

# [Report on appraisal questions](https://assignbuster.com/report-on-appraisal-questions/)

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1. The valuation approach is simple. QFinance (2012) suggests creating a base line valuation for investment appraisal. Thus, American Cable will buy AirThread for its “ current” value, that is, the value of its operations and assets, as well as the intricacies considered (stated in the case files). AirThread is expected to negotiate with American Cable and depending on the appetite of American Cable for acquisition, it may allow for certain upward price movements with respect to AirThread’s total value. This is the second step of the valuation, the determination of the contribution of American Cable’s acquisition to AirThread’s operations.
2. Valuation Methodologies
a. The Adjusted Present Value of the company’s free cash flows (FCF) was used inc calculating the cash flows from 2008 to 2012. Adjusted Present Value is a Discounted Cash Flow (DCF) approach wherein debt financing is removed from the calculations. This simply determines the viability of project if it were funded using solely shareholder equity. The DCF is discounted using the company’s average return on assets of 7. 82%.
b. The company’s perpetual cash flows after 2012 was calculated using the terminal value formula using the company’s WACC, computed to be 7. 19% as discount factor.
c. ATC’s investments were calculated by multiplying the book value of ATC’s investments with the Price-Earnings ratio of the different companies to approximate the market value of these investments.
3. Choice of Rates
a. Return on Assets is the discount factor of choice for unlevered FCF since it’s a measure of efficiency and should be the same regardless of how the company is funded.
b. Weighted Average Cost of Capital is used as the discount factor for the terminal value. The WACC approximates the cost of debt and equity for the company’s current case.
c. The median of the 30-year historical GDP rates is used to determine long-term growth.
4. Calculating the company as a going concern
a. The first five years were calculated using the APV approach at a discount factor of 7. 82% giving an adjusted NPV of US$ 1. 272 billion.
b. To calculate the NPV of the terminal value of AirThread’s operations we use the Weighted Average Cost of Capital (WACC) of 7. 19% and a growth rate equal to a 30-year inflation index (3. 5%). Calculating the terminal value of operations uses the formula:
Terminal Value = CashFlow X (1 + growth rate) / (WACC – growth rate).
c. Since the approach is unlevered, we integrate the value of the tax subsidy into the calculations. Using the assumption that debt is five times the company’s EBITDA, we calculate that the value of the tax subsidy is US$ 237 million.
d. The value of AirThread’s investments in other companies is calculated using the book value of AirThread’s investments multiplied with the average Price Earnings ratio of the different companies they invested in. The value of this asset is computed to be US$ 1. 730 billion.
e. Finally, because AirThread is a privately held company and American Cable is listed in the stock markets, there is a private company discount upon the acquisition of the company. This is simply 15% of the gross value of the company.
5. The total value of the company
a. If American Cable were to go ahead with the acquisition, its base case value for AirThread is US$ 7. 97 billion.
b. The upper limit of the value that American Cable can give AirThread is calculated using the same approach, but with differences in the cash flows due to the synergies. Currently, we only estimate the 20% decrease in operating expenditures of AirThread after the acquisition, which leads to an Adjusted NPV of free cash flows calculated to be US$ 1. 9 billion. Terminal value of operations will change as well, leading to a recalculated US$ 11. 63 billion! Non-operating assets are the same for this round of calculations since they are not affected by the cost savings as well as the tax subsidy. The resulting value due to synergies is now calculated to be US$ 13. 1765 billion.