Quiz 2: Valuation

Answer all questions and show necessary work. Please be brief. This is an open book, open notes exam.

1. You are reviewing the cash flows forecasts for Swingell Inc., a publicly traded steel company, for the next three years:

	1	2	3
EBIT (1-t) =	$120.00	$132.00	$145.20
- Reinvestment	$48.00	$105.60	$116.16
FCFF	$72.00	$26.40	$29.04
Expected growth rate	10%	10%	10%
Cost of capital	12%	12%	12%

Swingell's return on capital is expected to remain unchanged at its current level in perpetuity and its cost of capital is expected to drop to 7.5% after year 3.

a. If the expected growth rate in after-tax operating income (EBIT(1-t)), after year 3 is expected to be 2.5%, **estimate the terminal value for Swingell (at the end of year 3).** (2 points)

b. Estimate the present value (today) of just the terminal value . (Don't just show a number. Show your discounting details.) (1 point)

2. Visco Inc. is a publicly traded company that has two cross holdings, a 10% ownership of Mello Inc., which is recorded as a minority holding and a 60% stake in Robo Enterprises, which is fully consolidated. You have been given the following information on the three companies (with values in millions):

	Visco (Consolidated)	*Mello*	*Robo*
FCFF next year	$120.00	$45.00	$72.00
Cost of capital	10.00%	8%	12%
Expected growth rate	2.50%	2%	3%
Cash	$100.00	$50.00	$25.00
Debt	$300.00	$-	$125.00
# Shares	100.00	50.00	80.00

Estimate the **value per share in Visco Inc**. (4 points)

3. Cameron Inc. is an engineering company that is very exposed to economic cycles. In the most recent year, it had an operating loss of $100 million, its book value of equity is $300 million and its book value of debt is $1200 million; it has no cash. It's prospects for next year are dependent on the overall economy:
   a. If the economy improves, Cameron expects to generate $180 million in after-tax operating income next year and grow 3% a year in perpetuity; its return on capital will stabilize at next year's level and its cost of capital is 9%.
   b. If the economy stays depressed, Cameron will be forced into default. Its assets will be sold for 90% of book value and it will have to pay off all its debt outstanding.

   If the probability of the economy improving is 80% and the staying depressed is 20%, and Cameron's cost of capital is 9%, estimate the value of equity in Cameron. (3 points)