

## Session 7: Post Class tests

1. Lixit Inc. is a publicly traded company that reported \$100 million in revenues in the most recent fiscal year that ended on December 31. You are valuing the company in April and know that the company reported \$30 million in revenues for the first quarter, up from the \$22 million it reported in revenues in the same quarter of the previous year. In valuing Lixit today, which of the following numbers would you use for your base year revenues, if you want an updated valuation?
  - a. \$ 100 million
  - b. \$108 million
  - c. \$92 million
  - d. \$120 million
  - e. \$130 million
2. You are analyzing Sterling Stores, a retail company. The company reported \$25 million in pre-tax operating income in the most recent year and invested capital of \$125 million. The operating income, though, was computed after operating lease expenses that amounted to \$25 million in the most recent year and the company has commitments to make \$20 million in lease payments every year for the next 8 years. Assuming that Sterling Stores has a pre-tax cost of debt of 4% and that you decide to capitalize operating leases, what is the pre-tax return on capital is for Sterling Stores?
  - a. 26.53%
  - b. 10.53%
  - c. 19.26%
  - d. 12.77%
  - e. None of the above
3. Livewire Inc. is a technology company that reported a pre-tax operating loss in the most recent year of \$10 million, after expensing R&D expenses of \$30 million during the year. The company reported invested capital of \$40 million at the end of the most recent year. You are told that the R&D typically takes 3 years to pay off in this business, and that Livewire had R& D expenses of \$24 million, \$18 million and \$12 million in each of the last 3 years. Assuming that you decide to capitalize R&D expenses, what is the pre-tax return on capital for Livewire?
  - a. 2.17%
  - b. 5.00%
  - c. -10.87%
  - d. 43.48%
  - e. None of the above
4. Loomix Inc, is a company that has a history of losing money and has accumulated \$100 million in net operating losses. You expect the company to generate an operating loss of \$50 million next year, followed by pre-tax operating profits of \$75 million and \$125 million in the following two years. If your marginal tax rate is 40%, how much will Loomix pay cumulatively as taxes in the next three years?
  - a. \$90 million
  - b. \$60 million

- c. \$20 million
  - d. \$30 million
  - e. None of the above
5. You have been asked to normalize earnings for Lewis Enterprises, a company that reported losses in the most recent year. The company has tripled its revenues over the last 5 years and its loss is entirely attributable to a natural disaster during the course of the year that did not affect revenues for the year but caused substantial costs. The company reported revenues of \$ 1 billion and an operating loss of \$50 million in the most recent year; its products sell at a lower price than its competitors do. Which of the following would you use as your measure of normalized pre-tax operating income?
- a. Average operating income earned over the last 5 years (\$25 million)
  - b. Operating income based upon the average pre-tax margin of the sector (10%): 10% of \$1 billion = \$100 million
  - c. Operating income based upon the average pre-tax margin of the company over the prior 5 years (5%): 5% of \$ 1 billion = \$50 million
  - d. None of the above