Fin 533 Test Problems – Equity -- Spring 2008

1. Michael's Enterprises plans to pay a $1.50 a share dividend at the end of each of the next three years. Also, at the end of year 3, Michael's will pay a final liquidating dividend of $29 a share. After that, the company will close its doors permanently. What is the current value of this stock if the appropriate discount rate is 13 percent?

2. CD Bargain Barn is forecasting earnings per share of $3.30 next year. Its investors require a return of 16%. If the stock price is currently $47, what is the present value of growth opportunities?

3. Sallie Mae Clothing is in the process of selling its peripheral businesses and returning to a pure clothing store. In conjunction with this reorganization the dividend will be decreased by 20 percent this year, 15 percent the second year, and 10 percent the following (third) year. After that, the dividend will resume its historical pattern of 3 percent annual increases. The required return on this stock is 10 percent and the last dividend paid was $5.00 per share. What is one share of this stock worth today?

4. What is the value of a share of Bank of America stock using relative valuation? You can assume that the other stocks and Bank of America are comparable in P/E.

	Symbol	Price	P/E
Citigroup	C	$23.09	6.49
Wachovia Corp	WB	$30.41	7.55
Wells Fargo & Co.	WFC	$28.87	10.35
Regions	RF	$20.59	8.65
Bank of America	BAC	$39.18	8.71

5. Alpha Corp just paid a dividend of $1.50. EPS and dividends growth rates are estimated at 12% per year for the first four years and 6% thereafter. This stock is 15% less risky than the market as a whole. The risk-free rate is 7%, and the market risk premium is 8%. What is the intrinsic value of this stock?

6. Star Saucers just paid a dividend of $2.00 per share and its latest earnings per share were $6.00. The required rate of return for this stock equals 12%, and the ROE equals 14%. What is the intrinsic value of a share of Star Saucers?

7. Paglia Pasta, Inc. has developed a low-carb pasta that tastes good. The company expects growth in FCFE of 25% in the coming year, 15% in the following year after which the low-carb craze is predicted to slow, so that growth in FCFE will average 5% as the pasta will be marketed primarily to individuals with diabetes. Capital expenditures, depreciation, and working capital are all expected to increase proportionately with FCFE. If the required rate of return for Paglia Pasta is 10%, determine the value of a share using the FCFE approach.

Paglia Pasta, Inc.
Balance Sheets

	2006	2007		2006	2007
Current assets	$279.0	$293.0	Current liabilities	$210.0	$222.0
			Long-term bonds	164.0	173.0
Net plant and equipment	265.0	281.0	Shareholders equity	170.0	179.0
Total assets	$544.0	$574.0		$544.0	$574.0

Paglia Pasta, Inc.
Income Statement

	2007
Sales	$530.0
Depreciation	30.0
Other operating costs	400.0
EBIT	$100.0
Interest	23.0
Earnings before taxes	$77.0
Taxes (40%)	30.8
Net income	$46.2
Common stock dividends	$37.2
Common shares outstanding	100