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RJR Nabisco

On October 20, 1988, Charles E. Hugel, the chairman of RJR Nabisco, was appointed chairman of the Special Committee. The Special Committee (**Exhibit 1**) was formed to consider a proposal to purchase the company for $17 billion by a group consisting of F. Ross Johnson, the president and chief executive officer of RJR Nabisco; Edward A. Horrigan, the vice chairman of RJR Nabisco and chief executive officer of RJ Reynolds Tobacco Company; and the investment banking firm of Shearson Lehman Hutton (the Management Group). At $75 a share, the buyout offer was 34% above the preoffer price of $55.875. No details about the form of the offer were immediately available.[1] Within four days, Kohlberg, Kravis, Roberts & Co. (KKR), a firm specializing in leveraged buyouts, announced a competing tender offer for RJR Nabisco. The KKR bid was for $90 a share, or about $20.3 billion in total.

Company Background

RJR Nabisco began as a tobacco company in 1875 and remained primarily a tobacco company until the RJR Foods subsidiary was formed after a series of acquisitions in 1967. By 1987, the company's sales had grown to $15.8 billion (**Exhibit 2**), and assets stood at $16.9 billion (**Exhibit 3**). The tobacco business included established brand-name cigarettes such as Winston, Salem, Camel, and Vantage and also included products such as Planters nuts and LifeSavers candies. The business segment data in **Exhibit 4** show that the tobacco business had sales of $6.3 billion and operating income of $1.8 billion in 1987.

The food businesses initially included Hawaiian Punch beverages, Chun King oriental foods, My-T-Fine puddings, Davis baking powder, Vermont Maid syrup, and Patio Mexican dinners. Del Monte, which was acquired in 1979, added canned goods and fresh bananas and pineapples. RJR Nabisco's food business expanded substantially with the 1985 acquisition of Nabisco Brands, which added brand names such as Oreo, Fig and Fruit Newtons and Chips Ahoy! cookies; Ritz, American Classic, and Quackers crackers; Nabisco Shredded Wheat cereal; Fleischmann's margarine; A-1 Steak Sauce; Ortega Mexican foods; and Milk-Bone dog biscuits. In 1987, the food business had sales of $9.4 billion and an operating income of $915 million.

[1]The directors of RJR Nabisco viewed Johnson's consideration of a buyout as material information and disclosed the buyout proposal when it was discussed by the board.

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RJR Nabisco had also entered and exited several lines of business. Sea-Land, a container-shipping company, was acquired in 1969 and divested in 1984. Heublein, a producer of alcoholic beverages and the owner of Kentucky Fried Chicken, was acquired in 1982. Kentucky Fried Chicken was sold in 1986, and the remaining wine and spirits business of Heublein was sold in 1987. The company entered the energy business with the acquisition of American Independent Oil Company in 1970 and the U.S. subsidiaries of Burmah Oil Company in 1976. It exited the energy business by selling these assets in 1984.

Exhibit 5 contains projections for RJR Nabisco, assuming that it continued under its pre-offer operating plans. A total of nearly $10 billion in capital expenditures was projected for 1989 through 1998. The major investment in the tobacco business was extending development and test marketing of the Premier, a smokeless cigarette. The company had already spent $300 million on the Premier, and substantial costs would be associated with manufacturing and marketing the product. It had also approved plans to spend about $2.8 billion to modernize Nabisco's bakeries. The plans included constructing two new bakeries for $600 million each, spending $1.6 billion on the complete retrofittings of four plants, and closing five others.

The Management Group Bid

The Management Group's strategy was to sell off RJR Nabisco's food businesses and retain its tobacco business. The strategy was based on the view that the market undervalued the strong cash flows from the tobacco business and did not fully value its food businesses because of its association with tobacco. Selling RJR Nabisco's food assets and taking the tobacco business private would eliminate the undervaluation and generate substantial gains.

F. Ross Johnson had experience selling food assets. He was CEO of Standard Brands when Nabisco acquired it to form Nabisco Brands in 1981. And he was CEO of Nabisco Brands when RJ Reynolds acquired it in 1985 to form RJR Nabisco. Furthermore, the Management Group bid occurred when the food industry was undergoing a major restructuring and revaluation. Both Pillsbury and Kraft were in the midst of takeover contests.

Grand Metropolitan PLC began a hostile tender offer for Pillsbury on October 4, 1988. Grand Met was a diversified British company that brewed and distributed beer, ale, and lager; produced and distributed alcoholic beverages; and owned and operated pubs and restaurants. Pillsbury was a diversified food and restaurant company, with popular brands such as Pillsbury Doughboy bakery items, Green Giant vegetables, and Häagen-Dazs ice cream in its food business and Burger King in its restaurant group. The $5.2 billion Grand Met bid was a 53% premium over the previous market price - about 25 times Pillsbury's net earnings and about four times the book value of common equity.[2] Pillsbury opposed the bid, and its outcome was uncertain.

Philip Morris offered to purchase all Kraft common stock at $90 a share in cash on October 18, 1988. Like RJR Nabisco, Philip Morris earned most of its profits from tobacco: its Marlboro, Benson & Hedges, and Virginia Slims cigarettes had 1987 sales of $14.6 billion and operating profits of $3.3 billion. And, also like RJR Nabisco, Philip Morris acquired most of its food assets in 1985. Philip Morris acquired General Foods with brand-name products such as Maxwell House coffee, Birds Eye frozen foods, Jell-O, Oscar Mayer meats, Ronzoni pasta, and Post cereals. Philip Morris also had

[2]Pillsbury's 1988 net earnings per share were $2.45, excluding unusual items, and $0.81, including unusual items. The difference was due to a restructuring charge of $1.64 per share. Its 1987 earnings per share was $2.24, excluding unusual items, and $2.10, including unusual items.

brewing interests, with brands like Miller, Lite, and Matilda Bay Wine Coolers. Kraft was known for such brand names as Miracle Whip, Seven Seas, and Kraft salad dressings; Kraft real mayonnaise; Velveeta cheese; Parkay and Chiffon margarines; Lender's Bagels; and Breyers ice cream. The $11 billion Philip Morris offer for Kraft was a 50% premium over the preoffer stock price and about 21 times Kraft's net earnings.[3]

Based on the prices bid for Pillsbury and Kraft, analysts estimated the value of RJR Nabisco's food businesses as:

Nabisco	$8	to	$9.5	billion
Del Monte	$3	to	$4	billion
Planters	$1.5	to	$2	billion
Total	**$12.5**	**to**	**$15.5**	**billion**

Exhibit 6 contains projections for RJR Nabisco under the Management Group plan.

The KKR Bid

Henry Kravis, a general partner of KKR, first expressed interest in organizing a leveraged buyout of RJR Nabisco in a September 1987 dinner meeting with F. Ross Johnson. KKR was organized in 1976 by three former executives of Bear Stearns & Co.: Jerome Kohlberg, Henry Kravis, and George Roberts. Since then, KKR had acquired more than 35 companies, paying more than $38 billion in total. KKR also completed the $6.2 billion leveraged buyout of Beatrice foods in 1986, at the time the largest completed leveraged buyout.

KKR offered to purchase up to 87% of RJR Nabisco common stock for $90 a share in cash. The remaining shares would receive securities with a value of $90 a share, and terms to be negotiated by KKR and the Special Committee. KKR's $20.7 billion bid also offered $108 a share for the preferred stock of RJR Nabisco.[4] The KKR bid was conditional on approval of the merger by RJR Nabisco's board of directors.

KKR's strategy for managing RJR Nabisco contrasted sharply with the Management Group's proposal to sell all of the company's food assets. According to KKR's letter to the Special Committee:

> [W]e do not contemplate the dismemberment of the Company's operations. . . .[O]ur present intention is to retain all of the tobacco business and to continue their important presence in Winston-Salem, North Carolina. We also expect to retain a significant portion of the food operations. Moreover, our financing plan does not require, nor do we intend, any presales of parts of the Company.

Exhibit 7 contains projections for RJR Nabisco under the KKR operating plan.

KKR did not present specific details on financing for its offer. It had raised a $5.6 billion pool of equity capital for investments in leveraged buyouts. Also, KKR retained Morgan Stanley & Co.,

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[3]Kraft's forecasted 1988 net income from continuing operations was $522 million. It also had income of $658 million from the sale of its Duracell battery business to KKR in 1988.

[4]RJR Nabisco had 225,336,442 shares of common stock outstanding and outstanding employee stock options to purchase 3,628,414 common shares. There were 1,308,760 shares of preferred stock outstanding.

Wasserstein, Perella & Co., Drexel Burnham Lambert & Co., and Merrill Lynch Capital Markets to assist in financing the cash portion of the buyout.

Following its bid, KKR entered into a confidentiality agreement with RJR Nabisco, giving KKR access to nonpublic material information about the company. The agreement also gave KKR the opportunity to meet with RJR Nabisco's management. Meeting them was especially important to KKR because its rival, the Management Group, had access to such information because of its position within the firm. In return for access to the information, KKR agreed not to purchase any RJR Nabisco securities, participate in a proxy contest, or advise or influence any participant in such a contest for two years unless it obtained approval of RJR Nabisco's Board of Directors.

KKR invited the Management Group to join with it in a joint bid. However, the two parties could not agree on a joint bid and abandoned the attempt on October 26, 1987. A second attempt to form a joint bid also failed, on November 3, and later that same day the Management Group announced a revised proposal to acquire RJR Nabisco. The revised bid was for $92 a share, or $21.1 billion in total, and included $84 a share in cash and $8 a share in securities. Like the KKR bid, no details on the financing for the offer or the terms of the securities were available.

In addition to the bids by the Management Group and KKR, groups led by Forstmann, Little & Co. and First Boston Corporation were also considering a bid for RJR Nabisco. The Forstmann Little group had entered into a confidentiality agreement much like KKR's agreement with RJR Nabisco.

The Auction

On November 7, the Special Committee adopted a set of rules and procedures "to determine which alternative would best serve the interests of [RJR Nabisco's] shareholders." Although not a commitment to recommend selling the company, the rules were "intended to constitute a single round of bidding. Any proposal should reflect the potential purchaser's highest offer." All bids were due by 5:00 pm on Friday, November 18. Any bid that did not conform to these rules the Special Committee would consider hostile.[5] The rules for bids included:

- Proposals should not be conditional on the sale of any assets of RJR Nabisco;
- Proposals should provide RJR Nabisco shareholders with a "substantial common-stock-related interest";
- Proposals should include details on financing arrangements, including commitment agreements and details of any noncash component of the offer; and
- Proposals should be approved by the bidding firm's board of directors.

The board of directors and the Special Committee reserved the right to amend or terminate any of the rules, to terminate discussions with any bidder, and to reject any or all proposals.

[5]RJR Nabisco had a variety of antitakeover provisions that could be used to oppose a hostile offer, including a super-majority provision (requiring a two-thirds vote of disinterested shareholders to approve a merger), a poison pill rights plan (which forces an acquiring firm to purchase preferred stock at a substantial premium), and Section 203 of Delaware Law (which prevents a merger within three years of acquiring 15% or more of a target firm).

The Bids

On a per share basis, KKR's bid was $75 cash, $11 for pay-in-kind preferred stock, and $6 principal amount of pay-in-kind converting debt, which KKR valued at $8.[6] The debt would convert to common stock at the end of one year unless the holder decided to retain it. If all debt was converted into common stock, it would represent 25% of the outstanding common stock of RJR Nabisco. The cash portion of the bid would be financed by $1.5 billion in equity, $3.5 billion in subordinated debt, and $12.4 billion in bank debt. KKR also planned on assuming the $5.2 billion of preexisting debt.

On a per share basis, the Management Group's bid was $90 cash, $6 of pay-in-kind preferred stock, and $4 of convertible preferred stock. The convertible preferred stock, as a class, could be converted into about 15% of the surviving company's equity, but it was callable by the company at any time for the face value and accumulated dividends. The cash portion of the bid would be financed by $2.5 billion in equity, $3 billion in subordinated debt, and $15 billion in bank debt. Like KKR, the Management Group planned on assuming the $5.2 billion of outstanding debt.

The First Boston Group's offer involved the purchase of RJR Nabisco's tobacco business by the First Boston Group and the sale of the food business. The food business would be sold for a $13 billion installment note before December 31, 1988, and a right to 80% of the net proceeds of the subsequent sale of the food business in excess of the installment note. RJR Nabisco shareholders would receive the proceeds from the sale of the food business. First Boston would purchase the tobacco business for $15.75 billion, plus warrants (valued at $2 to $3 per RJR Nabisco share) to acquire up to 20% of the equity of the tobacco business. On a per share basis, RJR Nabisco shareholders would receive a cash payment ranging from $98 to $110, securities valued at $5, and warrants worth $2 to $3. Unlike the bids by KKR and the Management Group, the First Boston proposal did not include information about its financing.

[6] Pay-in-kind securities pay dividends and coupons with additional units of the security instead of cash.

Exhibit 1 Composition of the Special Committee of the RJR Nabisco Board of Directors to Consider Offers for the Company.

Committee Members:	*Biographical Sketch*	*Common Stock Ownership*
Charles E. Hugel, Chairman	Age 60; chairman of RJR Nabisco; president and chief executive officer of Combustion Engineering, Inc.	750 shares
John D. Macomber, Vice Chairman	Age 60; chairman of Lasertechnics; retired chairman and chief executive officer of Celanese Corporation	16,425 shares
Martin S. Davis	Age 61; chairman and CEO of Gulf and Western, Inc.	1,000 shares
William S. Anderson	Age 69; retired chairman and chief executive officer of the Executive Committee of NCR Corporation	1,500 shares
Albert L. Butler, Jr.	Age 70; president of Arista Company; chairman of RJR Nabisco's Organization, Compensation, and Nominating Committee	9,465 shares

Investment Bankers:

Dillon, Read & Co.

Lazard Freres, Inc.

Legal Counsel:

Skadden, Arps, Slate, Meagher and Flom

Young, Conaway, Stargatt and Taylor

Source: Casewriter.

Exhibit 2 Exhibit 2 Condensed Operating and Stockholder Information for RJR Nabisco, 1982-1987 (in millions of dollars, except per share data).

	1982	1983	1984	1985	1986	1987
Operations:						
Revenues	$7,323	$7,565	$8,200	$11,622	$15,102	$15,766
Operating income	1,142	1,205	1,412	1,949	2,340	2,304
Interest and debt expense	180	177	166	337	565	489
Income before provision for income taxes	1,012	1,110	1,353	1,663	1,782	1,816
Income from continuing operations	548	626	747	917	1,025	1,081
Income from discontinued operations[a]	322	255	463	84	39	128
Net income	**870**	**881**	**1,210**	**1,001**	**1,064**	**1,209**
Stockholder Information:						
Earnings per share	$3.13	$2.90	$4.11	$3.60	$3.83	$4.70
Dividends per share	1.14	1.22	1.30	1.41	1.51	1.76
Closing stock price at year end	20.40	24.30	28.80	31.38	49.25	45.00
Price/earnings at year end	6.5x	8.38x	7.01x	8.72x	12.86x	9.57x
Numbers of shares at year end (millions)[b]	281.5	283.2	258.4	250.6	250.4	247.4
Beta[c]	0.80	0.70	0.74	1.21	1.24	0.67

Source: Company reports and Casewriter estimates.

[a] Divestitures and acquisitions for the years 1982 to 1987 are as follows:

1982—Heublein acquired for $1.36 billion.

1983—Energy Division sold for an after-tax gain of $275 million.

1984—Divestiture of transportation division completed by spinning off common stock to Sea-Land Corp. (transportation accounted for as a discontinued operation since 1983).

1985—Nabisco brands, Inc., acquired at a total cost of $4.9 billion.

1986—Kentucky Fried Chicken sold at an after-tax loss of $39 million.

1987—Heublein, Inc. sold at an after-tax gain of $215 million.

[b] Figures include a 2 1/2-for-1 stock split, effective May 17, 1985.

[c] Calculated using daily stock price data for each year by ordinary least-squares regression.

Exhibit 3 Consolidated Balance Sheets for RJR Nabisco, 1986-1987 (in millions of dollars).

	1986	1987
Assets:		
Cash	$827	$1,088
Net receivables	1,675	1,745
Inventories	2,620	2,678
Other current assets	273	329
Property, plant and equipment, net	5,343	5,847
Goodwill and other intangibles	4,603	4,525
Net assets of discontinued operations	716	--
Other assets	644	649
Total assets	**$16,701**	**$16,861**
Liabilities:		
Notes payable	$518	$442
Accounts payable	2,923	3,187
Current portion of long-term debt	423	162
Income taxes payable	202	332
Long-term debt	4,833	3,884
Deferred income taxes	751	846
Redeemable preferred stock	291	173
Other noncurrent liabilities	1,448	1,797
Total liabilities	**$11,389**	**$10,823**
Stockholders' equity	5,312	6,038
Total liabilities and stockholders' equity	**$16,701**	**$16,861**

Source: Company reports.

Exhibit 4 Financial Summary of RJR Nabisco by Business Segment, 1982-1987 (in millions of dollars).

	1982	1983	1984	1985	1986	1987
Tobacco:						
Sales	$4,822	$4,807	$5,178	$5,422	$5,866	$6,346
Operating profit	1,187	1,150	1,305	1,483	1,659	1,821
Identifiable assets	3,219	3,378	3,812	4,496	4,882	5,208
Depreciation	81	78	107	146	205	244
Capital expenditures	238	383	527	647	613	433
Operating profit/identifiable assets	36.9%	34.0%	34.2%	33.0%	34.0%	35.0%
Restructuring expense	--	--	--	--	--	(261)
Food Products:						
Sales	$2,501	$2,758	$3,022	$6,200	$9,236	$9,420
Operating profit	21	129	181	549	820	915
Identifiable assets	1,710	1,761	2,211	9,598	9,822	10,117
Depreciation	51	56	68	195	376	380
Capital expenditures	84	94	86	279	344	445
Operating profit/identifiable assets	1.2%	7.3%	8.2%	6.0%	8.0%	9.0%
Restructuring expense	--	--	--	--	--	18
Spirits and Wines:						
Sales	$392	$746	$703	$766	$876	$--
Operating profit	53	113	122	131	138	--
Identifiable assets	1,084	740	815	895	991	--
Depreciation	14	24	22	24	30	--
Capital expenditures	11	13	13	26	25	--
Operating profit/identifiable assets	4.9%	15.3%	15.0%	14.6%	14.0%	--
Restructuring expense	--	--	--	--	--	--
Other (including "corporate"):[a]						
Sales	$--	$--	$--	$--	$--	$--
Operating profit	(66)	(74)	(74)	(83)	(139)	(182)
Identifiable assets	3,106	3,197	2,257	1,684	1,319	1,536
Depreciation	11	16	16	13	24	28
Capital expenditures	16	15	29	20	65	58
Operating profit/identifiable assets	-2.1%	-2.3%	-3.3%	-5.0%	-10.5%	-11.9%
Restructuring expense	--	--	--	--	--	(7)

Source: Company reports.

[a]Includes earnings on cash and short-term investments and miscellaneous discontinued operations.

Exhibit 5 Cash Flow Projections for RJR Nabisco Under Its Prebid Strategy, 1988-1998 (in millions of dollars).

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Tobacco sales	7,061	7,650	8,293	8,983	9,731	10,540	11,418	12,368	13,397	14,514	15,723
Food sales	9,889	10,438	11,383	12,092	12,847	13,651	14,507	15,420	16,393	17,428	18,533
Total	**16,950**	**18,088**	**19,676**	**21,075**	**22,578**	**24,191**	**25,925**	**27,788**	**29,790**	**31,942**	**34,256**
Operating income											
Tobacco	1,924	2,022	2,360	2,786	3,071	3,386	3,733	4,115	4,534	4,998	5,508
Food	1,079	1,163	1,255	1,348	1,459	1,581	1,713	1,855	2,011	2,178	2,361
Corporate	-350	-287	-279	-296	-314	-333	-353	-374	-396	-420	-445
Total	**2,653**	**2,898**	**3,336**	**3,838**	**4,216**	**4,634**	**5,093**	**5,596**	**6,149**	**6,756**	**7,424**
Interest	551	582	662	693	690	658	594	458	410	259	-21
Net income	1,360	1,498	1,730	2,023	2,259	2,536	2,858	3,251	3,625	4,094	4,625
Depreciation, amortization, & deferred tax	730	807	791	819	849	866	867	867	867	867	861
Capital expenditures	1,142	1,708	1,462	1,345	930	738	735	735	735	735	735
Change in working capital		80	111	98	105	113	121	130	140	151	162
Cash flow available for capital payments[a]		517	948	1,399	2,073	2,551	2,869	3,253	3,617	4,075	4,589

Source: Casewriter.

[a]Cash flow available for capital payments = net income + depreciation, amortization, and deferred tax - capital expenditures - change in working capital.

Exhibit 6 Cash Flow and Capital Structure Projections for RJR Nabisco Under the Management Group Strategy, 1989-1998 (in millions of dollars).

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Panel A: Operating Information										
Sales	7,650	8,293	8,983	9,731	10,540	11,418	12,368	13,397	14,514	15,723
Operating income	1,917	2,385	2,814	3,266	3,589	3,945	4,337	4,768	5,243	5,766
Interest	2,792	1,353	1,286	1,183	1,037	850	624	351	0	0
Amortization[a]	388	388	388	388	388	388	388	388	388	388
After-tax income	-965	293	621	987	1,297	1,655	2,063	2,527	3,073	3,418
Depreciation, amortization, & deferred tax	777	725	726	735	749	754	758	763	769	774
Capital expenditures	432	381	380	389	396	402	412	422	432	442
Change in working capital	41	45	48	52	57	61	67	72	78	85
Net proceeds from asset sales	12,680	0	0	0	0	0	0	0	0	0
Cash flow available for capital payments[b]	12,018	593	919	1,282	1,594	1,946	2,344	2,797	3,332	3,666
Panel B: Capital Structure										
Principal payments to:										
Assumed debt	310	375	721	816	400	728	1,854	0	0	0
Bank debt	11,708	218	198	466	1,194	1,217	0	0	0	0
Subordinated debt	0	0	0	0	0	0	490	2,510	0	0
Preferred stock	0	0	0	0	0	0	0	287	3,332	3,327
Convertible preferred stock	0	0	0	0	0	0	0	0	0	339
Total	**12,018**	**593**	**919**	**1,282**	**1,594**	**1,946**	**2,344**	**2,797**	**3,332**	**3,666**
Year-end book values:										
Assumed debt	4,894	4,519	3,798	2,982	2,582	1,854	0	0	0	0
Bank debt	3,292	3,075	2,877	2,411	1,217	0	0	0	0	0
Subordinated debt	3,000	3,000	3,000	3,000	3,000	3,000	2,510	0	0	0
Total	**11,186**	**10,594**	**9,675**	**8,393**	**6,799**	**4,854**	**2,510**	**0**	**0**	**0**
Preferred stock	1,632	1,938	2,303	2,736	3,250	3,861	4,587	5,162	2,801	0
Convertible preferred stock	1,035	1,229	1,460	1,735	2,061	2,448	2,909	3,455	4,105	4,538
Common stock	1,535	1,828	2,449	3,436	4,733	6,388	8,451	10,978	14,051	17,469
Total	**4,202**	**4,995**	**6,212**	**7,907**	**10,044**	**12,697**	**15,947**	**19,595**	**20,957**	**22,007**

Source: Casewriter.

[a]The amortization of goodwill of $338 million per year is from the proposed acquisition of RJR Nabisco at $22.9 billion which had the book value of $7.4 billion at the end of 1988. The difference between the purchase price and book value is amortized over 40 years using the straight-line method.

[b]Cash flow available for capital payments = net income + depreciation, amortization, and deferred tax - capital expenditures - change in working capital + net proceeds from asset sales.

Exhibit 7 Cash Flow and Capital Structure Projections for RJR Nabisco Under KKR's Strategy, 1989-1998 (in millions of dollars).

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Panel A: Operating Information										
Tobacco sales	7,650	8,293	8,983	9,731	10,540	11,418	12,368	13,397	14,514	15,723
Food sales	8,540	6,930	7,485	8,084	8,730	9,428	10,183	10,997	11,877	12,827
Total	**16,190**	**15,223**	**16,468**	**17,815**	**19,270**	**20,846**	**22,551**	**24,394**	**26,391**	**28,550**
Operating income										
Tobacco	2,022	2,360	2,786	3,071	3,386	3,733	4,115	4,534	4,998	5,508
Food	1,060	1,026	1,191	1,245	1,307	1,367	1,430	1,494	1,561	1,630
Corporate	-219	-158	-167	-176	-185	-194	-203	-213	-224	-235
Total	**2,862**	**3,228**	**3,811**	**4,140**	**4,508**	**4,906**	**5,341**	**5,815**	**6,335**	**6,902**
Interest expense	2,754	2,341	1,997	1,888	1,321	1,088	806	487	21	0
Amortization[a]	388	388	388	388	388	388	388	388	388	388
After-tax income	-281	233	845	1,134	1,751	2,168	2,641	3,164	3,814	4,203
Depreciation, amortization & deferred tax	1,159	991	899	907	920	924	928	933	939	945
Capital expenditures	774	556	555	572	586	598	618	638	658	678
Change in working capital	79	84	87	94	102	110	119	129	140	151
Noncash interest expense	206	237	312	366	0	0	0	0	0	0
Net proceeds from asset sales	3,500	2,700	0	0	0	0	0	0	0	0
Cash flow available for capital payments[b]	3,732	3,521	1,414	1,740	1,983	2,383	2,832	3,330	3,956	4,319
Panel B: Capital Structure										
Principal payments to:										
Assumed debt	310	375	721	816	400	400	2,182	0	0	0
Bank debt	3,422	3,146	693	924	1,583	1,983	629	0	0	0
Subordinated debt	0	0	0	0	0	0	21	3,330	149	0
Preferred stock	0	0	0	0	0	0	0	0	3,806	4,319
Total	**3,732**	**3,521**	**1,414**	**1,740**	**1,983**	**2,383**	**2,832**	**3,330**	**3,956**	**4,319**
Year-end book values:										
Assumed debt	4,894	4,519	3,798	2,982	2,582	2,182	0	0	0	0
Bank debt	8,958	5,812	5,119	4,195	2,612	629	0	0	0	0
Subordinated debt	3,500	3,500	3,500	3,500	3,500	3,500	3,470	149	0	0
Converting debt[c]	1,580	1,817	2,129	2,495	0	0	0	0	0	0
Total	**18,932**	**15,648**	**14,546**	**13,172**	**8,694**	**6,311**	**3,470**	**149**	**0**	**0**
Preferred stock	2,896	3,331	3,958	4,702	5,586	6,636	7,883	9,365	7,320	4,377
Common stock	1,219	1,452	2,297	3,430	7,676	9,844	12,485	15,648	19,463	23,666
Total	**4,115**	**4,783**	**6,255**	**8,132**	**13,262**	**16,480**	**20,368**	**25,013**	**26,783**	**28,043**

Source: Casewriter.

[a]The amortization of goodwill of $338 million per year is from the proposed acquisition of RJR Nabisco at $22.9 billion which had the book value of $7.4 billion at the end of 1988. The difference between the purchase price and the book value is amortized over 40 years using the straight-line method.

[b]Cash flow available for capital payment = net income + noncash interest + depreciation, amortization, and deferred tax - capital expenditures - change in working capital + net proceeds from asset sales.

[c]Assumes converting to equity in 1993.