Session 17: Post Class tests

1. You are considering doing a leveraged buyout of Alameda Inc., a mature, manufacturing company. The company has an EV/EBITDA of 5, which is lower than the EV/EBITDA for the sector and the market. The company has EBITDA of $100 million, DA of $ 40 million, capital expenditures of $ 58 million, no working capital needs and a tax rate of 40%. If the cost of capital for the company is 10%, it earns a return on invested capital of 6% and has in stable growth, is the company cheap or expensive?
    a. Cheap
    b. Expensive
    c. Correctly priced

   Explain.
2. Sisley Stores is a publicly traded company that expects revenues of $ 1 billion and after-tax operating income of $80 million, next year. It is in stable growth, growing 2% a year, and has invested capital of $800 million. If the cost of capital for the company is 8%, estimate the EV/Sales ratio for the company.
    a. 0.8
    b. 1.0
    c. 1.067
    d. 1.333
    e. None of the above
3. If you are doing a relative valuation, you have to compare how your company is priced to how “comparable” companies are being priced out there. You often have to decide what to include in this “comparable” firm list and how big a sample to go for. Under which of the following would you prefer to stay with a small list of closely comparable firms (over a larger list of firms that may differ on one or more dimensions from your firm)?
    a. The company has to be in a narrow and unique business.
    b. The closely comparable companies have similar growth potential to the company being valued.
    c. The closely comparable companies have the same risk profile as the company being valued.
    d. The closely comparable companies generate the same returns on equity and margins as the company being valued.
    e. All of the above.
4. Assume that you are doing a valuation, where you are comparing the price to book ratio of GenSys Bank to other banks. GenSys has a price to book ratio of 2.00 and a return on equity of 16%. The average price to book ratio across all banks is 1.20 but you have run a regression of price to book against return on equity across banks and arrived at the following:

   $$PBV = 0.72 + 80\ (ROE)$$

   Based on this regression, which of the following conclusions would you draw?
    a. Gensys is under valued (cheap)
    b. Gensys is over valued (expensive)
    c. Gensys is fairly valued

5. Selena Inc. is a fashion apparel manufacturer that is trading at an EV/EBITDA multiple of 9.0, much higher than the average multiple for the sector. Which of the following best explains why this may be happening?
    a. The company is in a risky emerging market, whereas the comparable companies are in developed markets.
    b. Selena Inc. has a much lower return on invested capital than the comparable companies in the group
    c. Selena Inc. pays no taxes but comparable companies pay tax rates that average 30%.
    d. Selena Inc. has much larger reinvestment needs forthcoming than comparable companies in the group.
    e. None of the above