the negotiations for the sale of the matches and lighters businesses, including updated projections once the sales referred to in paragraphs 3.34 to 3.37 had been agreed. Schroders, after making its own enquiries, used substantially the same assumptions regarding turnover, operating margins, interest rates etc as had been used for the MGTC management case projections. Its projections were, however, expressed in SEK.

3.48. We first set out in Table 3.7 the latest projection of Swedish Match NV's profit and loss account for 1990, taking into account the sale of the matches and lighters businesses.

TABLE 3.7 Swedish Match NV projected profit and loss account for 1990

SEK million

	Jan to Aug	Sept	Sept to Dec	Jan to Dec
	All activities	Lighters and matches	Wilkinson Sword	Swedish Match NV corporate All activities
Sales	[
Operating income before depreciation				
Depreciation				
Profit before interest				
Interest (net)				
Other financial items				
Profit before tax				
Tax				
Loss after tax before minority interest]

Source: MMC from Swedish Match NV data.

Notes:

1. The above projection is derived from the consolidated management accounts of Swedish Match NV for the eight months to 31 August, the estimated matches and lighters businesses' results for September and the results for the four months to 31 December of the Wilkinson Sword businesses and for Swedish Match NV group companies.

2. The high tax charge arises mainly because Swedish Match NV is unable to set interest on corporate borrowings and losses incurred by some of its operating subsidiaries against the trading profits of certain of its other operating subsidiaries.

1.3. Next, in Table 3.8 we show the projected balance sheet position at 31 December 1990.

TABLE 3.8 Swedish Match NV projected balance sheet position at 31 December 1990

	SEK million	\$ million*
Net tangible assets before deducting borrowings†	403	70.3
Borrowings:		
Bank loans and overdrafts	(63)	(11.0)
Senior debt	(414)	(72.1)
Institutional mezzanine debt	(424)	(73.9)
Gillette mezzanine debt	(498)	(86.8)
Stora loan note	(300)	(52.3)
	<u>(1,699)</u>	<u>(296.1)</u>
Net tangible deficit after deducting borrowings	(1,296)	(225.8)
Being:		
Share capital, equity loan stock and reserves	135	23.5
Minority interests	1	0.2
Goodwill and intangibles‡	(1,432)	(249.5)
	<u>(1,296)</u>	<u>(225.8)</u>

Source: MMC from Swedish Match NV data.

*For the purpose of this projected balance sheet SEK have been converted at 5.74 = \$1 (an estimated rate for December 1990).

†Net assets before deducting borrowings are projected to consist of:

	SEK million	
Operating assets	603	
Investment in Wilkinson Sword Inc	35	
Amount receivable by Indian business not taken over by purchaser	36	
Sellers' note on sale of matches and lighters businesses (payable March 1992)	302	
Cash and marketable securities:		
Soft currency	29	
Hard currency	80	
Other assets	<u>11</u>	
	1,096	
Less:		
Operating liabilities	404	
Accrued interest on long-term loans	47	
Wilkinson Sword US loan (amount owing for repurchase of US business)	37	
Other liabilities	<u>205</u>	<u>693</u>
		<u>403</u>

‡Goodwill and intangibles of \$249.5 million are higher than the amount of \$194 million referred to in paragraph 3.41 (d). The difference arises mainly from adjustments due to exchange rate fluctuations, inter-company indebtedness and increased payments to management on the sale of the matches and lighters businesses earlier than expected.

1.4. During the years 1991 to 1994 inclusive Swedish Match NV's gross borrowings are expected, according to these latest projections, to fall from SEK 1,699 million to SEK 1,476 million as shown in Table 3.9. At the end of 1994 its total net borrowings, taking account of the amount of SEK 36 million owing for the repurchase of the US business and the \$80 million hard currency cash balances, are forecast to be \$1,432 million.

TABLE 3.9 Swedish Match NV: movements in gross borrowings, 1991 to 1994

	<i>SEK million</i>				
	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>1994</i>	<i>Period 1991 to 1994</i>
Borrowings at start of year	1,699	1,549	1,561	1,523	1,699
Deduct: net positive cash flow	<u>226</u>	<u>76</u>	<u>140</u>	<u>165</u>	<u>607</u>
	1,473	1,473	1,421	1,358	1,092
Add: accrued interest on Gillette mezzanine debt	<u>76</u>	<u>88</u>	<u>102</u>	<u>118</u>	<u>384</u>
Borrowings at year end	1,549	1,561	1,523	1,476	1,476

Source: MMC from Swedish Match NV data.

1.5. Details of the projected borrowings at 31 December 1994 are shown in Table 3.10. In the absence of a substantial injection of equity, possibly as part of a refinancing exercise, Swedish Match NV appears likely (as is often the case when a business is acquired at a price which includes substantial goodwill, financed largely by borrowings) to continue to have a large deficit of tangible assets for the foreseeable future.

TABLE 3.10 Swedish Match NV: projected borrowings at 31 December 1994

	<i>SEK million</i>	<i>\$ million</i>
Bank loans and overdrafts	63	11.0
Institutional mezzanine debt	233	40.6
Gillette mezzanine debt	880	153.3
Stora loan note	<u>300</u>	<u>52.3</u>
	1,476	257.2

Source: Swedish Match NV.

Note: For the purpose of this table Swedish Match NV assumed an exchange rate of SEK 5.74 = \$1.

1.6. Borrowings at 31 December 1994 according to Schrodgers' latest projections are higher than they were according to the MGTC management case projection (see Table 3.4). Swedish Match NV provided us with an approximate explanation of the difference which we set out in Table 3.11.

TABLE 3.11 Reconciliation of MGTC and Schrodgers' projections of borrowings as at 31 December 1994

	SEK million	\$ million*
Borrowings projected by Schrodgers	1,476	246
Cash	(80)	(13)
Amount owing for repurchase of US business	<u>36</u>	<u>6</u>
	<u>1,432</u>	239
Borrowings projected in MGTC management case (see Table 3.4):		
Stora loan note	48	
Gillette mezzanine	<u>133</u>	<u>181</u>
Difference		<u>58</u>
Accounted for by:		
Repurchase of US business		6
Difference in estimated net disposal proceeds of matches and lighters businesses		3†
Increased payments to management on earlier sale of matches and lighters businesses		19†
Shortfall of cash flow from matches and lighters businesses because of their earlier sale		32†
Miscellaneous differences		<u>(2)</u>
		58

Source: MMC from Swedish Match NV data.

*For the purpose of this reconciliation Swedish Match NV assumed an exchange rate of SEK 6=\$1.

†Includes consequential interest costs.

3.53. Finally, Swedish Match NV gave us a broad assessment of the estimated value of the equity of the business at the end of 1994 (based on Schrodgers' projections and although calculated in SEK, expressed in US dollars using an assumed rate for the purpose of SEK 6.03=\$1) and of the potential return to the equity investors. These are summarised in Table 3.12.

TABLE 3.12 Swedish Match NV: potential return to the equity investors

	US \$ million
Forecast 1994 earnings before interest and tax Capitalised at a multiple of 9.5, which Swedish Match NV regarded as appropriate for a predominantly German business	[
Less: projected debt	‡
Projected value of equity	
Estimated rate of return to equity investors on their initial investment of \$55.2 million (%)]

Source: MMC from Swedish Match NV data.