

UNIVERSITI SAINS MALAYSIA

Second Semester Examination
Academic Session 1994/95

April 1995

AGW 606 - CORPORATE FINANCE

Time : [3 hours]

INSTRUCTIONS :

Please ensure that this examination paper consists of **FOUR (4)** printed pages before you begin.

Answer **FIVE** questions only. All questions carry equal marks.

1. "The most important job of a financial manager is to create value from the firm's capital budgeting, financing and liquidity activities".
(Ross, Westerfield & Jaffe)

How do financial managers create value? Discuss why value creation is difficult to achieve.

[20 marks]

2. "The beta of a company is a function of a number of factors. Perhaps the 3 most important are : cyclicity of revenue, operating leverage and financial leverage".
(Stern & Chew)

Describe how beta factors are determined and used.

[20 marks]

3. The directors of Garuda Sdn. Bhd., clients of yours, have informed you that they are contemplating the acquisition of HICOM Bhd. Although they are aware of 3 methods of valuing shares, i.e. assets, price/earning ratio and gross dividend yield, they are inexperienced and have requested further explanation. Advise them on these methods. Discuss the details of the concepts.

[20 marks]

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4. a) Discuss what is meant by the information content of dividends. How does this concept fit in with the efficient markets hypothesis?

[12 marks]

- b) Discuss the concept of "clientele effect" in the context of the debate on dividend policy.

[8 marks]

5. a) What is meant by the efficient market hypothesis? In your answer distinguish between the three forms of market efficiency.

[8 marks]

- b) The following is an excerpt from "The Star" of Saturday, February 18, 1995:

"Interest in Oriental Shares Shoots Up".

PENANG: Trading of Oriental Holdings Bhd shares shot up after news of chairman Tan Sri Loh Boon Siew's death reached the market yesterday.

The counter saw little trading in the morning, opening and closing at RM11.50 with only 36 lots traded before the lunch break. When trading resumed at 2:30 pm, prices rose swiftly and 10 minutes later went limit-up at RM14.90.

A total of 2,187 lots had changed hands when trading closed. Commenting on the price movements, an analyst said punters had been waiting for a long time to dabble in the stock. "Investors generally agree that Loh did not condone speculation of his stock," he observed.

He said those who invested in Oriental Holdings were mainly long-term investors who would hold the stock for many at least five years. "Even though Oriental Holdings has a big cash reserve estimated at some RM200 million at the end of 1994, the company has been conservatively run," he said. "Beside remaining in its core activity of assembly and property development, shareholders would like to see a more aggressive Oriental Holdings venturing into other activities, especially non-motor manufacturing," he added.

Another analyst said it was ironic the counter should go up with the death of its helmsman. It is widely speculated that the most likely candidate to take over is the managing director of Kah Motors, Robert Wong, one of Loh's sons-in-law.

...3/-

The following table gives the closing price and daily turnover of both Oriental Holdings Berhad and Kuala Lumpur Stock Exchange Composite Index:

Date	Oriental Holdings		KLCI	
	Price (RM)	Volume (million)	Index	Volume (million)
Feb 13	11.40	0.124	980.42	369.8
Feb 14	11.30	0.058	972.99	177.8
Feb 15	11.30	0.053	979.28	247.6
Feb 16	11.50	0.081	989.99	395.1
Feb 17	14.90	2.187	995.24	232.9
Feb 20	14.40*	4.006	986.50	280.2
Feb 21	13.50	1.426	971.10	146.8
Feb 22	13.20	0.958	941.07	192.0
Feb 23	13.30	0.573	949.46	171.3
Feb 24	13.70	2.152	970.45	242.1
Feb 27	13.10	0.564	953.79	189.2
Feb 28	13.50	0.335	979.64	192.8
March 6	12.90	0.303	953.40	155.0
March 7	12.20	0.632	947.23	140.0

*On Monday, February 20, 1995 the price reached a high of RM 18.00 before closing at RM14.40.

Is this an efficient market at work? Discuss.

[12 marks]

6. a) "Last year we had a substantial income in Singapore dollars(S\$) which we hedged by selling S\$ forward. In the event S\$ rose against the ringgit and our decision to sell forward cost us a lot of money. I think that in future we should either stop hedging our currency exposure or just hedge when we think S\$ is overvalued". As a financial manager, how would you respond to this chief executive's comment?

[10 marks]

...4/-

- b) Companies X & Y have been offered the following rates per annum on a \$5 million 10-year loan:

<i>Company</i>	<i>Fixed Rate</i>	<i>Floating Rate</i>
X	7.0%	LIBOR + 0.5%
Y	8.8%	LIBOR + 1.5%

Company X requires a floating rate loan; Company Y requires a fixed rate loan. Design a swap that will net a bank, acting as intermediary, 0.2% per annum and which will appear attractive to X and Y.

[10 marks]

7. a) Discuss the factors that affect the price of a stock option.

[8 marks]

- b) "Many debt issues are packages of bonds and warrants or convertibles". (Brealey & Myers, p.535). Discuss the similarities and differences between a convertible and a package of bonds and warrants. What is the role of options theory in evaluating the value of such debt instruments?

[12 marks]

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