Felix DCF Challenge

You work within ECM and your team acts as advisor to ATI Inc (ticker: ATI), which manufactures specialty alloys and components used across the aerospace and oil & gas industries. The company operates within the Semiconductor industry.

During FY22/23 ATI restructured their business and disposed of two underperforming business units. They also announced plans to increase FY23-FY27 investment to support growth in their High-Performance Materials and Components (HPMC) division. In the last year, this segment experienced revenue growth of 7.5%, generated 52% of firm revenues and generated EBITDA margins of 20.3%.

The CEO is keen to understand whether the company's current market valuation reflects the recent strategic changes and management's current growth and margin expectations.

Your MD has asked you to build a standalone DCF valuation for the company as of 1 January 2025, based on 8-year free cash flow forecasts and using the growth perpetuity formula for the terminal value. Use your DCF to calculate the company's implied share price and the implied EV/FY1 EBITDA multiple.

Your MD has passed you the following notes from their conversation with the CEO:

- Management expects revenue growth of c8%p.a. over the next few years and 8-year revenue CAGR of 6.0%.
- Growth is being fueled by the higher-margin HPMC segment which will lead to margin expansion throughout the forecasts. Management is targeting combined EBITDA margins of 23.0% within the next 6 years.
- Capex will remain elevated for the next 3 years and will then drop to c4% of revenues. Capex guidance for FY25 is $260-280m
- No changes are expected to the company's effective tax rate in the future.
- Operating working capital was abnormally high in FY24 due to elevated levels of inventory. Management expects future operating working capital relative to sales to be consistent with FY22 and FY23 levels.
- The company has two non-controlled JV investments. These are not separately disclosed on the balance sheet but have a total current market value of c$200m.
- The company considers its main competitors to be Howmet Aerospace Inc (ticker: HWM) and Texas Instruments Inc (ticker: TXN) for the HPMC segment, and Reliance (ticker: RS) and Carpenter Tech Corp (ticker: CRS) for the Alloys & Solutions segment.

When building your DCF:

- Obtain the required FY24 income statement, balance sheet and cashflow statement information from the company's filings in Felix.
- You are not required to build a full three statement model, but your MD has specifically requested that you monitor invested capital growth and return on invested capital in your forecasts, to sense-check your valuation.
- Use the Felix company analytics tool to identify WACC. You should use a 'custom' Equity Risk Premium of 5.0% and industry beta in your WACC, based on identified peers.
- Use mid-year discounting in your calculations.

When you have completed your valuation comment on:

1. How the growth rate in invested capital in your terminal year compares to the growth rate in your terminal value. If they are different, how do you think this impacts your valuation?
2. How return on invested capital evolves during the forecasts. If it is increasing or decreasing throughout your forecasts, why do you think this is and do you think it is appropriate?

