PRINCETON UNIVERSITY

WACC and APV for an Acquisition

Example: GM and Hughes

- General Motors evaluates the acquisition of Hughes Aircraft Corp. It assumes that Hughes is approximately the same risk as its competitors Lockheed and Northrop that produce similar products

  - GM: Beta = 1.20 D/E=0.40
  - Lockheed: Beta = 0.90 D/E=0.90
  - Northrop: Beta = 0.85 D/E=0.70

- Lockheed and Northrop operate with a fixed level of debt
- GM plans to operate Hughes with a constant target D/E ratio of 1
- Future after tax cash flows: Next year $300m, annual growth rate of 5%
- Marginal tax rate: 0.34
- Discount rate of debt equals the risk-free rate: 0.08 (implies $\beta_D = 0$)
- Market return: 0.14

To do

1. Valuation of an acquisition using WACC

2. Valuation of an acquisition using APV