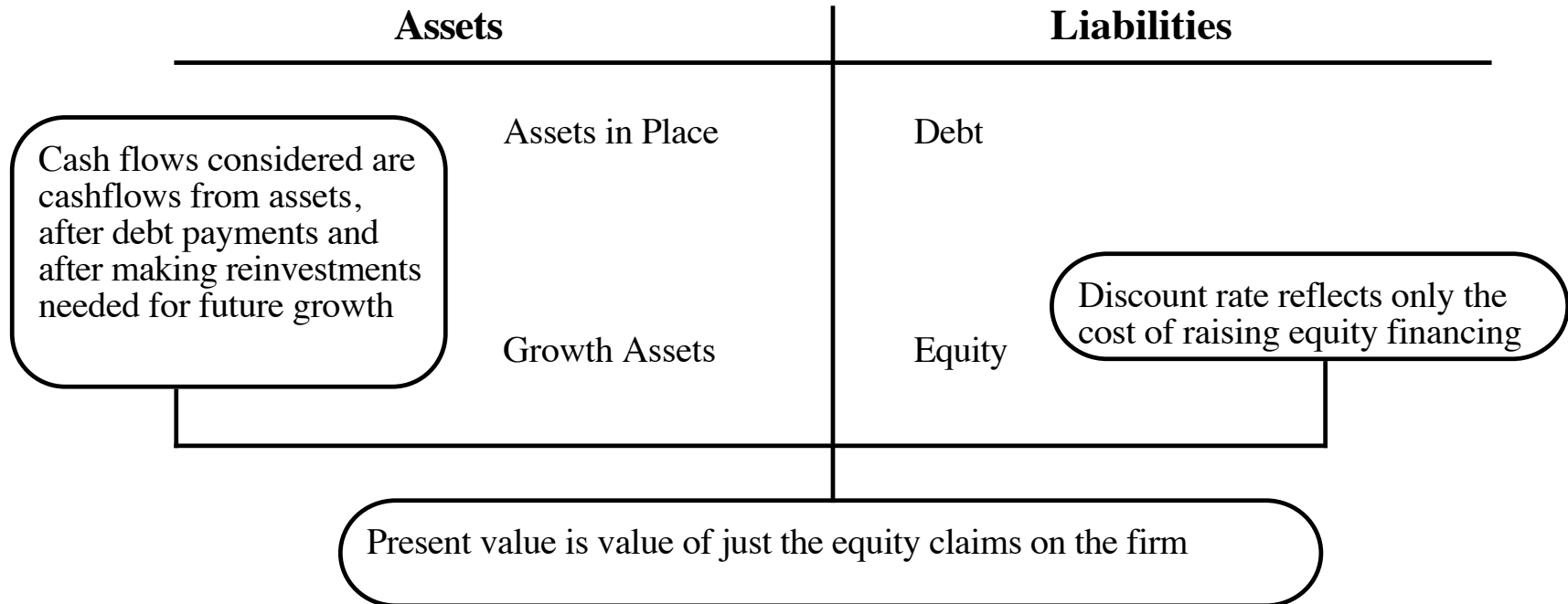


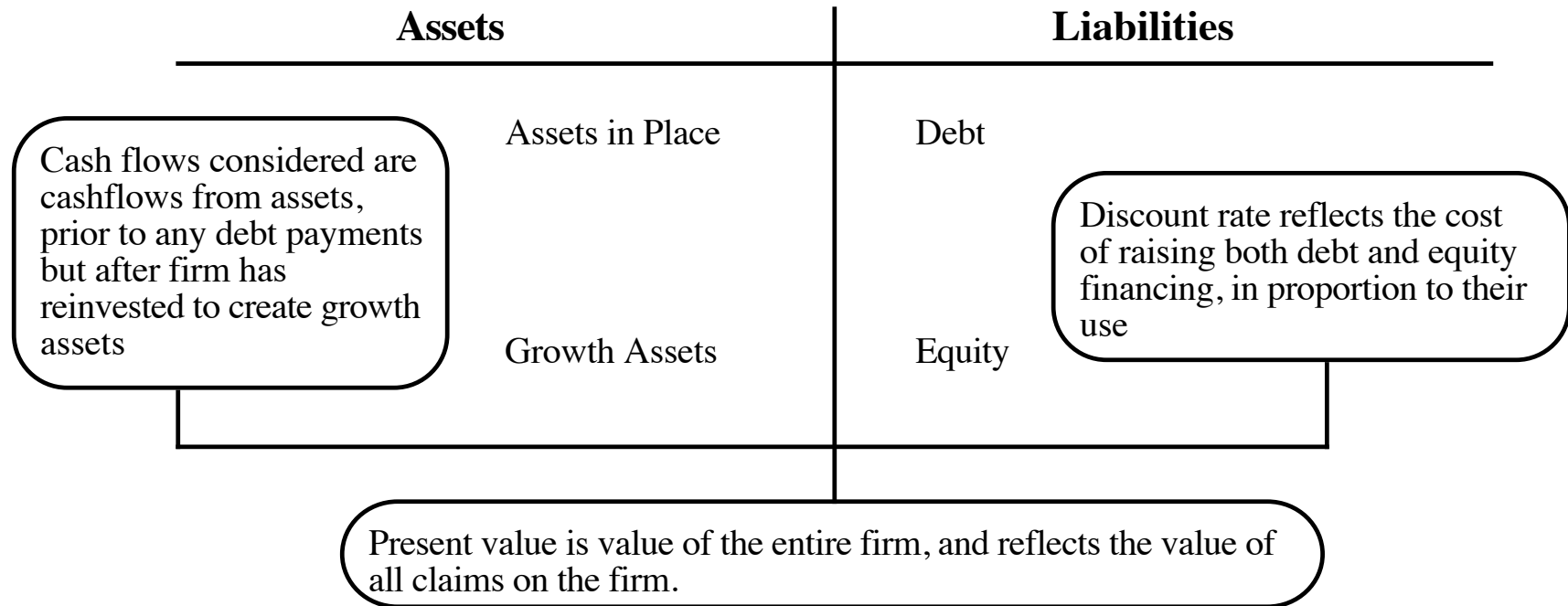
Equity Valuation

Figure 5.5: Equity Valuation



Firm Valuation

Figure 5.6: Firm Valuation



To get from firm value to equity value, all you need to do is subtract out the debt outstanding today. Not only should you include all debt that you considered as debt in your cost of capital, but also any other “overhanging liabilities”, including under funded pension/health care obligations & potential liabilities from lawsuits.

KENNECOTT COPPER CORPORATION

(Carborandum Co. fin. data reflecting Kennecott acquisition at \$66 per share)
(\$ millions except for per share and ratio data)

INCOME STATEMENT:	1977 (unadj.)	adjustmts	1977 (adj.)	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Sales	717.6			790.1	885.9	1005.2	1129.9	1265.5	1392.1	1531.3	1684.4	1852.8	2038.1
Net Income (bef. adj.)	38.4			43.1	50.7	60.1	70.6	84.7	93.2	102.5	112.7	124.0	136.4
Interest adjustment	0.0			6.5	7.8	8.5	9.2	9.8	10.7	11.7	12.8	14.0	15.4
Goodwill adjustment	0.0			2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Plant write-up adj.	0.0			2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Net Income (aft. adj.)	38.4			31.8	38.1	46.8	56.6	70.1	77.7	86	95.1	105.2	116.2
BALANCE SHEET													
Working capital	198.8	+37 +100 -140	195.8	202.9	223	248.1	274.2	302.8	329.3	358.6	390.7	426.1	465
Prop, plant & equip	181.8	+124	305.8	334.2	367.4	384.6	400.1	411.6	437.5	466.6	499.1	535.6	576.1
Goodwill	0	+80	80	78	76	74	72	70	68	66	64	62	60
Total assets	584.3	+201	785.3	824	889.9	948.4	1007	1065.8	1135.5	1213.1	1299	1394.6	1500.3
Long-term debt	86.2	+100	186.2	220.9	238.8	252.9	266.8	280.1	297.7	317.5	339.4	363.9	391
Shhldrs. equity	309	+101	410	410.1	443.5	469.7	495.4	520.2	553	589.6	630.3	675.7	726
Total capital	395.2	+201	596.2	631	682.3	722.6	762.2	800.3	850.7	907.1	969.7	1039.6	1117
CAPITAL SOURCES													
Profit Retentions				0.1	33.4	26.2	25.7	24.8	32.8	36.6	40.7	45.4	50.3
Capital from Kennecott				-	-	-	-	-	-	-	-	-	-
Debt financing (net)				34.7	17.9	14.1	13.9	13.3	17.6	19.8	21.9	24.5	27.1
Total capital added				34.8	51.3	40.3	39.6	38.1	50.4	56.4	62.6	69.9	77.4
KEY FINANCIAL RATIOS													
Growth rate in sales(%)	16.90			10.1	12.1	13.5	12.4	12	10	10	10	10	10
Sales/assets	1.23			0.96	1.00	1.06	1.12	1.19	1.23	1.26	1.30	1.33	1.36
Profit/sales	0.054			0.04	0.043	0.047	0.05	0.055	0.056	0.056	0.056	0.057	0.057
Assets/net worth	1.89			2.01	2.01	2.02	2.03	2.05	2.05	2.06	2.06	2.06	2.07
Profit/net worth	0.124			0.078	0.086	0.10	0.114	0.135	0.141	0.146	0.151	0.156	0.160
CASH FLOW TO KENNECOTT													
Acquisition of Carborandum			-550										
Dividends to Kennecott			140	31.7	4.7	20.6	30.9	45.3	44.9	49.4	54.4	59.8	65.9
Utilization of Kennecott tax loss carryforwards			-	20	20	-	-	-	-	-	-	-	-
Tax shelter from plant write-up adj.				2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Terminal value at 10 times earnings													1044.9
Net cash flow			-410	54.5	27.5	23.4	33.7	48.1	47.7	52.2	57.2	62.6	1113.6

In discounting these net cash flows,
which of these discount rates would
you use?

	Cost of equity	Cost of capital
Kennecott (Acquirer)	13.00%	10.50%
Carborandum (Target)	16.50%	12.50%
Merged Entity	14.00%	11.00%