

**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) usually the phrase “maximize shareholders wealth” is listed at the best way of expressing the primary goal of a firm’s financial managers. Two other phrases are sometimes listed as viable alternatives. Name one of them.

2. Using the goal you listed above, give an example of an agency problem that might arise by using this goal instead of “maximize shareholders wealth.”

3. The most common method of firm financing for publicly traded firms is:

- |                    |                     |
|--------------------|---------------------|
| a. Retaining Bonds | b. Retaining Equity |
| c. Retaining Cash  | d. Selling bonds    |
| e. Selling Equity  | f. Selling Cash     |

4. Chapter 11 considers the impact to all stakeholders when allocating funds while Chapter 7 allocates funds strictly based on seniority of claim.

- a. True                      b. False

5. (4 points) (Complete the sentence) The optimal contract is:

6. If it were possible and not unreasonably costly for the principal to monitor the agent's actions perfectly, there would be no agency problems.

- a. True                      b. False

7. New-issue activity tends to decrease during periods of rising share prices.

- a. True                      b. False

8. Which of the following is not an advantage of going public?

- A) Going public enables a firm to raise additional capital.
- B) Going public gives existing shareholders a chance to sell portions of their shares as part of the IPO giving them a cash return on their investment and allows them to diversify their investment portfolios.
- C) Going public generally brings a lower price in the public market than in the venture capital or private placement markets.
- D) Going public achieves liquidity and diversification for current shareholders
- E) None of the above is an advantage of going public.

9. (4 points) You are at a party consisting of investment bankers, CEO's and hungry models. A CEO, whose firm is in financial distress, makes following statement, "My pill is holding, but I am concerned about free riders. I met a banker who claimed he could grant me an automatic stay." In non-financial terms, describe briefly what your friend was saying.

10. (4 points) Later than night, you also bumped into the banker. He said "I can form a syndicate that would give her an automatic stay. We would reorganize under Chapter 9, and absolute priority would stop a cramdown." In non-financial terms, describe briefly what the banker was saying.

11. A leveraged buyout is an acquisition that is financed mainly by debt, sometimes more than 90%, by debt.

- a. True
- b. False

12. Empirical evidence suggests that mergers tend to produce synergy and that the stockholders of acquired firms tend to benefit handsomely.

- a. True
- b. False

12. A conglomerate merger combines two firms in the same line of business.

- a. True
- b. False

13. List the basic ways of structuring a corporate acquisition that results in only assets being acquired.

14. What is a z-score?

15. What is human capital?

Exam I Spring 2006 FINC 4532 Your Name \_\_\_\_\_  
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1. (5 points) Fran Lotsch is considering a loan for \$750,000 to GM Holdings. Laura estimates that she will incur \$12,000 in monitoring costs.

a. Packard is promising to pay 9% annually on the loan. After paying monitoring costs, what annual percent return is Fran receiving?

b. If a fair return on this loan is 8.9%, what is the minimum interest rate that Fran would require on this loan?

2. (9 points) ABC Utilities currently wishes to raise \$50 million through a rights offering. It currently has 35,000,000 shares with a market price of \$26 each. ABC wishes each right to be worth at least \$.20 initially.

a. What is the subscription price?

b. What is the subscription ratio?

c. After the offering commences, the shares trade at a price of \$24 per share. What is the value of one right?

3. (4 points) Astral Telecom is considering acquiring Bright Wiring. Astral has a total market value (VA) of \$145M (M = million), and Bright has a total market value (VB) of \$230M. Their merger will lead to operating efficiencies and will produce a synergistic effect of \$15M. Assume a \$24M merger premium. Should Astral acquire Bright Wiring? 1 point for the correct answer, 3 points for showing why your answer is correct.

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	21,000	17	\$.54	_____
Nofer	70,000	4	\$2.75	_____
Combined Company	_____	_____	_____	_____

5. (6 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=\$36, Year 4=\$27, Year 5=\$28.

The appropriate discount rate is 17%. The projected after-tax liquidation value of the firm's assets is \$220 if we liquidate the firm today. If we liquidate the firm in 5 years, the liquidation value is expected to be \$210.

a. (1 point for your answer, and 3 points for showing why your answer is correct.) Should we file Chapter 7 or Chapter 11?

We should file Chapter \_\_\_\_\_ because:

b. (2 points) In the previous problem, what was the IRR if we continue to operate the firm for 5 more years?

6. (3 points) An acquisition target currently has 10M (M = million) shares outstanding. They are trading at \$27. This gives the target a current market value of \$270M. The acquirer's financial staff analyzes 10 recent acquisitions of firms in the same industry. It finds that the merger premiums fall between 50% and 66%. Given the premiums paid, what might one guess to be the most reasonable offering price?

7. (1.5 points per blank, fill in all the blanks) 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 \$20. 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. Notes Payable is the most senior claim, followed by Senior convertibles then by Senior Subordinated. All other liabilities and equity have their normal claim order. An unusual aspect of this bankruptcy is that the operating divisions will be sold as "going concerns," with the acquirers' receiving only Fixed Assets. The bankrupt firm will retain all current assets, liabilities, and equity. These going concerns can be sold at an average price-to-sales ratio of 17%, based on the annual sales level of \$900. Current assets will be liquidated at a market to book ratio of 65%.

			Amount Collected
CURRENT ASSETS	\$336.5	ACCOUNTS PAYABLE	\$146.7 _____
NET FIXED ASSETS	64.0	NOTES PAYABLE (BANKS)	80.0 _____
		ACCRUED WAGES	14.3 _____
		CURRENT LIABILITIES	\$241
		SENIOR SUBORDINATED	\$ 54.8 _____
		SENIOR CONVERTIBLE	51 _____
		DEBENTURES	20.0 _____
		TOTAL LONG-TERM DEBTS	124.8
		PREFERRED STOCK	\$ 8.0 _____
		COMMON STOCK	429.8 _____
		RETAINED EARNINGS	-403.1 _____
		TOTAL EQUITY	\$34.7
TOTAL ASSETS	\$400.5	TOTAL CLAIMS	\$400.5