

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. True/False questions are worth 2 points. Multiple-choice questions are worth 3 points. Short answer questions are worth 4 points unless otherwise noted.
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!

1. Usually the phrase “maximize shareholders wealth” is listed as the best way of expressing the primary goal of a firm’s financial managers, while “asset substitution” is a serious agency problem. Describe a situation where “asset substitution” could be consistent with “maximizing shareholders wealth.” Be precise in defining asset substitution.

2. Explain why the statement, “We would generally expect the value of a firm to be unaffected by agency problems,” could be a true statement.

3. One of the most obvious examples of moral hazard (the possibility of agent misbehavior) involves employee decisions that affect personal benefits, or perquisites. These include _____.

- a. the use of an expense account for company business
- b. the use of a company car for personal business
- c. up-to-date office decor needed to conduct business
- d. all of these
- e. none of these

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

- a. Retaining Accounts Receivable
- b. Retaining Equity
- c. Selling Preferred Stock
- d. Selling bonds
- e. Selling Equity
- f. Selling Cash

5. (4 points) Which announcement would have the greater negative impact on a firm’s current stock price; issuing new equity via a Rule 144A placement or via a Rule 415 placement? Why is your answer correct.

6. Preferred stock is a hybrid security that is often viewed as a form of “expensive” debt.

- a. True
- b. False

7. List the four basic rights of shareholders.

8. Which of the following statements is false?
- a. Liquidation is preferable to reorganization when selling the debtor's assets in liquidation would produce value that exceeds the debtor's reorganization value.
 - b. The firm or its creditors file a petition under Chapter 7 (bankruptcy with intent to liquidate the firm).
 - c. In some cases, the parties to a Chapter 11 cannot agree upon a plan of reorganization and decide to convert to a Chapter 7.
 - d. Liquidation value is usually higher than reorganization value.
 - e. All of the above are true

9. Which of the following is the optimal managerial contract?
- a. Contracting costs are \$5, Monitoring Costs are \$15, and Misbehavior Costs are \$41.
 - b. Contracting costs are \$40, Monitoring Costs are \$15, and Misbehavior Costs are \$5.
 - c. Contracting costs are \$15, Monitoring Costs are \$27, and Misbehavior Costs are \$11.
 - d. Contracting costs are \$15, Monitoring Costs are \$15, and Misbehavior Costs are \$17.
 - e. Contracting costs are \$13, Monitoring Costs are \$5, and Misbehavior Costs are \$22.

10. A questionable motive two firms may have for merging include _____.
- a. to achieve economies of scale in production, distribution, or another phase of their operations
 - b. to realize tax benefits
 - c. to realize financial synergy
 - d. to get to surplus cash
 - e. none of the above are questionable motives

11. Financial synergy is more likely than business synergy to be a good reason to merger two firms.

- a. True
- b. False

12. The disadvantage of a proxy contest relative to a tender offer is that few succeed.

- a. True
- b. False

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

- a. True
- b. False

14. Which of the following is false?

- a. The basic premise of Chapter 11 is that debtors and creditors should negotiate to achieve a consensual plan of reorganization given the going-concern value of the reorganized debtor exceeds its liquidation value.
- b. The purpose of the cramdown provision is to facilitate the confirmation of a proposed plan when dissenting classes are refusing to accept a viable plan.
- c. A prepackaged bankruptcy attempt is most likely to succeed when there is only one class of creditors that will be disadvantaged by the plan.
- d. Holdouts are holders of outstanding securities who refuse to exchange their securities for new ones.
- e. All of the above are true statements.

15. _____ permits the bankruptcy court to confirm a proposed plan over the objections of one or more classes of creditors.

- a. Chandler's Method
- b. The cramdown procedure
- c. The absolute priority doctrine
- d. none of these

16. (4 points) You read the following headline, "Pill did not work, Pac-man was defeated, greenmail not an option," about a stock you own. Does this make you happy or sad? Explain your answer.

Instructions:

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- 2) Point values are listed with the question.
- 3) 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.
- 4) 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!**
- 5) If you have additional time remaining, give your work one last check.

1. (4 points) Your business has experienced some financial distress. Your assets have a two-thirds chance of being worth \$1,800 and a one-third chance of being worth \$900 at year's end. Your debt is \$900 and due at the end of the year. Your creditors (or debtholders) will receive \$1,000 when the assets are high and \$800 when they are low. What is your expected payoff?

2. (4 points) Your assets have an equal chance of being worth either \$1,600 or \$800 at year's end. Your debt is \$1,000 and due at the end of the year. Now suppose you substitute your current assets for riskier assets that have the same expected value but a wider dispersion. The riskier assets now have equally likely payoffs of \$1,800 and \$600. With the same expected value, the asset substitution renders a zero NPV. Does this mean that you are just as well off?

- a. No, there has been a \$600 wealth transfer to them.
- b. Yes, there has been a \$200 wealth transfer to you.
- c. No, you are not just as well off but have lost \$100 in expected value.
- d. You are even better off because you have gained \$100 in expected value.

3. Carrollton Utilities currently has 4,000 shares with a market price of \$12.50. They announce a rights offering of 500 shares with a subscription price of \$8 per new share during the 16-day subscription period.

a. (3 points) How many rights will be needed to purchase a new share?

b. (3 points) What is the market value of each right given this stock price?

c. (4 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?

4. (4 points) Astral Telecom and Bright Wiring will merge. Astral has a total market value (VA) of \$285M (M = million), and Bright has a total market value (VB) of \$210M. Their merger will lead to operating efficiencies and will produce a synergistic effect of \$15M. Answer the following questions. If the NAM is -\$31, and expenses to complete the merger are \$5, what premium is being paid?

5. Fill in the Blanks (15 points).

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

	# Shares	P/E	EPS	Stock Price
Peta	14,000	42	\$19	_____
Nofer	100,000	17	\$1.30	_____
Combined Company	_____	_____	_____	_____

6. (18 points) Below is the Webegone Company's Balance Sheet. The firm is being liquidated in Chapter 7 bankruptcy. The firm's Trustee's are owed \$1.0. Given the below balance sheet, fill in the blanks with 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. The Mortgages are secured by Fixed Assets. All other debt is unsecured.

CURRENT ASSETS	\$17.0	ACCOUNTS PAYABLE	\$20.0	_____
NET FIXED ASSETS	28.8	NOTES PAYABLE (BANKS)	9.5	_____
		ACCRUED WAGES	.3	_____
		FEDERAL TAXES	1.5	_____
		STATE/ LOCAL TAXES	1.2	_____
		CURRENT LIABILITIES	\$31.3	
		FIRST MORTGAGE	\$ 12.0	_____
		SECOND MORTGAGE	11.5	_____
		DEBENTURES	15.0	_____
		TOTAL LONG-TERM DEBTS	38.5	
		PREFERRED STOCK	\$ 8.0	_____
		COMMON STOCK	65.0	_____
		PAID-IN CAPITAL	2.0	_____
		RETAINED EARNINGS	-99.0	_____
		TOTAL EQUITY	\$-24	
TOTAL ASSETS	\$45.8	TOTAL CLAIMS	\$45.8	
THE LIQUIDATION SALES RESULTED IN THE FOLLOWING PROCEEDS:				
		FROM SALE OF CURRENT ASSETS OTHER THAN INVENTORY	\$9.5	
		FROM SALE OF INVENTORY	\$7.5	
		FROM SALE OF FIXED ASSETS	\$9.9	
		TOTAL RECEIPTS	\$26.9	