

**FIN201 Corporate Finance II Questions – Set IV**  
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**Question 1: I) If an equity owner have 200 shares, and the firm gives a 2 for1 stock split, then the equity owner will receive 400 new shares for a total of 600 shares.  
II) If a firm maintains its dividend rate, then stock splits will not result in dollar dividends changing.  
I&II are: A) FT B) FF C) TT D) TF**

**Information for Questions 2 to : Consider a firm that has physical assets that the market believes will produce a perpetual expected profits of \$25M a year of riskiness such that the discount rate is 12.5%. The firm also has \$100M liquid assets (convertible to cash at short notice), and 10M stock outstanding. The liquid assets are invested in securities that have the same ROE as the firm, pay out all profits as dividends, and there are no taxes.**

**Question 2: What would be the firm's stock price?**  
A) \$10  
B) \$20  
C) \$30  
D) \$40

**Question 3: What are the expected total earnings for the firm?**  
A) \$37.5M  
B) \$40 M  
C) \$42.5 M  
D) \$45 M

**Question 4: What is the P/E ratio for the firm?**  
A) 6  
B) 8  
C) 10  
D) 12

**Information for Questions 5 to Now suppose the firm purchases shares for \$60M by using cash obtained by selling its liquid assets. This repurchase announcement does not lead the market to change its beliefs about earnings from the physical assets of the firm. The firm pays market price for repurchased shares.**

**Question 5: How many shares will be firm be able to repurchase with the \$60M?**  
A) 1M  
B) 2M  
C) 3M  
D) 4M

**Question 6: What are the new (post-repurchase) expected total earnings for the firm?**

- A) \$22.5M
- B) \$25 M
- C) \$27.5M
- D) \$30M

**Question 7: What is the new (post-repurchase) P/E ratio for the firm?**

- A) 8
- B) 10
- C) 15
- D) 20

**Information for Questions 8 to : Now instead suppose the announcement of equity repurchase of total amount \$60M (using cash by selling liquid assets) causes the market to update its beliefs about expected perpetual earnings from the physical assets of the firm to \$37.5M a year but no change in riskiness of these earnings. The firm pays market price for repurchased shares.**

**Question 8: How many shares will the firm be able to repurchase with the \$60M?**

- A) 1M
- B) 1.5M
- C) 2M
- D) 2.5M

**Question 9: What are the new (post-repurchase) expected total earnings for the firm?**

- A) \$42.5M
- B) \$45 M
- C) \$47.5M
- D) \$50M

**Question 10: What is the new (post-repurchase) P/E ratio for the firm?**

- A) 8
- B) 10
- C) 15
- D) 20

**Question 11: I) Directors of a firm have a Fiduciary Duty to protect the interests of the employees.**

**II) There will be decreased conflict of interest if directors are also employees of the firm.**

**I&II are: A) FT B) FF C) TT D) TF**

**Question 12: I) A staggered Board of Directors is a good corporate governance practice.**

**II) Compensation of the Directors being linked to share price performance is a good corporate governance practice.**

**I&II are: A) FT B) FF C) TT D) TF**

**Question 13: I) Key committees formed by board members include Audit, Compensation, Nominating, and Corporate Governance.**

**II) The Corporate Governance Committee identifies individuals qualified to become Board members of the Board of Directors.**

**I&II are: A) FT B) FF C) TT D) TF**

**Question 14: I) For all firms, proposals sponsored by shareholders that pass at AGMs are binding on management.**

**II) For all firms, all classes of shares have equal voting rights.**

**I&II are: A) FT B) FF C) TT D) TF**

**Question 15: I) Takeover defenses may protect entrenched management indifferent to shareholders' welfare.**

**II) A "poison pill" is a form of takeover defense.**

**I&II are: A) FT B) FF C) TT D) TF**

**1) B**

**2) C**

**3) A Answer: Liquid assets of \$100M produce \$12.5 M in expected earnings.**

**4) B**

**5) B Answer: Price does not change from \$30 following repurchase announcement.**

**6) D Answer: \$25M from physical assets and \$5M from remaining liquid assets.**

**7) A**

**8) B Answer: The price will rise to \$40 a share due to the higher expected total earnings. This will mean the firm can repurchase only  $\$60M/\$40 = 1.5M$  shares.**

**9) A Answer: \$37.5M from physical assets, and \$5M from liquid assets.**

**10) A Answer: No change in riskiness of earnings means discount rate remains the same.**

**11) B**

**12) A**

**13) D**

**14) B**

**15) C**