

FIN 345 (Spring 2020)

IPO Valuation: FCFE valuation practice.

Suppose Company A is in a maturity market, which as regulations on product pricing. Therefore, it is unlikely that Company A will be able to reach a high growth. Company A is expected to grow at 10% per year forever; and its leverage is stable (i.e. we can consider its D/E ratio is constant over time). We need to calculate Company A's stock price per share.

- FCFE model: use the constant dividend growth model. $P_0 = \frac{FCFE_1}{r_E - g}$

1. Suppose in 2019, Company A has the following information. **Calculate its FCFE per share in 2019.**

- Current Information:
- Earnings per Share (EPS) = \$1.56
- Capital Expenditures per share = \$4.25
- Depreciation per share = \$2.85
- Change in Net Working Capital per share = \$0
- Debt ratio = 60%

(Hint: In Topic II Part 2 IPO valuation DCF model class notes file, slide #19, there are two formulae for FCFE. Which formula can you use?)

2. Suppose the beta for Company A's stock is 1.10. In 2019, the 30-year U.S. Treasury Bond is 2%, and the S&P 500 market index return is 30%. **Calculate Company A's cost of equity (r_E).**
3. Suppose in the future, Company A's earnings, capital expenditures and depreciation are all expected to grow at 10% a year forever. **Calculate Company A's current stock per share by using the FCFE model.**

Submission: Students shall submit the answer file into the "05 Individual comprehensive practice (IPO)" dropbox in LIVE, by 11:59PM, May 1st 2020 (Friday).