

Quiz 1: Corporate Finance

Answer all questions and show necessary work. Please be brief. This is an open books, open notes exam.

1. Corporate Governance/Risk Basics section.
Each of the following multiple-choice questions is worth ½ point. Please pick only one answer for each question.
 - a. If you were an activist investor, which of the following companies would be your best target?
 - i. Well managed companies where managers hold little or no equity
 - ii. Badly managed companies where managers hold little or no equity
 - iii. Well managed companies where managers have large equity holdings
 - iv. Badly managed companies where managers have large equity holdings
 - b. If you accept the proposition that the objective in corporate finance is maximizing firm value, which of the following actions is inconsistent with that objective?
 - i. Taking an investment that generates a return that exceed the hurdle rate for that investment
 - ii. Taking advantage of loopholes in loan agreements to increase earnings
 - iii. Borrowing money to reduce your hurdle rate.
 - iv. Using excess cash to pay dividends.
 - v. Giving equity options to managers as part of compensation.
 - c. An efficient market is one where the stock price is a good measure of value. Which of the following is conclusive evidence against market efficiency?
 - i. High growth companies trade at much higher multiples of earnings than low growth companies
 - ii. High risk companies trade at lower multiples of earnings than low risk companies
 - iii. Stock prices are volatile and change a lot from moment to moment.
 - iv. Stock prices react to earnings reports and corporate announcements
 - v. None of the above
 - vi. All of (i) through (iv)
 - d. If you have a market with poor corporate governance, i.e., managers of publicly traded companies are not accountable to stockholders, all companies in that market will be badly managed.
 - i. True
 - ii. False

2. Warsaw Bikes Inc. is a publicly traded Polish company that manufactures and sells bikes in Germany, Hungary and Poland.

<i>Country</i>	<i>Currency</i>	<i>Govt Bond Rate (in local currency)</i>	<i>Govt Bond Rate (in Euros)</i>	<i>Passenger Revenues (in millions)</i>
Poland	Zloty	6.00%	2.25%	PLN 500.00
Hungary	Forint	5.00%	2.50%	PLN 250.00
Germany	Euros	1.00%	1.00%	PLN 250.00

- a. If you assume that the local currency sovereign bond ratings for each of the countries matches their foreign currency ratings, estimate the risk free rate for Warsaw Bikes, in Zlotys. (1 point)

- b. If equity markets in each of these countries is 1.5 times more volatile than the local currency government bonds, estimate the equity risk premium for Warsaw Bikes. (You can assume that Germany is Aaa rated & a mature market and that the mature market equity risk premium is 6%) (2 points)

3. Concord Hotels is a publicly traded hospitality company, owning hotels in the United States and Canada. It has 80 million shares trading at \$25/share and \$500 million in debt outstanding (book and market terms). The unlevered beta of being in the hotel business is 0.80.
 - a. Estimate the levered beta for Concord Hotels. (You can assume that Concord has a negligible cash balance and that the marginal tax rate is 40% for all companies). (2 points)

- b. The company is considering selling its Canadian hotels (which comprise about 40% of the overall value of the firm today) and using the proceeds to do the following: 50% of the proceeds will be used to buy a fast-food restaurant chain, 25% will be used to pay a special dividend and 25% will be held to pay down debt. Estimate the levered beta after the transaction if the unlevered beta of the restaurant business is 1.20. (3 points)