



2. (10 points) You are valuing a large mature firm using a discounted cash flow model based on free cash flow to the firm (FCFF). The free cash flow to the firm in the most recent year (year 0) was \$650 million. You expect cash flows to grow at an annual rate of 6% for each of the next six years. Following this period of positive growth, you expect the firm's cash flows to remain constant in perpetuity. You estimate the firm's cost of equity to be 13.0% and its weighted average cost of capital (WACC) to be 9.0%.

Given the information provided, what is the value of this firm based on discounted cash flows?

### Consolidated Financial Statements - Firm A

<b>Income Statement (in millions):</b>	<b>2005</b>	<b>2006</b>
Sales	1,237	1,102
Cost of Goods Sold and Expenses	545	604
EBIT	500	498
Interest Expense	52	51
Taxable Income	448	447
Tax Expense	156	156
Net Income	292	291

  

<b>Balance Sheet (in millions):</b>	<b>2005</b>	<b>2006</b>
<b>Assets</b>		
Total Current Assets	503	523
Net Property, Plant, and Equipment	1,805	1,756
Total Assets	2,308	2,279
<b>Liabilities and Owners' Equity</b>		
Total Current Liabilities	475	489
Long-Term Debt	1,011	902
Long-Term Debt, less current installments	902	884
Total Liabilities	1,486	1,391
Total Stockholders Equity	822	888

### Consolidated Financial Statements - Firm B

<b>Income Statement (in millions):</b>	<b>2005</b>	<b>2006</b>
Sales	13,547	15,628
Cost of Goods Sold and Expenses	6,616	7,632
EBIT	6,931	7,996
Interest Expense	580	623
Taxable Income	6,351	7,373
Tax Expense	2,222	2,580
Net Income	4,129	4,793

  

<b>Balance Sheet (in millions):</b>	<b>2005</b>	<b>2006</b>
<b>Assets</b>		
Total Current Assets	8,033	9,021
Net Property, Plant, and Equipment	16,502	17,025
Total Assets	24,535	26,046
<b>Liabilities and Owners' Equity</b>		
Total Current Liabilities	2,033	2,445
Long-Term Debt	8,964	8,975
Long-Term Debt, less current installments	8,620	8,650
Total Liabilities	10,997	11,420
Total Stockholders Equity	13,538	14,626