Session 15C: Post Class tests

1. You are trying to value Lorax Inc., a mature food processing company that is expected to generate $200 million in after-tax operating income next year. The company is being targeted by activist investors for change and have come up with the following information:

	Growth Rate	*ROIC*	*Cost of capital*	*Probability*
Status Quo	3%	10%	9%	60%
Activist in charge	3%	15%	8%	40%

   Estimate the expected value per share today, assuming that net debt is zero, and there are 100 million shares outstanding.
2. You are valuing GenStore, an aging retail firm, and you expect it to generate $50 million in after-tax operating income next year. You expect these earnings to decline 2% a year, in perpetuity, and you expect your return on capital to be 10% forever. If your cost of capital is 8%, and you have $250 million in net debt (based on market value of debt today), estimate the value of equity today.
3. Now assume that you were told that the debt in GenStore is publicly traded and takes the form of one zero coupon bond with ten years to maturity and a face value of $400 million. Estimate the probability of failure that the bond market is attaching to the firm, and your equity value, if it is worth nothing in the event of failure. (The riskfree rate is 3%)
4. You are valuing an emerging market company that is family controlled and has a history of bad management. When you value the company, you assume that it will continue to be run as it has historically, taking projects that earn a return on capital of 6% in perpetuity, even though they have a cost of capital of 10%. If the growth rate in perpetuity is 3% and the firm expects to generate after-tax operating income of $20 million next year, estimate the value of the operating assets.
5. An analyst argues that you should be discounting this value for the fact that corporate governance is non-existent and you cannot change the management of the company. Should you?
   a. Yes
   b. No
   If no, explain why.