Spring 2016 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. (1/2 point each. So, don't take forever to pick)*
   *a.* Assume that you are looking at ways in which you can make managers at publicly traded companies more accountable to stockholders. Which of the following actions, related to voting at annual meetings, is most likely to accomplish this objective?
      *i.* Don't count proxy votes that don't get returned.
      *ii.* Count all proxy votes that don't get returned as votes for management.
      *iii.* Count all proxy votes that don't get returned as votes against management.
      *iv.* Allow only those who have held shares for more than a year in the company to vote at meetings.
      *v.* Allow only institutional investors to vote at annual meetings.

   *b.* Lenders often have different interests and incentives than stockholders in a firm. This often plays out when companies pay dividends or buy back stock. If you are a lender to a firm, which of the following dividend policies would you be most likely to support?
      *i.* Pay all earnings as dividends.
      *ii.* Pay out whatever is left over as a cash flow, if any, after reinvestment and taxes.
      *iii.* Pay 60% whatever is left over as a cash flow, if any, with the remaining 40% held in cash by the company.
      *iv.* Pay 60% of earnings as dividends.
      *v.* Pay a fixed dollar dividend, irrespective of earnings.

   *c.* In an efficient market, it is impossible for a company's stock price to go up or down by more than 50% in a day.
      *i.* True
      *ii.* False

   *d.* Conglomerates that are in many businesses, are more diversified and should therefore have lower betas than companies that are in a single business.
      i. True
      ii. False

2. Pavel Corporation is a Czech-based multinational with operations in three markets. The table below lists the Government bond rate for local currency bonds in each of these markets, the sovereign ratings and CDS spreads of each country and the revenues that Pavel expects to generate in each market.

| *Country* | *Revenues in Millions of Koruna* | *Local Currency* | *Government Bond Rate in local currency* | *Sovereign Rating* | *Sovereign CDS Spread* |
|---|---|---|---|---|---|
| Russia | 800 | Rubles | 12.00% | Ba1 | 2.50% |
| Germany | 200 | Euro | 1.50% | Aaa | 0.00% |
| Czech Rep | 1000 | Koruna | 1.25% | A1 | 0.50% |

a. Estimate the equity risk premium for the company, assuming that equity in non-Aaa rated markets is 1.5 times more risky than the government bond in these markets, and that mature markets (Aaa rated) have an equity risk premium of 6%. (2 points)

b. Estimate the cost of equity for the company in Czech Koruna, assuming that it has a beta of 1.20. (2 points)

3. Google is considering an acquisition of Netflix to super charge its movement into the entertainment and you have been given the following information on the two companies:

| | *Google* | *Netflix* |
|---|---|---|
| Market Cap (in billions) | $360 | $80 |
| Debt (in billions) | $ 0 | $10 |
| Levered Beta | 0.90 | 1.36 |

Both firms face a marginal tax rate of 40%.

a. Estimate the unlevered beta for Google after the acquisition. (2 points)

b. Assume that Google will borrow \$130 billion to buy out Netflix shareholders, assume Netflix's debt and use the rest to buy back stock, estimate the beta for Google after the acquisition. (2 points)