Assume that Helgen Enterprises always has earnings before interest and taxes of $10 million per year and that the total value of Helgen is currently $100 million. Assume also that Helgen’s current interest expense equals $10 million per year. Finally, assume that the corporate tax rate is 35%, the personal tax rate on dividends and capital gains is 10%, and the personal tax rate on interest income is 25%.

a. Calculate Helgen’s value if it issues an additional $5 million of debt and uses the proceeds to repurchase $5 million of shares.

b. Calculate Helgen’s value if it issues an additional $10 million of equity and uses the proceeds to retire $10 million of debt.

Comment: Think very carefully before answering parts c. and d. below.

Wall Street Journal Questions are on the back of this page.