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):

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<tr>
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<th>1</th>
<th>2</th>
<th>3</th>
</tr>
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<tbody>
<tr>
<td>FCFE</td>
<td>-$25.00</td>
<td>$50.00</td>
<td>$150.00</td>
</tr>
<tr>
<td>Cost of equity</td>
<td>14%</td>
<td>12%</td>
<td>10%</td>
</tr>
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   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?
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