

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. Allow only institutional investors to vote at annual meetings.
 - ii. Allow only those who have held shares for more than a year in the company to vote at meetings.
 - iii. Count all proxy votes that don't get returned as votes against management.
 - iv. Count all proxy votes that don't get returned as votes for management.
 - v. Don't count proxy votes that don't get returned.

- 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% of earnings as dividends.
 - iv. Pay 60% whatever is left over as a cash flow, if any, with the remaining 40% held in cash by the company.
 - v. Pay a fixed dollar dividend, irrespective of earnings.

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

- d. A young, biotechnology firm is exposed to significant risk, because its drugs have to make it through the FDA approval process. It should therefore have a high beta (in the capital asset pricing model).
 - i. True
 - ii. False

2. Gromyko Corporation is a Russia-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 Gromyko expects to generate in each market.

<i>Country</i>	<i>Revenues in Millions of Rubles</i>	<i>Local Currency</i>	<i>Government Bond Rate in local currency</i>	<i>Sovereign Rating</i>	<i>Sovereign CDS Spread</i>
Russia	800	Rubles	12.00%	Ba1	2.50%
Germany	700	Euro	1.50%	Aaa	0.00%
Czech Rep	500	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 Russian Rubles, assuming that it has a beta of 1.20. (2 points)

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

	<i>Google</i>	<i>Tesla</i>
Market Cap (in billions)	\$360	\$30
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 \$70 billion to buy out Tesla shareholders, assume Tesla's debt and use the rest to buy back stock, estimate the beta for Google after the acquisition. (2 points)