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 – JUNE 2007
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 1 questions from Part I and any three others.
3. Electronic calculators may be used.
4. All workings to be shown.
5. Write legibly.

Part I

Question 1 **[25 marks]**

Briefly discuss the Trade off, Perking order and Signalling (asymmetric information) theories of capital structure policy. To what extent, if at all, are these theories consistent with each other ?
[7,7,7,4 marks]

Question 2 **[25 marks]**

NUST Limited is considering diversifying into the Fast Foods industry. The industry has an average equity beta of 1.5, an average Debt/Equity ratio of 20% and an average marginal rate of corporate tax of 35%.

The project is expected to cost $400 million and generate additional net operating profit of $100 million per year in years 1 to 3 and $120m per year thereafter for the foreseeable future. In addition, the project is expected to generate additional Debt capacity, which will be fully utilized, resulting in Project Debt/Equity ratio of 25%.

You have been hired to advise NUST Ltd whose marginal rate tax is 40%.

The riskfree rate of return and the market risk premium are 20% and 10% respectively.

Advise on the course of action that NUST should take, highlighting the critical assumptions of the Models you have employed. [17, 8 marks]

Part II

Question 3 **[25 marks]**

3.1 It has been argued that, in imperfect product and financial markets, shareholder value is enhanced by the creation off sustainable competitive advantages. Discuss, briefly, the seven drivers of shareholder value in imperfect markets. [15 marks]

3.2 The table below shows the business and financial risk matrix highlighting combinations of business risk and financial risk that would (√) and would not (x) be acceptable to some corporate stakeholders. Explain why the inverse combination of business and financial risk optimises the requirements of lenders, shareholders and directors.

Business risk	Financial risk: Low	Financial risk: High
High	✓	x
Low	x	✓

[10 marks]

<u>Question 4</u> **[25 marks]**

Examine Executive remuneration schemes of cash bonuses, performance shares and share options in the context of executive retention and alignment, highlighting the pros and cons.

<u>Question 5</u> **[25 marks]**

The current trend in corporate restructuring is the strategy of unbundling to unlock shareholder value. Explore the sources of this shareholder value. [25 marks]