

# [Finance notes assignment](https://assignbuster.com/finance-notes-assignment/)

BBC has contently 1. 5 million shares outstanding and its stock police is $ 20. It has a new investment opportunity which cost $ 6 rolling and generates a present value of free cash flows of $ 20 million. However, the company knows that the project is too complicated to explain to the market. Hence the market will underestimate the value of the project and assault it is a zeal net present value project. The company cannot issue debt and has to raise $ 6 million equity.

It is considering two alternatives (I) A rights issue at an issue price of $ 12. Although the issue is not underwritten, at this price, the issue will succeed with 100 0/0 certainly. Each share will have one eight. However, because current shareholders have a poor opinion about the management’s ability to create shareholder value (the stock used to trade at $ 40 per share a year ago) the company also believes that only 113 of the rights will be exercised by current investors, while the remaining 213 of the rights will be exercised by new investors who will buy them from the current investors.

A public issue to new investors, underwritten (f, arm commitment) by at an issue price (net proceeds) of$ 20. An investment bank, the management wants to maximize the interest of the current investors (which are al assumed to be long-term shareholders who eventually find out that the investment opportunity creates $ 20 million in free cash-flows), what should it do? Assume stock has a zero beta and the risk-free rate is zero. ) Calculate the wealth of current shareholders, in the long run, when the true value of the firm is revealed, if the company makes a rights issue b) Calculate the wealth of the cuffed shareholders in the long run when the true value of the firm is revealed, if the Finn raises money through a public issue c) It is often said that rights issues are superior to direct issues when the stock is undervalued. Given this, explain the difference (if any) between your answers to (1) and (2) 5 “ 45141 5: Summer 2013 – Corporation Finance” Assignment N” 5 (To be handed in, Week 9) Question a) The Hornier Pie Company pays a quarterly dividend of $ 1 .

Suppose that the stock price is expected to fall on the ex-dividend date by $. 90. Would you prefer to buy on the withstanding date or the ex-dividend date if you were (I) a tax-free investor, an investor with a marginal ataxias of 40 percent on income and 16 percent on capital gains? B) In a study of ex-dividend behavior, Elton and Grubber estimate that the stock price fell n average by 85 percent of the dividend. Assuming that the tax rate on capital gains was 40 percent of the rate on income tax, what did Elton and Grubber’s result imply about investors’ marginal rate of income tax? ND Grubber also observed that the ex-dividend price fall was different for high- payout stocks and for low-payout stocks. Which group would you expect to show the larger price fall as a proportion of the dividend? Date alter your c) Elton d) Would the fact that investors can trade stocks freely around the ex-dividend interpretation of Elton and Grubber’s study? Question 2 BBC is all equity financed, has 1 million shares outstanding and a current stock price of $10.

Although management believes the stock is fairly valued, they came across some obscure research on share buybacks that shows that companies announcing repurchase tender offers see their stock prices increase significantly. In particular, ref the company makes a fixed price tender offer at a premium (PREMIUM) above the market price for 20 %” of the shares, the short-teen percentage abnormal return to the non-tendering shareholders after the announcement of a tender offer can be estimated as AR: . 6 x PREMIUM + 0. 25 x 0. 2: O. X PREMIUM + The management is concerned about the stock price as Joe Raider is on the prowl and may make a hostile bid for the company during the next month. The management is particularly concerned as Joe wants to eliminate their perks ($2 million worth (in present value) of spending on corporate Jets, plush off, tees, executive courses on the Bahamas). Management owns 20 %o of the shares and cannot participate in a tender offer. It is advised by Bill Slick who points out that the probability of a takeover bid is inversely related to the stock price.