Spring 2015 Name:

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 have large equity holdings
      ii. Badly managed companies where managers have large equity holdings
      iii. Well managed companies where managers hold little or no equity
      iv. Badly managed companies where managers hold little or no equity

   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. Borrowing money to reduce your hurdle rate.
      iii. Using excess cash to pay dividends.
      iv. Taking advantage of loopholes in loan agreements to increase earnings
      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. All of the above
      vi. None of the above

   d. If you have a market with good corporate governance, i.e., stockholders have power over managers and keep them accountable, all companies in that market will be well managed.
      i. True
      ii. False

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

Country	*Currency*	*Govt Bond Rate (in local currency)*	*Govt Bond Rate (in Euros)*	*Passenger Revenues (in millions of HUF)*
Poland	Zloty	6.00%	2.25%	HUF 250.00
Hungary	Forint	5.00%	2.50%	HUF 500.00
Germany	Euros	1.00%	1.00%	HUF 250.00

a. If you assume that the <u>local currency sovereign bond ratings for each of the countries matches their foreign currency ratings</u>, estimate the risk free rate for Bevin Bikes, in Forint. (1 point)

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

3. Riverfront Hotels is a publicly traded hospitality company, owning hotels in the United States and Canada. It has 60 million shares trading at $30/share and $600 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 Riverfront Hotels. (You can assume that Riverfront has a negligible cash balance and that the marginal tax rate is 40% for all companies). (1 point)

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. (4 points)