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UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

SUPPLIMENTARY EXAMINATION PAPER MAY 2019 ACADEMIC YEAR 2018/2019

PROGRAMME OF STUDY	**Bachelor of Commerce**
YEAR OF STUDY	**Year 4 (Full/Part Time)**
TITLE OF THE PAPER	**Advanced Business Finance**
COURSE CODE	**ACF 418/AC 428 /AC 513**
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.

QUESTION ONE

a) A U.S. firm wishes to invest in Europe and its analysis a potential project has yielded the following projected cash flows in euros

Initial Cost	Year 1	Year 2	Year 3
- €2,000,000	€900,000	€850,000	€800,000

Assume risk-free rate in Europe is 5%, U.S. risk free rate is 3% and the spot exchange rate is $0.95/€. The company estimates that cost of capital for this project is 10% (5% risk premium)

Required

a) Evaluate this project and advise the company directors whether they should take up the project using

i. The Foreign Currency Approach. **6 Marks**

ii. The Home Currency Approach. **9 Marks**

b) A UK company is exporting £1 million of goods to a Canadian firm when the spot rate of exchange is C$1.60/£. It invoices the customer in the home currency. The three-month forward rate is C$1.65/£. The Canadian firm is given three months to pay. Three months later;

Scenario 1: The dollar has strengthened against the pound to C$1.5/£.

Scenario 2: Now assume that the dollar has weakened against sterling to C$1.8/£.

Calculate the exporter's profit/loss under each scenario if it uses a forward contract to hedge its revenue. **5 Marks**

c) George Smith has saved up $10,000 for investing purposes. He sees that the CD rate in Japan is 5% for the coming year and only 4% in the United States. He also sees that the current indirect exchange rate is 120 yen per US dollar. Looking at the forward rates, George sees that the one-year forward indirect rate is 125. Can he exploit this situation to his gain? Explain. **5 Marks**

Total 25 Marks

QUESTION TWO

Blue Print Technologies is working on acquiring a rapid growth software company, KZN Corporation.

KZN Corporation has 10 million shares in issue with a total market value of E130 000 000, and an equity beta of 1.5.

Post-acquisition, Blue Print Technologies expect KZN to start generating positive incremental after-tax cash flows of E10 million at the end of the fourth year. These positive cash flows should grow at a rate of 25 percent per year during years 5 and 6, and at a constant rate of 10 percent per year thereafter.

If the acquisition goes ahead, Blue Print Technologies will increase KZN's debt ratio from 0.45 to 0.65, and this increase will provide an annual perpetual interest tax shield of E1 500 000. The applicable cost of debt is 10%.

The expected return on the market is 12% and the risk free rate is 7%. The corporate tax rate, payable by both companies, is 30%.

Blue Print Technologies has 60 million shares and each share is currently trading at E12 each.

Required:

(a) Calculate the discount rate Blue Print Technologies should use in valuing KZN's incremental cash flows. **(5 marks)**

(b) Calculate the value of the incremental after-tax cash flows and the interest tax shield of acquiring KZN. **(8 marks)**

(c) Calculate the maximum cash price that Blue Print Technologies would be willing to offer for each KZN share. **(5 marks)**

(d) If Blue Print Technologies decides to offer R180 million worth of newly-issued shares in the post-merger company instead of cash, calculate the exchange ratio that should be offered to KZN's shareholders. **(7 marks)**

Total 25 Marks

QUESTION THREE

STAC investments need to upgrade its mainframe systems. A suitable one costs E240, 000. The systems can be purchased or leased. The terms of the purchase and lease agreements are as follows;

Lease

The lease would require annual end-of-year payments of E78, 400 over four years. Maintenance costs of E 8,000 per annum will be paid by the lease. The lessee will also purchase the assets for E26, 000 at the end of the lease

Purchase

The cost will be financed through FNB bank. It would require a four year 16% loan with end of year payments for the four years

STAC will pay insurance and maintenance costs of E10, 000 per annum. At the end of the period the equipment will be sold at its scrap value of E20, 000. Straight line depreciation method is used.

Additional information

- STAC is in the 30% tax bracket.
- The before tax cost of debt is 10%.

Required

a) Determine the after tax cash outflows and the present value of each cash outflow under both alternatives **25 Marks**

b) State the alternative you would recommend and explain why. **5 Marks**

Total 30 Marks

QUESTION FOUR

1. Which of the statements below is FALSE?
   A. One way to hedge the future conversion of known sales is to enter into a forward contract at the time of the sale and lock in an exchange rate for the foreign currency to U.S. dollars.
   B. The forward rate is the current spot rate divided by the different anticipated inflation rates between two countries.
   C. Operating exposure reflects the impact on the long-run viability of a foreign business when unexpected change in exchange rates move against the domestic company.
   D. The forward rate is the current spot rate times the different anticipated inflation rates between two countries.

2. The following is not a way by which MNCs can defend against political risk.
   A. Keeping critical operations private.
   B. Financing operations and assets with local money.
   C. Receiving primary inputs outside the local economy.
   D. None of the above.

3. Specific issues related to cultural differences can arise in the management of a multinational enterprise. All of the following are related to cultural differences EXCEPT:
   A. a requirement to have local management.
   B. issues with promotion of women into management positions.
   C. issues with observation of religious holidays.
   D. nationalization of the assets of a company by the foreign government.

4. The hubris hypothesis postulates that
   A. Managers of target firms are lazy.
   B. Managers of the acquiring firm are very good in turn around strategies.
   C. Managers of the acquiring firm normally over-estimates their own abilities.
   D. Mangers of the acquiring firm normally under-estimates their own abilities.
   E. None of the above.

5. Which of the following is false?
   A. Using cash to purchase another firm has the advantage that the acquiring firm's shareholders retain the same level of control over their company.
   B. Using cash to purchase another firm has the advantage that its simplicity and precision gives a greater chance of acceptance by the target shareholders.
   C. Using cash to purchase another firm has the possible disadvantage for the target shareholders of realizing a capital gain and therefore the payment of tax.
   D. Using cash to purchase another firm has the advantage to the acquiring firm's shareholders of being able to play the price-to-earnings ratio game.

6. The main reason for a merger is that the value of the combined firm should be greater than the sum of the values of the individual firms prior to the merger. This value is referred to as
   A. Cynergy.
   B. Synergy.
   C. Signage.
   D. None of the above.

7. Which of the following statements most accurately describes translation risk?
   A. The risk that transactions already entered into in a foreign currency, or for which the firm is likely to have a commitment, will have a variable value in the home currency because of exchange rate movements.
   B. Financial data denominated in one currency are then expressed in terms of another currency; exchange rate movements can distort comparability.
   C. A company's value may decline as a result of forex movements causing a loss of competitive strength.
   D. D Loss may result from foreign exchange movement due to the action of governments.

8. Operating exposure reflects the impact on the short-run viability of a foreign business when unexpected exchange rates move against the domestic company. True or False

9. Which of the statements below is FALSE?
   A. One way to hedge the future conversion of known sales is to enter into a forward contract at the time of the sale and lock in an exchange rate for the foreign currency to U.S. dollars.
   B. The forward rate is the current spot rate divided by the different anticipated inflation rates between two countries.

C. Operating exposure reflects the impact on the long-run viability of a foreign business when unexpected change rates move against the domestic company.
D. The forward rate is the current spot rate times the different anticipated inflation rates between two countries.

10. In regard to the cultural risks related to human resources management, which of the statements below is TRUE?
    A. In some countries, women are restricted from management positions.
    B. The hiring of local citizens instead of bringing in foreign expatriates is often a necessary part of doing business abroad.
    C. Foreign expatriates would find it difficult living and working in a community where they are seen as taking away wages and livelihood from local citizens.
    D. All of these statements are true.

(Total Marks 20)

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