

To Readers of *It's Earnings That Count*:

Many linx-eyed readers have pointed out a few errors in my book. Alas, some of the numbers in the Wrigley case study are wrong. If you were inconvenienced in any way, my apologies. To borrow a line from Chrissy Hynde, "No one is perfect, Not even a perfect stranger."*

The correct numbers on pages 59, 75, 76, 78, 79, 80, 81, and 145 are in **pink**. You may want to print the following pages for easy reference.

If you have any questions or comments, please e-mail me at Hewitt.Heiserman@EarningsPower.com.

Thank you for reading my book, and good luck in your efforts to find your own Make A Difference stock!

Sincerely,

Hewitt Heiserman

P.S. Be sure to check out the It's Earnings That Count discussion board (<http://boards.fool.com/Messages.asp?mid=20687166&bid=116735>) at The Motley Fool. (Free registration required.)

*Lyric from The Pretenders' "Time The Avenger" (*Learning To Crawl*, 1984)

As calculated below, Wrigley made a \$64 million investment in working capital in 2002.

Table 5.1		
Wrigley's Investment in Working Capital, 2002 (in thousands)		
	12/31/01	12/31/02
Working capital assets:		
Receivables	\$239,885	\$312,919
Inventory	278,981	321,196
Other current assets	<u>46,896</u>	<u>47,720</u>
Total	\$565,762	\$681,835
Working capital liabilities:		
Payables	\$91,397	\$97,705
Accrued expenses	128,264	172,137
Dividends payable	42,741	46,137
Income taxes payable	<u>68,467</u>	<u>66,893</u>
Total	\$330,869	\$382,872
Working capital, net	\$234,893	<u>\$298,963</u>
Investment working capital		\$64,070
Source: Company reports (2002 annual report); EarningsPower.com		

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As Table 6.3 shows, Wrigley's gross enterprising capital at year-end 2002 was \$2.0 billion. After subtracting excess cash (which I assume for a company of Wrigley's stature is any amount over 2 percent of revenue), short-term investments, and marketable securities, we get net enterprising capital of \$1.8 billion. Since a firm's enterprising capital will change throughout the year, use the two-year average figure in your calculations. For Wrigley, it works out to \$1.6 billion.

As calculated below, Wrigley employed \$1.597 billion (average two years) of enterprising capital in 2002.

Table 6.3			
Wrigley's Capital and Equivalents (in thousands)			
		12/31/01	12/31/02
Debt	Working capital line of credit	n/a	n/a
	Current portion long-term debt	n/a	n/a
	Long-term debt	n/a	n/a
	Total debt	n/a	n/a
Other	Other senior liabilities	122,842	129,044
Stockholders' Equity	Total	1,276,197	1,522,576
	Deferred taxes	3,434	21,244
Capital Equivalents	Capitalized operating leases	n/a	25,099
	Net capitalized intangibles	321,713	351,147
	Gross	\$1,724,186	2,049,111
Enterprising Capital	Less: Excess cash	(259,757)	(224,350)
	Less: Short-term investments	(25,450)	(25,621)
	Less: marketable securities	(25,300)	(19,411)
	Net	\$1,413,679	\$1,779,729
	Average 2 years		\$1,596,704

Source: Company reports (2002 annual report); EarningsPower.com

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Since Wrigley employed \$1.6 billion of enterprising capital in 2002 and its WACC was 11.8 percent, we estimate its interest expense to be \$188.4 million:

$$\begin{aligned} \text{Enterprising interest} &= \text{Enterprising capital} \times \text{WACC} \\ &= \$1.597 \text{ billion} \times 11.8\% \\ &= \$188.4 \text{ million} \end{aligned}$$

7. Enterprising interest expense: \$188.4 million

8. Imputed interest operating leases: In 2002, interest on operating leases is estimated at \$1.0 million.

9. Taxes: \$171.6 million.

As we see in Table 6.6, Wrigley's accrual profits of \$401.5 million, or \$1.78 per share, compared with enterprising profits of \$244.9 million, or \$1.09 per share.

Table 6.6		
Types of Profits: Wrigley. For the year ending December 31, 2002 (thousands except per-share)		
Income Statement	Accrual	Enterprising
Revenue	\$2,746,318	\$2,746,318
Cost of sales	1,150,215	1,150,215
Selling, marketing and admin	1,011,029	1,011,029
Other expense	10,571	10,571
Investment income	(8,918)	n/a
(Intangibles reversal)	n/a	(362,548)
Investment fixed capital (#1)	n/a	n/a
Investment working capital (#2)	n/a	n/a
Intangibles (#3) (advertising)	n/a	333,113
Interest expense (#4)	n/a	188,411
Imputed interest operating leases	n/a	(1,004)
Taxes	<u>181,896</u>	<u>171,618</u>
Total expenses	\$2,344,793	\$2,501,407
Profit	\$401,525	\$244,911
Per-share (225,575)	\$1.78	\$1.09

Source: Company reports (2002 annual report); EarningsPower.com

As shown below, Wrigley's enterprising taxes in 2002 totaled \$171.6 million.

Defensive taxes	\$164.1 million
Interest tax benefit	0.4 million
Intangibles tax benefit	10.3 million
(Nonoperating income tax benefit)	<u>(3.1) million</u>
Enterprising taxes	\$171.6 million

Table 6.7

How To Calculate Wrigley's Capitalized Operating Leases
(figures in thousands)

	Future Value	Discount Rate (8%)	Present Value
Year 1	\$10,269	0.9259	\$ 9,508
Year 2	\$13,042	0.8573	\$11,181
Year 3	0	0.7938	0
Year 4	\$ 5,999	0.7350	<u>\$ 4,409</u>
Capitalized operating leases			\$25,099
Capitalized operating leases-average 2 years			\$12,550

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The present value of Wrigley's capitalized operating leases, using an 8.0 percent discount rate, is \$25.1 million. Since the company didn't report any operating leases for 2001, the two-year average is \$12.6 million. At an interest rate of 8.0 percent, the estimated interest expense is \$1.004 million, as the following calculation shows:

Capitalized operating leases avg. 2 years	\$12.6 million
times: Implied interest rate	x 8.0%
Implied interest	\$1.004 million

The next step is to calculate the interest tax benefit. This is the sum of accrual interest and the implied interest on operating leases, which we just estimated for Wrigley to be \$1.004 million. At a 35 percent tax rate, its interest tax benefit is \$0.4 million.

Interest (accrual plus implied operating leases)	\$1.004 million
times: Tax rate	x 35%
Interest tax benefit	\$0.4 million

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By way of example, in 2002 Wrigley's enterprising profits were \$245.456 million, and its enterprising interest \$187.866 million. (Because I'm using data from the last six years' worth of financial statements, eNOPAT is slightly different from the amount calculated in Chapter 6.) eNOPAT, as shown below, totaled \$433.322 million.

$$\begin{aligned} \text{eNOPAT} &= \text{Enterprising profits} + \text{enterprising interest} \\ &= \$245.456 \text{ million} + \$187.866 \text{ million} \\ &= \$433.322 \text{ million} \end{aligned}$$

In 2001, Wrigley's eNOPAT was \$364.1 million. Also, its enterprising capital for December 31, 2001, and December 31, 2002, was \$1409.061 and \$1775.111 million, respectively:

Return on greenest dollar

$$\begin{aligned} &= \frac{\text{Change in eNOPAT}}{\text{Change in enterprising capital}} \\ &= \frac{\$433.322 \text{ million} - \$364.1 \text{ million}}{\$1775.111 \text{ million} - \$1409.06 \text{ million}} \\ &= \frac{\$69.22 \text{ million}}{\$366.05 \text{ million}} \\ &= 19\% \end{aligned}$$

As calculated, Wrigley's return on greenest dollar in 2002 was 19 percent. This means the \$366.05 million investment in enterprising capital made in 2002 produced an additional \$69 million of eNOPAT.