

Value Drivers

All three companies start with **NOPAT = €100m** and face a **WACC of 10%**.

	ValueCo	VolumeCo	GrowthCo
NOPAT (in €million)	100 €	100 €	100 €
Invested Capital (in €million)	500 €	1.000 €	500 €
ROIC			
Target growth (g)	5%	5%	8%
WACC	10%	10%	10%

$$NOPAT = EBIT \cdot (1 - \text{taxrate})$$

$InvCap = Debt + Equity$: the total amount of investor capital deployed in the enterprise

$$ROIC = \frac{NOPAT}{InvCap}$$

by how much do the managers want to grow their Invested Capital?

how much in annual return do investors in this industry expect, or demand?

Step 1: What are the firms' investment rates?

$$IR = \frac{\Delta InvCap}{NOPAT} = \frac{\Delta InvCap}{InvCap} \cdot \frac{InvCap}{NOPAT} = \frac{g}{ROIC}$$

IR			
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ValueCo and VolumeCo grow at the same rate. Why does VolumeCo have to reinvest twice as much?

Step 2: What FCF does each firm generate today?

$$FCF = NOPAT - \Delta InvCap = NOPAT - IR \cdot NOPAT = NOPAT \cdot (1 - IR)$$

FCF (in €million)			
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GrowthCo has lower FCF than ValueCo this year. Is that a problem?

Step 3: What is this year's Economic Profit (EVA) of all firms?

$$EVA = (ROIC - WACC) \cdot Invested\ Capital$$

EVA (in €million)			
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Step 4: What is each firm worth?

$$Value = \frac{FCF}{(WACC - g)} = \frac{NOPAT \cdot \left(1 - \frac{g}{ROIC}\right)}{(WACC - g)}$$

Value (in €million)			
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ValueCo and VolumeCo have identical earnings and identical growth. Why is ValueCo worth 50% more?

Further questions...

a) can VolumeCo grow its way out of the "low valuation rut" by accelerating growth and reinvesting more aggressively?

b) MshareCo is in a mature lowgrowth industry. Its focus has been to aggressively pursue market share, resulting in growth rates of 4% and ROIC of 8%, facing the same cost of capital as the others. Is the growth strategy that seems successful for GrowthCo similarly successful here? Why or why not? Compare the above 4 steps for MshareCo to confirm your intuition.