Seminář 1

The following information relates to Questions 9–16

Guardian Capital is a rapidly growing US investment firm. The Guardian Capital research team is responsible for identifying undervalued and overvalued publicly traded equities that have a market capitalization greater than $500 million.

Due to the rapid growth of assets under management, Guardian Capital recently hired a new analyst, Jack Richardson, to support the research process. At the new analyst orientation meeting, the director of research made the following statements about equity valuation at Guardian:

Statement 1
"Analysts at Guardian Capital seek to identify mispricing, relying on price eventually converging to intrinsic value. However, convergence of the market price to an analyst's estimate of intrinsic value may not happen within the portfolio manager's investment time horizon. So, besides evidence of mispricing, analysts should look for the presence of a particular market or corporate event—that is, a catalyst—that will cause the marketplace to re-evaluate the subject firm's prospects."

Statement 2
"An active investment manager attempts to capture positive alpha. But mispricing of assets is not directly observable. It is therefore important that you understand the possible sources of perceived mispricing."

Statement 3
"For its distressed securities fund, Guardian Capital screens its investable universe of securities for companies in financial distress."

Statement 4
"For its core equity fund, Guardian Capital selects financially sound companies that are expected to generate significant positive free cash flow from core business operations within a multiyear forecast horizon."

Statement 5
"Guardian Capital's research process requires analysts to evaluate the reasonableness of the expectations implied by the market price by comparing the market's implied expectations to his or her own expectations."

After the orientation meeting, the director of research asks Richardson to evaluate three companies that are retailers of men's clothing: Diamond Co., Renaissance Clothing, and Deluxe Men's Wear.

Richardson starts his analysis by evaluating the characteristics of the men's retail clothing industry. He finds few barriers to new retail entrants, high intra-industry rivalry among retailers, low product substitution costs for customers and a large number of wholesale clothing suppliers.

While conducting his analysis, Richardson discovers that Renaissance Clothing included three non-recurring items in their most recent earnings release: a positive litigation settlement, a one-time tax credit, and the gain on the sale of a non-operating asset.

To estimate each firm's intrinsic value, Richardson applies appropriate discount rates to each firm's estimated free cash flows over a ten-year time horizon and to the estimated value of the firm at the end of the ten-year horizon.

Michelle Lee, a junior technology analyst at Guardian, asks the director of research for advice as to which valuation model to use for VEGA, a fast growing semiconductor company that is rapidly gaining market share.

The director of research states that "the valuation model selected must be consistent with the characteristics of the company being valued."

Lee tells the director of research that VEGA is not expected to be profitable for several more years. According to management guidance, when the company turns profitable, it will invest in new product development; as a result, it does not expect to initiate a dividend for an extended period of time. Lee also notes that she expects that certain larger competitors will become interested in acquiring VEGA because of its excellent growth prospects. The director of research advises Lee to consider that in her valuation.

9. Based on Statement 2, which of the following sources of perceived mispricing do active investment managers attempt to identify? The difference between:

A. intrinsic value and market price.
B. estimated intrinsic value and market price.
C. intrinsic value and estimated intrinsic value.

10. With respect to Statements 3 and 4, which of the following measures of value would the distressed securities fund's analyst consider that a core equity fund analyst might ignore?

A. Fair value
B. Liquidation value
C. Fair market value

11. With respect to Statement 4, which measure of value is most relevant for the analyst of the fund described?

A. Liquidation value
B. Investment value
C. Going-concern value

12. According to Statement 5, analysts are expected to use valuation concepts and models to:

A. value private businesses.
B. render fairness opinions.

C. extract market expectations.

13. Based on Richardson's industry analysis, which of the following characteristics of men's retail clothing retailing would positively affect its profitability? That industry's:

A. entry costs.
B. substitution costs.
C. number of suppliers.

14. Which of the following statements about the reported earnings of Renaissance Clothing is most accurate? Relative to sustainable earnings, reported earnings are likely:

A. unbiased.
B. upward biased.
C. downward biased.

15. Which valuation model is Richardson applying in his analysis of the retailers?

A. Relative value
B. Absolute value
C. Sum-of-the-parts

16. Which valuation model would the director of research most likely recommend Lee use to estimate the value of VEGA?

A. Free cash flow
B. Dividend discount
C. P/E relative valuation

The following information relates to Questions 17–20

Bruno Santos is an equity analyst with a regional investment bank. Santos reviews the growth prospects and quality of earnings for Phoenix Enterprises, one of the companies he follows. He has developed a stock valuation model for this firm based on its forecasted fundamentals. His revenue growth rate estimate is less than that implied by the market price.

Phoenix's financial statements over the past five years show strong performance, with above average growth. Santos has decided to use a lower forecasted growth rate in his models, reflecting the effect of "regression to the mean" over time. He notes two reasons for his lower growth rate forecast:

Reason 1
Successful companies tend to draw more competition, putting their high profits under pressure.

Reason 2
Phoenix's intellectual property and franchise agreements will be weakening over time.

Santos meets with Walter Hartmann, a newly hired associate in his department. In their conversation, Hartmann states, "Security analysts forecast company performance using both top-down and bottom-up analysis. I can think of three examples:

A restaurant chain forecasts its sales to be its market share times forecast industry sales.

An electric utility company forecasts that its sales will grow proportional to increases in GDP.

A retail furniture company forecasts next year's sales by assuming that the sales in its newly built stores will have similar sales per square meter to that of its existing stores."

Hartmann is reviewing some possible trades for three stocks in the health care industry based on a pairs-trading strategy. Hartmann's evaluations are as follows:

HG Health is 15% overvalued.

Corgent Cell Sciences is 10% overvalued.

Johnson Labs is 15% undervalued.

17. Based on Santos's revenue growth rate estimate, the shares of Phoenix are most likely:

A. undervalued.
B. fairly valued.
C. overvalued.

18. Which of the reasons given by Santos most likely justifies a reduction in Phoenix's forecasted growth rate?

A. Reason 1 only
B. Reason 2 only
C. Both Reason 1 and Reason 2

19. Which of Hartmann's examples of company performance forecasting best describes an example of bottom-up forecasting?

A. Restaurant chain
B. Electric utility company
C. Retail furniture company

20. Based on his trading strategy, which of the following should Hartmann recommend?

A. Short HG Health and Corgent Cell Sciences
B. Buy Johnson Labs and Corgent Cell Sciences
C. Buy Johnson Labs and short Corgent Cell Sciences

The following information relates to questions 21–23

Abby Dormier is a sell-side analyst for a small Wall Street brokerage firm covering publicly and actively traded companies with listed equity shares. Dormier is responsible for issuing either a buy, hold, or sell rating for the shares of Company A and Company B. The appropriate valuation model for each company was chosen based on the following characteristics of each company:

Company A is an employment services firm with no debt and has fixed assets consisting primarily of computers, servers, and commercially available software. Many of the assets are intangible, including human capital. The company has a history of occasionally paying a special cash dividend.

Company B operates in three unrelated industries with differing rates of growth: tobacco (60% of earnings), shipbuilding (30% of earnings), and aerospace consulting (10% of earnings). The company pays a regular dividend that is solely derived from the earnings produced by the tobacco division.

Dormier considers the following development in making any necessary adjustments to the models before assigning ratings:

Company B has finalized the terms to acquire 70% of the outstanding shares of Company X, an actively traded tobacco company, in an all-stock deal.

Dormier assigns ratings to each of the companies and provides a rationale for each rating. The director of research asks Dormier: “How did you arrive at these recommendations? Describe how you used a top-down approach, which is the policy at our company.”

Dormier replies, “I arrived at my recommendations through my due diligence process. I have studied all of the public disclosure documents; I have participated in the company conference calls, being careful with my questions in such a public forum; and I have studied the dynamics of the underlying industries. The valuation models are robust and use an extensive set of company-specific quantitative and qualitative inputs.”

21. Based on Company A’s characteristics, which of the following absolute valuation models is most appropriate for valuing that company?

A. Asset based
B. Dividend discount
C. Free cash flow to the firm

22. Based on Company B’s characteristics, which of the following valuation models is most appropriate for valuing that company?

A. Asset based
B. Sum of the parts
C. Dividend discount

23. Which of the following is most likely to be appropriate to consider in Company B’s valuation of Company X?

A. Blockage factor
B. Control premium
C. Lack of marketability discount

Výpočty

1.

For liquidity purposes, a client keeps $100,000 in a bank account. The bank quotes a stated annual interest rate of 7 percent. The bank's service representative explains that the stated rate is the rate one would earn if one were to cash out rather than invest the interest payments. How much will your client have in his account at the end of one year, assuming no additions or withdrawals, using the following types of compounding?

A. Quarterly
B. Monthly
C. Continuous

2.

A bank quotes a rate of 5.89 percent with an effective annual rate of 6.05 percent. Does the bank use annual, quarterly, or monthly compounding?

3.

A couple plans to set aside $20,000 per year in a conservative portfolio projected to earn 7 percent a year. If they make their first savings contribution one year from now, how much will they have at the end of 20 years?

4.

A client can choose between receiving 10 annual $100,000 retirement payments, starting one year from today, or receiving a lump sum today. Knowing that he can invest at a rate of 5 percent annually, he has decided to take the lump sum. What lump sum today will be equivalent to the future annual payments?

5.

Westcott–Smith is a privately held investment management company. Two other investment counseling companies, which want to be acquired, have contacted Westcott–Smith about purchasing their business. Company A's price is £2 million. Company B's price is £3 million. After analysis, Westcott–Smith estimates that Company A's profitability is consistent with a perpetuity of £300,000 a year. Company B's prospects are consistent with a perpetuity of £435,000 a year. Westcott–Smith has a budget that limits acquisitions to a maximum purchase cost of £4 million. Its opportunity cost of capital relative to undertaking either project is 12 percent.

A. Determine which company or companies (if any) Westcott–Smith should purchase according to the NPV rule.

B. Determine which company or companies (if any) Westcott–Smith should purchase according to the IRR rule.
C. State which company or companies (if any) Westcott–Smith should purchase. Justify your answer.