Corporation finance analysis essay sample

1. The following are examples of disguised options for firms: I) acquiring growth opportunities II) ability of the firm to terminate a project when it is no longer profitable III) options that are associated with corporate securities that provide flexibility to change the terms of the issues A. I only B. II only C. I and III only D. I, II, and III 2. The owner of a regular exchange-listed call-option on the stock: A. has the right to buy 100 shares of the underlying stock at the exercise price B. has the right to sell 100 shares of the underlying stock at the exercise price C. has the obligation to buy 100 shares of the underlying stock at the exercise price D. has the obligation to sell 100 shares of the underlying stock at the exercise price 3. Figure-2 depicts the:

A. position diagram for the buyer of a call option B. profit diagram for the buyer of a call option C. position diagram for the buyer of a put option D. profit diagram for the buyer of a put option 4. If the stock makes a dividend payment before the expiration date then the put-call parity is: A. Value of call = value of put + share price – present value (PV) of dividend – PV of exercise price B. Value of call = value of put – share price + PV of dividend – PV of exercise price C. Value of call = value of put + share price + PV of dividend + PV of exercise price D. Value of call = value of put + share price + PV of dividend – PV of exercise price

Chapter 21 Valuing Options 5. An equity option’s theoretical delta reflects the sensitivity of its market price to changes in: A. the volatility of the underlying stock price B. the dividends paid to the underlying stockholders C. the underlying stock price D. the time to expiration 6. The important assumptions of the Black-Scholes formula are: I) the price of the underlying asset follows a lognormal random walk. II) investors can adjust their hedge

continuously and at no cost. III) the risk-free rate is known. IV) the underlying asset does not pay dividends. A. I only B. I and II only C. I, II, III and IV D. III and IV only Chapter 22 Real Options

7. The opportunity to defer investing to a later date may have value because: I) The cost of capital may increase in the near future. II) Uncertainty may be increased in the future. III) Investment costs fluctuate over time. IV) Market conditions may change and increase the NPV of the project. A. I only B. I and II only C. III only D. IV only 8. The opportunity to invest in a project can be thought of as a three-year real option that is worth $500 million with an exercise price of $700 million. Calculate the value of the option given that, N(d1) = 0. 3 and N(d2) = 0. 15. Assume that the interest is 6% per year. A. $60 million B. $61. 84 million C. $55. 55 million D. None of the above. C = 500(0. 3) – (0. 15)(700)/(1. 06^3) = 61. 84

True / False questions 1. If you write a put option, you acquire the right to buy stock at a fixed strike price. TRUE/ FALSE 2. Option delta for a put option is always positive. TRUE/FALSE 3. Delta of a put option is equal to the delta of an equivalent call option minus one. TRUE/FALSE 4. The option to wait is a type of real option. TRUE/FALSE 5. Options contracts are marked to market. TRUE/FALSE Short Answer Questions 1. Define the terms ‘ option’, ‘ call option’ and ‘ put option’

An option is defined as a right, but not an obligation, to buy or sell an underlying asset at a fixed price during a specified period of time. A call option is defined as a right, but not an obligation, to buy an underlying asset at a fixed price during a specified period of time. A put option is defined as a

right, but not an obligation, to sell an underlying asset at a fixed price during a specified period of time. 2. Explain the difference between a European option and an American option. A European option may be exercised only on the expiration date. An American option may be exercised anytime up to the expiration date. 3. How can managers create real options? Briefly explain. How does an abandonment option increase the value of a project? Managers are not passive onlookers in a firm. They can make decisions to capitalize on good fortune or to mitigate losses. By adding flexibility to the firm’s investments and operations decisions, managers can create real options and thereby add value to the firm. The option to abandon a project, a put option, provides partial insurance against failure and hence increases the value of a project. It can also be thought of as providing a downside limit to the project, thereby increasing its value.