

## GROUP WORK ASSIGNMENT

### GESTÃO FINANCEIRA II

#### UNDERGRADUATE PROGRAMS

#### 2<sup>ND</sup> SEMESTER 2011-2012

The Group Work Assignment of Gestão Financeira II consists in solving a practical corporate investment project case. This involves a sound knowledge of cash flow forecasting, determining cost of debt and cost of equity in different industries, making credible assumptions about different scenarios, and decision-making.

The case study is briefly summarized in the next page, but please read first the rules of the game.

#### Rules of the Game:

**1) Important Dates:**

**Group Composition by April 20<sup>TH</sup>, 2012:** Each group must give to one of the course instructors a sheet of paper containing – for each member of the group: name, student number, photograph, and class (turma) attended.

**Final Due Date is May 18<sup>TH</sup>, 2012, before 2 pm:** you can hand in your assignments to your class instructor (during any class before the deadline) or address it to Professor Clara Raposo (Gabinete 616) – at the reception of the ISEG building in Rua Miguel Lupi, No. 20.

**2) Each group must be of 4 to 5 students.** If any of you has a problem in finding partners, let your class instructor know as soon as possible, and a solution will be found.

**3) The assignment involves producing three elements:**

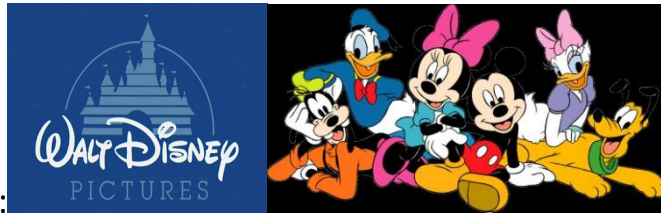
A **Report** written in Microsoft Office **word**, discussing your choice of methodology, assumptions, computations, tables, and conclusions (MAXIMUM 10 pages A4)

A **Spreadsheet** in Microsoft Office **excel** in a cd-rom, supporting your written report;

A **Presentation** in Microsoft Office **PowerPoint** included in the cd-room.

**4) Any group and group member may be asked by the course instructors to present their assignment.**

CASE DESCRIPTION:



***DISCLAIMER: Most numbers provided regarding costs and prices are totally fictional!!!***

Walt Disney Pictures has been creating dozens of memorable characters for almost a century. Now they want to revive the most classical ones: Mickey and Minnie Mouse; Donald Duck; Daisy; Goofy; and Pluto.

The Walt Disney Company is the largest media conglomerate in the world in terms of revenues. Its history of family entertainment lasts for more than eighty years since the animator Walt Disney started producing short film animations. In 1928 Walt Disney created one of the most successful cartoons around the world, Mickey Mouse. The goal of this company is to provide family entertainment in the different industries where the company operates. Given all of this success the company pretends to produce a movie to revive the most classical characters.

The Walt Disney Company has been working on the plot for the last year and already spent \$5 million (including a market research).

A financial analyst in the Walt Disney Company has forecasted the following figures for the film production. The capital expenditures of the film are expected to be around \$70 million in the beginning of the year 2013 and \$10 million in the beginning of 2014, each one to be depreciated in 4 years.

The movie will take 3 years to produce and it will be released during 2016. The box office revenues are expected to be similar of those from their previous project "*The Princess and the Frog*" (box office revenues are to be considered only for the release year).

The total revenues must include the revenues associated with the merchandising. The merchandising revenues may include sales of DVD's, Blu-ray, books, video games, toys, t-shirts and other type of clothes and accessories. The Walt Disney Company is expected to sell \$50 million of merchandise during 2016, \$150 million during 2017, and then decrease by 50% each year.

Because Walt Disney movies are "eternal", it is best to consider a continuation value for the Project. The cash flows from the 7<sup>th</sup> year are the first to be stable, and are expected to decrease at a rate of 50% per year, forever.

Regarding operating costs (excluding depreciation) assume that the costs are approximately 40% of the revenues. Selling, General and Administrative costs are expected to be as follows:

Year	Selling, General and Administrative
1	\$15.000.000,00
2	\$20.000.000,00
3	\$20.000.000,00
4	\$15.000.000,00
5	\$10.000.000,00
6	\$5.000.000,00
7	\$5.000.000,00
8	\$2.500.000,00

The Net Working Capital needs of the project are expected to be as follows:

Year	NWC
0	\$13.000.000,00
1	\$14.000.000,00
2	\$12.500.000,00
3	\$13.200.000,00
4	\$15.350.000,00
5	\$13.970.000,00
6	\$2.000.000,00
7	\$1.875.000,00
8	\$1.812.500,00

As a newly hired expert in the capital budgeting division you have been asked to evaluate the new project. You will compute the appropriate costs of capital and the net present value. You must seek out the information necessary to value the free cash flows. But you'll be given some directions to follow!

### Additional Help on How to Get More Information:

Data on The Walt Disney Company (quote DIS) is available at Yahoo Finance (<http://finance.yahoo.com>):

- Go to Yahoo Finance (<http://finance.yahoo.com>) and get the quote for The Walt Disney Company (symbol: DIS). If you click “Key Statistics”, in the bottom of the page you will find “View Financials”. You can then choose to view “Income Statements”, “Balance Sheet” or “Cash Flow”, for the last 3 years (select Annual Data).
- For the cost of debt ( $r_D$ ) you can go to NasdBondInfo.com, (<http://cxa.marketwatch.com/finra/BondCenter/Default.aspx>), and click to search by symbol. Enter the symbol DIS, which is the ticker for Walt Disney Company. After entering Walt Disney’s symbol, you select the “Corporate” toggle, and press “Enter.” You should have access to Walt Disney’s average **credit rating** for long-term bonds.
- For the cost of equity ( $r_E$ ) you can get **the yield on U.S. Treasury Bonds** from Yahoo! Finance (<http://finance.yahoo.com>). If you scroll down to the Market Data, on the right hand side you select “Bonds” and then you have information on the Yield to maturity. Enter that yield as the risk-free rate. To find the **beta** for Walt Disney Company use (<http://www.nasdaq.com/symbol/dis>), where DIS is the ticker for Walt Disney Company. (Sometimes you must be patient.)
- Use a **market risk premium** of 4.50%.
- To compute the **net debt** for Walt Disney Company, add the long-term debt and the short-term debt and subtract cash and cash equivalents for each year on the balance sheet.
- To compute Disney’s **market capitalization** at the end of each fiscal year multiply the historical stock prices by the “Basic Weighted Shares Outstanding” data in the income statement.
- You may also get information on industry betas from <http://pages.stern.nyu.edu/~adamodar/> by selecting Updated Data/ Levered and Unlevered Betas by Industry.

## QUESTIONS

1. Estimate the FCFs of the project. Explain your assumptions.
2. Assume that the project is financed exclusively with equity (unlevered). Is this new investment valuable? Explain your answer.
3. Perform reasonable sensitivity and /or scenario analysis. Explain.
4. Now assume that the project uses a target capital structure, which is equal to the firm's average capital structure of the last 3 years. Compute the WACC rate, and re-evaluate the project. Comment.
5. Now imagine that the cash flows of this project were actually related to another company's project: DreamWorks Animation. Assuming the movie is to be financed with a target debt-to-equity ratio of 1.2. What would the NPV be?