Capital Investment Analysis & Valuation

Faced with the problems of reducing **its leverage ratios to less than 55% and its equity multiplier to less than 2.7 next year**, the CFO of Noname Inc. (hereby referred to as NN) is considering three alternative investment opportunities:

(1) Investing in show business i.e., Sponsoring a popular cooking show with chef Jamie Oliver
(2) Selling NN common stocks to an investment bank
(3) Acquiring a similar company called Target Co

Upon reviewing the profitability and viability of each project, the final decision to undertake or forsake will ultimately depends on two factors: (1) if the project helps NN meet the bank requirements to continue to provide credits, and (2) if the projects does not cause any harm to existing shareholders' value.

Option 1: Show Business

Upon analysis of the sponsorship opportunity that NN is offered, the findings indicate that although it is a profitable investment with a NPV estimated at 0.93 million, the project contributes less to decreasing the leverage ratio to merely 57% in 2012 from 62% in 2011. Also, it does not help in meeting the required equity multiplier neither (from 3.27 in 2011 to 3.08 in 2012). As a result, this option cannot be pursued.

Option 2: Investment Bank

Upon analysis of the option that NN must sell 400,000 shares to an investment bank, at a share price of $10 to raise $4 million in equity, we find that the bank's requirements are met, with the leverage ratio dropping to 52% and the equity multiplier coming to 2.5 in 2012. However, this option significantly dilutes the current ownership by 31% and violates one of the conditions we set initially. Furthermore, issuing shares at a lower price from the current $12,4 share price may signal distress to the market and will lead to a lower post-money value of $13 million instead of $16 million for 1307865 shares of NN. As a result, this option is forsaken.

Option 3: Acquisition of Competition

NN is also considering an acquisition deal, where NN would exchange $5.02 million worth of their stock (404,908 shares) for ownership of Target Co. First, a valuation of Target Co is conducted where the market value of equity was $12 million. The dilution of 25.8% of current ownership under this option is neither favorable to existing shareholders but unlike option 2, NN share is sold at the current market price and results in a higher post-valuation of the company. In addition, Target Co market value of equity is valued at $12 million significantly higher than the $5 million paid. The acquisition of Target Co will result in the desired leverage ratio of 50% (<55%) and lower equity multiplier of 2.40 (<2.7) by June 30, 2012. Consequently, we recommend this option to the firm since it meets all requirements set initially:

- Option 3 helps NN meets all the banks requirements to continue extending credit,
- Option 3 maximizes existing shareholders' value by acquiring a high value asset (Colorado).