UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

MAIN EXAMINATION PAPER NOVEMBER 2018 ACADEMIC YEAR 2018/2019

PROGRAMME OF STUDY	Bachelor of Commerce
YEAR OF STUDY	Year 4 (Full Time/Part Time)
TITLE OF THE PAPER	Corporate Finance II
COURSE CODE	ACF 417/AC 426/ AC514
TIME ALLOWED	Three (3) Hours

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 ONE

LWS Ltd, a manufacturing firm listed on the Johannesburg Stock Exchange, wish to measure their weighted average cost of capital. You have been provided with the following data:

Equity: The firm has 1 million common shares outstanding. The next two annual dividends will be R3.15 and R3.40 per share respectively, whereafter the dividend will grow at 8% per annum indefinitely. The required return on ordinary shares is 12%.

Debt: The firm has twenty thousand 10% semi-annual coupon bonds trading at 102% of par, with 5 years to maturity. The par value of each bond is R1000.

Preference shares: The firm has two hundred and fifty thousand 8% preference shares with a par value of R100 and a current dividend yield of 6.25%.

The firm is in the 30% tax bracket.

Required:

(a) Calculate the current price of a LWS Ltd ordinary share. **(4 marks)**

(b) Calculate the current price of a LWS Ltd preference share. **(4 marks)**

(c) Calculate LWS Ltd's after-tax cost of debt. **(8 marks)**

(d) Calculate LWS Ltd's Weighted Average Cost of Capital (WACC). **(14 marks)**

Note: *Round off all prices to the nearest cent, values to the nearest lilangeni, interest factors and decimalized interest rates to four decimal places, and decimalized weightings to four decimals.*

(Total 30 marks)

QUESTION TWO

With the aid of fully labeled diagrams, show similarities and differences (compare and contrast) between Modigliani and Miller (M & M) Proposition II <u>with</u> and <u>without</u> taxes.

(Total 25 marks)

QUESTION THREE

Link Park Corporation is comparing two different capital structures, an all-equity plan (Plan I) and a levered plan (Plan II). Under Plan I, Link Park would have 100,000 shares of stock

outstanding. Under Plan II, there would be 50,000 shares of stock outstanding and E15 million in debt outstanding. The interest rate on the debt is 10 percent and there are no taxes.

You are required to answer the following questions

(a)   If EBIT is E2,000,000, which plan will result in the higher EPS? *(10 marks)*

(b)   If EBIT is E7,000,000, which plan will result in the higher EPS? *(10 marks)*

(c)   What is the break-even EBIT?   *(5 marks)*

(Total 25 marks)

QUESTION FOUR

(a) State any five disadvantages of Gordon's Dividend Valuation Model   **(10 Marks)**

(b) Assume a long straddle with the following information / price:

Call option exercise price = $50, premium = $5.5, Put option price exercise = $50, premium = $4.5.

Required

i.   Calculate your profit / loss if the spot price is $60.   **(10 Marks)**

ii.   Draw and fully label a diagram of this long straddle.   **(10marks)**

Total Marks   20 Marks

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