NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART IV- 2ND SEMESTER FINAL EXAMINATION – MAY 2006
CORPORATE FINANCIAL STRATEGY & RESTRUCTURING [CFI 4201]
TIME ALLOWED : 3 HOURS 10 MINUTES

INSTRUCTIONS

1. The paper is 3 hours 10 minutes, of which 10 minutes is reading time. .
2. Answer at **least ONE,** question from Part I and any **Three others**.
3. Electronic calculators may be used.
4. All workings to be shown.
5. Write legibly.

PART 1

Question 1 **[25 marks]**

The value of a firm is independent of its capital structure – MM Proposition 1, 1958. Prove, analytically, the above postulation highlighting the critical conditions under which it is valid. ***[25 marks]***

Question 2 **[25 marks]**

ABC is considering undertaking a project. The project will generate, after tax real asset cashflows of $50 million in years 1, 2, 3, 4 and 5 and $70 million per year thereafter for the foreseeable future. Moreover, the project is expected to generate additional Debt capacity to ABC of $10 million in years 1, 2 and 3 and $20m per year thereafter for the foreseeable future. The firm will utilise only 60% of this debt capacity. ABC debt stock is considered riskfree.

The project will operate in an industry with an equity beta of 1.2, an average Debt/Equity ratio of 40% and an average marginal rate of corporate tax of 35%.

The expected returns on ZSE index and Treasury Bills are 40% and 30% respectively.

2.1 What is the expected return of the project if it is wholly financed by equity? Justify. **[12 *marks]***

2.2 What is the maximum amount that ABC should pay for the project if it is motivated, solely, by value? Justify. ***[13 marks]***

Part II
Question 3 **[25 marks]**

Discuss the levels of Financial risk acceptable to Shareholders, Directors and Lenders, in the context of the Business and Financial Risk Matrix, and relating to Corporate Financial Strategy through Product Life Cycle.

Question 4 **[25 marks]**

Explore Financial Strategies that companies could employ to address corporate under- valuation due to both internal leverage problems and external market perceptions?

Question 5 **[25 marks]**

Discuss the main considerations in structuring a Management Buyout so that the, often conflicting, needs of key stakeholders are satisficed?

Question 6 **[25 marks]**

Evaluate, the main limitations of Executive Share Option Schemes` ability to foster alignment, and the criticisms of using earnings per share [EPS] growth as a basis for measuring executive performance.