FACULTY OF BUSINESS SCIENCES AND MANAGEMENT

DEPARTMENT OF ACCOUNTING

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**BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING**

PART II SECOND SEMESTER EXAMINATION

**CORPORATE FINANCE II [BAC2202]**

JUNE 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) 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**

**SECTION A COMPULSORY (Answer all questions) [40 marks]**
**Each question carries 2 marks**
**QUESTION 1**

1. The mixture of debt and equity used by a firm to finance its operations is called:
A. working capital management.
B. financial depreciation
C. capital budgeting.
D. capital structure

2. 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.

3. Which of the following is NOT an example of a financial intermediary?
A. Bindura Nickel Corporation (BNC)
B. Old Mutual Fund.
C. People's Own Savings Bank (POSB)
D. Infrastructural Development Bank of Zimbabwe (IDBZ)

4.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

5. 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.

6.The type of lease that includes a third party, a lender, is called a(n)
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 consolidation happens when similar two large companies join to form one.

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.The following reasons are good motives for mergers except:
(I) Economies of scale
(II) Complementary resources
(III) Diversification
(IV) Eliminating Inefficiencies
A) I only
B) II only
C) III only
D) I, II, and IV only

10. Old Mutual acquiring OK Zimbabwe Limited is an example of:
(I) Horizontal merger
(II) Vertical merger
(III) Conglomerate merger
(IV) Cross-border merger

11. There are **five "C"s** that are considered for determining credit standards. Which of the following is not one of the C's
A. character
B. capacity
C. collateral
D. customer

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. The ________ of a business firm is measured by its ability to satisfy its short-term obligations as they become due.
A) Liquidity

B) Debt
C) Profitability
D) Activity

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 ,17 and 18**
The following information has been collected for the purpose of calculating the cash operatingcycle.

| | 31 December 2000 $ | 2001 $ |
|---|---|---|
| Credit sales | 3 240000 | 3 600000 |
| Purchases of raw materials | 1 125000 | 1 687500 |
| Raw materials consumed | 1 080000 | 1 440000 |
| Costofgoodsmanufactured | 2 160000 | 2 880000 |
| Cost of goods sold | 1 800000 | 2 700000 |
| Debtors Creditors | 540 000 | 800 000 |
| Stocks: Rawmaterials | 156 250 | 375 000 |
| Work in progress | 90 000 | 60 000 |
| Finished goods | 60 000 | 120 000 |
| | 25 000 | 75 000 |

Assuming a 360 day year calculate the cash operating cycle for both years

15. Calculate the raw materials conversion time (RMCT) for year 2000.
A. 30 days
B. 15 days
C. 25 days
D. 50 days

16. Calculate the creditors conversion time (CCT) for year 2001.
A. 50 days
B. 80 days
C. 40 days
D. 20 days

17. Calculate the work – in –progress conversion time for year 2000

A. 15 days
B. 5 days
C. 10 days
D. 25 days

18. Calculate the finished goods conversion time for year 2001.

A. 10 days
B. 20 days
C. 5 days
D. 15 days

19.Which of the following is **not** an advantage of debt financing

A. Cost of debt is lowered because interest on debt is a tax – deductible expense
B. The use of debt instead of instead of ordinary shares does not dilute control
C. Interest on debt is fixed
D. There are no restrictive covenants in debt financing

20. Which of the following is **not** a cost of holding high levels of inventory

A. Purchase costs
B. Storage costs
C. Stores administration costs
D. Setup costs

**SECTION B (Answer any three questions)**

**QUESTION 2 [20 MARKS]**

- **a.** Explain the concept of overtrading and how it can be diagnosed. **[4 marks]**
- **b.** Critically analyze the Dividend irrelevance theory by Miller and Modigliani **[10 marks]**
- c. Explain the following dividend policies
  - **i.** Uniform cash dividend plus bonus policy **[3 marks]**
  - **ii.** Multiple dividend increase policy **[3 marks]**

**QUESTION 3 [20 MARKS]**

d. A company is planning to acquire a machine with an economic life of ten years at a cost of $400 million. The machine will only be used for ten years after which the product line will be discontinued. The company will borrow the required $400 million at an interest rate of 20% per year in order to finance the purchase of the machine. The machine will be depreciated on a straight line basis at $40 million per year and will have a scrap value of $300 million after five years of use.

Alternatively, the company can lease the machine for a period of five years at a rental charge of $125 million per year payable in advance. The lessor will maintain the equipment at no additional charge to the company. However, if the company buys the machine it will have to maintain it at a cost of $20 million per year. This cost is payable in advance to a maintenance contractor. The tax rate applicable to the company is 25%.

a. Evaluate whether the company should lease or purchase the machine. Show all relevant calculations. **[18 marks]**

b. Explain with the aid of an example a sale and lease back method of financing. **[2 marks]**

**QUESTION 4 [20 MARKS]**

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) | $20,000 | $5,000 |
| Shares outstanding (000) | 10,000 | 4,000 |
| Earnings per share (EPS) | $4.00 | $2.50 |
| Price per share | $54.00 | $30.00 |
| Price Earnings (P/E) ratio | 8 | 6 |

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

**a)** Calculate the exchange ratio. **[2 marks]**

b) Assuming that the earnings of the component companies stay the same, what will be the EPS of the surviving company after the acquisition? **[2 marks]**

c) Calculate the post-merger EPS related to each share of company B previously held.

**[2 marks**

d. Evaluate the use of the Just In Time model in managing inventory levels and supplier relationships for a business **[10 marks]**

e**.** Explain any two advantages of a scrip dividend **[4 marks]**

**QUESTION 5 [20 MARKS]**

a. A manufacturing company places a semi-annual order of 24,000 units at a price of $20 per unit. Its carrying cost is 15% and the order cost is $12 per order.
   Required:
   i. What is the most economical order quantity? **[4 marks]**
   ii. How many orders need to be placed? **[4 marks]**

b. Explain what is meant by the following takeover defenses used by companies to avoid a takeover
   i. Liability restructuring **[3 marks]**
   ii. Leveraged recapitalization **[3 marks]**
   **iii.** Staggered board **[3 marks]**
   iv. Poison put **[3 marks]**

**END OF EXAMINATION PAPER**