Key for Quiz C: 03/18/13

Assume that StreamingProfits Inc. announces plans to issue additional shares of common stock and use the proceeds to repurchase outstanding bonds. At the announcement, the prices of StreamingProfits' common shares and its outstanding bonds rose. Excluding tax issues, how would you explain these reactions?

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

✓✓ The value of the firm has risen

✓✓✓✓ 1) expected bankruptcy costs have fallen

✓✓✓✓ => chance of bankruptcy is lower

Direct costs = costs to hire ✓✓ outside experts during bankruptcy process

✓ Examples: cost to hire accountants, lawyers, and investment bankers

Indirect costs = costs that stem from changes in beha✓✓vior towards the firm

✓✓ Examples: loss of customers, suppliers and trade credit, best employees, value as employees fight fires rather than maximize value, greater difficulty collecting from customers, fires sale of assets, losses by creditors as firm defaults on what owes them

✓✓✓✓ 2) fewer foregone future positive NPV projects

✓✓ => stockholders less likely to have net loss if they provide funding

✓✓ => less of benefits shared with bondholders

Scale:

10=50
9=48
6=43
4=38
3=34

2=32
1=30
0+=20