15.514 Quiz

1. Marketable Securities

The following information relates to the investment securities held by Trimex Corporation. The abbreviations used in the chart are HTM (Held to Maturity Securities), TR (Trading Securities), and AFS (Available for Sale Securities).

					Market Value as of 12/31		
Security	Acquisition Date	Acquisition Cost	Date Sold	Selling Price	2001	2002	2003
A (HTM)	3/13/01	$35,000	-	-	$38,000	$30,000	$33,000
B (TR)	6/24/01	65,000	5/27/03	$70,000	60,000	67,000	-
C (AFS)	10/3/01	100,000	6/30/03	105,000	102,000	98,000	-

Trimex closes its books on December 31 each year. Assume a tax rate of 40%.

Required:
What is the effect on net income, other equity, and deferred taxes at the end of each year for the three securities?

2. Long-term Liabilities

MITCO issued $40 million of bonds with an annual coupon rate of 5% many years ago at par. The bonds now have 20 years until scheduled maturity. Because market interest rates have risen to 9%, the market value of the bonds has dropped to 63% of par. MITCO has $5 million of other debt and $35 million of shareholders' equity in addition to the $40 million of long-term debt in its financial structure. The reported income of MITCO for the year is expected to be $10 million in the absence of any other actions. The CFO of MITCO proposes the company issue at par new 9% bonds to mature in 20 years and use the proceeds to retire the outstanding bond issue. Assume that such action is taken and that any gain on bond retirement is taxable immediately, at the rate of 40%.

Required:

a) Show the effects using the Balance Sheet Equation for the issue of new bonds and the retirement of the old bonds. Ignore income taxes related to the retirement of the bond when calculating the value of the new bonds. That is, the amount of new bonds issued should be equal to the market value of the bonds repurchased.
b) What is the effect on income for the year? Give both dollar and percentage amounts.
c) What is MITCO’s debt-equity ratio before and after the transaction?

3. Leases

Excerpts from Duane Reade's Notes to Financial Statements:

10. Capital Lease Obligations

As of December 29, 2001, the present value of capital lease obligations was $1.0 million. Such obligations are payable in monthly installments and bear interest at an average rate of 10.8%. At December 29, 2001, the aggregate maturities of capitalized lease obligations are as follows (in thousands):

2002	$ 820
2003	176
	$ 996

15. Commitments and Contingencies

Leases: Duane Reade leases all of its store facilities under operating lease agreements expiring on various dates through the year 2024. In addition to minimum rentals, certain leases provide for annual increases based upon real estate tax increases, maintenance cost increases and inflation.

Rent expense, including deferred rent, real estate taxes and other rent-related costs and income for the fiscal years ended December 29, 2001, December 30, 2000 and December 25, 1999 was $84,044,000, $69,685,000 and $59,535,000, respectively.

Minimum annual cash rent obligations under non-cancelable operating leases at December 29, 2001 (including obligations under new store leases entered into but not opened as of December 29, 2001) are as follows (in thousands):

2002	$ 85,882	
2003	88,524	
2004	86,302	
2005	86,000	
2006	82,954	
2007 to 2024	602,960	(PV: $218,684)
Total	$1,032,622	

To simplify your calculation, the present value of the lease obligation from 2007 to 2024 as of 12/29/2001 is given as $218,684.

Required:

By how much will long-term liabilities increase if Duane Reade were to begin reporting the operating leases as capital leases? (Use an interest rate of 10.8%)