

CFA® SAMPLE QUESTION - LEVEL I

Corporate Finance

Q: Perfect Machinery is investing \$400 million in new industrial equipment. The present value of the future after-tax cash flows resulting from the equipment is \$700 million.

Perfect Machinery currently has 200 million shares of common stock outstanding, with a relevant current market price of \$36 per share.

Assuming that this project is new information and is independent of other expectations about the company, what is the theoretical effect of the new equipment on Perfect's stock price? The stock price will?

CORRECT ANSWER:

b) increase to \$37.50

First of all, the NPV contribution of the new equipment to the company is $700 - 400 = \$300$ million.

Based on the assumptions given in the question, this NPV of the project will fully added to the Perfect Machinery's current market value.

Then on a per-share basis, the addition is worth $\$300 \text{ million} / 200 \text{ million} = \1.50 per share.

So the updated theoretical share price should be $36 + 1.5 = \$37.50$ per share



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