

Corporate Finance 15.402
Case 8: Dixon Corporation

Your job is to help Dixon's management decide whether to acquire the Collinsville plant at the proposed price. Some of the managers in charge of the decision are familiar with the simple WACC valuation method (i.e., using a single WACC to discount all cash flows) and so you have been asked to perform the valuation in this way. However, because you are aware of certain pitfalls of this method, you are also performing an APV-based valuation exercise.

- 1) Estimate the weighted average cost of capital that is appropriate for discounting the Collinsville plant's incremental cash flows. You should estimate and present each component of the WACC separately, explaining briefly but clearly what assumptions you are making for each of them. In the same spirit, estimate the appropriate all-equity cost of capital for the APV-based valuation.
- 2) Project the incremental cash flows associated with the acquisition of the Collinsville plant without the laminate technology. Use projections from Exhibit 8 through 1984. After 1984 assume: EBIT is flat; capital expenditures are \$600,000 per year; and that net working capital increases 8% per year. Assume that the plant is shut down at the end of 1989 and that its salvage value is zero.
- 3) Estimate the value of the Collinsville plant without the laminate technology using the simple WACC method.
- 4) Project the incremental cash flows associated with the 1980 investment in laminate technology. Using the simple WACC method, estimate the investment's net present value.
- 5) Compare the WACC-based valuation to the APV-based valuation. Do they differ and how much? If the difference is important, explain why. If the difference is small or zero, explain why.
- 6) As CEO of Dixon Corporation, would you approve the acquisition of the Collinsville plant at the price and on the terms proposed? Why, or why not?