1. Are the four components of Marriott’s financial strategy consistent with its growth objective?
   Manage rather than own hotel assets – Although this strategy has a risk of contract expiration it makes easier to expand.
   Invest in projects that increase shareholder value – This component definitely stimulates growth, although may force management to take more risk.
   Optimize the use of debt in the capital structure – The concept of optimal capital structure stands for the growth, nevertheless the techniques used by management sometimes limit it in favour for the higher rating.
   Repurchase undervalued shares – In a number of cases this component may lead to directing the cash flows not in the projects with positive NPV, which may impede growth.

2. How does Marriott use its estimate of its cost of capital? Does this make sense?
   Marriott used (or considered to use) the estimate for the cost of capital in two ways:
   a) Discounted CFs from projects by the appropriate division’s hurdle rate to get NPV, which makes a lot of sense since the risk among divisions varies.
   b) Thought about incorporating hurdle rate in compensation policy – this doesn’t make much sense, because the rate reflects the risk of activities, not the performance of managers.

3. Compute the WACC of Marriott Corporation:
   a. What risk-free rate and the risk premium did you use to calculate the cost of equity?
      To be consistent with risk premium calculations I used the arithmetic average (best estimator) of historic LT US Government Bonds (4.58%) for the longest period because of the most precise estimate (unfortunately, ignoring possible structural change).
      As a risk premium I used the 7.43% (Spread between S&P Index and LT US Government Bonds), although it’s relatively high, my comparably low risk free rate will compensate for that.
      Then to calculate the cost of equity we need beta. As there are no good comparables that match the Marriot’s operational profile, I use historical beta with correction on target D/E ratio and reaching 1 in the long run.
      Beta = 1.17
      ke=4.58%+1.17*7.43%=13.27%

   b. How did you measure Marriott’s cost of debt?
      I added the premium, according to the rating of the company, to the current 10-years US government interest rate. I used this rate because it matches on average the company’s profile.
      kd = 1.3% + 8.72% = 10.02%
      As the rating of the company is very high the probability of default is low and the difference between this estimated cost of debt and the actual one is expected to be low.

      So the WACC = 13.27%*0.4 + 10.02%*(1-0.42)*0.6 = 8.79496%

4. Calculate the hurdle rate for the lodging division.
   First we assume that the Contract services have the same risk as Restaurant business. This is a necessary assumption as we don’t have any comparables for the Contract services.
   Then we calculate WACC for Restaurant business: we use 5 comparable firms that are only involved in food business, calculate the unlevered betas for them, use the medium beta (0.63) for further leverage with our particular D/E for Contract services and Restaurant business, thus get the levered beta of 0.9, with which calculate the cost of equity = 4.58%+0.9*7.43% = 11.26%. The cost of debt is 1.5%+8.72%=10.22% (weighted average premium was used). After that we calculate WACC for “food division” = 0.41*10.22%*(1-0.42)+0.59*11.26%=9.07%.
   Now we know WACC for the company as a whole and two other divisions. So we can figure out the WACC for the Lodging division (the weights should be the division value, but we don’t have the multiples to calculate it, so we use the sales), which is:
      WACC lodging = (8.795-0.49*9.07)/0.51 = 8.53%