FIN 2601- Practice questions: Share Valuation Answers

Question 1

A – 2; B – 3 ; C – 1.

See chapter 7, pages 302 and 303.

Question 2

Venture capital would suit the firm as they are fast growing and could not secure any other capital.

The fact that the firm has looked at listing on the JSE indicates that they may secure VC funding with the expectation that the firm would later go public as many VC firms require an exit strategy.

See chapter 7, pages 302 and 303.

Question 3

By buying the securities from the issuer and selling the securities on the market or to a selling group at a higher price than the purchase price. There is some risk involved as the bankers valuation may be overvalued in which case a loss would be made.

Question 4

For this question you needed to use the variable growth model. For the first two years you needed to discount the dividends to the present. For year three you should have used the zero growth model to find the value of the share at the end of year 2 and discount that value to the present.

$P_n = \frac{D1}{(1+rs)} + \frac{D2}{(1+rs)^2}$ for the first part, then add the present value of P2, the price of the share at the end of year two.

Pn = (2 ÷ 1,1) + (4 ÷ [1,1²]) = 1, 82 + 3, 31 = R 5, 13

P2 = D3 ÷ rs = 5 ÷ 0,1 = R 50

PV of P2 -> N = 2, FV = 50, I = 10% so PV = R 41, 32

P0 = Pn + PV(P2) = R 5, 13 + R 41, 32 = R 46, 45

Question 5

For this question you needed to use the FCF valuation model, specifically the constant growth model application thereof (Chapter 7, page 318).

Then you should have used the formula: Vs = Vc – Vd – Vp to find the total value of ordinary shares (in total).

$VFCF0 = FCF1 \div (Ra - g_{FCF})$ -> 1 800 000 ÷ (0, 12 – 0,5) ≈ R 25 714 286

then

Vs = Vc – Vd – Vp -> 25 714 286 – 12 014 086 – 0 = R13 700 200