UNIVERSITI SAINS MALAYSIA

SEMESTER EXAMINATION

APRIL 1993

AGW 606 - CORPORATE FINANCE

TIME : [3 HOURS]

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Answer any FOUR of the following ten questions. Each question carries equal marks.

1. Discuss the role of financial management as part of the management process in a company.

2. Discuss the matters which have to be taken into consideration when a Board of Directors is formulating its dividend policy.

   OR

   Explain the main theoretical and practical factors to be considered when deciding on whether, and at what level, a dividend should be paid. Indicate the importance of each factor. Can a change in dividend levels affect firm valuation?

3. "The search for optimal capital structure is like the search for Truth or Wisdom; you will never completely attain either goal. However, there has been progress."

   (S.C. Myers)

   Discuss the progress that has been made towards an understanding of the capital structure puzzle. How can "share re-purchase" assist in achieving an appropriate capital structure?

4. Explain how a quoted company can determine the beta coefficient of (i) its equity and (ii) its operating assets. Explain how you can use the knowledge of a beta coefficient. What are the limitations inherent in the application of a beta coefficient within corporate financial management?

Percentage Return

Month	MIGB	Market	Month	MIGB	Market
1	2	2	13	6	6
2	-12	-6	14	18	16
3	-8	-6	15	-8	-2
4	6	10	16	18	10
5	10	16	17	-6	6
6	-2	2	18	14	-12
7	-10	-10	19	6	4
8	-4	-4	20	10	8
9	12	10	21	-6	-10
10	6	2	22	-12	-14
11	1	-2	23	14	6
12	-4	-6	24	-16	-14

MIG has identified two firms which operate only in the industries associated with projects 2 and 3. In each case the firm concerned has operated in those industries for many years.

Great Malaysian Holdings (GMH) operates in the industry associated with project 2 and Global Business Synergy (GBS) with project 3. GMH has a beta of 1.6 and is all equity financed whereas GBS's equity has a beta of 0.8 and has a capital structure of 40% debt, 60% equity.

The expected after tax operating cash flows, which incorporate the best estimates of future inflation, for each of project 1, 2 & 3 are:

Project	Cost ($000's)	Annual After Tax Cash flows ($000's)	Life Yrs
1	210	60	5
2	80	20	7
3	60	15	6

(These cash flows already include the impact of capital allowances and tax on operating cash flows).

The expected annual cash flows are subject to some variability and, if current economic condition hold, the actual cash flows in any one year could be up to about 10% different from those expected - however any differences are unlikely to be systematic and will probably tend to even out over the life of each project. Of course the expected cash flows will be altered by changes in economic conditions generally.

MIGB wishes to incorporate the tax advantages of debt into the discount rate and wishes, therefore, to determine the "weighted average cost of capital" for each project.

Project 4 has a cost of $220,000 and future after tax operating cash flows will be at one of three possible levels:

...4/-

OR

You are asked to assist MIGB in determining the appraisal discount rates and advise MIGB on the desirability of project 4, both with and without the salvage value option.

7. "In essence, our arguments are captured in two claims: today's definition of cash management is outdated, and the people currently in cash management will not fit the new definition"

(N C Hill & D M Ferguson)

What are the differences between traditional and new definition of cash management? Why do the people currently in cash management not fit with the new definition of cash management? How can a broader definition of cash management help to enhance the goal of a firm?

8. Explain the purpose of portfolio management in an efficient market? To what extent will the objectives of the portfolio manager of each of the following be similar and in what respects will they differ?: (i) Unit Trust (ii) Investment Trust (iii) Insurance company and (iv) Pension Fund

OR

Discuss whether corporate mergers and takeovers can be justified in an efficient market.

9. "Valuation of a company and its common stock is an important part of financial management. Valuation inevitably enters discussion of (a) the prospect of selling new equity (b) the timing of a new equity issues (c) the pricing of acquisitions and divestitures and (d) the advisability of a stock repurchase program ...... We outline the limitations and dangers of commonly employed valuation methods and encourage the reader to use as one approach a method that recognizes the fundamental determinants of value."

(T R Piper & W E Fruhan Jr.)

Explain the limitations of valuation model. Discuss the fundamental determinants of the value.

...6/-