Problem 1
1a. In any currency, as long as your growth rates, cash flows and discount rates are estimated in that currency.
1b. The implied equity risk premium today. (This is the only way to be market-neutral.) I did give a half a point for those who picked the implied premium over the last 40 years, because it is partially correct.
1c. The S&P 500. You want the broadest index that you can find for the CAPM. Remember that you are trying the mirror the market portfolio, which includes all traded stocks in proportion to their market value.

Problem 2

<table>
<thead>
<tr>
<th>Business</th>
<th>Revenues</th>
<th>Estimated Value</th>
<th>Value Weights</th>
<th>Beta</th>
<th>D/E</th>
<th>Unlevered Beta</th>
<th>Weight *</th>
<th>Unlevered Beta</th>
<th>Enterprise Value/Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel</td>
<td>$1,200</td>
<td>$1,800</td>
<td>42.86%</td>
<td>1.20</td>
<td>25%</td>
<td>1.04</td>
<td>0.45</td>
<td>1.50</td>
<td>3.00</td>
</tr>
<tr>
<td>Publishing</td>
<td>$800</td>
<td>$2,400</td>
<td>57.14%</td>
<td>1.50</td>
<td>10%</td>
<td>1.42</td>
<td>0.81</td>
<td>3.00</td>
<td>1.26</td>
</tr>
<tr>
<td>Firm</td>
<td>$2,000</td>
<td>$4,200</td>
<td>100.00%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.26</td>
<td></td>
</tr>
</tbody>
</table>

The weights should be value weights, if you can get them.

Market Value of Equity = 100* 30 = $3,000
Market Value of Debt = $1,200 ! Value of firm - Value of Equity = 4200 - 3000
Debt/Equity Ratio = 40.00%
Levered Beta = 1.56

Problem 3

PV of Operating Lease Commitments = $310.49
Adjusted EBIT = $78.63 ! = 60 + .06*310.49 ! Some of you added an extra year of operating leases. I gave you full credit even if you did.
EBIT (1-t) = $47.18
+ Depreciation 50
- Capital Expe 110 ! Includes all acquisitions, including those funded with stock. All you are doing is skipping a step - if you had issued the stock to the public and used the cash - it would have been a cash acquisition.
- Change in N 20 ! Looks at only non-cash Working capital = (180-80)-(200-120). The cash is not a wasting asset - it is invested in T.Bills, earning a fair rate of return
FCFF $7.18

Grading
1a. All or nothing
1b. 1/2 point for average implied equity risk premium. If you chose none of the above and you can come in and explain what you would use if you were doing a market neutral valuation, I will consider giving you the point.
1c. All or nothing...

2. Wrong weights (many of you used revenue weights): -1
Wrong debt to equity ratio : -1
Other errors: -1/2 (unlevering beta wrong, forgot tax rate.....)

3. Did not capitalize operating leases correctly: -1
Failed to consider stock acquisition: -1
Miscalculated working capital change: -1
Forgot to after-tax operating income: -1/2