

La Quinta Holdings, Inc. (LQ)

As of 8 May 2018

SELL

Key Statistics in US\$ millions

Year	2015	2016	2017
Revenue	1006.8	981.1	953.1
EBITDA (% of rev)	30.10%	22.99%	28.24%
Net income (% of rev)	2.62%	-0.13%	15.94%
Current share price	19.62		
52 week range	13.11 - 21.06		
Price as per valuation	16.31		
Potential Downside	-16.86%		

Downside:

-16.86%

U.S.

Hotels & Motels Industry

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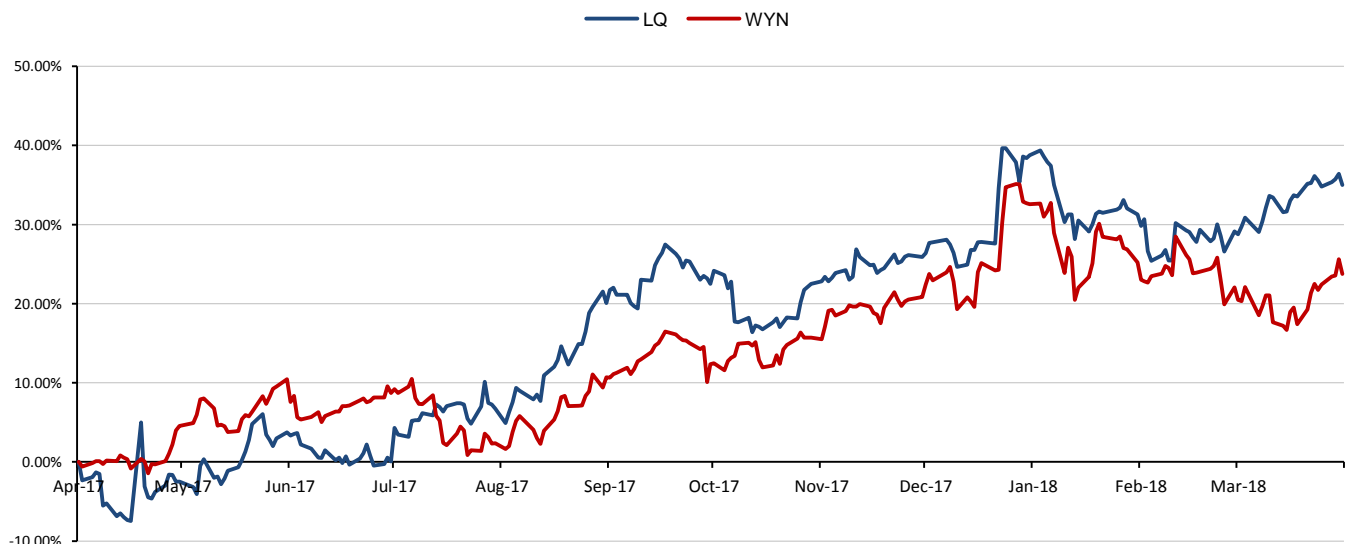
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Source: Yahoo Finance

Please see the disclaimer on page 15 for important information.

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La Quinta Holdings, Inc. (LQ)

Company Overview

La Quinta Holdings Inc. owns, operates, and franchises select-service hotels. As of December 31, 2017, the company had 902 hotels, which included **317 owned and operated**, as well as **585 franchised hotels** with approximately **88,400 rooms** under the La Quinta Inn, La Quinta Inn & Suites, and LQ Hotel trademarks primarily in 48 states of the United States, as well as in Canada, Mexico, Honduras, and Colombia. It serves the **upper-midscale and midscale segments**, principally under the La Quinta brand. La Quinta Holdings Inc. was founded in 1968 and is headquartered in Irving, Texas.¹

Wyndham Worldwide Acquisition Agreement

Under the terms of the agreement, **stockholders of La Quinta will receive \$8.40 per share in cash** (approximately \$1.0 billion in aggregate), and Wyndham Worldwide will **repay approximately \$715 million of La Quinta debt net of cash and set aside a reserve of \$240 million for estimated taxes** expected to be incurred in connection with the taxable spin-off of La Quinta's owned real estate assets into CorePoint Lodging Inc.²

Immediately prior to the sale of La Quinta to Wyndham Worldwide, La Quinta will spin off its owned real estate assets into a publicly-traded real estate investment trust, CorePoint Lodging.³

¹ Yahoo Finance LQ profile

² PR Newswire press release, Jan 18 2018

³ PR Newswire press release, Jan 18 2018

Our Outlook

CorePoint Lodging Inc. (CPLG) is positioned to become the only pure-play publicly-traded REIT focused exclusively on select-service midscale and upper-midscale lodging. Upon completion of the spin, CorePoint Lodging will own a portfolio of 315 hotels and more than 40,000 rooms throughout the United States in attractive locations in or near employment centers, airports and major travel thoroughfares.⁴

The New La Quinta

Leading select-service franchisor and operator

- Attractive capital-light business model creates strong cash flow profile
- 886^(a) hotels in our system as of March 31, 2017
 - » 316^(a) managed and 570 franchised properties
- One of the fastest growing franchisors of select-service hotels
- Significant growth opportunity:
 - » Pipeline of 249 hotels, representing 23,300 rooms
 - » Nearly one-third of STR market tracts wide open to new La Quinta entry
- 20 year franchise and management contracts provide for stable and growing EBITDA

- 2017 Estimated Adjusted EBITDA: \$110M to \$115M^(b)
- Projected net leverage at approximately 3.5x to 4.5x TTM Adjusted EBITDA

CorePoint Lodging Inc.

Pure-play select-service hotel owner that offers attractive cash flow characteristics

- Only public U.S. lodging REIT strategically focused on midscale and upper-midscale select-service segments
- Diversified and strong portfolio: 316^(a) hotels with approximately 40,500 rooms located in 41 U.S. states
- 32% of CorePoint's rooms will be located within Top 25 markets as defined by Smith Travel Research (STR)
- Margins above full-service lodging REITs
- Will benefit from La Quinta's capital investment of over \$180M to renovate and reposition approximately 50 hotels upward within their markets, driving an enhanced guest experience and RevPAR growth. Renovations are expected to be complete in early 2018
- Strong and mutually beneficial relationship with La Quinta as its largest property owner and franchisee

- 2017 Estimated Adjusted EBITDA: \$200M to \$215M^(b)
- Projected net leverage at approximately 5.5x to 6.5x TTM Adjusted EBITDA

^(a) Excludes hotels designated as assets held for sale
^(b) Includes estimated incremental costs of operating as a stand-alone public company

Source: LQ investor deck July 2017

An investor buying the stock **today at a price of \$19.51** will get back **\$8.40 a share** for the sale of 'The New La Quinta' when the deal goes through Q2 2018. The remainder of the current stock price is the market's valuation of 'CorePoint Lodging Inc'.

As such, finding the valuation of CPLG and then adding \$8.40 to the price per share will allow us to arrive at a recommendation.

Following La Quinta's spinoff and the acquisition agreement, a few things will be different for CPLG:

- Absence of franchise business.
- Pay new La Quinta a management fee of 5.0% of gross hotel revenues in return for day-to-day management of its hotels.
- Pay a royalty fee of 5.0% of gross room revenues.
- Debt will be reduced by \$715 million.
- Additional reserve of \$240 million will be available.⁵

⁴ PR Newswire press release, Jan 18 2018

⁵ LQ form 10 registration statement

Geographical Presence

Owned and operated hotels are based in the US; franchises are based in US and Americas (Mexico and Central and South America). Expansion is driven by both domestic expansion and continuing expansion of franchise business into Mexico and Central and South America.⁶

It should be noted that there are **no owned hotels in pipeline**.

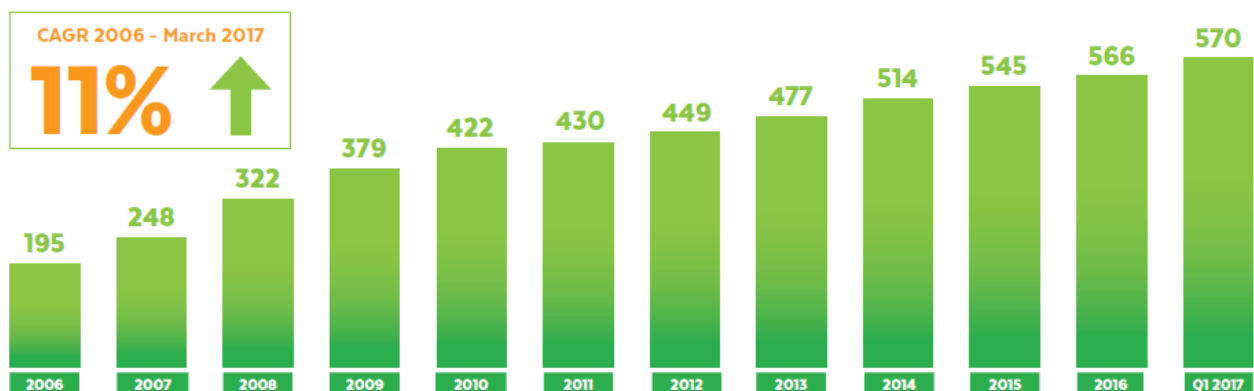
HOTELS			
	Total in Operation	Pipeline	Total with Pipeline
Owned	319	-	319
Franchised	570	249	819
Total	889	249	1,138

ROOMS			
	Total in Operation	Pipeline	Total with Pipeline
Owned	40,900	-	40,900
Franchised	46,500	23,300	69,800
Total	87,400	23,300	110,700

Source: LQ investor deck July 2017

Established Franchise Business

LQ franchise business is capital light and has experienced significant growth.⁷



Total Number of Franchised Hotels Source: LQ investor deck July 2017

⁶ LQ investor deck July 2017

⁷ LQ investor deck July 2017

Host Hotels & Resorts, Inc. (HST)

For the purpose of finding an estimate to some of our projections given that CPLG is positioned to become a publicly-traded REIT, we will use HST as a comparable to help guide our projections.

Given that CPLG will be the **first** publicly traded REIT to focus exclusively on midscale and upper-midscale of the lodging business, there are no perfect comparables. While they may differ in some ways, we feel that HST will be the most suitable comparable due to the following reasons:

- HST is the largest hotel REIT in the market by a wide margin with a focus on upscale; CPLG will be the first and largest REIT focusing on midscale and upper-midscale.⁸
- Both CPLG and HST have about the same scale of operation; they have a comparable huge number of rooms compared to other REITs. CPLG will have a portfolio of 315 hotels and 40,000 rooms compared with HST with 114 hotels and 61,000 rooms.⁹
- Other publicly traded REIT range only from a few hundred to 8,000 rooms.

⁸ The Motley Fool, 5 top hotel REITs for 2017.

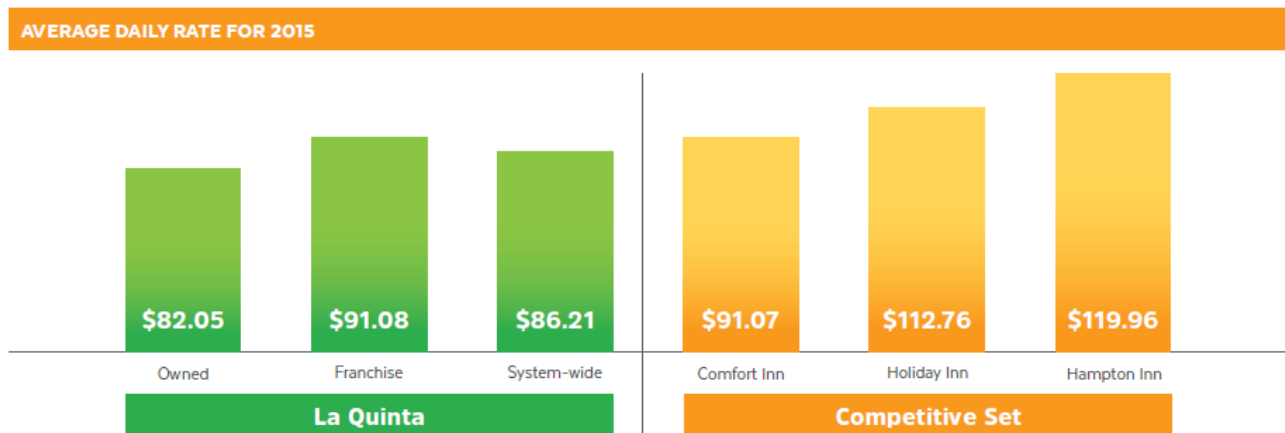
⁹ The Motley Fool, 5 top hotel REITs for 2017.

Forecast

Revenue

We forecast each revenue driver separately.

1. Room revenues



Source: LQ investor deck July 2017

There is room for growth for CPLG's nightly rates of owned hotels as evident from the lower daily rates of owned hotels of \$82.05 as compared to \$91.07 of competitor Comfort Inn. The above represents a ~10% price difference.

In recent years, LQ has been **deploying strategic capital investments** at 50 owned hotels, representing approximately 20% of owned hotel EBITDA, in order to reposition upwards within the market and capture additional revenue.¹⁰

The renovations increases quality, delivers a positive impact on guest experience and therefore, we expect CPLG to be able to raise rates. Furthermore, synergies with WYN should increase the likelihood of higher rates and booking.

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% growth	6.10%	11.68%	4.86%	-3.61%	-4.18%	5.50%	5.50%	5.50%	4.00%	3.00%
Room revenues	757.7	846.2	887.4	855.3	819.5	864.6	912.2	962.3	1,000.8	1,030.9

We feel that the **optimistic** outcome will be 5-6% growth rate projections **given that revenues are on a downward trajectory in recent years and that LQ has only managed to secure a 6-year historic CAGR of 2.5%**.

Nonetheless, we project the **optimistic case for room revenues growth of 5-6% for the first three years which slowly tapers off to 3% in 2022E** (because 6-year CAGR is ~2.5%), expected to be driven by synergies and increased rates.

¹⁰ LQ investor deck July 2017

2. Franchise and other fee-based revenues

After the spinoff, CPLG will only own a portfolio of 315 hotels, so we **exclude this income for our projections.**

3. Other hotel revenues

This is small as compared to room revenues and has been consistent historically; we **project a constant 19M going forward.**

4. Total revenues

The above will yield us the following revenue projections:

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% growth	6.10%	11.68%	4.86%	-3.61%	-4.18%	5.50%	5.50%	5.50%	4.00%	3.00%
Room revenues	757.7	846.2	887.4	855.3	819.5	864.6	912.2	962.3	1,000.8	1,030.9
Franchise and other fee-based revenues	79.2	89.7	100.1	106.5	114.6	-	-	-	-	-
Other hotel revenues	17.9	19.5	19.3	19.3	19.0	19.0	19.0	19.0	19.0	19.0
Total revenues	854.8	955.5	1,006.8	981.1	953.1	883.6	931.2	981.4	1,019.9	1,049.9

Expenses

Similar to revenue projections, we forecast each expense as a separate item.

1. Direct lodging expenses:

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% room rev	45.47%	44.75%	44.95%	47.92%	50.84%	45.06%	45.06%	45.06%	45.06%	45.06%
Direct lodging expenses	-344.5	-378.7	-398.8	-409.9	-416.7	-389.6	-411.0	-433.6	-450.9	-464.5

Historically, this expense comes directly and **only** from the owned hotels. The higher lodging expense as % of room revenue in 2016 and 2017 is due to recent renovations and strategic capital investments in preparation for the spinoff, which are also expected to be completed by 2017. As such, we **expect the ratio to drop to previous average of 45.06% by using a 3-year average of 2013-2015.**

2. Depreciation and amortization:

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% room rev	19.19%	18.12%	17.38%	14.99%	15.57%	16.00%	16.00%	16.00%	16.00%	16.00%
Depreciation and amortizat	-164.1	-173.1	-175.0	-147.1	-148.4	-138.3	-145.9	-154.0	-160.1	-164.9

Item	2013	2014	2015	2016	2017
Property and equipment, net of accumulated depreciation	2,761.5	2,826.2	2,623.5	2,456.8	2,506.5

As part of LQ's repositioning, LQ renovated some of its hotels and also disposed some of its unproductive assets. This resulted in its D&A being lower in 2016 and 2017 due to smaller PPE in recent years. Total number of owned hotels decreased from 319 in early 2017 to 317 by the end of 2017.

It should be noted that the repositioning is carried out for the purpose of the spinoff and unproductive assets planned to be rid off will be sold, by the spinoff. We expect all 315 owned hotels to follow through into the portfolio of CPLG as per the agreement. As such, we **expect D&A as a % of room revenue to be stable about current levels and we use an optimistic projection of 16% going forward.**

3. General and administrative expenses:

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% rev	8.75%	14.93%	11.66%	11.79%	15.00%	8.63%	8.63%	8.63%	8.63%	8.63%
General and administrative expenses	-74.8	-142.6	-117.4	-115.7	-142.9	-76.3	-80.4	-84.7	-88.0	-90.6

This expense item differs from the other expense items as it is affected by the franchise business of LQ.

Although historically it has ranged about 11-15% of revenue, we expect this expense to decrease after the spinoff as CPLG will no longer need to manage the 300+ owned hotels as they will be managed by the new La Quinta. As such, we **used HST's ratio of 8.63% of revenue for our projections forward.**

4. Management and royalty fee:

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% rev						5.00%	5.00%	5.00%	5.00%	5.00%
LQ management fee	-	-	-	-	-	-44.2	-46.6	-49.1	-51.0	-52.5
% room rev						5.00%	5.00%	5.00%	5.00%	5.00%
LQ royalty fee	-	-	-	-	-	-43.2	-45.6	-48.1	-50.0	-51.5

As the new La Quinta will be managing CPLG's 315 owned hotels, under the spinoff agreement, it is expected that new La Quinta will enter into amended and restated franchise and management agreements with CPLG. These agreements are expected to provide that CPLG will pay new La Quinta:

- a management fee of 5.0% of gross hotel revenues in return for day-to-day management of its hotels, and
- a royalty fee of 5.0% of gross room revenues.¹¹

5. Other lodging and operating expenses:

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% rev	13.48%	13.01%	18.63%	23.44%	13.04%	13.00%	13.00%	13.00%	13.00%	13.00%
Other lodging and operating expenses	-115.3	-124.3	-187.5	-230.0	-124.3	-114.9	-121.1	-127.6	-132.6	-136.5

Other lodging and operating expenses has been a consistent ~13% of revenue except for 2015 and 2016 during which there is impairment loss of 104.3M and 50.1M respectively, due to asset sales. Given that the asset sales are part of the preparations to support the spinoff, we **do not expect the same after the spinoff and hence we use a 13% of revenue for this expense in our projections.** Moreover, HST's other expenses is a ~14% of revenue which is similar to our projection.

¹¹ LQ form 10 registration statement

Tax

REITs are taxed differently than most other types of companies. As long as they pay out at least 90% of their taxable income to shareholders, they aren't taxed at the corporate level. So it is their shareholders who pay income tax on those dividends.¹²

In most cases, REITs take advantage of the tax incentive and pay out at least 90% of their taxable income. As such, we **project a tax rate of 0% for CLPG.**

Change in Net Working Capital

Item	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
% rev	8.06%	7.62%	2.84%	8.44%	4.88%	12.00%	12.00%	12.00%	12.00%	12.00%
Net working capital	68.9	72.8	28.6	82.8	46.5	106.0	111.7	117.8	122.4	126.0
Change in net working capital	-5.0	-3.9	44.2	-54.2	36.3	-59.5	-5.7	-6.0	-4.6	-3.6

Net working capital as a percentage of revenue has always averaged around 3% to 8%. However, we expect NWC to increase after the spinoff as an REIT is required to do more sale and repurchase of properties. **Comparable HST has a NWC to revenue ratio of 12.87% and we use a conservative 12% in our projections.**

CapEx

CapEx **has been averaging around 15% of room revenue.** The sale of the franchise business should not affect CapEx and as such, we do not expect a change.

¹² The Motley Fool: Tax reform could drive REIT shares higher

Valuation methodology

Terminal Growth Rate

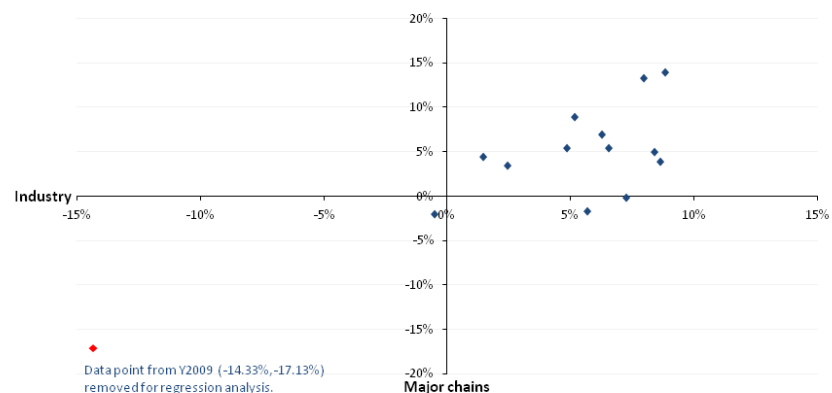
Item	Value	Source
Real LT GDP growth rate	3.25%	Historic 60-years CAGR
Inflation rate	0.87%	2017 inflation rate
Nominal LT GDP growth rate	4.12%	

US nominal LT GDP growth rate is estimated to be 4.12%.

Change in Sales		2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Hotels & Motels US, NAICS 72111																
Industry <i>in billion US</i>	Total revenue	115.0	117.8	124.5	135.5	147.2	156.4	155.6	133.3	142.0	153.3	155.5	163.0	176.7	189.5	199.3
	Change		2.43%	5.69%	8.84%	8.63%	6.25%	-0.51%	-14.33%	6.53%	7.96%	1.44%	4.82%	8.40%	7.24%	5.17%
Major Hotel Chains																
MAR	Total revenue	8441.0	9014.0	10099.0	11550.0	12160.0	12990.0	12928.0	10932.0	11691.0	12317.0	11814.0	12784.0	13796.0	14486.0	17072.0
HST	Total revenue	3691.0	3427.4	3635.0	3901.0	4915.0	5474.0	5298.0	4133.0	4444.0	5022.0	5311.0	5153.0	5384.0	5461.0	5454.0
CHH	Total revenue	365.6	386.1	428.8	477.4	544.7	615.5	641.7	564.2	596.1	638.8	691.5	724.7	758.0	859.9	924.6
MGM	Total revenue	4019.9	3908.8	4238.1	6482.0	7176.0	7691.6	7208.8	5978.6	6019.2	7849.3	9160.8	9809.7	10082.0	9190.1	9455.1
IHG	Total revenue	5675.6	6214.4	4162.9	3282.9	1880.3	1752.1	1854.0	1538.0	1628.0	1768.0	1835.0	1903.0	1858.0	1803.0	1715.0
	Total revenues	22193.0	22950.7	22563.8	25693.3	26675.9	28523.3	27930.4	23145.8	24378.3	27595.1	28812.4	30374.3	31878.0	31799.9	34620.8
	Change		3.41%	-1.69%	13.87%	3.82%	6.93%	-2.08%	-17.13%	5.33%	13.20%	4.41%	5.42%	4.95%	-0.24%	8.87%

We first **assume that the hotel industry grows at the same rate as GDP in the long run**. We then attempted to estimate the growth of incumbent hotel chains by **removing the impact of new entrants** on industry growth. Using 15-years of historic data we found the scatter-plot to be as such:

Scatter of Change in Total Revenues



Removing the anomalous data point from 2009 which was due to the financial crisis, we found a **beta of 0.832** through a regression of the **percentage change in revenues of 5 major hotel chains with that of the hotel industry**.

Since **LQ has generally been growing at a slower rate than incumbent hotel chains** (with a 6-year CAGR of ~2.5%), we did a further **regression of the percentage change in revenues of LQ with that of the 5 major hotel chains** and found the **beta to be 0.681**.

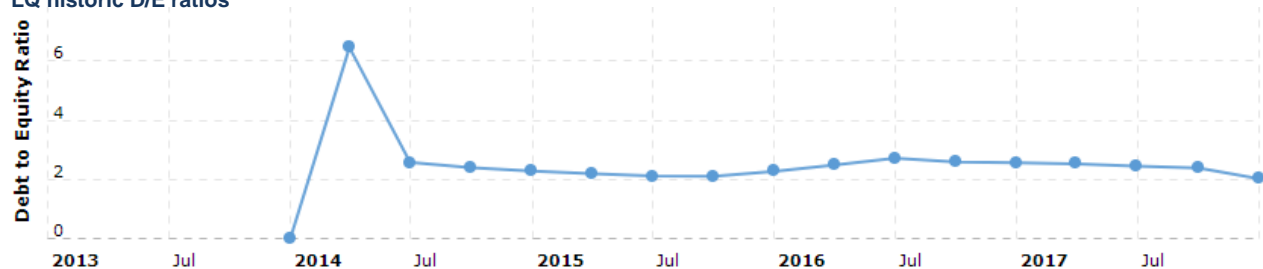
Item	Value	Source
Nominal LT GDP growth rate	4.12%	
Adjustment for entrants	0.832	Beta from first regression
Adjustment for LQ historic growth	0.681	Beta from second regression
Terminal growth rate	2.34%	

Therefore, we use a **terminal growth rate of 2.34% in our projections**. We found this to be appropriate given that historic 6-year CAGR is ~2.5%.

Debt to Equity Ratio

LQ Debt to Equity ratio has been consistent in recent years at levels of 2.1 to 2.3.

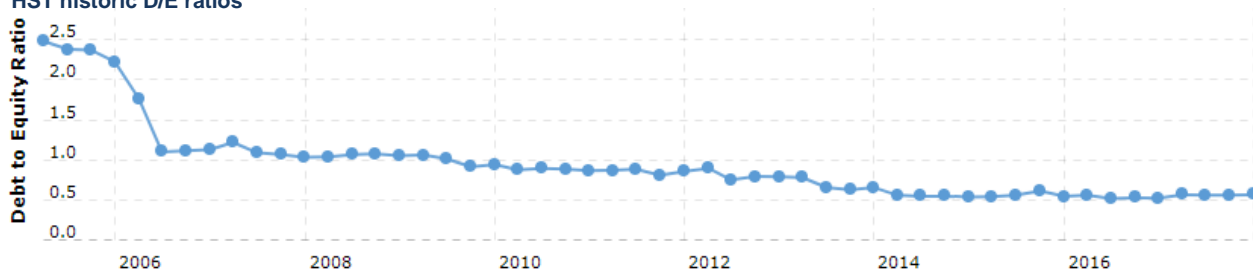
LQ historic D/E ratios



Source: Macrotrends

After the spin-off, LQ total debt of \$1688 million is expected to decrease by \$715 million and another \$17.5 million based on the maturity of debt to a **new debt level of \$955.4 million**. Following the deal agreement terms and an increase in reserve fund of \$240 million in cash, **equity is expected to increase to \$1783 million**. This gives us a **new debt to equity ratio following the spin-off of 0.535**.

HST historic D/E ratios



Source: Macrotrends

Comparing with comparable REIT HST, debt to equity ratio of HST is consistent at levels of 0.52 to 0.56 for the last 5 years. **Considering that LQ has maintained its D/E ratio in prior years, coupled with the similar D/E ratio of HST, we feel that CPLG will maintain its D/E ratio around levels of 0.535 after the spin-off and we use this ratio for our WACC valuation methodology.**

As in the 10K, we use 2017 LIBOR rate of 1.56% + 3% for cost of debt.

Item	Value	Source
Risk free rate	1.80%	Pablo Fernandez survey - 1% to account for risk-premium on 10-year treasuries
Market risk premium	5.40%	Pablo Fernandez survey
Beta	1.60	Estimate from rolling 3 Year beta
Cost of debt	4.56%	2017 LIBOR + 3%
Tax rate	0.00%	
WACC	8.39%	

WACC Valuation Result

We used the new cash and debt levels after the spin-off to derive the equity value of CPLG.

Item	Value
Enterprise value	1,497.8
Cash	380.8
Debt	-955.4
CPLG Equity value	923.2
no. of diluted shares	116.7
CPLG price per share	7.91

An investor buying the stock **today at a price of \$19.62** will get back **\$8.40 a share** for the sale of 'The New La Quinta' when the deal goes through Q2 2018. The remainder of the current stock price is the market's valuation of 'CorePoint Lodging Inc'.

Item	Value
CPLG price per share	7.91
New La Quinta reimbursement	8.40
Price per share	16.31
Current share price	19.62
Down side	-16.86%

We found the price per share to be \$16.31, which is a 16.86% downside to the current share price of \$19.62 and we recommend a strong sell based on the following reasons:

- There is no arbitrage opportunity as seen from the estimated downside.
- CPLG price per share of \$7.91 is considerably lower than its current valuation of \$11.71 (19.62-8.40), which suggests a downside of 32.42%.
- **We used optimistic revenue and D&A projections, as well as conservative costs and NWC projections, in our opinion.**
- There are additional risks, such as the termination of the deal which may have a great negative impact on stock prices.

DCF	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	TV
<i>in US\$ millions</i>											
% growth	6.10%	11.68%	4.86%	-3.61%	-4.18%	5.50%	5.50%	5.50%	4.00%	3.00%	
Room revenues	757.7	846.2	887.4	855.3	819.5	864.6	912.2	962.3	1,000.8	1,030.9	
Franchise and other fee-based revenues	79.2	89.7	100.1	106.5	114.6	-	-	-	-	-	
Other hotel revenues	17.9	19.5	19.3	19.3	19.0	19.0	19.0	19.0	19.0	19.0	
Total revenues	854.8	955.5	1,006.8	981.1	953.1	883.6	931.2	981.4	1,019.9	1,049.9	
% room rev	45.47%	44.75%	44.95%	47.92%	50.84%	45.06%	45.06%	45.06%	45.06%	45.06%	
Direct lodging expenses	-344.5	-378.7	-398.8	-409.9	-416.7	-389.6	-411.0	-433.6	-450.9	-464.5	
% room rev	19.19%	18.12%	17.38%	14.99%	15.57%	16.00%	16.00%	16.00%	16.00%	16.00%	
Depreciation and amortization	-164.1	-173.1	-175.0	-147.1	-148.4	-138.3	-145.9	-154.0	-160.1	-164.9	
% rev	8.75%	14.93%	11.66%	11.79%	15.00%	8.63%	8.63%	8.63%	8.63%	8.63%	
General and administrative expenses	-74.8	-142.6	-117.4	-115.7	-142.9	-76.3	-80.4	-84.7	-88.0	-90.6	
% rev						5.00%	5.00%	5.00%	5.00%	5.00%	
LQ management fee	-	-	-	-	-	-44.2	-46.6	-49.1	-51.0	-52.5	
% room rev						5.00%	5.00%	5.00%	5.00%	5.00%	
LQ royalty fee	-	-	-	-	-	-43.2	-45.6	-48.1	-50.0	-51.5	
% rev	13.48%	13.01%	18.63%	23.44%	13.04%	13.00%	13.00%	13.00%	13.00%	13.00%	
Other lodging and operating expenses	-115.3	-124.3	-187.5	-230.0	-124.3	-114.9	-121.1	-127.6	-132.6	-136.5	
Total operating expenses	-698.6	-818.8	-878.7	-902.6	-832.3	-806.5	-850.5	-897.0	-932.7	-960.5	
EBIT	156.2	136.7	128.1	78.5	120.8	77.2	80.7	84.3	87.2	89.3	
% tax	35.00%	35.00%	35.00%	35.00%	35.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
NOPAT	101.5	88.8	83.2	51.0	78.5	77.2	80.7	84.3	87.2	89.3	
Depreciation and amortization	164.1	173.1	175.0	147.1	148.4	138.3	145.9	154.0	160.1	164.9	
% rev	8.06%	7.62%	2.84%	8.44%	4.88%	12.00%	12.00%	12.00%	12.00%	12.00%	
Net working capital	68.9	72.8	28.6	82.8	46.5	106.0	111.7	117.8	122.4	126.0	
Change in net working capital	-5.0	-3.9	44.2	-54.2	36.3	-59.5	-5.7	-6.0	-4.6	-3.6	
CapEx	-115.5	-78.6	-100.8	-143.8	-217.5	-129.7	-136.8	-144.4	-150.1	-154.6	
Free Cash Flow	145.1	179.4	201.6	0.1	45.8	26.3	84.1	87.9	92.5	96.1	1,624.1
									Enterprise value		1,497.8

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