NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY

FACULTY OF COMMERCE

GRADUATE SCHOOL OF BUSINESS

MASTER OF BUSINESS ADMINISTRATION (BANKING AND FINANCE)

STRATEGIC FINANCIAL MANAGEMENT [MBF 5207]

FINAL EXAMINATIONS - APRIL 2010

INSTRUCTIONS

1. Answer question 1 from Section A and any other 3 questions from Section B
2. All questions carry equal (25) marks.
3. Questions may be answered in any order
4. Credit will be given for use of appropriate examples

QUESTION 1

D'Leon Inc.

Donna Jamiso, a 1997 graduate of the University of Zimbabwe with four years of banking experience, was recently brought in as assistant to the chairman of the board of D'leon inc., a small food producer that operates in eastern Zimbabwe and whose specialty is high-quality pecan and other nut products sold in the snack-foods market. D'leon's president, Ali Watikin, decided in 2001 to undertake a major expansion and to "go national" in competition with Frito-lay, Eagle, and other major snack-food companies. Watikin felt that D'leon's products were of a higher quality than the competition's, that this quality differential would enable it to charge a premium price, and that the end result would be greatly increased sales, profits, and stock price.

The company doubled its plant capacity, opened new sales offices outside its home territory, and launched an expensive advertising campaign. D'leon's results were not satisfactory, to put it mildly. Its board of directors, which consisted of its president and vice-president plus its major stockholders (who were all local business people), was most upset when directors learned how the expansion was going. Suppliers were being paid late and were unhappy, and the bank was complaining about the deteriorating situation and threatening to cut off credit. As a result, Watikin was informed that changes would have to be made, and quickly, or he would be fired. Also, at the board's insistence Donna Jamiso was brought in and given the job of assistant to Fred Campo, a retired banker who was D'leon's chairman and largest stockholder. Campo agreed to give up a few of his golfing days and to help nurse the company back to health, with Jamiso's help. Jamiso began by gathering the financial statements and other data given in tables below. Assume that you are Jamiso's assistant, and you must help her answer the following questions for Campo.

D'Leon Inc., Part I

Financial Statements and Taxes

TABLE IC2-1. BALANCE SHEETS

	2002	2001
ASSETS		
CASH	$ 7,282	$ 57,600
ACCOUNTS RECEIVABLE	632,160	351,200
INVENTORIES	1,287,360	715,200
TOTAL CURRENT ASSETS	$1,926,802	$1,124,000
GROSS FIXED ASSETS	1,202,950	491,000
LESS ACCUMULATED DEPRECIATION	263,160	146,200
NET FIXED ASSETS	$ 939,790	$ 344,800
TOTAL ASSETS	$2,866,592	$1,468,800
LIABILITIES AND EQUITY		
ACCOUNTS PAYABLE	$ 524,160	$ 145,600
NOTES PAYABLE	636,808	200,000
ACCRUALS	489,600	136,000
TOTAL CURRENT LIABILITIES	$1,650,568	$ 481,600
LONG-TERM DEBT	723,432	323,432
COMMON STOCK (100,000 SHARES)	460,000	460,000
RETAINED EARNINGS	32,592	203,768
TOTAL EQUITY	$ 492,592	$ 663,768
TOTAL LIABILITIES AND EQUITY	$2,866,592	$1,468,800

TABLE IC2-2. INCOME STATEMENTS

	2002	2001
SALES	$6,034,000	$3,432,000
COST OF GOODS SOLD	5,528,000	2,864,000
OTHER EXPENSES	519,988	358,672

TOTAL OPERATING COSTS EXCLUDING DEPRECIATION AND AMORTIZATION	$6,047,988	$3,222,672
EBITDA	($ 13,988)	$ 209,328
DEPRECIATION AND AMORTIZATION	116,960	18,900
EBIT	($ 130,948)	$ 190,428
INTEREST EXPENSE	136,012	43,828
EBT	($ 266,960)	$ 146,600
TAXES (40%)	(106,784)[a]	58,640
NET INCOME	($ 160,176)	$ 87,960
EPS	($1.602)	$0.880
DPS	$0.110	$0.220
BOOK VALUE PER SHARE	$4.926	$6.638
STOCK PRICE	$2.250	$8.500
SHARES OUTSTANDING	100,000	100,000
TAX RATE	40.00%	40.00%
LEASE PAYMENTS	40,000	40,000
SINKING FUND PAYMENTS	0	0

Note:

The firm had sufficient taxable income in 2000 and 2001 to obtain its full tax refund in 2002.

(i) What effect did the expansion have on sales, net operating profit after taxes (NOPAT), net operating working capital (NOWC), total investor-supplied operating capital, and net income**?[10 marks**)

(ii) What effect did the company's expansion have on its net cash flow, operating cash flow, and free cash flow? **[6 marks]**

(iii) Jamiso also has asked you to estimate D'leon's EVA. She estimates that the after-tax cost of capital was 10 percent in 2001 and 13 percent in 2002. **[5 marks]**

(iv) Looking at D'leon's stock price today, would you conclude that the expansion increased or decreased MVA? **[2 marks]**

(v) Did D'leon finance its expansion program with internally generated funds or with external capital?
How did the choice of financing affect the company's financial strength? **[2 marks]**

(vii) Refer to Tables ic2-1 and ic2-2. Suppose D'leon broke even in 2002 in the sense that sales revenues equaled total operating costs plus interest charges. Would the asset expansion have caused the company to experience a cash shortage that required it to raise external capital?
[2 marks]

1(b) The MBA company does not want to grow. Its financial management believes it has no positive net present value projects. The company's operating financial characteristics are;
Profit Margin- 10%
Asset-Sales Ratio-150%
Debt-Equity Ratio-100%
Dividend Payout Ratio-50%

(i) Calculate the Sustainable Growth Rate (SGR) for the MBA Company **[3 marks]**
(ii) How can the MBA achieve such a growth rate? **[2 marks]**

c) Cosafa owns Nike stock because its price has been steadily rising over the past years and they expect its performance to continue. Cosafa is trying to convince widow Zifa to purchase some Nike stock, but Zifa is reluctant because Nike has never paid a dividend. Zifa depends on the steady dividends to provide her with income.

(a) What preferences are these two investors demonstrating? **[4 marks]**
(b) What argument should Cosafa use to convince widow Zifa that Nike stock is the stock for her?
[4 marks]
(c) Why might Cosafa's argument not convince widow Zifa? **[2 marks]**

2) It has been claimed that failures in corporate governance have hampered the growth and profitability of some prominent firms located in emerging markets. What are some typical causes of these failures in corporate governance? **[20 marks]**

3) When might the goals of growth and value maximization be in conflict, and when would they be

aligned?

[20 marks]

4) Suppose that basic business risks to all firms in any given industry are similar. Would you expect all firms in this industry to have approximately the same cost of capital? Explain. **[20 marks]**

5) What advantages are there for a group, in spinning- off its divisions into subsidiaries? Can this be considered to be a defense against takeover? **[20 marks]**

6) How do average dividend pay out ratios for companies headquartered in English common law countries compare to those of companies headquartered in civil law countries? What explains this difference?

[20 marks]