

NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
CORPORATE FINANCIAL STRATEGY AND RESTRUCTURING [CFI 4201]

SUPPLEMENTARY EXAMINATION AUGUST 2010

TIME ALLOWED: 3 HOURS

Instructions to Candidates

1. Answer any **FOUR** questions
2. Show **ALL** calculations
3. All questions carry 25 marks each

QUESTION 1

Discuss Trade off, Pecking Order and Signaling Theories of Capital Structure decisions. To what extent are these theories consistent with each other? **(25 marks)**

QUESTION 2

Adven Limited is negotiating a merger with Barca Limited. The following data about the two companies is available:

	Adven Ltd	Barca Ltd
Earnings per share	\$120.00	\$90.00
Dividend per share	\$80.00	\$60.00
Growth rate	9% pa	11% pa
Book value per share	\$4 000.00	\$5 600.00
Market value per share	\$6 500.00	\$8 000.00
Shares outstanding	4 million	1.5 million
P/E ratio	54.17	88.89
Total earnings	\$480 million	\$135 million
Total value of equity	\$26 000 million	\$8 400 million
Projected P/E ratio (after the merger)	80	

Required

- (a) Assuming an exchange ratio of 1.5 shares of Adven for 1 share of Barca, should the shareholders of **both companies** approve the merger? **(7 marks)**
- (b) Calculate the maximum and minimum exchange ratios for the acquiring company (Adven) and the acquired company (Barca). **(8 marks)**
- (c) What are the projected synergistic benefits from the proposed merger? **(6 marks)**
- (d) If the actual exchange ratio agreed upon is 1.5 shares of Adven for 1 share of Barca, how will the synergistic benefits be shared? **(4 marks)**

QUESTION 3

- (a) Discuss the various strategies that can be used to restructure a company that has a wrong financial strategy. **(20 marks)**
- (b) Distinguish a spin off from an equity carve out. **(5 marks)**

QUESTION 4

With reference to a Zimbabwean company in the mature stage of its life cycle, discuss how you would use the seven drivers of value to create shareholder value. **(25 marks)**

QUESTION 5

It is crucial for a company to be able to attract, retain and align good executives. Discuss how a company can make the following decisions with regards to directors' remuneration:

- (a) Gearing of remuneration **(12 marks)**
- (b) Length of performance evaluation period **(7 marks)**
- (c) Performance measures to be used **(6 marks)**

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QUESTION 6

- (a) The directors of Tsmyme Holdings, a conglomerate that has interests in horticulture, mining, manufacturing and tourism, are planning to unbundle the company into four different subsidiaries. They are however not sure how this move will add shareholder value in the long term. Provide justification for their intentions. **(15 marks)**
- (b) A levered firm (L) and an unlevered firm (U) are identical in every respect except that the levered firm has 6% \$200 000.00 debt outstanding. According to the Net Income (NI) approach, the valuation of the two firms is as follows:

	Unlevered firm(\$)	Levered firm (\$)
Net Operating Income	60 000.00	60 000.00
Total cost of debt	0	12 000.00
Net earnings (NI)	60 000.00	48 000.00
Equity capitalisation rate	0.10	0.111
Market value of shares	600 000.00	432 000.00
Market value of debt	0	200 000.00
Total value of the firm	600 000.00	632 000.00

Suppose that you have \$2000 worth of levered firm's shares. Illustrate how you can reduce your outlay to earn the same return through arbitrage. **(10 marks)**

END OF PAPER. GOOD LUCK.