Session 3: Post class test solutions

1. **c. $50 million.** The premium paid on the acquisition is $250 million ($5/share * 50 million shares). The price of Cipra drops by $200 million ($2 per share * 100 million shares). The net change in value for the combined company is $50 million.
2. **d. Retire short-term debt and hold on to the remaining cash.** As a lender to the firm, with a long term, fixed rate loan, you get no upside. Hence, even if an investment or acquisition is a good one or if stockholders will be better off with a dividend or buyback, your primary concern is that the company be able to pay you and have less default risk. Paying off short-term debt and holding on the cash will make you happiest, since it makes your debt more secure (safer).
3. **a. Much higher interest rates on your borrowing.** When lenders feel exposed, they lend out less and charge much higher interest rates. Hence, the ultimate cost is borne by borrowers.
4. **f. None of the above.** While any of these can be evidence of short termism in some companies, none of them is clear evidence of it. After all, if the market's role is to capture the value of a business, in some companies, these actions may be creating the change in value that the stock price is reflecting.
5. **c. No news is bad news.** This is a tricky one. When companies are quick to reveal good news and sit on bad news, the absence of news can be construed as bad news. I knows it sounds convoluted… but the market fills information vacuums with its own suppositions (many of which are not good).