

Question 1:

A company currently pays a dividend of \$2 per share ($D_0 = \2). It is estimated that the company's dividend will grow at a rate of 20% per year for the next 2 years, then at a constant rate of 7% thereafter. If investors require rate of return 12%, what is your estimate of the stock's current price?

Answer:

Year	0	1	2	3	
Growth		20%	20%	7%	thereafter
Dividend	2	2.4	2.88	3.0816	
Terminal Value			61.632		
Total		2.4	64.512		
Estimated Price	53.57				

Question 2:

Assume that the average firm in your company's industry is expected to grow at a constant rate of 6% and that its dividend yield is 7%. Your company is about as risky as the average firm in the industry, but it has just successfully completed some R&D work that leads you to expect that its earnings and dividends will grow at a rate of 50% [$D_1 = D_0(1 + g) = D_0(1.50)$] this year and 25% the following year, after which growth should return to the 6% industry average. If the last dividend paid (D_0) was \$1, what is the value per share of your firm's stock?

Answer:

Year	0	1	2	3	
Required Return	13.00%				
Growth		50%	25%	6%	thereafter
Dividend	1	1.5	1.875	1.9875	
Terminal Value			28.39286		
Total		1.5	30.26786		
Estimated Price	25.03				