Chapter 9 – Examples

1. Assume Vesemir Corp expects earnings per share of $11 a year from today. Assume also that over the next three years, Vesemir expects to pay out 20% of its earnings as dividends and to reinvest 80% of earnings in projects earning a rate of return of 25%. Starting four years from today and continuing thereafter forever, Vesemir's return on new investments will fall to 8%, and Vesemir will boost its payout to 90% of earnings. What is the value today of Vesemir's stock if Vesemir's equity cost of capital equals 12%?

2. Assume a firm had revenues of $121 million for the year ended today and that revenues are expected to grow at a rate of 25% per year through five years from today. Variable costs will equal 70% of sales and fixed costs will equal $15 million per year. Depreciation will equal $8 million per year and capital spending will equal depreciation each year. Cash equals 17% of revenues in the current year and accounts receivable equal 17% of revenues in the current year. Inventory equals 16% of the following year's sales, and accounts payable equal 90% of inventory. The firm's tax rate equals 21%. The cost of capital for the firm equals 8%. Beyond year 5, free cash flows (and revenues) are expected to grow at a rate of 2% per year forever. The firm's outstanding debt equals $95 million and the firm has 9 million shares outstanding. What is the price per share for the firm's stock?

Note: if you plug this information into the spreadsheet on my website (name of link is "Discounted FCF Example"), the Free Cash Flows are as follows:

Year	1	2	3	4	5
Free Cash Flow:	6.79	13.03	20.82	30.57	44.12