

III. Value Enhancement, Estimating Growth

End of Chapter Exercises: Chapter 11 Estimating Growth

2. BIC Corporation reported a return on equity of 20% and paid out 37% of its earnings as dividends in the most recent year.
 - a) Assuming that these fundamentals do not change, estimate the expected growth rate in earnings per share.
 - b) Now assume that you expect the return on equity to increase to 25% on both new and existing investments next year. Estimate the expected growth rate in earnings per share.

Answer:

3. You are trying to estimate the expected growth in net income at Metallica Corporation, a manufacturing firm that reported \$150 million in net income in the just-completed financial year; the book value of equity at the beginning of the year was \$1 billion. The firm had capital expenditures of \$160 million, depreciation of \$100 million, and an increase in working capital of \$40 million during the year. The debt outstanding increased by \$40 million during the year. Estimate the equity reinvestment rate and expected growth in net income.

Answer:

6. SoftTech Inc. is a small manufacturer of entertainment software that reported revenues of \$25 million in the most recent financial year. You expect the firm to grow significantly over time and capture 8% of the overall entertainment software market in 10 years. If the total revenues from entertainment software in the most recent year amounted to \$2 billion and you expect an annual growth rate of 6% in these revenues for the next 10 years, estimate the compounded annual revenue growth rate at SoftTech for the next 10 years.

Answer: