Econ 135 Case Questions

Please answer all questions in **10 lines or less**. Some answers may require extensive calculations, in which case you should add a print-out of your Excel spreadsheet.

Netflix

1. *(1 point)* What is Netflix's long-run objective? How does Netflix plan to achieve its long-run objective? How would you assess Netflix's performance to date?
2. *(1 point)* What is a subscriber model for forecasting? Why does McCathy want to use a subscriber model for Netflix's future cash flow requirements? What are the basic elements of a subscriber model?
3. *(8 points)* Construct an annual subscriber model for Netflix that can be used to forecast the expected cash flows for a new subscriber. What is the value of a new Netflix subscriber? Based on your analysis, should Netflix be acquiring new subscribers?
   - Hint: To answer these questions, you will need to estimate the average number of discs a customer views each month, the discs per subscriber in inventory, the cost of trial-subscriber discs, and the monthly cost of newly purchased paid-subscriber discs.
   - Please assume a discount rate of 20%. Also assume that continuing subscribers drop their subscriptions after 5 years.

Ocean Carriers

1. *(1 point)* Do you expect daily spot hire rates to increase or decrease next year?
2. *(1 point)* What factors drive average daily hire rates?
3. *(1 point)* How would you characterize the long-term prospects of the capesize dry bulk industry?
4. *(6 points)* Should Ms. Linn purchase the $39 million capesize? Make two different assumptions. First, assume that Ocean Carriers is a U.S. firm subject to 35% taxation. Second, assume that Ocean Carriers is located in Hong Kong, where owners of Hong Kong ships are not required to pay any tax on profits made overseas and are also exempted from paying any tax on profit made on cargo uplifted from Hong Kong.
   Note: This question requires you to model cash flows in Excel. Please hand in a print-out of your spreadsheet. You need to calculate OCF, NCS, change in NWC, and CFFA for each year to find the NPV. Ocean Carriers uses a 9% discount rate.
5. *(1 point)* What do you think of the company's policy of not operating ships over 15 years old?

Marriott Corp

1. *(1 point)* What are the four components of Marriott's financial strategy?
2. *(1 point)* How does Marriott use its cost of capital?
3. *(3 points)* What is the weighted average cost of capital for Marriott?
   - What risk-free rate and risk premium did you use to calculate the cost of equity?
   - How did you measure Marriott's cost of debt?
4. *(1 point)* What type of investments would you value using Marriott's WACC?
5. *(1 point)* If Marriott uses a single cost of capital for all its divisions, what will happen to the company over time?
6. *(3 points)* What is the cost of capital for the restaurant division of Marriott?
   - What risk-free rate and risk premium did you use in calculating the cost of equity for the division? Why did you choose these numbers?
   - How did you measure the cost of debt for the division? Should the debt cost differ across divisions? Why?
   - How did you measure the beta of the division?

Note: Please assume a marginal tax rate of 34%.

UST

1. *(2 points)* What are the primary business risks associated with UST as seen from the perspective of a bondholder?
2. *(1 point)* Why is UST considering a leveraged recapitalization after such a long history of conservative debt policy?
3. *(1 point)* Should UST undertake the $1 billion recapitalization? Assume the transaction occurs on Jan. 1, 1999, the debt is perpetual and the tax rate is 38 percent.
   1. *(2 points)* What will be the effect on UST's value?
   2. *(1 point)* What will be the effect on UST's earnings per share?
4. *(2 points)* Does it appear the company will be able to meet the interest obligations on the debt safely?
5. *(1 point)* UST had paid uninterrupted dividends since 1912. Might the recapitalization hamper future dividend payments?