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 4 points. Short answer questions usually take less than three sentences and are worth 5 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 weighted average cost of capital (WACC).
   a. True  b. False

3. The Internal Revenue Service has established guidelines to distinguish true leases from installment sales agreements and secured loans
   a. True  b. False

4. If certain guidelines are met, the lessee can deduct for tax purposes the full amount of each lease payment, and the lessor is entitled to the tax deductions and tax credits of asset ownership. These guidelines include which of the following?
   a. The lessor can grant the lessee a purchase option.
   b. The term of the lease cannot exceed 80% of the useful life of the asset.
   c. The lessor must hold title to the property, and it must demonstrate that it expects to earn a pretax profit from the lease transaction horizontal that is, profit apart from any tax deductions and tax credits it will realize.
   d. all of the above.
   e. none of the above.

5. As discussed in the text, list three good reasons why a company might lease an asset rather than buying it?

6. For a given company, the primary difference between a mortgage bond and a debenture is that debentures are more likely to be secured debt.
   a. True  b. False

7. When the value of the another country's currency appreciates against the United States dollar, we can purchase more of the foreign currency per dollar.
   a. True  b. False

8. If the United States were running a surplus trade deficit with Europe, we would expect the value of the Euro to depreciate against the U.S. dollar.
   a. True  b. False
9. Suppose that 110 yen could be purchased in the foreign exchange market for $1 U.S. dollar today. If the yen were expected to depreciate by 8 percent tomorrow, it would take more than 110 yen to buy $1 U.S. tomorrow.
   a. True   b. False

10. An American depository receipt, or ADR, is a receipt that represents ownership of shares of a foreign corporation’s ____________.
   A) common stock   B) preferred stock
   C) bonds.   D) convertible debt
   E) any of the above may be an ADR.

11. What does the international Fisher effect say?

12. What is a forward contract?

13. Interest rate parity states a relationship between the interest rates and the inflation rates for two countries.
   a. True   b. False

14. The objective of the managers of a multinational corporation is to maximize international profits.
   a. True   b. False

15. For a given company issuing 15 year bonds with semiannual coupons at par, the yield to maturity on callable bonds will probably be lower than the coupon rate on a bond with a sinking fund.
   a. True   b. False
Exam 2    Spring 2004   FINC 4532  Your Name ______________________________

YOU HAVE 100 MINUTES TO COMPLETE BOTH PARTS OF THIS EXAM

Instructions:
1) The part of the exam is open book and open notes.
2) Point values are listed with the question.
3) Look over the entire exam before starting. The best strategy is generally to “cherry pick”. In other words, solve the easiest (and/or most familiar) problems first. This will save time (and energy) that can be expended on the more difficult problems.
4) 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!
5) If you have additional time remaining, give your work one last check.

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 $5,600, which is 100% of the purchase price, at 10 percent on an amortized loan to buy the tools, or it can make four equal end-of-year lease payments of $1,760. The firm’s tax rate is 40 percent. Whether the firm leases or buys, it is responsible for the annual maintenance costs associated estimated at $230. The salvage value of the machine at the end of 4 years is 200. The firm’s pre-tax cost of debt is 10%, weighted average cost of capital 9.2%, and the levered cost of equity is 13%. Should the firm lease or buy the piece of equipment (1 point)? Numerical evidence that your answer is correct (14 points)
2. For a conventional project, the NPV is -$1. Leasing generates the following after-tax cash flows: cost of the new equipment at time 0 is $61. The after-tax cash flows associated with the lease are $10, and the after-tax residual value (RV) of the equipment at t = 10 is $10. The after tax cost of secured debt is 11%. The WACC is 14%.

a. (5 points) What is the NAL?

b. (3 points) Should we accept this project? Why?

3. (3 points) A 15-year 8% debenture, with semiannual coupons, costs $1,132.. What is its yield to maturity?

4. (4 points) A firm needs to raise $20,000,000. They plan to sell 20-year, 4% mortgage bonds, with semiannual payments that will yield 9%. How many bonds must they sell?

3. (2 points) In the spot market, 1 British pound equals $1.65. In the 180-day forward market, 1 British pound equals $1.61. T-Bill interest rates in Britain are 7% APR. Assume interest rate parity holds. Interest rates in the Unites States are ___________%.

(2 points) Inflation rates in the United States are _______% higher / lower (circle 1, e.g. 6% higher) than interest rates in Britain

4. (3 points) Given an exchange rate of $1.7 per one British pound, what will an item worth pound 15,000 cost in United States dollars?

5. (3 points) One Canadian dollar (C$) equals 1.2526 Swiss francs (SFrancs). How many SFrancs per C$1?
6. (3 points) Suppose exchange rates between Ugandan Shilling's and Swiss francs is SF 1 = 3104 Ugandan Schilling and the exchange rate between the U.S. dollar and the Swiss Francs is $1.00 = 1.98 SF. What is the cross-rate of U.S Dollars to Ugandan Shillings?

7. (6 points) You can borrow $100,000 for 1 week at no interest. Here in Atlanta you notice that the spot rate is 110 yen equals $1. You observe that the spot rate is 10.4 Mexican Pesos equals $1 in Cancun. You observe that the spot rate is 1 yen equals 12 Mexican pesos in Kyoto Japan. These rates will be stable for the next week. Assume there are no transportation costs, restrictions on currency exchange, and you had nothing better to do with your time. What is the total profit, in dollars, that can make, in one round trip (starting in Atlanta and ending in Atlanta)? Explain in detail how you would make this profit? (Note, by in detail your first sentence should be either I sell $100,000 dollars to buy _____ or I fly to _______ and sell $100,000 dollars to buy _______)