

Session 14A: Post Class tests

1. You are valuing a company that is in a declining business. It expects to generate \$10 million in after-tax operating income on \$200 million in revenues next year and the depreciation is expected to be \$ 3 million for the year. If the firm plans not to invest in new capital expenditures and to reduce its non-cash working capital by \$2 million next year, what is the reinvestment rate for the next year.
 - a. -50%
 - b. -20%
 - c. -10%
 - d. 20%
 - e. None of the above
2. You have just completed a DCF valuation of Starling Enterprises, a company that has been generating losses and has significant debt outstanding. The value that you derived for the operating assets is \$100 million and the company has \$20 million in cash and \$ 60 million in debt outstanding; there are 10 million shares outstanding. Using a statistical technique (PROBIT), you have estimated that there is a 60% chance that the firm will not survive and that if it fails, you will receive only 25% of your estimated fair value in liquidation. What is the expected value per share?
 - a. \$3.00/share
 - b. \$3.60/share
 - c. \$4.20/share
 - d. \$6/share
 - e. \$10/share
3. You are valuing an emerging market company that faces a significant change of being nationalized. The company is expected to generate \$10 million in after-tax cash flows, growing 3% a year in perpetuity with an 8% cost of capital, if it remains a growing concern. Its book value is currently \$50 million and if nationalized, you expect to receive the book value. If the firm has no debt outstanding and no cash balance, what is the value of equity per share, if there is a 30% chance of nationalization? (There are 50 million shares outstanding.)
 - a. \$ 1.00/share
 - b. \$1.90/share
 - c. \$2.80/share
 - d. \$3.10/share
 - e. \$4.00/share
4. You can value a bank using a dividend discount model, but in doing so, you are assuming that the bank is paying out what it can afford to in dividends. Which of the following banks will you find correctly valued using a dividend discount model?
 - a. Bank A: ROE = 10%, Expected growth rate = 2%, Payout ratio =0%
 - b. Bank B: ROE = 10%, Expected growth rate = 2%, Payout ratio =20%
 - c. Bank C: ROE = 10%, Expected growth rate = 2%, Payout ratio =80%
 - d. Bank D: ROE = 10%, Expected growth rate = 2%, Payout ratio = 100%

5. Savers Bank is a small, growing bank that is coming under pressure from regulatory authorities to raise its regulatory capital holdings. In the most recent year, the bank reported net income of \$10 million on loans of \$500 million (made to businesses and individuals). The bank reported regulatory capital of \$25 million, 5% of the loans made. The bank expects the loans it makes to increase by 20% next year, while maintaining its profit margin, and would like to increase its regulatory capital ratio to 6% of loans by the end of year 5. How much dividend can Savers Bank afford to pay next year?
- Zero
 - \$ 1 million
 - \$7 million
 - \$11 million
 - \$12 million
 - None of the above