

Session 26: Post Class tests

1. Kanazawa Inc., a Japanese retailer, is considering acquiring Konshu Inc., a Korean apparel manufacturer. The cash flows for Konshu have been estimated before debt payments, in Korean Won. Which of the following would you use as the discount rate in a DCF valuation?
 - a. The cost of equity of Kanazawa in Japanese Yen
 - b. The cost of capital of Kanazawa in Japanese Yen
 - c. The cost of equity of Kanazawa in Korean Won
 - d. The cost of capital of Kanazawa in Korean Won
 - e. The cost of equity of Konshu in Korean Won
 - f. The cost of capital of Konshu in Korean Won

2. Generra Corporation is a large conglomerate that has a Moody's Aaa rating and is able to borrow money at 3%, after taxes and has a 30% debt to capital ratio. It is considering acquiring Mendocino Technologies, a company that is a young, high growth, risky company that has a 10% debt ratio (its optimal debt ratio is also 10%) and an after-tax cost of debt of 6%. Generra plans to borrow 30% of the acquisition price, at its 3% after-tax cost of debt, to fund the acquisition. In computing the cost of capital to use in valuing Mendocino, which of the following would you use for debt characteristics?
 - a. A debt ratio of 10% and an after-tax cost of debt of 6%
 - b. A debt ratio of 10% and an after-tax cost of debt of 3%
 - c. A debt ratio of 30% and an after-tax cost of debt of 6%
 - d. A debt ratio of 30% and an after-tax cost of debt of 3%
 - e. None of the above

Bonus: Would your answer be different if you were told that Mendocino had an optimal debt ratio of 20% and an after-tax cost of debt of 6.5% at that debt ratio?

3. Carpe Inc. is a publicly traded company that is considering merging with Diem Inc, another publicly traded company in the same business, motivated by the potential for cost savings from business overlap. The combination is expected to save \$30 million in after-tax operating cash flows (increasing operating income) next year, with a growth rate of 2% a year in perpetuity. The following table lists the costs of equity and capital for the two companies and the merged entity:

	Carpe	Diem	Carpe Diem (combined)
Cost of equity	10.00%	12.00%	10.50%
Cost of capital	9.00%	10.80%	9.60%

What is the value of the cost savings synergy in this merger?

- a. \$300.00 million
- b. \$340.91 million
- c. \$352.94 million
- d. \$375.00 million
- e. \$394.74 million
- f. \$428.57 million

4. Tinga Inc., a poorly run restaurant chain, is currently fairly valued, based on the expectation that it would generate \$25 million in after-tax operating income next year, growing at 2% a year. The company has \$500 million in invested capital and is expected to maintain its current return on investment capital; its cost of capital is 8%. You believe that you can run the firm better and double its after-tax operating income without adding any invested capital. Assuming that you can maintain your return on capital in perpetuity as well, how much of a control premium (in percentage terms, over and above current value) would you be willing to pay for Tinga?
 - a. 20%
 - b. 100%
 - c. 167%
 - d. 200%
 - e. None of the above
5. If you are asked to value an acquisition, using relative valuation, which of the following will yield the best estimate of relative value?
 - a. The median multiple for the peer group (companies in the same business)
 - b. The multiple for the peer group, adjusted for differences on risk, growth & cash flows between the target company and the peer group.
 - c. The median multiple for other companies that have been acquired in the recent past
 - d. The multiple for other companies that have been acquired in the recent past, adjusted for differences on risk, growth & cash flows between the target company and this group.