GROWTH TESTS

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Analyst Estimates of Growth

- For many companies, you can get analyst estimates of expected growth for the next five years. What is the problem with valuing a company using an analyst estimate of growth?

a. The growth is estimated in earnings per share. You often need a growth rate in operating income or revenues.
b. The growth rate is generally highly correlated with historical growth.
c. The growth rate is not a good estimate of future growth.
d. If you use an analyst estimate of growth, it is not really your intrinsic value for the company.
e. All of the above.

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Fundamental Growth

- Fundamental growth is tied to how much a company reinvests back into the business and how well it reinvests. A company reports after-tax operating income of $ 75 million on revenues of $ 1 billion (thus generating a return on capital of 7.5%). It does not plan to reinvest in new assets, but will maintain existing assets and its current return on capital. What follows?
  a. The company cannot grow
  b. The company cannot grow in the short term
  c. The company cannot have sustainable long term growth
  d. The company will shrink

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Efficiency and Growth?

- If this company thinks that it can improve its return on capital on existing assets to 10% next year by making them more efficient, what growth rate will you see in operating income next year? (You can still assume no reinvestment)

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