Instructions:
1) The part of the exam is closed book and closed notes. No scrap paper is allowed; use the back of the exam if necessary.
2) Partial points are based on readily observable evidence that you know at least part of the solution concept. The more evidence presented (and the clearer the evidence), the better the chance for partial points. In other words, SHOW ALL WORK!
3) True/False questions are worth 3 points. Multiple choice questions are worth 5 points. Short answer questions usually take less than three sentences and are worth 6 points.

1. In an operating lease, to qualify for an unqualified audit report, a firm must list the leased item as an asset and the present value of the costs of the leased item as a liability.
   a. True   b. False

2. The riskiness of the cash flows to the lessee, with the possible exception of residual value, is about the same as the riskiness of the lessee’s long-term debt.
   a. True   b. False

3. The owner of a bond with warrants bond owns, in effect, both a bond and a call option.
   a. True   b. False

4. Which of the following statements about warrants and convertibles is false?
   a. Both warrants and convertibles are types of option securities.
   b. One primary difference between warrants and convertibles is that warrants bring in additional funds when exercised, while convertibles do not.
   c. The value of a warrant depends on its exercise price, its term, and the underlying stock price.
   d. Warrants usually can be detached and traded separately from their associated debt.
   e. Investors are willing to accept lower interest rates on convertibles because they are less risky than straight debt.

5. Which of the following statements concerning preferred stock is most correct?
   a. From the issuer’s point of view, preferred stock is less risky than bonds.
   b. Preferred stock, because of the current tax treatment of dividends, is bought mostly by individuals in high tax brackets.
   c. Unlike bonds, preferred stock cannot have a convertible feature.
   d. Preferred stock generally has a higher component cost to the firm than does common stock.
   e. By law in most states, all preferred stock issues must be cumulative, meaning that the cumulative, compounded total of all unpaid preferred dividends must be paid before dividends can be paid on the firm’s common stock.

6. As discussed in the text, list three common differences between operating leases and financial leases?
7. As discussed in the textbook, list four reasons that would cause companies to go from domestic to multinational corporations (i.e., go global)?

8. When the value of the U.S. dollar depreciates against another country’s currency, we may purchase more of the foreign currency per dollar.
   a. True   b. False

9. If the United States were running a surplus trade balance with Great Britain, we would expect the value of the British pound to depreciate against the U.S. dollar.
   a. True   b. False

10. The problem of dilution never arises with call options, but it can arise with warrants.
    a. True   b. False

11. Suppose that 288 yen could be purchased in the foreign exchange market for two U.S. dollars today. If the yen is expected to depreciate by 8 percent tomorrow, it would take more than 288 yen to buy two U.S. dollars buy tomorrow.
    a. True   b. False

12. Issuing convertible bonds increases the chance of firm bankruptcy, while issuing preferred stock does not increase the chance of bankruptcy.
    a. True   b. False

13 (4 points) Why is your answer to number 12 correct?
1. BlackRock Corporation is considering a leasing arrangement to finance some special manufacturing tools that it needs for production during the next four years. A planned change in the firm’s production technology will make the tools obsolete after 4 years. The firm will depreciate the cost of the tools using the MACRS 3 year schedule. The firm can borrow $5,700,000, the purchase price, at 12 percent on an amortized loan to buy the tools, or it can make three equal beginning-of-year lease payments of $2,800,000. The firm's tax rate is 40 percent. Annual maintenance costs associated with ownership are estimated at $180,000. Should the firm lease or buy the piece of equipment (1 point)? Numerical evidence that your answer is correct (12 points)
2. (8 points) Charles River Company has just sold a bond issue with 20 warrants attached. The bonds have a 20-year maturity, an annual coupon rate of 7.1 percent, and they sold at their $1,000 par value. The current yield on similar straight bonds is 8.5 percent. What is the implied value of each warrant?

3. (6 points) Georgia Enterprises is considering issuing a 20-year convertible bond that will be priced at its $1,000 par value. The bonds have a 6.5 percent annual coupon rate, and each bond can be converted into 25 shares of common stock. The stock currently sells at $30 a share, has an expected dividend in the coming year of $4, and has an expected constant growth rate of 6.0 percent. What is the estimated floor price of the convertible at the end of Year 6 if the required rate of return on a similar straight-debt issue is 8.0 percent?
4. (10 points)

<table>
<thead>
<tr>
<th>Current Balance Sheet</th>
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<tbody>
<tr>
<td>Current Assets 3000</td>
</tr>
<tr>
<td>Long Term Assets 9000</td>
</tr>
<tr>
<td>Total Assets 12000</td>
</tr>
<tr>
<td>Current Liabilities 6300</td>
</tr>
<tr>
<td>Long Term Liabilities 4000</td>
</tr>
<tr>
<td>Total Liabilities and Owners Equity 12000</td>
</tr>
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The above is your firm's current balance sheet. You need to pay off 40000 in short term loans and to increase your working capital by 3000. You are considering the following three financing alternatives.

a. Sell common stock at $30 per share.
b. Sell convertible bonds at a 6% coupon rate, convertible into 25 shares.
c. Sell debentures with a 7% coupon rate with 30 warrants to buy common stock at $50.

Show the balance sheet for alternatives A-C. For alternatives B and C, show the balance sheet after the bond conversion or warrant exercise. In other words, you need to show a total of 5 balances sheets.
5. (3 points) 90-day investments in Britain have an 8 percent annualized return. In the U.S., 90-day investments of similar risk have a 4 percent annualized return. In the 90-day forward market, 1 British pound equals $1.60. If interest rate parity holds, what is the spot exchange rate?

\[
\$1 = \text{________________________ Pounds}
\]

6. (3 points) If one Malawi Kwacha buys 1 234.56 Cypriot Pounds, how many Kwacha’s are needed to buy one Cypriot Pound?

7. (3 points) Suppose exchange rates between Ugandan Shilling’s and Swiss francs is SF 1 = 3264 Ugandan Shilling and the exchange rate between the U.S. dollar and the Swiss Francs is German mark is \$1.00 = 1.58 SF. What is the cross-rate of U.S Dollars to Ugandan Shillings?

8. (5 points) You have $1000 in a Savings account. You observe that the spot rate is 8.2 Mexican Pesos to $1 and that this rate will be stable for the next three months. Assume there are no transportation costs, restrictions on CD imports or exports. You have observed that the new Princess Superstar CD can easily be bought or sold in Atlanta for $11 and you also are certain that these same CDs can easily be bought or sold for 90 Pesos in Cancun. You are going to Cancun next week. Explain in detail how you can make a profit on importing/exporting CDs. What is the total profit, in dollars, that will you make?