**Quiz B for 1:00 Class: 03/27/13** Name Key

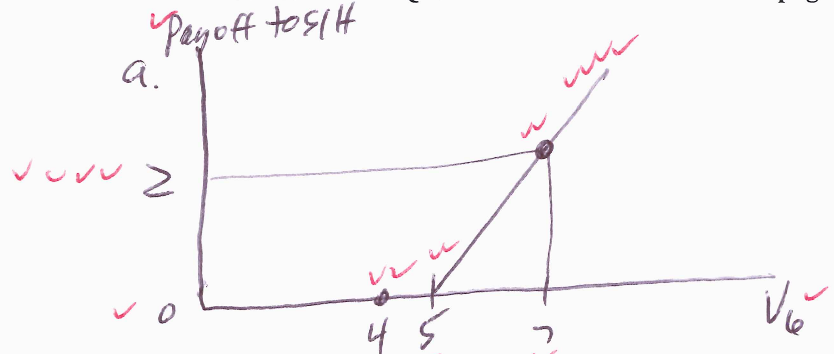
Assume Hoops Inc. has outstanding debt that matures for $5,000,000 six years from today.

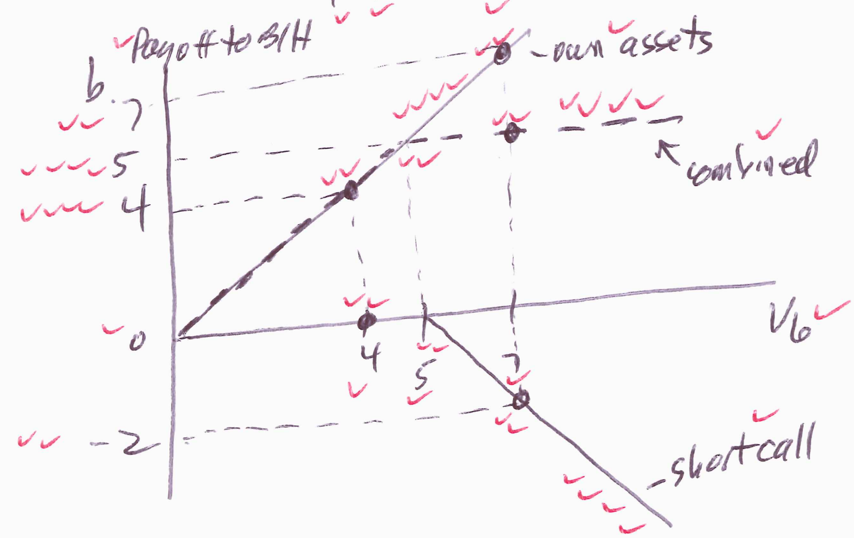
a. Sketch a graph of the potential payoffs on Hoops stock as a function of the value of the firm's assets three years from today. Show the specific payoffs if the value of the firm's assets equal $4,000,000 and $7,000,000 ~~three~~ six years from today. Clearly label and identify each payoff.

b. From the perspective of viewing Hoops' risky bonds as equivalent to a portfolio of options and owning the firm's assets, sketch the payoffs on the portfolio, owning the firm's assets, and the options if Hoops' assets end up being worth $4,000,000 and $7,000,000 ~~three~~ six years from today. Clearly label and identify each payoff.

c. Assume that due to a covenant violation, the amount owed bondholders in six years jumps to $6,000,000. Explain in terms of options how this ~~drop in the value of Hoops' assets~~ change affects the value of the firm's outstanding stock and bonds.

**Wall Street Journal Questions are on the back of this page.**




Scale:

83-84 = 50
80 = 49
79 = 48
78 = 47
76-77 = 46
75 = 45
73 = 44
68 = 42
67 = 41
66 = 40
63 = 38
62 = 37
59-60 = 36
57 = 35
49 = 34
46-47 = 33
34 = 32

31 = 31
26 = 30
19-21 = 29
16 = 28
14 = 27
8 = 25

c. stock = call
⇒ as strike ↑, value of call falls
bond = assets − call
⇒ as strike ↑, value of bonds rise as subtract smaller #