NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY

FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN
Accounting; Finance; Banking; Fiscal
Insurance & Risk Management
Actuarial Science
Marketing; Management
PART II 2ND SEMESTER SUPPLEMENTARY EXAMINATION - OCTOBER 2009
CORPORATE FINANCE II [CFI 2201]
TIME ALLOWED: 3HOURS

INSTRUCTIONS

- ANSWER ANY FOUR QUESTIONS

Question One

(a) A company has the following capital in its balance sheet. 5 year 12% coupon bond with par value of $100 and issued to raise $5,000,000, $10,000,000 worth of preference shares with a par value of $100, currently trading at $80 and carry a fixed dividend of 10% in perpetuity. It also has ordinary share capital of $20,000,000 each share with a par value of $100 and cost of equity is 15%. The company recently paid dividend on ordinary shares of $12 and dividends are expected to grow at 8%. Cost f preferred capital is and debt is 13%.

(a) Calculate the current price of the bond issued by the company (3)
(b) Calculate WACC for this company (4)
(c) What is the relationship between he coupon rate of a bond and the required rate of return by bondholders? (6)
(d) What are the three advantages and three disadvantages of :
(i) Debt capital (6)
(ii) Equity Capital (6)

Question Two

(a) Explain the following terms as they apply to Lease financing:
(i) Sale and Lease back (2)
(ii) Leveraged lease (2)
(iii) Capital lease (2)

(b) Why would a company lease an asset instead of buying it outright, state and explain three reasons. (6)

(c) TSL Ltd has 20,000 ordinary shares in issue. The company has just paid a dividend of $2.30 per share. The cost of equity for the company is 18% and dividends are expected to grow at 7% forever. Calculate the total market value of the firm (6)

(d) Under what circumstances will shareholders prefer dividends to be ploughed back into the firm than be paid to them as cash? (7)

Question Three

(a) Explain capital structure with reference to :

(i) Pecking Order Theory (4)

(ii) M-M with Taxes Proposition (4)

(iii) Traditional Theory of Capital structure (4)

(b) What four factors affect the dividend policy of a firm (8)

(c) Discuss the dividend Irrelevant theories (5)

Question Four

(a) Define a Put option. (2)

(b) What is the rationale of buying a call option (4)

(c) A share is currently selling for $90 and an investor buys an European call on this share at a premium of 8% of the going market price. The exercise price is $109 and the contract is for 30 days .

(i) What would be the action of the investor if the price of the share is $116.2? (3)

(ii) Draw the pay off diagram for this option. (4)

(d) Explain the following terms as they apply to margin trading:

(i) Initial margin (2)

(ii) Margin Call (2)

(iii) Variation margin (2)

(e) Differentiate Money markets from Capital Markets (6)

Question 5

(a) What is the importance of financial markets to a firm? (6)

(b) Explain the following terms:

(i) Inventory conversion period (2)

(ii) Payment deferral period (2)

(c) ABC is a long term supplier to Edgars Ltd. On 2 October 2009, ABC supplied $50,000 worth of merchandise. Edgars issued ABC a promissory note/ post dated cheque redeemable in 35 days time. ABC however had urgent cash requirements hence decided to discount the post dated cheque with a local bank. The arrangement fees charged by the bank were 1.5% of the value and the discount rate was at 28%.

(i) Calculate the total cost incurred by ABC in discounting the promissory note. (3)

(ii) How much will the bank pay ABC? (3)

(d) State and explain 3 reasons why companies would merge. (6)

(e) State three ways of fighting a hostile takeover (3)