FACULTY OF BUSINESS SCIENCES AND MANAGEMENT

DEPARTMENT OF ACCOUNTING

BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING

PART II SECOND SEMESTER EXAMINATION

CORPORATE FINANCE II [BAC2202]

NOVEMBER 2024

DURATION: 3 HOURS

INSTRUCTIONS

1. Answer **all** questions in **Section A**, and any **three** questions from **Section B**.
2. Begin each question on a new page.
3. Show all your workings.
4. Please indicate your study format (Conventional/Block/Parallel) on the cover of your answer script.

INFORMATION

1. Questions may be answered in any order
2. You may use a scientific calculator.

This paper consists of seven (7) printed pages including the cover page

<u>SECTION A COMPULSORY (Answer all questions) [40 marks]</u>
<u>Each question carries 2 marks</u>
QUESTION 1

1. The purpose of financial markets is to:
A. increase the price of common stocks.
B. lower the yield on bonds.
C. allocate savings efficiently.
D. control inflation.

2. Which of the following is a benefit to a private limited company of using retained profit to finance its growth?
A. The business will not be required to pay dividends to its shareholders
B. The business will pay less tax on its profits
C. The amount will not need to be paid back
D. The amount available will always match fully the company's requirements

3.Which of the following best describes a residual dividend policy
A. the percentage of earnings paid out of dividends remains constant.
B. a low, regular dividend is maintained
C. the minimum rate of dividend per share is paid in cash plus bonus shares
D. dividends are paid out of earnings not needed to finance new acceptable capital projects

4. A company may raise capital from the primary market through _____________.
A. Public issue
B. Rights issue
C. Offer for sale
D. All of the above.

5.The constant growth model of equity valuation assumes that _____________.
A. the dividends paid by the company remain constant.
B. the dividends paid by the company grow at a constant rate of growth.
C. the cost of equity may be less than or equal to the growth rate.
D. the growth rate is less than the cost of equity

6.The type of lease that includes a third party, a lender, is called a/an
A. sale and leaseback.
B. direct leasing arrangement.
C. leveraged lease.
D. operating lease

7. Which of the following statements concerning mergers is most correct?
A. A conglomerate merger is a merger of firms in the same general industry, but for which no customer or supplier relationship exists.

B. A horizontal merger is a combination of two firms that produce the same type of good or service.
C. A congeneric merger is a merger of companies in totally different industries.
D. A vertical merger is a union between two companies in the same industry but at different stages of the production process.

8. A merger in which an entirely new firm is created and both the acquired and acquiring firms cease to exist is called
A. Divestiture.
B. Consolidation.
C. Conglomerate
D. Congeneric

9. Leasing of machinery can be categorized as______
A. Structuring decision
B. Investment decision
C. Financing decision
D. Capital budgeting decision

10. ________________ is one that maximizes value of business, minimizes overall cost of capital, that is flexible, simple and futuristic, that ensures adequate control on affairs of business by the owners and so on.
A. Minimal capital structure.
B. Moderate capital structure.
C. Optimal capital structure.
D. Deficit capital structure.

11. Which of the following would be consistent with a conservative approach to financing working capital
A. Financing short term needs with short term funds
B. Financing short term needs with long term debt
C. Financing seasonal needs with long term funds
D. Financing long term needs with short term funds

12. The restructuring of a corporation should be undertaken if
A. the restructuring can prevent an unwanted takeover.
B. the restructuring is expected to create value for shareholders.
C. the restructuring is expected to increase the firm's revenue.
D. the interests of bondholders are not negatively affected.

13. __________ is a payment of additional shares to shareholders in lieu of cash.
A. Stock split.
B. Stock dividend.
C. Extra dividend.

D. Regular dividend.

14. Inventory ratio is a relationship between ______.
A. Cost of goods purchased and cost of average inventory.
B. Cost of goods sold and cost of average inventory, and cost of goods purchased and cost of average inventory.
C. Cost of goods sold and cost of average inventory.
D. None of the options is correct.

Use the following information to answer questions 15,16 , and 17

You are given the following financial data in the case where company A is considering the acquisition, by common stock, of company B.

	Company A	Company B
Present Earnings (000)	$40,000	$10,000
Shares outstanding (000)	10,000	4,000
Earnings per share (EPS)	$4.00	$2.50
Price per share	$64.00	$30.00
Price Earnings (P/E) ratio	16	12

Company A has agreed to offer $36 (20% premium above company B's stock) a share to company B, to be paid in company A's stock.

15. Calculate the exchange ratio**.**

A. 0.56
B. 0.47
C. 0.74
D. 0.83

16.Assuming that the earnings of the component companies stay the same, what will be the EPS of the surviving company after the acquisition?

A. $2.00
B. $4.80
C. $3.25
D.$4.00

17.Calculate the post-merger EPS related to each share of company B previously held.
A. $3.00
B. $2.08
C. $3.18
D. $1.83

18. The method of raising equity capital from existing members by offering securities on pro rata basis is referred to as ______________.
A. Public issue.
B. Bonus issue.
C. Private placement.
D. Bought-Out-Deal

19.The market value of the firm is the result of ____________.
A. dividend decisions.
B. working capital decisions.
C. capital budgeting decisions
D. trade-off between cost and risk

20. A way to analyse whether debt or lease financing would be preferable is to:
A. compare the net present values under each alternative, using the cost of capital as the discount rate.
B. compare the net present values under each alternative, using the after-tax cost of borrowing as the discount rate.
C. compare the payback periods for each alternative.
D. compare the effective interest costs involved for each alternative

SECTION B (Answer any three questions)

QUESTION 2 [20 MARKS]

a. Explain the following dividend policies.
   - **i.** Uniform cash dividend plus bonus policy. **[4 marks]**
   - **ii.** Low regular plus extra dividend policy. **[3 marks]**
   - **iii.** Stable dividend policy. **[3 marks]**

b. The Johnson Metals Company estimates its inventory carrying cost at 15% and its ordering cost at $9 per order. The estimated annual requirement is 96,000 units at a price of $4 per unit.
   - **i.** What is the most economical number of units to order? **[4 marks]**
   - **ii.** How many orders should be placed in a year? **[3 marks]**
   - iii. How often should an order be placed? **[3 marks]**

QUESTION 3 [20 MARKS]

a. Outline any five factors that determine the amount of working capital required by a business. **[10 marks]**

b. Explain the following factors of making new shares
   i. Offer for sale. **[2 marks]**
   ii. Private placement. **[2 marks]**
   iii. Stock Exchange introduction. **[2 marks]**

c. Explain what is meant by a staggered board and a poison pill in takeover defences. **[4 marks]**

QUESTION 4 [20 MARKS]

a. Critically analyse the Preference theory by Miller and Modigliani. **[5 marks]**
b. Using examples explain any five antitakeover amendments that a firm can employ to frustrate the company intending to acquire it in a hostile takeover bid. **[15 marks]**

QUESTION 5 [20 MARKS]

a. The following information has been collected from National Foods Limited for the year ended 2021.

	31 December 2023
Credit sales	3 240000
Purchases of raw materials	1 125000
Raw materials consumed	1 080000
Costofgoodsmanufactured	2 160000
Cost of goods sold	1 800000
Debtors	540 000
Creditors	156 250
Stocks: Rawmaterials	90 000
Work in progress	60 000
Finished goods	25 000

Assuming a 360-day year calculate the following:

i. Raw materials conversion time. **[2 marks]**
ii. Creditors conversion time. **[2 marks]**
iii. Work – in –progress conversion time. **[2 marks]**
iv. Finished goods conversion time. **[2 marks]**

v. Debtor's conversion time. **[2 marks]**

vi. Cash Operating Cycle. **[2 marks]**

b. Using relevant practical examples, explain any four reasons why businesses merge. **[8 marks]**

END OF EXAMINATION PAPER