UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

MAIN EXAMINATION QUESTION PAPER

APRIL 2014

ACADEMIC YEAR 2013/2014

PROGRAMME OF STUDY	:	**Bachelor of Commerce**
YEAR OF STUDY	:	**Year 4 & 5 (Full Time)**
TITLE OF THE PAPER	:	**Business Finance II**
COURSE CODE	:	**AC 428 / AC 513 (M)**
TIME ALLOWED	:	**Three (3) Hours**
TOTAL MARKS	:	**100**
INSTRUCTIONS	1	**There are FIVE (5) questions, ANSWER ALL.**
	2	**Begin the solution to each question on a new page.**
	3	**The marks awarded for a question are indicated at the end of each question.**
	4	**Show your necessary workings.**

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 layout and presentation of your answer.**

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR / SUPERVISOR.

SPECIAL REQUIREMENT: FINANCIAL CALCULATOR

QUESTION 1

(a) How does a tender offer differ from a proxy fight? Why might these two corporate control actions be considered different ways to achieve the same objective? **(3 marks)**

(b) If you wanted to expand your operations into a foreign country with nebulous laws and an unstable political climate, would you favour internal or external expansion? Why? **(3 marks)**

(c) What is the free cash flow theory of mergers? Why do you think that managers might be tempted to pursue size-increasing mergers even when these do not maximize value? **(2 marks)**

(d) What is meant by a change in corporate control? List and describe **five** various ways in which a change of corporate control may occur. **(6 marks)**

(e) Briefly explain what is meant by privatization? Name **three** benefits of privatization. **(4 marks)**

(Question 1 – Total marks : 18)

QUESTION 2

(a) Chidende Smart Products plans to acquire Hutchinson Snazzy Snaps, which will create E8 million in incremental cash flows for Chidende each year for the first six years. Chidende Smart Products plans to divest Hutchinson Snazzy Snaps at the end of the sixth year for E112,500,000. Chidende's beta (β) is 1.2, and is expected to remain so after the acquisition. The risk free rate is 5 percent and the expected return on the market is 16 percent. Chidende has a 100% equity capital structure which will be maintained post-acquisition.

(i) Disregarding taxes, what is the maximum price that Chidende should pay for Hutchinson?

(ii) Chidende has a share price of E23 per share and 8 million shares outstanding. If Hutshinson shareholders are to be paid the maximum price determined in part (a) via a share issue, how many new shares will be issued, and what will be the post-merger share price? **(9 marks)**

(b) Manqoba Manufacturing plans to acquire Mzwandile Chemicals, by giving Mzwandile shareholders 1.75 shares of Manqoba stock per share of Mzwandile. There are 2 million shares of Mzwandile Chemicals outstanding, with a pre-merger-offer price of E25 per share, and Manqoba's pre-offer stock price is E16.50.

(i)What is the control premium being offered by Manqoba Manufacturing?

(ii) If, six months later at the completion of the merger, Manqoba's stock price has dropped to E14 per share, what is the completed control premium percentage? **(5 marks)**

(c) You are the Director of Capital Acquisitions for Lokshin Chicken Dust. One of the projects you are deliberating is the acquisition of Yibekelahleni Mfo!, a company that owns and operates a chain of open wood-flame-grilled chicken spazas. Sibhekile Mndzebele, Yibekelahleni Mfo!'s owner, is willing to sell her business to Lokshin Chicken Dust only if she is offered an all-cash purchase price of E4.5 million. Your project analysis team estimates that the purchase of Yibekelahleni Mfo! will generate the following after-tax marginal cash flow:

Year	**Cash Flow**
1	E1,990,000
2	E1,994,000
3	E1,997,000
4	E2,000,000
5	E2,003,000

If you decide to go ahead with this acquisition, it will be funded with Lokshin Chicken Dust's standard mix of debt and equity, at the firm's weighted average (after-tax) cost of capital of 7.5 percent. Lokshin Chicken Dust's tax rate is 27.5 percent. Should you recommend acquiring Yibekelahleni Mfo! to your CEO? **(7 marks)**

(d) You are the Director of Mergers and Acquisitions for Bigger is Better Ice Cream Company. One of the projects you are analyzing is the acquisition of Nothing Better! Ice Creams, Inc. by your firm. The ice cream company is a wholly owned subsidiary of Sweet Meltz Investments, which has set a firm selling price of E10,000,000. From your work you estimate that Nothing Better! will generate the following incremental cash flows for Bigger is Better:

Year	**Incremental Cash Flow**
1	E1,000,000
2	E1,500,000
3	E3,000,000
4	E4,000,000
5	E4,500,000

To fund the E10 million price, Bigger is Better can use E2 million from internal sources (retained earnings) with a required return of 15 per cent, while the rest would come from a new debt issue yielding 10 per cent. Bigger is Better's tax rate is 28 per cent. Should you recommend acquiring Nothing Better! Ice Cream, Inc. to your CEO? **(8 marks)**

(Question 2 – Total marks : 29)

QUESTION 3

(a) Explain the difference between a net lease and a gross lease. **(3 marks)**
(b) Differentiate between a full-payout lease and a sale and lease-back. **(3 marks)**
(c) State **three** advantages and **three** disadvantages of equipment leases. **(6 marks)**
(d) Potential homeowners need to evaluate many factors before deciding whether to buy or rent. Briefly discuss **five** of these factors. **(5 marks)**

(Question 3 – Total marks : 17)

QUESTION 4

(a) Ntumi Enterprises can acquire Thabiso, Inc for E250,000 in either cash or stock. Both companies are 100% equity financed. The synergy value of the acquisition for Ntumi is E35,000. Currently Ntumi has 25,000 shares outstanding which trade at E29 a share, whereas Thabiso has 15,000 shares outstanding that trade at E14 a share.

(i) What is the value of Thabiso, Inc to Ntumi Enterprises? **(2 marks)**

(ii) For Ntumi and Thabiso, what is the value of the post-merger firm if cash is used? **(3 marks)**

(b) Mcoleli Audit Firm wants to acquire Nomfanelo Audit Firm. Recently, Nomfanelo Audit Firm's stock price increased from E20 to E24 per share, evidently due to its excellent financial performance. Mcoleli Audit Firm thus estimates Nomfanelo Audit Firm's stand-alone price at E24. Mcoleli Audit Firm intends to purchase all 100,000 shares of Nomfanelo Audit Firm for E27 per share (cash offer), expecting a post-merger gain of E800,000. However, the CFO, Phinda Magagula suggests a re-evaluation of the offer, pointing out that the true stand-alone value of Nomfanelo Audit Firm may be E20 per share, not E24 per share. If the stand-alone value is E20 per share, will the merger still generate positive NPV for Mcoleli Audit Firm? **(5 marks)**

(c) Dumsile Airways has a value of E100 million and Timanga Airways has a value of E70 million. Merging the two would enable cost savings with a present value of E20 million. Dumsile Airways purchases Timanga Airways for E75 million. What is the gain from this merger? **(2 marks)**

(d) Sandile Smart Gadgets has a value of E100 million and Sakhile iGadgets has a value of E70 million. Merging the two would enable cost savings with a present value of E20 million. Sandile Smart Gadgets purchases Sakhile iGadgets for E75 million. What is the cost of this merger? **(2 marks)**

(e) Retail Companies Kusenies and Vukanies are valued as follows:

	Kusenies	Vukanies
# of shares	2000	1000
Earnings per share	E10	E10
Shares price	E100	E50

Kusenies now acquires Vukanies by offering one (new) share of Kusenies for every two shares of Vukanies (that is, after the merger, there are 2,500 shares of Kusenies outstanding). If investors are aware that there are no economic gains from the merger, what is the price-earnings ratio of Kusenies's stock after the merger? **(3 marks)**

(f) Fashion Houses Simangele and Nomthandazo are valued as follows:

	Simangele	Nomthandazo
# of shares	2000	1000
Earnings per share	E10	E10
Shares price	E100	E50

Simangele now acquires Nomthandazo by offering one (new) share of Simangele for every two shares of Nomthandazo (that is, after the merger, there are 2,500 shares of Simangele outstanding). Suppose that the merger really does increase the value of the combined firms by E20,000 (i.e., $PV_{SimaNomt} - PV_{Sima} - PV_{Nomt} =$ E20,000). What is the cost of the merger? **(3 marks)**

(g) The following data on a merger is given:

	Mlondie	Mpendulo	Combined
Price per share	E100	E10	
Total earnings	E500	E300	
Shares outstanding	100	40	
Total value	E10,000	E400	E11,000

Mlondie has proposed to acquire Mpendulo at a price of E20 per share for Mpendulo's stock. Calculate the NPV of the merger. **(2 marks)**

(Question 4 – Total marks : 22)

QUESTION 5

(a) Briefly discuss **five** explanations of why multinational firms exist and why they are as large as they are. **(5 marks)**

(b) Anti-corporate advocates criticize multinational corporations for entering countries that have low human rights or environmental standards. Explain **five** of these criticisms/claims. **(5 marks)**

(c) COMESA as a regional economic grouping achieved an FTA on 31 October 2000. In accordance with the tariff reduction schedule which was adopted for the gradual removal of tariffs on intra-COMESA trade in an effort to move towards customs union, this has faced challenges. Explain **four** harmonisation problems in COMESA. **(4 marks)**

(Question 5 – Total marks : 14)

END OF PAPER