## Session 27: Post Class tests

1. Classify the following actions into value changing and value neutral actions. If value changing, specify whether it will increase or decrease the intrinsic value of equity in a business.
   a. A stock dividend
   b. Impairment of goodwill from a past acquisition (not tax deductible)
   c. A non-cash restructuring charge (not tax deductible)
   d. Impairment of goodwill from a past acquisition (a portion is tax deductible)
   e. A non-cash restructuring charge (tax deductible)
   f. A corporate name change with no change in business focus
   g. A corporate name change with a change in business focus
2. Claremont Inc. is a company that has two divisions, both of which are in stable growth (growing 2% a year) and have a cost of capital of 10%. You have been provided with the following information on the divisions (in millions):

| | Expected After-tax Operating Income next year | Invested Capital |
|---|---|---|
| Food | $150 | $1,000 |
| Chemicals | $50 | $1,000 |

   Assume that if you continue to run the chemical business, your return on capital will stay at existing levels and that you can divest the business for $ 800 million. What effect will the divestiture have on company value?
   a. Decrease value by $200 million
   b. No change in value
   c. Increase value by $175 million
   d. Increase value by $300 million
   e. Increase value by $ 425 million
3. Charisma Software is a technology company is expected to report after-tax operating income of $ 1 billion next year, earned on an invested capital base of $10 billion. The company is expected to grow 1% a year in perpetuity and has a cost of capital of 9%. The firm wants to double its growth rate in perpetuity, while maintaining its current return on capital. How much will the value of its operating assets change in dollar terms?
   a. Decrease value
   b. No change
   c. $178.57 million
   d. $1607.14 million
   e. $1785.71 million
   f. None of the above

How would your answer change if the invested capital base were $ 11 billion? How about if it were $12 billion?

4. Caribou Enterprises is an all-equity funded company with a cost of equity of 9%; the risk free rate is 3% and the equity risk premium is 6%. The company is

considering borrowing money at 5% (pre-tax) and pushing its debt to capital ratio to 20%. If the marginal tax rate is 40%, what will the new cost of capital be at 20%?

   a. 7.80%
   b. 8.20%
   c. 8.52%
   d. 8.92%
   e. 9.00%

5. Voltar Inc. is a company with 600 million non-voting shares and 400 million voting shares. You have valued the company, run by the existing management, at $ 10 billion but you believe that with new management, the company would have a value of $12 billion. If the probability of management changing is 20%, what is the value of each voting share?
   a. $10.00/share
   b. $10.40/share
   c. $11.00/share
   d. $12.00/share
   e. $14.00/share