

The Fourth Outlet

Student brief

A Lagos quick-service restaurant group runs three outlets — Ikeja, Surulere, and Victoria Island. Nigerian food, fast service, mostly office workers at lunch. The business is profitable and has been for nine years.

The family that owns it wants to open a fourth outlet in Lekki. A landlord has offered a five-year lease on a good corner site. The operations director has spent three months on the proposal and is presenting it to the family this week.

Mountain River has been asked for a view.

Exhibit 1 • The commitment and the assumptions

THE COMMITMENT

₦ millions

ITEM	AMOUNT
Fit-out and equipment	85.0
depreciated straight-line over 5 years, so	17.0 a year
Initial working capital	5.6
Total Year 0 outlay	90.6

THE OPERATING ASSUMPTIONS

ITEM	VALUE
Year 1 revenue	₦140.0m
Revenue growth, Years 2–5	10%
Food cost	38% of revenue
Year 1 operating expenses	₦62.0m
Operating expense growth	12%
Working capital	4% of revenue
Tax rate	30%
Discount rate	22%
Long-run growth after Year 5	8%
Terminal return on invested capital	14%

The plan assumes NO cannibalisation of the Victoria Island outlet.

Exhibit 2 • Free cash flow — Years 1 to 5 supplied

FREE CASH FLOW • YEARS 1 TO 5 SUPPLIED

¥ millions. Explicit-period present value at 22% is ¥66.92m.

LINE	Y1	Y2	Y3	Y4	Y5
Revenue	140.00	154.00	169.40	186.34	204.97
Food cost	(53.20)	(58.52)	(64.37)	(70.81)	(77.89)
Operating expenses	(62.00)	(69.44)	(77.77)	(87.11)	(97.56)
Depreciation	(17.00)	(17.00)	(17.00)	(17.00)	(17.00)
EBIT	7.80	9.04	10.26	11.43	12.53
Tax at 30%	(2.34)	(2.71)	(3.08)	(3.43)	(3.76)
After-tax EBIT	5.46	6.33	7.18	8.00	8.77
Add depreciation	17.00	17.00	17.00	17.00	17.00
Less increase in working capital	0.00	(0.56)	(0.62)	(0.68)	(0.75)
FREE CASH FLOW	22.46	22.77	23.56	24.32	25.02

Exhibit 3 • Discount factors at 22%

DISCOUNT FACTORS AT 22%

YEAR	FACTOR	YEAR	FACTOR
1	0.8197	4	0.4514
2	0.6719	5	0.3700
3	0.5507		

Question 1 • 15 minutes

The present value of Years 1 to 5 is supplied as ¥66.92 million. Compute the terminal value **twice**:

(a) by growing Year 5 free cash flow at 8 percent and applying the perpetuity formula; (b) by rebuilding Year 6 free cash flow with the supplied terminal reinvestment bridge below, then applying the same formula.

Terminal reinvestment rate = g / ROIC
 = 8% / 14%
 = 57.1% of NOPAT

Maintenance capex equals depreciation. Total reinvestment also includes growth net capex and the increase in working capital.

Report the project NPV under each.

Question 2 • 13 minutes

The two answers differ enormously. Explain why, and say which is right.

Your explanation should describe, in plain language, what business the incorrect version is actually describing.

Question 3 • 9 minutes

What do you tell the family?

The plan assumes no cannibalisation of the Victoria Island outlet, fifteen minutes away. Name the evidence you would want on that — and state what else would change your recommendation.