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Investment Banking 60-Minute 3-Statement Modeling Test (The ABC Company)

Your bank is advising The ABC Company [NYSE:ABC], a U.S.-based provider of turf and landscape maintenance equipment and precision irrigation systems.

The company's net sales reached \$2.6 billion in its most recent fiscal year, and it has earned operating margins of 14-15% historically.

Its Return on Average Invested Capital has ranged from 20% to 30% over the past decade, primarily because it has achieved modest revenue growth while issuing Dividends representing 30-40% of Net Income and completing significant stock repurchases.

ABC has \$313 million of Debt currently, and its long-term Debt / EBITDA target is 1-2x.

The company's share price has outperformed the S&P 500 over the past 5 years, more than doubling, vs. a ~71% gain for the S&P and a ~54% gain for its peer group.

ABC believes that its success is due to its shareholder-friendly Dividend and Stock Repurchase policies, and it wants to continue and accelerate those policies into the future.

To do this, the company plans to increase its Dividend Payout Ratio from the ~30% level to the ~40% level over 5 years, and to increase its Stock Repurchases up to the \$250 million level over the same time frame.

It will also continue to invest in Capital Expenditures (CapEx) and in acquisitions.

In this case study, you will complete a 3-statement projection model for the company and use it to answer several short questions about its business model and financial performance.

Please use the following assumptions and complete the provided Excel template. You have **60 minutes** to complete this task and answer the questions:

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Part 1: Assumptions and Financial Projections (Suggested Time: 45 Minutes)

Follow the existing assumptions that have been entered into Excel, and either extend existing historical trends or use average percentages if no clear trend exists.

Overall revenue growth is expected to remain between 4% and 6%, and operating margins are expected to decline to ~13% over 5 years.

The effective tax rate will be between 25% and 30%, and the company's Working Capital requirements may change slightly, but won't significantly affect its cash flow profile.

Capital Expenditures will be between 50% and 55% of the Change in Revenue, and, as mentioned above, the Dividend Payout Ratio will increase to 40% over time, with Stock Repurchases increasing to \$250 million per year by the end, and Net Acquisitions and Sales rising to \$55 million.

With the Debt Schedule, set the Minimum Cash Balance equal to **8%** of Cost of Sales + SG&A, and assume that the company must borrow more Debt if it falls below that.

Debt Issuance fees will be 2%, the maturity of the average Debt issuance will be 10 years, and the weighted average interest rate on Debt can remain at the 6.1% level. Account for the differences between the Face Value and Book Value of the Debt.

Part 2: Case Study Questions (Suggested Time: 15 Minutes)

Once you're done, please respond to the following questions:

- 1) Is ABC's strategy a good one? Should it aim to increase its Dividend Payout Ratio and Stock Repurchases? If so, why? If not, what should it do instead?
- 2) What else could the company *reasonably* focus on to improve its financial performance and become more attractive to shareholders?
- 3) Is Debt the best funding source for the company? What additional information would you need to give a firm answer?

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