

**Finance 5360 Quiz A: 7/28/15**

Name \_\_\_\_\_

Assume that Amorgy Inc. has a 30% chance of earning an EBIT of \$100 million per year, a 45% chance of earning an EBIT of \$175 million per year, a 20% chance of earning an EBIT of \$225 million per year, and a 5% chance of earning an EBIT of \$300 million per year. Assume also that Amorgy's current interest expense equals \$200 million. Amorgy is considering issuing additional \$100 million of permanent debt at a 10% interest rate and using the proceeds to repurchase common stock.

- a. How does the value of Amorgy change if markets are perfect? Note: Answer is a number.
- b. How does the value of Amorgy change if the only market imperfection is corporate taxes and the corporate tax rate equals 35%? Note: Answer is a number.
- c. How does the value of Amorgy change if the only market imperfections are corporate and personal taxes? Assume the corporate tax rate equals 35%, the personal tax rate on equity income equals 15%, and the personal tax rate on interest income equals 25%. Note: Answer is a number.
- d. How would your answer to "c" change if we also assume indirect financial distress costs exist? Note: All you need to do is indicate the direction of the change.
- e. How would your answer to "d" change if we also assume the presence of stockholder-manager conflict? Note: All you need to do is indicate the direction of the change.