Spring 2019 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. In much of Asia and Latin America, companies that are parts of family groups comprise a large percentage of publicly traded companies. From a corporate governance standpoint, which of the following would concern you the most at these companies?
      i. They will not borrow enough money to fund operations
      ii. They will be too aggressive, in seeking out growth and investments.
      iii. They will pay out too much in dividends.
      iv. They will make decisions that are in the best interests of the company, rather than in the best interests of the family group.
      v. They will make decisions that are in the best interests of the family group, rather than in the best interests of the company

   b. There is a heated debate about whether companies should be banned from buying back their own stock. Assuming that you want to restrict buybacks, which of the following groups of companies would you target for the ban?
      i. Under levered (too little debt) firms, with few good investment opportunities.
      ii. Over levered (too much debt) firms, with few good investment opportunities.
      iii. Under levered (too little debt) firms, with many good investment opportunities.
      iv. Over levered (too much debt) firms, with many good investment opportunities.

   c. In an efficient market, **assume that a firm that is perceived to have great growth opportunities announces that it will start paying dividends for the first time.** What effect will this announcement have on stock prices?
      i. To fall
      ii. To rise
      iii. To stay unchanged.

   d. If you are a diversified investor in Facebook, which of the **following types of risk would you include in your discount rate**?
      i. The risk that new privacy laws will restrict data gathering and access
      ii. The risk that users will find a different social media platform to spend their time on.
      iii. The risk that Mark Zuckerberg will stay on as CEO
      iv. The risk that Mark Zuckerberg will leave as CEO
      v. The risk that a global economic slowdown will affect how much companies spend on advertising

2. Calima Inc. is a US-based consumer product company that is considering expanding into Southeast Asia, expecting to get 60% of its revenues in Indonesia and 40% in Vietnam. You have collected the following information on the two countries:

| | 10-year Govt Bond Rate (in local currency) | Sovereign CDS Spread | σ (Equity)/ σ (Govt Bond) |
|---|---|---|---|
| Indonesia | 6.50% (Rupiah) | 2.50% | 1.5 |
| Vietnam | 8.50% (Dong) | 4.50% | 1.2 |

The US treasury bond rate is 3%, the US equity risk premium is 6% and Calima has a beta of 1.20. Estimate the **cost of equity in US dollars** that Calima should **use for its Southeast Asian expansion**. (3 points)

3. You are trying to estimate the levered beta for Navia Streaming, a niche movie streaming business that focuses on just animated and children's movies. It has increasingly expanded its content arm, making original content for its streaming subscribers, and its current business mix with estimated values in millions is listed below:

| | Estimated Value (in $ millions) | Unlevered Beta |
|---|---|---|
| Movies (Content) | 400 | 1.2 |
| Streaming (Subscription) | 1200 | 0.8 |

The company is trading at its fair value, has no cash and $600 million in debt outstanding. The marginal tax rate is 25%.

a. Estimate the levered beta for the company. (2 points)

b. Now assume that Navia Streaming acquires an animated movie company to augment its content business. If the acquisition was at fair value, and was funded by issuing $200 million in new shares and $300 million in new debt, estimate the new levered beta for Navia Streaming, after the acquisition. (You can assume that the animated movie company is in the content business.)