Chapter Nine Exercises

1. On April 30, 1985, Atlantic Richfield (Arco), the nation's sixth largest oil company, unveiled a massive restructuring plan "designed to confront what it sees as weakening oil markets:" The company announced that it would: repurchase $4 billion of its stock; increase its dividend by a third; sell all of its refining and marketing operations east of the Mississippi; and reduce its investment spending to about $2.8 billion annually, down from a previously budgeted $3.6 billion. The day this program was announced, Arco was the most actively traded stock on the New York Stock Exchange, and its price jumped from $53.00 to $58.25. How could the stock price rise so much, when Arco seemed to be in so much trouble?

2. Explain why you agree or disagree with the following comment: "A fast-growing company that can generate the bulk of the funds it needs internally is of course far more desirable than one that must rely heavily on outside borrowing or on the sale of stock, which would dilute the present shareholders' equity."

3. Explain the flaw in this argument:

    > Here's a sneaky one: A number of major corporations in recent years have announced programs for buying their own stocks, especially at times when the prices of those stocks were depressed. . . . Now, on the surface, an investor might think that this is a splendid confirmation of his own fine judgment; after all, if the corporation itself is buying its stock, it must augur great things to come, right? Well, maybe, but don't count on it. It could be a device to increase earnings per share. When those shares come into the company's treasury, there are that many fewer shares outstanding—so the same amount of earnings will produce higher earnings per share.

4. "I bought XXX stock because it is the largest advertising agency in the world and its stock was selling for only $2 a share." Give two distinct and quite different reasons why the intrinsic value of shares of the largest advertising agency in the world could be only $2 a share, when the intrinsic values of shares of smaller advertising agencies are more than $20 a share.

5. In 1992 *The Wall Street Journal* reported that many corporations were repurchasing their shares, and noted that one money manager "cautions against buying the stocks of companies that are borrowing money to finance share repurchases." Do shareholders always lose when companies borrow money and repurchase their shares?