
Question 3: Equity Valuation and Analysis**(32 points)**

The JUN Corporation's share price is currently 95 euros, and its book value per share was 100 euros at the end of last year. The Research Department at MKI Asset Management has published an investment opinion on JUN's stock, forecasting a return on equity (ROE) of 10% and a payout ratio of 30% into perpetuity. The risk-free rate is 3%, the stock market risk premium 7% and JUN's estimated beta is 1.1.

Assumptions used in the JUN Corporation investment opinion:

Return on shareholders' equity (ROE)	10%
Payout ratio	30%
Book value per share (BVPS) at the end of last year	100 euros
Risk-free rate	3%
Stock market risk premium	7%
JUN's beta	1.1
JUN's share price	95 euros

a) Based on the forecasts from the MKI Asset Management Research Department, calculate the expected rate of return (implied return) on JUN's shares at the current share price, by using the constant growth dividend discount model. Then, discuss whether JUN's shares are trading at a discount or at a premium if the CAPM holds. (12 points)

b) Mr. White, an analyst at MKI Asset Management, uses a different approach. He calculates the theoretical share price by adding the present value (PV) of the future residual income per share to the current book value per share (BVPS) using the following formulae:

Theoretical share price =
(BVPS at end of last year) + (PV of residual income per share in and after this year)

Residual income per share =
EPS – (BVPS at end of last year) · (Required rate of return on equity)

Show the calculations following Mr. White's approach. Then, discuss whether JUN's shares are trading at a discount or at a premium. (10 points)

c) Mr. Field, a fund manager at MKI Asset Management, aggressively includes in his portfolio shares with a price-to-book ratio (PBR) below 1, based on the rationale that such shares are trading at a discount, as they are cheaper than liquidation value. Based on this philosophy, he has decided to invest in JUN's shares. Explain what is wrong with Mr. Field's investment decision. (4 points)

d) Provide two arguments that could support Mr. Field's investment philosophy mentioned above. (6 points)