Financial Statement Analysis – E2200100
Quiz 4 (27.3.2019)

Question

Judy Choi is thinking about starting a truck rental business. She plans to buy four trucks now and to then add a fifth truck at the end of the second year. Each truck will cost $20,000. Judy has carefully evaluated the local market for rental trucks and believes that each truck will generate $5,000 of net operating cash flow each year. At the end of five years, she believes the trucks can be sold for $30,000 in total.

Additional information:

- Choi will put $80,000 cash into the business. This amount represents beginning equity.
- The company will pay out all excess cash as dividends each year. The cash needed to buy the truck in Year 2 will come from operating cash flows that year. No new investment will be required.
- Truck depreciation is $3,043.48 per truck per year, which results in the trucks having a book value of $30,000, the expected salvage value, at the end of Year 5.
- The appropriate discount rate is 10%.

Required

How much is the business worth? Use the abnormal earnings approach to valuation. You may use the quiz 4 template.

Voluntary work

Calculate the value for different scenarios:

a) The company makes an impairment write-off of $20,000 in Year 2.
b) The company makes an impairment write-off of $20,000 in Year 3.

Hint: make required adjustments for subsequent depreciation.