

Session 23a: Post Class tests

1. We have argued that the right debt for a company is one where the debt payments are linked to operating performance, rising when operating cash flows are high and falling when they are low. Which of the following is a benefit of matching debt cash flows to asset cash flows?
 - a. Reduced default risk, for any given level of debt
 - b. Lower interest rates on debt, for any given level of debt
 - c. Increased debt capacity
 - d. Lower cost of capital, for any given level of debt
 - e. All of the above
2. Assume that you are advising a Mexican company that derives all of its revenues in the US, has long-term projects and no pricing power. What is the right type of debt for the company?
 - a. Long term, fixed rate US \$ debt
 - b. Long term, floating rate US \$ debt
 - c. Short term, floating rate US\$ debt
 - d. Short term, fixed rate Mexican Peso debt
 - e. Long term, fixed rate Mexican Peso debt
 - f. Long term, floating rate Mexican Peso debt
 - g. None of the above
3. Banks are among the biggest issuers of preferred stock in the United States. Which of the following is the best explanation for why?
 - a. Preferred stock is counted as part of regulatory capital
 - b. Preferred stock is cheaper than common equity
 - c. Preferred stock is cheaper than debt
 - d. Preferred stock generates tax advantages
 - e. All of the above
 - f. None of the above
4. You have run a regression of firm value against the change in long term interest rates, for Robela Inc, and obtained the following output:
Change in firm value = $0.035 - 6$ (Change in interest rates)
Assume that Robela has \$5 billion in zero coupons outstanding currently, with a maturity of 5 years and is planning on raising \$10 billion from a new zero coupon bond issue. What should the maturity of the new issue be, for the duration of the debt to be matched up with the duration of the assets, after the new issue?
 - a. 5 years
 - b. 5.67 years
 - c. 6 years
 - d. 6.5 years
 - e. 7 years
5. Now assume that Robela is planning on entering the social media business and that the typical duration in this business is only 2 years. If Robela's existing value, as a business, is \$15 billion and it planning to invest the \$10 billion from the new bond issue into the social media business, what should the maturity of the new

issue be, for the duration of the debt to be matched up with the duration of the assets, after the expansion?

- a. 2 years
- b. 4 years
- c. 4.1 years
- d. 4.4 years
- e. 6 years
- f. None of the above