Chapter 7: Corporate Valuation and Stock Valuation Mini Case
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Chapter Review

Mini Case

Your employer, a mid-sized human resources management company, is considering expansion into related fields, including the acquisition of Temp Force Company, an employment agency that supplies word processor operators and computer programmers to businesses with temporary heavy workloads. Your employer is also considering the purchase of Biggerstaff & McDonald (B&M), a privately held company owned by two friends, each with 5 million shares of stock. B&M currently has free cash flow of $24 million, which is expected to grow at a constant rate of 5%. B&M's financial statements report short-term investments of $100 million, debt of $200 million, and preferred stock of $50 million. B&M's weighted average cost of capital (WACC) is 11%. Answer the following questions.

a. Describe briefly the legal rights and privileges of common stockholders.

b. What is free cash flow (FCF)? What is the weighted average cost of capital? What is the free cash flow valuation model?

c. Use a pie chart to illustrate the sources that comprise a hypothetical company's total value. Using another pie chart, show the claims on a company's value. How is equity a residual claim?

d. Suppose the free cash flow at Time 1 is expected to grow at a constant rate of g_L forever. If $g_L < \text{WACC}$, what is a formula for the present value of expected free cash flows when discounted at the WACC? If the most recent free cash flow is expected to grow at a constant rate of g_L forever (and $g_L < \text{WACC}$), what is a formula for the present value of expected free cash flows when discounted at the WACC?

e. Use B&M's data and the free cash flow valuation model to answer the following questions.

1. What is its estimated value of operations?
2. What is its estimated total corporate value? (This is the entity value.)
3. What is its estimated intrinsic value of equity?
4. What is its estimated intrinsic stock price per share?