UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING

MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY	:	B COMM V
TITLE OF PAPER	:	BUSINESS FINANCE 11
COURSE CODE	:	AC 503
TIME ALLOWED	:	THREE (3) HOURS
INSTRUCTIONS	1.	TOTAL NUMBER OF QUESTIONS ON THIS PAPER: FOUR (4)
	2.	ANSWER ALL QUESTIONS
	3.	WHERE APPLICABLE ALL WORKINGS SHOULD BE SHOWN
	4.	ALL CALCULATIONS ARE TO BE MADE TO THE NEAREST LILANGENI.

NOTE: YOU ARE REMINDED THAT IN ASSESSING YOUR WORK, ACCOUNT WILL BE TAKEN OF ACCURACY OF THE LANGUAGE AND THE GENERAL QUALITY OF EXPRESSION, TOGETHER WITH THE LAYOUT AND PRESENTATION OF YOUR FINAL ANSWER.

SPECIAL REQUIREMENT: PV TABLES

THIS PAPER IS NOT TO BE OPENED UNTILL PERMISSION HAS BEEN GRANTED BY THE INVIGILATER.

QUESTION 1

The board of directors of Winile Ltd. is discussing whether to alter the company's capital structure. Corporate legislation permits Winile Ltd. to purchase its own shares and it is proposed to issue E5 million of new debentures at par, and to use the funds to repurchase ordinary shares.

A summary of Winile current balance sheet as at 30June 2007

	E'000
Fixed Assets (net)	24, 500
Current Assets	12, 300
Current liabilities	(8, 600)
	28, 200
Financed by	
25c ordinary shares	4, 500
Reserves	14, 325
	18, 825
5% debentures redeemable at par in ten years time	9, 375
	28, 200

The company's current ordinary share price is 167cents and its debentures price is E80. Winile's Finance Director does not expect the market price of the existing ordinary shares or debentures to change as a result of the proposed issue of new debentures.

Debenture interest is payable at the end of each year. Issue costs and transactions costs may be assumed to be zero.

Winile's cost of equity is estimated by a leading firm of stockbrokers to be 17%.

Required:

(a) Evaluate the likely effect on the weighted average cost of capital of Winile Ltd if the company restructures its capital.
   (i) If the company pays tax at the rate of 35%.
   (ii) If the company does not expect to pay company taxes for the foreseeable future.

All the relevant calculations must be shown. State clearly any assumptions that you make ***(15marks)***

(b) Winile's Finance Director believes that the market price of the company's existing ordinary shares and debentures will not change. Explain why she might be wrong in her belief and suggest what changes might occur. ***(10marks)***

(Total: 25 marks)

QUESTION 2

As a defence against a possible takeover bid, Managing Director proposes that Cebi make a bid for Bandzile Ltd in order to increase Cebi's size and make a bid for Cebi more difficult. The companies are in the same industry.

Cebi's equity Beta is 1.2 and Bandzile's is 1.05. The risk free rate and market return are estimated to be 10 and 16 percent per annum respectively. The growth rate of after-tax earnings of Cebi in recent years has been 15 percent per annum and Bandzile 12 percent per annum. Both companies maintain an approximately constant dividend pay-out ratio.

Cebi's Directors require information about how much premium above the current market price to offer for Bandzile's shares. Two suggestions are:

(i) The price should be based upon the Balance sheet net worth of the company, adjusted for the current value of land and buildings, plus an estimated after tax profits for the next five years.

(ii) The price should be based upon a valuation using the Dividend Valuation Model, using existing growth rate estimates.

Summarised financial data for the two companies are shown below:

Most recent balance sheet (Figures in Em)

	CEBI		BANDZILE	
Land and Buildings (net)		560		150
Plant and Machinery (net)		720		280
Stock	340		240	
Debtors	300		210	
Bank	20	660	40	490
Less: Trade Creditors	200		110	
Overdraft	30		10	
Tax payable	120		40	
Dividends payable	50	400	40	200
Total assets less current liabilities		1540		720
Financed by:				
Ordinary shares**		200		100
Share premium		420		220
Other reserves		400		300
		1020		620
Loans due after one year		520		100
		1540		720

* Cebi's land and buildings have been recently revalued. Bandzile's have not been revalued for four years, during which time the average value of industrial land and buildings has increased by 25% per annum.

** Cebi 10cents par value, Bandzile 25cents par value.

Most recent Profit and loss Accounts **(Figures in Em)**

	CEBI	**BANDZILE**
Turnover	3500	1540
Operating profit	700	255
Net Interest	120	22
Taxable profit	580	233
Taxation	203	82
Profit attributable to shareholders	377	151
Dividends	113	76
Retained profit	264	75

The current share price of Cebi is 310 cents and of Bandzile is 470cents.

Required:

(a) Calculate the premium per share above Bandzile's current share price that would result from the two suggested valuation methods. Discuss which, if either, of these values should be the bid price.
State clearly any assumptions that you make ***(18marks)***

(b) Assess the Managing Director's strategy of seeking growth by acquisition in order to make a bid for Cebi more difficult. ***(7marks)***

(Total: 25 marks)

QUESTION 3

The XY Corporation, a Swaziland based firm is analysing an investment proposal from its subsidiary in a foreign market. The investment will be for 4 years and is expected to cost P60 000 000 in foreign currency. The current exchange rate is E2.25/P

Year	1	2	3	4
After tax cashflows ('000)	P25 000	P28 000	P30 000	P32 000
Royalties ('000)	P 2 000	P 2 000	P 2 000	P 2 000
Forecast Exchange rate (per P)	E2.3	E2.4	E2.45	E2.5

a) The after tax cashflows are the same as the annual net profit.
b) The after tax cashflows have been calculated as if the company is locally owned in the foreign country.
c) The tax rate in the foreign country is 30%.
d) The royalties have been included in the calculation of the after tax cash flow and treated as an expense.
e) All remittable dividends and royalties will be remitted when realised.
f) The cost of capital for the foreign project is 20%. The cost of capital for remittable cash flows is 26%.
g) For foreign country tax and dividend purposes profit has to be calculated as if the project is a local one.
h) The firm will realise P16 000 000 on termination of the project. This amount is freely remittable.
i) Foreign dividends are taxed in Swaziland at 15%. Capital flows and royalties are not taxed in Swaziland.

Foreign government regulations on foreign investment:

j) Dividends have a withholding tax of 10%.
k) All royalties are freely remittable at the end of each period but a tax of 20% is charged. The above profit and cashflow calculations do not include this tax as royalties have been treated as an expense.
l) There are no capital allowances available to foreign firms.

Required:

Calculate the Net Present Value of the project using:

a) Foreign subsidiary cashflows. ***(7marks)***
b) Remittable cash flows. ***(16 marks)***
c) Should the company invest in the project? ***(2marks)***

(Total: 25 marks)

QUESTION 4

Professor Mhlanga argues that the spark that ignited the LDC (Less-Developed-Country) debt crisis can readily be identified as Mexico's inability to service its outstanding debt to U.S. Commercial Banks and other creditors in 1982. He further states that the causes of the International Debt crisis are complex, rooted in economic policies and development choices going back to the 1970s and 1980s and in some cases to colonial times.

(a) List and explain five major causes of the debt crisis. ***(15 marks)***

(b) Explain why the market solutions to the debt crisis have been unsuccessful. ***(10 marks)***

(Total: 25 marks)

End of Question Paper

Present value interest factor of $1 per period at i% for n periods, PVIF(i,n).

Period	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09	0.10	0.11	0.12	0.13	0.14	0.15	0.16	0.17	0.18	0.19	0.20	0.22	0.24	0.26	0.28
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	0.820	0.807	0.794	0.781
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	0.672	0.650	0.630	0.610
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	0.551	0.525	0.500	0.477
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	0.451	0.423	0.397	0.373
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	0.370	0.341	0.315	0.291
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	0.303	0.275	0.250	0.227
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	0.249	0.222	0.198	0.178
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	0.204	0.179	0.157	0.139
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	0.167	0.144	0.125	0.108
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	0.137	0.116	0.099	0.085
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	0.112	0.094	0.079	0.066
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	0.092	0.076	0.063	0.052
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	0.075	0.061	0.050	0.040
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	0.062	0.049	0.039	0.032
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	0.051	0.040	0.031	0.025
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054	0.042	0.032	0.025	0.019
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045	0.034	0.026	0.020	0.015
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038	0.028	0.021	0.016	0.012
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031	0.023	0.017	0.012	0.009
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026	0.019	0.014	0.010	0.007
25	0.780	0.610	0.478	0.375	0.295	0.233	0.184	0.146	0.116	0.092	0.074	0.059	0.047	0.038	0.030	0.024	0.020	0.016	0.013	0.010	0.007	0.005	0.003	0.002
30	0.742	0.552	0.412	0.308	0.231	0.174	0.131	0.099	0.075	0.057	0.044	0.033	0.026	0.020	0.015	0.012	0.009	0.007	0.005	0.004	0.003	0.002	0.001	0.001
35	0.706	0.500	0.355	0.253	0.181	0.130	0.094	0.068	0.049	0.036	0.026	0.019	0.014	0.010	0.008	0.006	0.004	0.003	0.002	0.002	0.001	0.001	0.000	0.000
40	0.672	0.453	0.307	0.208	0.142	0.097	0.067	0.046	0.032	0.022	0.015	0.011	0.008	0.005	0.004	0.003	0.002	0.001	0.001	0.001	0.000	0.000	0.000	0.000
50	0.608	0.372	0.228	0.141	0.087	0.054	0.034	0.021	0.013	0.009	0.005	0.003	0.002	0.001	0.001	0.001	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000