

LOOSE ENDS

The cost of complexity

- You are investor, looking at two firms that look exactly identical on financial criteria – same operating income, same growth, same risk and same return on capital. Company A is in a single business and has transparent financials. Company B is a complex firm, in multiple businesses, with opaque financials/ holding structure. Which firm, if any, would you value more highly?
  - Company A: It is simpler to value
  - Company B: It is more diversified
  - Neither: They have the same financials and should have the same value

Debt and Value

- You have just completed a firm valuation (discounting cash flows to the firm at the cost of capital) of a publicly traded company and arrived at a value of $100 million. The firm has debt outstanding, with a face value of $100 million and a market value of $ 80 million. What is the value of equity in this firm?
  - $ 200 million
  - $ 0
  - Some number in the middle

Management Options

- Assume that you have valued equity in a firm to be worth $ 1 billion, by discounting free cash flows to equity at the cost of equity. The firm has 100 million shares outstanding. What is the value per share?

- Now assume that the firm grants 10 million options to its CEO, with a strike price set equal to $ 10. What is the value per share?
  - $ 9.09 (1000/110)
  - $ 10 (The options have no exercise value)
  - Between $9.09 and $ 10
  - Something else