

YOU HAVE 90 MINUTES TO COMPLETE BOTH PARTS OF THIS THIS EXAM

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) 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.
- 3) 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!
- 4) If you have additional time remaining, give your work one last check.
- 5) True/False questions are worth 2 points. Multiple-choice questions are worth 3 points. Short answer questions are worth 4 points unless otherwise noted.

1. (4 points) According to the text, what is the primary goal of a firm’s financial managers?
 - a. In most years, firms will sell more common stock than preferred stock, and sell more preferred stock than debt.
 - b. In most years, firms will sell more retained earnings stock than debt, and sell more debt than preferred stock.
 - c. For the average firm’s balance sheet, the reason that the common stock account is larger than the retained earnings account, is because retained earnings is a convertible security with a set redemption date while common stock has no redemption date.
 - d. Even though about 90% of securities issued are bonds, the book value of bonds is typically smaller than the market value of preferred stock.
 - e. All of the above statements are always false.
3. Even if a firm's cash flow projections indicate that it will soon be unable to meet scheduled interest payments on its debt, bankruptcy will not begin until the firm actually defaults on a scheduled payment.
 - a. True
 - b. False
4. (5 points) List the three components of an agency cost.
 - a.
 - b.
 - c.
5. A potential conflict of interests between the agent and the principal creates a signaling problem.
 - a. True
 - b. False

6. Which component of the gross underwriting spread is the largest?

- A) the selling concession
- B) the underwriting fee
- C) the management fee
- D) all of the above are about equal
- E) none of the above

7. (4 points) A friend met an investment banker at a bar. The friend and banker began to work together. You recently met the friend for lunch and she made the following statement. She began seeing the banker “in hopes of a merger premium, now he keeps telling her she needs to read Chapter 11 if she wants to avoid a holdout problem.” In non-financial terms, describe briefly what your friend was saying.

8. (4 points) Later than night, you also bumped into the banker. He was upset that at your friend because “what began as her shirking is turning into massive asset substitution, and that lack of monitoring had led to moral hazards.” In non-financial terms, describe briefly what the banker was saying.

9. Which of the following statements is most correct?

- a. Tax considerations often play a part in mergers. If one firm has excess cash, purchasing another firm exposes the purchasing firm to additional taxes. Thus, firms with excess cash rarely undertake mergers.
- b. The smaller the synergistic benefits of a particular merger, the greater the incentive to bargain in negotiations, and the higher the probability that the merger will be completed.
- c. Since mergers are frequently financed by debt more than equity, financial economies which imply a lower cost of debt or greater debt capacity are rarely a relevant rationale for mergers.
- d. Managers who purchase other firms often assert that the new combined firm will enjoy benefits from diversification such as more stable earnings. However, since shareholders are free to diversify their own holdings at lower cost, such a rationale is generally not a valid motive for publicly held firms.

10. Preferred stock may be _____.

- A) nonredeemable
- B) convertible
- C) redeemable
- D) all of the above
- E) none of the above

11. The managers' role in determining the firm's response to an unsolicited takeover bid reflects a potentially serious agency problem.

- a. True
- b. False

12. This is a news headline from February 22, 2005, "Level 3 surges after swallowing 'pill.'" Level 3 is a company. Please translate the headline into non-financial terms.

13. List the basic ways of structuring a corporate acquisition, that results in both assets and liabilities being acquired.

14. What is z-score?

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- 2) Point values are listed with the question.
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1. Carrollton Utilities currently has 3,000,000 shares with a market price of \$32.50. They announce a rights offering of 375,000 shares with a subscription price of \$30 per new share during the 16-day subscription period.

- a. (2.5 points) What is the market value of the firm before the right’s offering?
- b. (2.5 points) How many rights will be needed to purchase a new share?
- c. (2.5 points) What is the market value of each right given this stock price?
- d. (2.5 points) Assuming all of the rights are exercised, and no information was conveyed by the rights announcement, what is the expected stock price after the rights offering?

2. (8 points) Astral Telecom and Bright Wiring will merge. Astral has a total market value (VA) of \$275M (M = million), and Bright has a total market value (VB) of \$240M. Their merger will lead to operating efficiencies and will produce a synergistic effect of \$25M. Answer the following questions.

- a. Ignore expenses and the payment of a premium. What is the total market value of the merged firms?
- b. Assume the payment of a \$8 premium. If the merger would entail expenses amounting to \$5M, what is the net advantage to merging (NAM)?

3. (6 points) Carbon Scientific was worth \$30 per share. Helium Scientific with a current stock price of \$40 offer to acquire Carbon Scientific. What is the merger premium percent in the following two cases.

- a. Helium of 1.1 shares of stock for each share of Carbon.
- b. Helium offers \$38 in cash.

4. Fill in the Blanks (12 points).

The Peta Company acquires the Nofer Company in a stock-for-stock deal.

	# Shares	P/E	EPS	Stock Price
Peta	14,000	15	\$2.50	_____
Nofer	30,000	32	\$.30	_____
Combined Company	_____	_____	_____	_____

5. (5 points) The firm you work for is trying to decide to file a Chapter 7 or a Chapter 11 bankruptcy. If it chooses to reorganize, the following future cash flows are expected: Year 1=\$14, Year 2 =\$15, Year 3=\$16, Year 4=\$27, Year 5=\$28.

The appropriate discount rate is 17%. The projected after-tax liquidation value of the firm's assets is \$200 if we liquidate the firm today. If we liquidate the firm in 5 years, the liquidation value is expected to be \$210. Should we file Chapter 7 or Chapter 11? 1 point for your answer, and 4 points for showing why your answer is correct.

We should file Chapter _____ because:

6. (5 Points) In the previous problem, what was the IRR if we continue to operate the firm for 5 more years?

7. (18 points) Below is the Webegone Company's Balance Sheet. The firm is in Chapter 7 bankruptcy and is being liquidated. The firm's Trustee's are owed \$1.50. Given the below balance sheet, write out the amounts collected by each of the firm's creditors. All taxes and accrued wages have priority over secured debt. The Accounts Payable is secured by Inventory. Fixed Assets secure the Mortgages. All other debt is unsecured.

	Amount Collected		Amount Collected
CURRENT ASSETS	\$40.0	ACCOUNTS PAYABLE	\$10.0 _____
NET FIXED ASSETS	17.0	NOTES PAYABLE (BANKS)	4.0 _____
		ACCRUED WAGES	1.3 _____
		FEDERAL TAXES	1.5 _____
		STATE/ LOCAL TAXES	1.2 _____
		CURRENT LIABILITIES	\$18.0
		FIRST MORTGAGE	\$ 2.0 _____
		SECOND MORTGAGE	2.5 _____
		DEBENTURES	4.0 _____
		TOTAL LONG-TERM DEBTS	8.5
		PREFERRED STOCK	\$ 8.0 _____
		COMMON STOCK	25.0 _____
		PAID-IN CAPITAL	2.0 _____
		RETAINED EARNINGS	-4.5 _____
		TOTAL EQUITY	\$30.5
TOTAL ASSETS	\$57.0	TOTAL CLAIMS	\$57.0

THE LIQUIDATION SALES RESULTED IN THE FOLLOWING PROCEEDS:

FROM SALE OF CURRENT ASSETS OTHER THAN INVENTORY	\$10.5
FROM SALE OF INVENTORY	\$7.5
FROM SALE OF FIXED ASSETS	\$9.3
TOTAL RECEIPTS	\$27.3