School of Media Studies

THE NEW SCHOOL August, 2014 [[1]](http://www.charleswarner.us/CharlieMagazineCse.htm#_ftn1)

**CHARLIE’S NEWS WEBSITE**

Evaluating Investment Opportunities

Charlie has just inherited some money.  He will receive $2 million net after taxes today and $3 million net after taxes one year from today.  Charlie does not have any other assets. For the purpose of this case, you are to assume that all future cash flows are known with certainty (no risk whatsoever) and he can borrow money for certain at an interest rate of 5%.

Charlie is also a smart but conservative investor, so he can get a return of 5.5% on his investments for certain, no risk.

1. What is Charlie’s current wealth today? (Hint: Do a Present Value calculation on his future payment, assuming a 5.5% return on his investment, but not on the $2 million he receives today.)
2. If he wanted to, how much could he spend today?  (Hint: Assume he can borrow $3 million at 5%.)
3. How much money can he spend one year from today if he spends nothing today and invests all of his $2 million inheritance? (Hint: Assume he can invest at 5.5%.)

Charlie has always wanted to start a news website similar to BuzzFeed, He decides to invest some of his inheritance in Charlie’s News Website*,* which he will design, create, edit and manage.  The data below indicates the future cash flows at the end of the year for Charlie’s News Website.

|  |  |
| --- | --- |
| **Current Investment** | **Future Cash Flow (Year End)** |
| $1.0 million | $1.8 million |
|  2.0 million |  3.3 million |
|  3.0 million |  4.4 million |
|  4.0 million |  5.4 million |

1. What is the optimal amount that Charlie should invest in his website? (Hint: Calculate Profit Margins for each level of investment by stating the $ profit and then dividing the Future Cash Flow amount by the Current Investment amount, i.e. $800,000 divided by $1,000,000 is an 80% Profit Margin, or an 80% return on a $1 million investment. $2,000,000 divided by $1,300,000 is a 65% Profit Margin. Then calculate a total percentage point increase for each investment level over a higher investment level. And, finally, calculate a percentage profit level increase for each investment level over a higher investment level by dividing the percentage point increase into the next higher investment level’s profit margin, i.e. a 15 percentage point increase from a 65% to an 80% profit margin is a 23% increase.

Look for ***diminishing marginal returns*** in the four levels of investment and decide which investment level is optimal.

Charlie forms a C Corporation and issues 200,000 shares of stock when he starts the Charlie’s News Website. The website has an imputed value of $5 million, and Charlie owns 80% of the stock.

1. Suppose that Charlie has a strong preference for spending his two-phased-$5- million inheritance now, and would like to spend $3.8 million immediately (he has his eye on a yacht)?

a.  Can he buy the yacht in light of the planned optimal investment in Charlie’s News Website?

b.  If so, what is his best borrowing strategy?

1. After buying the yacht, what is Charlie worth? (Hint: Charlie’s current cash, plus proceeds from the $3 million loan, minus yacht payment, plus Present Value of the yacht, plus the value of Charlie’s stock.)

See Charlie’s News Website Spreadsheet Example in the Papers by CW section of my website as it contains the formulas needed, although some of the numbers have been changed. It also has an explanation of Diminishing Marginal Utility. Use this example spreadsheet as a template and insert the proper numbers in this case.

     [1] This case was adapted by Charles Warner from the Harvard Business School case, “Ginney’s Restaurant,” written by Mark Mitchell.