



2. You are assessing the pricing of two regional banks and have collected the following information on them:

	<i>SunTrust Bank</i>	<i>SouthEast Bank</i>
Market value of equity	\$150.00	\$100.00
Book Value of equity	\$90.00	\$80.00
Expected Net income next year	\$18.00	\$12.00

Both banks are in stable growth, growing 3% a year, and have the same cost of equity. If you believe that SunTrust Banks is fairly priced by the market, make your best assessment of Southeast Banks. (3 points)

3. You are considering buying Cervelli Plumbing, a privately owned plumbing business and have collected the following information.
- ➔ Francisco Cervelli, the owner, has provided you with the financial statements of the business that indicate that it generated after-tax operating income of \$200,000 last year on revenues of \$ 800,000.
  - ➔ Mr. Cervelli did not pay himself a salary and does much of the accounting, advertising and bill collection work himself. You believe that hiring an administrative service to do the same work will cost you \$ 50,000 a year (pre-tax).
  - ➔ The tax rate is 40%. The riskfree rate is 4% and the equity risk premium is 6%.
- The firm is entirely equity funded and is expected to generate its current after-tax operating income in perpetuity (no growth). You believe that a fair value for the firm, if you sell it in a private transaction (to a completely undiversified investor) is \$850,000. Assuming that 40% of the risk in a plumbing company is market risk (correlation = 0.4), estimate the fair value of the firm if you were selling it to a publicly traded company. ( 3 points)