**Equity Analysis and Evaluation - II**

**September 2024 Examination**

**Q1. Citadel Capital has appointed Andrew Jones as an analyst to provide equity research on Delta Airlines Inc. Citadel Capital is planning to buy a 10% stake in Delta Airlines to expand its portfolio into Air Transport Service providers. What are the different areas Andrew Jones need to cover while preparing the equity research on Delta Airlines? (10 Marks)**

**Ans 1.**

**Introduction**

Equity research is a critical component of investment decision-making, especially when considering a significant stake in a company. In the case of Citadel Capital, which plans to acquire a 10% stake in Delta Airlines, the role of an equity analyst like Andrew Jones becomes pivotal. The aviation industry is highly complex, influenced by various factors such as fuel prices, regulatory changes, geopolitical events, and technological advancements. Therefore, comprehensive equity

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**Q2. Economic Value Added evaluates the performance of a firm based on the shareholder value creation. Discuss the concept and measurement of Economic Value Added. (10 Marks)**

**Ans 2.**

**Introduction**

Economic Value Added (EVA) is a financial performance metric that measures the value a company generates for its shareholders. It is based on the principle that a firm is only truly profitable when it creates wealth above the cost of capital employed. Unlike traditional accounting measures such as net profit or earnings per share (EPS), which might provide a skewed picture of a company's financial health, EVA takes into account the opportunity cost of capital. This means that EVA not only assesses whether a company is making a profit but also whether it is generating

**Q3a. Freeport McMorran is negotiating with Phelp Dodge for acquiring 100% of its shares through an all-cash deal. Freeport has gathered the data of 3 recent acquisitions in the industry.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Acquirer** | **Target** | **Enterprise Value**  **(Rs. Million)** | **EBIDTA (Rs. Million)** | **Revenue** |
| **(Rs. Million** |
| **Alpha** | **Omega** | **1800** | **170** | **800** |
| **Beta** | **Theta** | **100** | **14** | **60** |
| **Gamma** | **Iota** | **3500** | **430** | **1220** |

**Phelps Dodge has a net debt outstanding of Rs.295 million. It has reported a Revenue of Rs.1580 million and its EBIDTA Margin is 16% for the most recent financial year. The number of shares outstanding for Phelps Dodge was 11 million.**

**Required:**

**Using the above data, determine the value per share of Phelp Dodge. (5 Marks)**

**Ans 3a.**

**Introduction**

Valuing a company during an acquisition is a critical task that involves various financial metrics and industry comparisons. In this scenario, Freeport McMorran is considering acquiring 100% of Phelps Dodge's shares through an all-cash deal. To determine a fair value per share, it is essential to analyze recent acquisitions in the industry and apply relevant valuation multiples such as EV/EBITDA and EV/Revenue. By comparing Phelps Dodge's financial metrics with those of similar companies, we can estimate its enterprise value and subsequently determine the

**Q3b. Discus the merits and limitations of using relative valuation for determining the value of a business enterprise. (5 Marks)**

**Ans 3b.**

**Introduction**

Relative valuation is a widely used method for determining the value of a business enterprise by comparing it to similar companies in the industry. This approach relies on valuation multiples such as Price-to-Earnings (P/E), Enterprise Value-to-EBITDA (EV/EBITDA), and Price-to-Sales (P/S), among others. These multiples are derived from comparable firms and are used to estimate the value of the target company. Relative valuation is popular because it is straightforward, easy to understand, and can provide quick insights into a company's worth. However, it has its