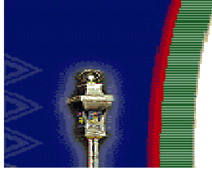

National University of Science and Technology

Think in Other Terms

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 2012

CORPORATE FINANCIAL STRATEGY & RESTRUCTURING [CFI 4201]

TIME ALLOWED: 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Answer **ALL** questions from section A and any **THREE** questions from section B.
2. Electronic calculators may be used.
3. All workings to be shown.
4. Answers to be written only on the top pages.

INFORMATION TO CANDIDATES

1. This paper contains TEN (10) Questions.
2. Section A carries 40 marks and each question in Section B carries 20 marks.
3. This paper contains FOUR (4) printed pages.
4. Candidates may write on the question paper but shall not write in the answer booklet during reading time.
5. The businesses in this question paper are intended to be fictitious.

SECTION A (Answer all questions) [TOTAL 40 MARKS]

QUESTION ONE

Chikaza Limited Company and Site Limited Company are similar, except that Chikaza Limited is unlevered, while Site Limited has $20,000 of 5% debentures outstanding. Given that corporate tax rate is 40%, Net Operating Income(NOI) is $4,000 and cost of equity is 10%.

1.1 Calculate the value of the firms, if M-M assumptions are met. [3 marks]

1.2 Suppose V_{Site}= $36,000. According to M-M do these represent equilibrium values? How will the equilibrium be met? Explain. [1;4 marks]

QUESTION TWO

NUST Ltd has multiple products. The company's debt capacity is 50% of the market value of its assets; the company's equity beta is 1.20. The risk-free rate is 10% and the average market premium is 9%. The corporate tax rate is 30%. NUST has a practice of using WACC in evaluating investment projects. The company is currently considering an electronic project requiring an investment of $50million. The project is expected to generate after-tax free cash flows of $8.85million in perpetuity. According to the finance manager, this project will add 30% debt capacity. In addition, she feels that the electronic business is more risky than the average risk of the firm, and estimates that fluctuations in the electronics business are 1.30 times the fluctuations in the overall business of the company.

2.1 What is NUST's WACC ? [2 marks]

2.2 Why should the project not be evaluated using the firm's WACC? In your opinion how should the project be evaluated? Show your calculations. [2, 6 marks]

QUESTION THREE

Goldware Ltd has earnings this year of $16.5 million, 50% of which is required to take advantage of the firm's excellent investment opportunities. The firm has 2,062,500 shares outstanding, currently selling at $32 per share. Assani Ndlovu, a major shareholder (187,500 shares), has expressed displeasure with a great deal of managerial policy. Management has approached him about selling his holdings back to the firm, and he has expressed a willingness to do this at a price of $32 per share. Assuming that the market uses a constant P/E ratio of 4 in valuing the stock, should the firm buy Ndlovu's shares? (Assume that dividends will not paid be on Ndlovu's shares if they are repurchased). [6 marks]

QUESTION FOUR

Generally, managers are obsessed with growth in earnings per share [EPS] which they usually benchmark against the rate of inflation. In the context of shareholder value, outline the limitations of this criterion for measuring performance. [6 marks]

QUESTION FIVE

Small Company is being acquired by Large Company on a share exchange basis. Their selected data are as follows:

	Large	Small
Profit after-tax($ in millions)	56	21
Number of shares (millions)	10	8.4
Earnings Per Share ($)	5.6	2.5
Price-earnings ratio	12.5	7.5

Determine:

5.1 The pre-merger market value per share. [2 marks]

5.2 The maximum exchange ratio Large Company should offer without the dilution of;

i. EPS [3 marks]

ii. Market value per share [5 marks]

SECTION B (Answer any three questions)

QUESTION SIX

Afex Engineering Company has cost of equity of 17%, cost of debt of 12% and debt ratio of 40%. The company is considering an investment project in its existing line of business. The project will need a cash outlay of $120million. It is expected to generate annual EBDIT of $35million for 8 years. The project will requires $3million each year for net working capital and capital expenditure. Afex will be able to borrow 50% of the project's cost from a financial institution at a rate of 12% p.a., and the loan will be repaid in five equal instalments after 3 years. Corporate tax rate is 30% , and assuming straight-line depreciation for tax purposes, with zero terminal value of the project;

6.1 Determine whether Afex should undertake the project. [10 marks]

6.2 Due to the company's credit worthiness, suppose the management of Afex is able to negotiate for a lower interest rate from the financial institution of 10% p.a. What effect would this have on the firm's NPV? [10 marks]

[TOTAL 20 MARKS]

QUESTION SEVEN

7.1 According to Walter's model the optimum payout ratio can be either zero or 100%. Explain the circumstances under which this is true. [6 marks]

7.2 From a mature Zimbabwean company's perspective, examine the practicality of Modigliani and Miller's Dividend Irrelevance Hypothesis. [14 marks]

[TOTAL 20 MARKS]

QUESTION EIGHT

"The Boston Consulting Group (BCG) matrix and the Product Life Cycle (PLC) concept are invaluable corporate strategic tools." Outline how a manager can use his/her understanding of the BCG matrix in the development of a corporate financial strategy. [20 marks]

[TOTAL 20 MARKS]

QUESTION NINE

9.1 Illustrating your answer with suitable examples, from a Zimbabwean context, distinguish between the concepts of merger, takeover and amalgamation. [8 marks]

9.2 Examine any **four non-valid reasons** of mergers and acquisitions from the perspective of shareholders. [12 marks]

[TOTAL 20 MARKS]

QUESTION TEN

Six managers of RetailOutlet Ltd are discussing the possibility of a management buyout on the part of the company that they work for. The buyout would require a total of $1million, of which $750, 000 would comprise the purchase cost and $250,000 for a small expansion activity and working capital. The managers believe they can jointly provide $60,000.

10.1 Discuss the possible sources of finance that the managers might use to raise the required funds. [8 marks]

10.2 Outline the major factors that a potential supplier of finance will consider before deciding whether to offer finance? In your answer consider what type of security or other conditions might the providers of finance specify? [12 marks]

[TOTAL 20 MARKS]

END OF EXAMINATION PAPER.