

Freenews Company

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Freenews Company settled down back in 1999 to publish one of the first totally free newspapers in France. The only revenues of this kind of papers come from advertisement. Otherwise, they are managed and work like any other newspaper.

Early in 2005, Freenews managers think seriously about investing in order to strengthen their market share on the internet. Actually, Freenews website is quite successful and one of the most read online French newspaper. The investment would allow the company to propose podcasts in addition to more traditional contents (like written tribunes, journalists' blogs, etc.). Most forecasting companies agree that podcasting will be more and more used in the near future.

The investment project should allow a substantial increase in the company's revenues from advertising, both directly, as podcasts are sponsored by corporations, and as a side effect, because traffic on the website should increase as a result of these new contents. The project's life is estimated to 4 years only, as technology evolves very quickly on the network.

The necessary expenses in additional assets (mainly server appliances) are 360,000 euros, depreciable over 4 years on a straight line basis. Actual investment should take place on the first days of 2005. Assets will be worth nothing and scrapped at the end of project.

Producing the podcasts contents will entail an increase in the company's workforce, and specialized reporters will be hired in order to cover the various sections of the paper (politics, economy, sport, etc.). The accounting department made forecasts and the estimation is a 450,000 euros yearly increase in labor expenses. Other expenses should amount to 23% of the revenues from advertisement. The working capital needed is 75,000 euros and would not increase in the future.

Freenews Company has been recently listed on the Euronext Paris stock market. The history of stock prices is thus very short, and it is not possible to make a beta calculation from statistical methods. However, Freenews CFO gathered information about a competitor which has similar activity, but different financing characteristics. The competitor's beta is 1.8 and its leverage 42 %. Given this information, competitor's cost of equity is 24 % per year.

An excerpt of Freenews balance sheet (before any new investment) is displayed below (all figures in '000 euros).

Liabilities as of 31/12/2004	
Long term debt	100,000
Retained earnings	45,000
Shareholder equity	100,000

They are 10,000,000 outstanding stocks. The end of 2004 stock price is 13.8 euros, and an 3.2 euros DPS should be paid in June 2005.

The long term debt is an interest only bonds issue. The bonds were issued 3 years ago with a 7 years maturity. Bonds characteristics follow:

- 100,000,000 bonds with 1 euro face value, issued at a discount (issuing price was 99%)
- repayment with a 2% premium
- 6 % coupon rate, paid once per year

OATs (French government bonds) have a 4.10 % yield these days, you may consider this is the risk free rate. The company's bank agrees to lend it necessary resources at a 6.8 % rate. Corporate tax rate is 34 % and

applies to capital gain as well.

Questions

1. What is the market value of Freenews' equity?
2. What is the current market price of Freenews bond?
3. What is the market value of Freenews debt?
4. Calculate Freenews beta.
5. What is this year's expected market return?
6. Estimate Freenews cost of equity capital.
7. According to the cost of equity capital from previous question, what is the expected growth on Freenews dividends?
8. What would you use as a required rate of return on the investment project? Give an estimation.
9. Suppose that the yearly turnover on the new project is 750,000 euros. What yearly operating cash-flow would result from this revenue?
10. Estimate the necessary yearly operating cash flow to have a 0 NPV.
11. What is the minimum yearly turnover on the project?
12. Estimate the NPV sensitivity to the turnover