

**Homework and Suggested Example Problems**  
**Investment Valuation – Damodaran**

**Lecture 3 – Estimating Earnings and Cash Flows**

Lecture 3 continues our discussion of inputs for discounted cash flow (DCF) valuation models. In this lecture, we will focus on measuring past earnings and on moving from reported earnings to estimates of cash flows. In measuring past earnings, we will discuss how to deal with specific items such as one-time charges, R&D expenses, operating lease expenses, and acquisitions. In estimating cash flows, we will discuss how to measure and forecast both capital expenditures and working capital requirements.

After completing this material, we will turn our attention to forecasts of future cash flows. We will also discuss the practical application of DCF models to several real companies.

***In-Class Discussion Problems:***

Complete the problems on the attached pages and be prepared to discuss your solutions in class.

***Additional Suggested Problems:***

The following suggested problems will serve as additional examples related to our class material and should give you a basic idea of the topics that I want to emphasize from the text. The solutions to these problems are available on the class web site.

Chapter	Topic	Suggested Problems
9	Estimating Earnings	1, 2, 3, 4, 5
10	From Earnings to Cash Flows	2, 3, 4, 5

### In-Class Discussion Problems - Lecture 3

1. **Operating Lease Adjustments:**

Future operating lease commitments for Nike, as listed in the 2009 10K, are shown below. Use this information to answer the questions below.

Year	Operating Lease Commitments (\$ millions)
2010	330.2
2011	281.3
2012	233.6
2013	195.6
2014	168.6
>2014	588.5
Total	1,797.8

- a) In the Lecture 2 homework, we found the cost of debt for Nike to be 4.67%. Using this cost of debt, calculate the value of the operating lease debt and operating lease asset for Nike as of FY 2009. Use these values any necessary information from Nike's financial statements to estimate the adjusted book values of debt and assets for Nike.
- b) Using your answers above and any necessary information from Nike's financial statements, calculate the value of after-tax operating income and Net Income in FY 2009 both before and after adjusting for operating leases. Assume a tax rate of 24.0%. Also, note that the firm paid operating lease expenses in 2009 of \$397.0 million.

2. **Capitalization of Advertising**

Advertising expenses for Nike in each of the past four years are listed below. Use this information to answer the subsequent questions.

Year	Advertising Expense (\$ millions)
2006	1,740.2
2007	1,912.4
2008	2,308.3
2009	2,351.3

- a) Assuming a three-year life for advertising, calculate the Advertising Amortization for Nike in FY 2009 and the unamortized value of Nike's Advertising asset in FY 2009. Use your answers and any necessary information from Nike's financial statements to calculate the adjusted book values of equity and assets.

- b) Using your answer above and any necessary information from Nike's financial statements, calculate the value of after-tax operating income and Net Income for Nike in FY 2009 after adjusting for the both operating lease and the capitalization of Advertising.

3. **Estimating Cash Flows:**

Answer the questions below using your answers to questions (1) and (2) and any necessary information from Nike's financial statements.

a) Calculate FCFF for Nike in FY 2009.

b) Calculate FCFE for Nike in FY 2009. Note that the cash flow statement shows that the firm raised a net amount of debt equal to \$170.3 million.