Session 27a: Post Class tests

1. Westerly Inc. is a publicly traded company that generated $1000 million in operating income in the most recent year, after taking a depreciation charge of $200 million. The company had capital expenditures of $500 million during the year and its working capital increased by $120 million. If the effective tax rate for the company was 30% for the year, what is the FCFF (Free Cash flow to the Firm) for the most recent year?
   a. $80 million
   b. $280 million
   c. $580 million
   d. $780 million
   e. None of the above
2. Now assume that Westerly reported a book value of equity of $2.5 billion and book value of debt of $1.5 billion at the start of the most recent year; the cash balance at the start of the year was $0.5 billion. Assuming that Westerly maintains its existing return on capital and reinvestment rate, what is the expected growth rate in operating income for Westerly?
   a. 8.4%
   b. 10.5%
   c. 12%
   d. 16.8%
   e. None of the above
3. You expect Westerly to become a mature company at the end of year 5, growing 3% a year in perpetuity. Assuming that you expect Westerly's return on capital to drop by half from current levels after year 5, what would your reinvestment rate be in year 6 (the first year for your stable growth)?
   a. 0%
   b. 25%
   c. 30%
   d. 60%
   e. None of the above

   Bonus: Estimate the terminal value at the end of year 5, if your cost of capital is 9% in perpetuity.

4. You are valuing Neruda Telecom, a growing telecom company. You have estimate the free cash flows to equity and cost of equity for the company for the next three years below (in millions):

	1	2	3
FCFE	-$25.00	$50.00	$150.00
Cost of equity	14%	12%	10%

   You expect the cash flows to grow 3% a year in perpetuity after year 3 and the cost of equity to stay at year 3 levels in perpetuity (after year 3). What is the value of equity in the firm?

a. $1,553 million
b. $1,650 million
c. $1,696 million
d. $1,789 million
e. $2,331 million

5. You are valuing Uggla Inc., discounting free cash flows to the firm at the cost of capital and have arrived at a present value of $2.5 billion. The company has $300 million in cash, $600 million in debt (market and book value) and a minority holding in other company (10% of that company) that is valued at $150 million. If there are 100 million shares outstanding, what is the value of equity per share?
   a. $14.50
   b. $17.50
   c. $20.50
   d. $23.50
   e. $35.50