UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

MAIN EXAMINATION QUESTION PAPER

APRIL 2015

ACADEMIC YEAR 2014/2015

PROGRAMME OF STUDY	:	Bachelor of Commerce
YEAR OF STUDY	:	Year 4 & 5 (Full Time) Level 6 Part-time
TITLE OF THE PAPER	:	Business Finance II
COURSE CODE	:	AC 428 / AC 513 (M)
TIME ALLOWED	:	Three (3) Hours
TOTAL MARKS	:	120
INSTRUCTIONS	1	There are FOUR (4) 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) Yolisa Service Company (YSC) is offering to exchange 2.5 of its own shares for each share of target firm Welile Corporation shares as consideration for a proposed merger. There are 10 million Welile Corporation shares outstanding, and its share price was E60 before the merger offer. YSC's pre-offer share price was E30.

(i) What is the control premium percentage offered? **(2 marks)**

(ii) Now suppose that when the merger is consummated eight months later, YSC's share price drops to E25. At that point, what is the control premium percentage and total transaction value? **(3 marks)**

(b) Zinhle Gule is the Director of Capital Acquisitions for Sakhiseni Hotel Company. One of the projects she is deliberating is the acquisition of Msime Hospitality, a company that owns and operates a chain of bed-and-breakfast inns. Nhlonipho Sukati, Msime's owner, is willing to sell his company to Sakhiseni only if he is offered an all-cash purchase price of E5 million. Zinhle's project analysis team estimates that the purchase of Msime Hospitality will generate the following after-tax marginal cash flow:

Year	Cash Flow
1	E1,000,000
2	E1,500,000
3	E2,000,000
4	E2,500,000
5	E3,000,000

If she decides to go ahead with this acquisition, it will be funded with Sakhiseni's standard mix of debt and equity, at the firm's weighted average (after-tax) cost of capital of 9 per cent. Sakhiseni's tax rate is 30 per cent. Should Zinhle recommend acquiring Msime Hospitality to her CEO? **(7 marks)**

(c) Tanele Zulu is the Director of Capital Acquisitions for Xoliswa Software Company. One of the projects she is considering is the acquisition of Velile Geekware, a private software company that produces software for finance professors. Velile Mamba, the owner of Geekware, is amenable to the idea of selling her enterprise to Xoliswa, but she has certain conditions that must be met before selling. The primary condition set forth is a non-negotiable, all-cash purchase price of E20 million. Tanele's project analysis team estimates that the purchase of Geekware will generate the following marginal cash flow:

Year	Cash Flow
1	E1,000,000
2	E3,000,000
3	E5,000,000
4	E7,500,000
5	E7,500,000

Of the E20 million in cash needed for the purchase, E5 million is available from retained earnings, with a required return of 12 per cent, and the remaining E15 million will come from a new debt issue yielding 8 per cent. Xoliswa's tax rate is 40 per cent. Should Tanele recommend acquiring Geekware to her CEO? **(10 marks)**

(d) Mvelo Magagula Inc. plans to acquire Jolwane Hlanze Inc. The acquisition would result in incremental cash flows for Mvelo of E10 million in each of the first five years. Mvelo expects to divest Jolwane at the end of the fifth year for E100 million. The β for Mvelo is 1.1, which is expected to remain unchanged after the acquisition. The risk-free rate, *Rf*, is 7 per cent, and the expected market rate of return, *Rm*, is 15 per cent. Mvelo is financed by 80 per cent equity and 20 per cent debt, and this leverage will also remain unchanged after the acquisition. Mvelo pays interest of 10 per cent on its debt, which will also remain unchanged after the acquisition.

a. Disregarding taxes, what is the maximum price that Mvelo should pay for firm B?

b. Mvelo has a share price of E30 per share and 10 million shares outstanding. If Firm B shareholders are to be paid the maximum price determined in part (a) via a new share issue, how many new shares will be issued, and what will be the post merger share price? **(14 marks)**

(Question 1 – Total marks : 36)

QUESTION 2

(a) (i) Buyani Dlamini Enterprises, an American Guava Juice company is considering opening a new manufacturing plant in France. The cost of the new plant will be €25 million and the plant is expected to generate after tax cash flows of €10 million at the end of each year for the next 4 years. After that the plant will be worthless. The current €/$ exchange rate is €0.8166/$. The expected rate of inflation for the U.S is 2.5% per year. The risk free rate in the U.S. is 4% and the risk free rate in France is 6%. What is the 2-year $/€ forward exchange rate? **(2 marks)**

(ii) What is the NPV of the investment in US dollars when evaluating the € denominated cash-flows? Assume a required return of 15%. **(3 marks)**

(b) Precious Kunene is a French wine producer who has a contract to sell $10,000,000 worth of wine in the U.S. for dollars 6 months in the future. If she would like to hedge this position, what could she do to hedge the currency risk involved in this transaction? **(2 marks)**

(c) With globalization here to stay and the internet spreading its web across most cultures and continents, financial managers and businessmen have to be well-equipped with knowledge about business practices, policies, and issues related to investing and managing funds across the globe. Discuss **five** cultural and political differences permeating business practices in different countries. **(10 marks)**

(d) Fluctuations in exchange rates cause a firm's future cash inflows, either from remittances from customers or from profits being sent home to vary significantly leading to possible losses and gains from transaction, operating and translation exposure. Discuss these three risk exposures. **(6 marks)**

(e) What does it mean to nationalize a business? Briefly discuss **three** ways a domestic company can minimize the risk of nationalization of its foreign operations? **(5 marks)**

(f) Should you recommend undertaking the following project?

EXAMPLE 18.3 **Domestic currency and foreign currency approaches for an NPV decision**

Problem Surfboards U.S.A. wants to produce and sell surfboards in Mazatlan, Mexico. The company has calculated the following after-tax incremental cash flow in pesos using a five-year project window:

- Initial investment of 120,000,000 pesos
- Operating cash flow

  Year 1: 30,000,000 pesos
  Year 2: 45,000,000 pesos
  Year 3: 56,000,000 pesos
  Year 4: 48,000,000 pesos
  Year 5: 34,000,000 pesos
- Working capital increases or decreases

  Investment increase in working capital: 6,000,000 pesos
  Recovery (decrease) in working capital, Year 5: 6,000,000 pesos

The appropriate discount rate for this project would be 12% in the United States. The anticipated inflation rate in the United States is 4%, and the anticipated inflation rate in Mexico is 7%. Let's assume a current indirect exchange rate of 13.5 pesos per dollar.

(10 marks)
(Question 2 – Total marks : 38)

QUESTION 3

(a) Describe the key aspects of:
(i) Finance leases **(2 marks)**

(ii) Hire purchase **(2 marks)**

(iii) Sale and leaseback **(2 marks)**

(iv) Discuss **three** critical conditions under which leasing may be advantageous. **(3 marks)**

(v) Briefly explain how the lessor's position changes as the lessee undergoes financial distress. **(2 marks)**

(b) Khulekani Dlamini's daughter who is studying in the U.S. has been shopping for a new car, and the best purchase price she can get is $15,000. She has been offered a lease with 36 month-end payments of $249 and a residual value of $7,500. The interest rate that the bank would charge her to borrow money is 9% (APR). What is the NPV of the lease arrangement? (Ignore taxes.) **(2 marks)**

(c) Suppose that a 10-year lease saves E200,000 per year in after-tax cash flows, compared to using a loan to purchase an asset. All else equal, and given a usable life of 10 years with no salvage value, what is the advantage of the lease given a discount rate of 7%? **(2 marks)**

(d) Kanyanta Chileshe Company acquired equipment on January 1, 2014, through a leasing agreement that required an annual payment of E30,000. Assume that the lease has a term of five years and that life of the equipment is also five years. The lease is treated as a capital lease, and you are to calculate the Fair Market Value of the equipment. Khanyanta uses the straight-line method to depreciate its fixed assets. The effective annual interest rate on the lease is 8 percent.

Required:

(i) Compute the amounts that would complete the table:

Date	**Balance Sheet Value of Equipment**	**LeaseHold Obligation**	**Interest Expense**	**Depreciation Expense**	**Total Expense**
1/1/14					
12/31/14					
12/31/15					
12/31/16					
12/31/17					
12/31/18					

(ii) Compute rent expense for 2014 - 2018 if the lease is treated as an operating lease.

(iii) Compute total expense over the 5-year period under the two methods and comment.

(11 marks)
(Question 3 – Total marks : 26)

QUESTION 4

(a) Globalization broadly refers to the expansion of global linkages, the organization of social life on a global scale, and the growth of a global consciousness, hence to the consolidation of world society. This has led to the inexorable integration of markets, nation-states, and technologies to a degree never witnessed before in a way that is enabling individuals, corporations and nation-states to reach around the world farther, faster, deeper and cheaper than ever before.

Briefly discuss **five** drivers of globalisation. **(10 marks)**

(b) Regional integration initiatives in Africa have a long history, dating back to the establishment of the South African Customs Union (SACU) in 1910 and the East African Community (EAC) in 1919. Since then, a number of regional economic communities (RECs) have been formed across the continent, particularly since the 1970s. Currently, there are about ten or so regional economic groupings in Africa. Today, there is no country in Africa that is not a member of at least one regional economic group. However, research result shows that regional groupings had insignificant effect on the flow of bilateral trade. The review of the issues indicates that the performance of regional blocs is mainly constrained by problems which seem to have made building successful economic groupings in Africa a daunting task, despite its perceived importance in the increasingly globalised world.

Briefly discuss **five** of these problems. **(10 marks)**
(Question 4 – Total marks : 20)

END OF QUESTION PAPER