

MEASURING CASH CREATION AND FLOW

Salvage and Terminal Values

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SALVAGE AND TERMINAL VALUES

- ▶ CAPX is spending cash
- ▶ Selling assets generates cash
- ▶ Asset sales go into FCF

THE END OF THE PROJECT

- ▶ The balance sheet is real
- ▶ PP&E cannot vanish
- ▶ Balance sheet must “sweep clean”
- ▶ We have to sell off anything on the books!

TERMINAL/SALVAGE VALUES

Projected Balance Sheet	0	1	2
Cash and Marketable Sec.	\$75	\$75	\$200
Other Current Assets	\$0	\$100	\$75
Fixed Assets			
At cost	\$500	\$500	\$500
Accumulated Depreciation	\$0	\$100	\$200
Net Fixed Assets	\$500	\$400	\$300
Total Assets	\$575	\$575	\$575
Current liabilities	\$75	\$75	\$75
LT Debt	\$250	\$250	\$250
Total liabilities	\$325	\$325	\$325
Stock and acc. ret. earnings	\$250	\$250	\$250
Total liabilities and equity	\$575	\$575	\$575

WHAT IF WE DON'T SELL THE ASSETS?

- ▶ Assets are an opportunity cost
- ▶ Moving assets has a cost
- ▶ Each project is separate
- ▶ Transfer pricing
- ▶ Best practice always sweeps clean

TERMINAL/SALVAGE VALUES

$$\begin{aligned}\text{FCF} = & \text{Operating Profit (after tax)} \\ & - \text{Increase in WC} \\ & + \text{Depreciation} \\ & - \text{Capital expenditure} \\ & + \text{After-tax salvage value}\end{aligned}$$

SUMMARY

- ▶ Assets sales must be included in FCF
- ▶ Balance sheet must always sweep clean
- ▶ Each project must stand alone
- ▶ Opportunity costs are key