Spring 2020 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. For corporate governance to work, you need an <u>effective board of directors</u>. Which of the following would you look for as <u>the best indication of an effective board</u>?
      i. A board of directors with <u>no conflicts of interest</u> with management
      ii. A board of directors that has <u>overridden management (and the CEO) on key decision</u>s.
      iii. A board of <u>long-tenured</u> directors
      iv. A board of directors with <u>expertise in the business</u> of the company
      v. A board of directors with <u>diverse backgrounds and interests</u>.

   b. One proposal that has been floated to make companies behave in a more long-term way is to restrict voting at annual meetings only to shareholders who have held shares for more than a year. What effect do you think this restriction will have on shareholder and managerial power?
      i. It will have no effect on the power of either shareholders or managers.
      ii. It will increase shareholder power and decrease managerial power
      iii. It will decrease shareholder power and increase managerial power

   c. Assume that you believe that markets are efficient. In efficient markets, which of the following would you expect to observe?
      i. Investors in well managed (good) companies should expect to earn higher returns than investors in badly managed firms, after adjusting for risk.
      ii. Investors in badly managed (bad) companies should expect to earn higher returns than investors in well managed firms, after adjusting for risk.
      iii. Investors in both well managed and badly managed firms should expect to earn the same returns, after adjusting for risk.

   d. A portfolio of 50 small cap, volatile stocks will always have a <u>higher standard deviation</u> than a portfolio of 50 large cap, more stable stocks.
      i. True
      ii. False

2. Zona Hotels is a Latin American hotel company that derives 75% of its revenues in Chile and 25% in Peru and you have collected the following information on the countries:

	US $ 10-year bond rate	Local Currency 10-year bond rate
Chile	2.50%	4.50%
Peru	5.50%	7.50%

If the risk free rate in US dollars is 1.50% and the equity risk premium in the US (a mature market) is 5%, estimate the cost of equity for Zona **in Chilean pesos**. (The beta for Zona is 1.20 and equity is 1.30 times more volatile than the government bonds in emerging markets). (3 points)

3. You have run a regression for Sylvan Steel, using stock price data from the last 2 years and arrived at the following:
   $\text{Return}_{\text{Ronan}} = 0.25\% + 0.92 \text{ Returns}_{\text{S\&P 500}}$
   During the two years (used in the regression), Sylvan Steel had an average debt to equity ratio of 20% and faced a marginal tax rate of 25%. While the marginal tax rate is still 25%, Sylvan Steel currently has a market capitalization of $800 million and total debt outstanding of $1,200 million. Starting with the regression beta, estimate the correct beta for the firm, given its changed financial leverage.
   (2 points)

4. Kalish Autos is an automobile company in two businesses, automobiles and energy, and you have been given the breakdown of the two businesses below:

	Revenues ($ millions)	EV/Sales	Unlevered Beta
Autos	$ 6,000.00	1.00	0.9
Energy	$ 4,000.00	3.00	0.6

If Kalish has $3,000 million in debt outstanding, estimate the levered beta for the company. (The marginal tax rate is 25%) (3 points)