NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY

FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN
Accounting; Finance; Banking
Insurance & Risk Management
Actuarial Science
Marketing; Management

PART II – 2ND SEMESTER FINAL EXAMINATION – MAY 2006

CORPORATE FINANCE II [CFI 2201]

TIME ALLOWED: 3 HOURS 10 MINUTES

INSTRUCTIONS

1. THIS PAPER IS 3 HOURS 10 MINUTES, OF WHICH 10 MINUTES IS READING TIME.
2. THIS PAPER CONTAINS SIX [6] QUESTIONS.
3. ATTEMPT ANY FIVE [5] QUESTIONS.
4. EACH QUESTION CARRIES 20 MARKS.
5. SHOW ALL YOUR WORKINGS.

QUESTION ONE [20 MARKS]

(a) Suppose NUST Ltd issued at par bonds with a10- year maturity, a $1 000 par value, a 10% coupon rate and semi-annual interest payments.

Two years after the bonds were issued, the interest rate on similar risk bonds fell to 6%. At what price should the bonds sell? [5]

(b) i. Ndlovu Brothers is expected to pay a $0.50 per share dividend at the end of the year [i.e. $D_1 = \$0.50$]. The dividend is expected to grow at a constant rate of 7% a year. The required rate of return on the stock, K_e, is 15%. What is the value per share of the company's stock? [2]

ii. What are the limitations of the model you have used. [4]

(c) Briefly discuss the advantages and disadvantages of going public. [9]

QUESTION TWO [20 MARKS]

(a) NUST Ltd has the following capital structure, which it considers to be optimal:

Debt	25%
Preferred Stock	15%
Common Stock	60%
Total Capital	100%

NUST Ltd`s tax rate is 40% and investors expect earnings and dividends to grow at a constant rate of 9% p.a in the future. NUST paid a dividend of $3,600 per share last year and its stock currently sells at a price of $60 000 per share. Treasury bonds yield is 11%, an average stock has a 14% expected rate of return and NUST`s beta is 1.51. These terms would apply to the new security offerings:

Preferred: New preferred stock could be sold to the public at a price of $100 000 per share, with a dividend of $11 000. Flotation costs of $5 000 per share would be incurred.

Debt: Debt could be sold at an interest rate of 12% after floatation costs.

(i) Find the component costs of debt, preferred stock and common stock. [6]

(ii) What is the Weighted Average Cost of Capital [WACC]? [2]

(b) Discuss the critical assumptions of MM`s propositions on capital structure. [12]

QUESTION THREE [20 Marks]

(a) Explain the theories of investor preference. [9]

(b) Explain the main factors that influence dividend policy. [10]

(c) Demonstrate the Pecking-Order Theory of Corporate Financing [1]

QUESTION FOUR [20 Marks]

Discuss the theoretical explanations to recent mergers and acquisitions in Zimbabwe.

QUESTION FIVE [20 Marks]

Examine any four cash management techniques that a firm can employ in its working capital management.

<u>QUESTION SIX</u> **[20 Marks]**

(a) Assuming that annual lease payments are made in advance and that there is no residual value:

i. What is the annual lease payment if purchase price, is $92 000, an implicit interest rate of 22%, and a 6 year lease period respectively. **[5]**

ii. What is the implied interest rate if, a purchase price of $420 000, a 5-year lease period, and an annual lease payment of $94 060 respectively. Solve for the implied interest rate. **[5]**

(b) Distinguish the following terms :

i. Financial lease and Operating lease. **[2]**

ii. Full-service [or maintenance] lease and Net lease. **[2]**

(c) "A lessee does not have to pay to buy the leased asset" What is the implied risk in such a lease contract. **[6]**