UNIVERSITY OF ESWATINI

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

MAIN EXAMINATION PAPER JUNE 2020

PROGRAMME	**:**	**BACHELOR OF COMMERCE**
TITLE OF PAPER	**:**	**ADVANCED BUSINESS FINANCE**
COURSE CODE	**:**	**ACF 418 / AC/428/ AC 513**
TOTAL MARKS	**:**	**100 MARKS**
EXAM PERIOD	**:**	**AUGUST, 2020**
TIME ALLOWED	**:**	**THREE (3) HOURS**

INSTRUCTIONS:

1. There are four (4) questions, ANSWER ALL.
2. Begin the answer to each question on a new page.
3. Show all necessary calculations.
4. The marks awarded for a question are indicated at the beginning of each question.
5. All questions carry equal marks.

Note: You are reminded that in marking your script, account will be taken of the accuracy of calculations and the clarity of presentation of your answers.

THIS PAPER MUST NOT BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR OR SUPERVISOR.

SPECIAL REQUIREMENTS: FINANCIAL CALCULATOR

Question 1 (25 marks)

Igboji Inc., a US company, is considering the establishment of a subsidiary in Eswatini that would manufacture laptops locally. Igboji's financial managers have asked the manufacturing, marketing, and financial departments to provide them with relevant input so they can apply a capital budgeting analysis to this project. In addition, some Igboji executives have met with government officials in Eswatini to discuss the proposed subsidiary. The project would end in three years. The information pertaining to the project is as follows:

The project would require an initial investment of *E*24,000,000, which includes funds to support working capital. The existing spot rate is $0.068 per Lilangeni.

The estimated price per laptop in the next 3years are *E*6100, *E*6250, and *E*6400; and the demand schedules during each of the next 3 years are 2500 units, 2600 units, and 2750 respectively.

The variable costs (for materials, labour, etc.) per unit have been estimated and consolidated for the next 3years as *E*2900, *E*2700, and *E*3100 respectively. The expense of leasing extra office space is *E*1,100,000 per year. Other annual overhead expenses are expected to be *E*1,200,000 per year.

The Eswatini government will impose a 22 percent corporate tax rate on income. In addition, it will impose an 8 percent withholding tax on any funds remitted by the subsidiary to the Igboji Inc.

The U.S. government will allow a tax credit on taxes paid in Eswatini; therefore, earnings remitted to the U.S. parent will not be taxed by the U.S. government.

The Igboji subsidiary in Eswatini plans to send all net cash flows received back to the parent firm at the end of each year.

The 3years projected forward exchange rates of the US dollar per lilangeni are $.068, $0.072, and $0.076, respectively. .

The Eswatini government will pay Igboji Inc USA *E*4,600,000 million to assume ownership of the subsidiary at the end of 3 years. Assume that there is no capital gains tax on the sale of the subsidiary.

Igboji Inc., requires a 12.5 percent return on this project.

You are required to:

(i) Determine the dollar cash flows to be remitted to the Igboji Inc. in each year. **(12 marks)**

(ii) Calculate the net present value (NPV) using the calculated dollar cash flows. **(10 marks)**

(iii) Invoke the NPV decision rule to advice Igboji Inc. on whether to establish the laptop manufacturing company in Eswatini or no not. **(3 marks)**

Question 2 (25 marks)

UNESWA Investment Ltd have *E*10,000,000 available for 180 days with two investment options: **(a)** invest in Eswatini financial market for 180days at 8% interest per annum, or **(b)** invest in USA Treasury Bills for 180days at 4% interest rate per annum. The *E*/$ spot exchange rate is *E*14.800/$.

You are required to:

(i) Calculate the 180day lilangeni/dollar (*E*/$) forward exchange rate and comment on your answer. **(8 marks)**

(ii) Use the forward exchange rate computed from question 2(i) above to evaluate UNESWA Investment Ltd's arbitrage profit or loss from the two investments. **(13 marks)**

(iii) Comment on whether interest rate parity (IRP) condition exists in the transactions. **(4 marks)**

Question 3 (25 marks)

First Bank plc has 25,000,000 shares in issue, which are currently trading at a market price of 1600 cents each. The bank is considering the acquisition of African Insurance plc, which has 15,000,000 shares in issue, trading at a market price of 640 cents each.

African Insurance's net cash flow after tax in the year just ended was *E*9,000,000. First Bank plc expects that managerial and other synergies arising out of the acquisition would result in African Insurance plc's after tax net cash flow increasing by 7% per year in the first 3 years after acquisition, and thereafter by an average rate of 4% per year for the foreseeable future.

The acquisition will involve transaction costs of *E*4,500,000, including the fees of the advisers appointed by First bank plc to plan the acquisition and provide advice on post-acquisition integration.

The appropriate discount rate for evaluating the cash flows of African Insurance plc for acquisition is estimated at 9.2%.

You are required to:

(i) Estimate the post-acquisition value of African Insurance plc. **(14 marks)**

(ii) Determine the financial benefit of acquiring African Insurance plc. **(6 marks)**

(iii) Comment on the financial benefit(s) that is expected to arise as a result of the acquisition of African Insurance plc **(5 marks)**

Question 4 (25 marks)

Dlamini Construction Company (DCC) Limited is planning to acquire new earthmoving equipment at a cost of *E*10,000,000, and is considering the following alternative sources of finance: (a) A bank loan for the full cost of the equipment, repayable over four years in equal annual instalments incorporating interest at a rate of 5% per annum, the first instalment to be paid one year from the date of taking out the loan. (b) A finance lease with an annual lease rental of *E*223,000. The first rental is payable in advance, followed by further annual rental payments for the next four years. The equipment would have no residual value at the end of the period of four years.

You are required to:

(i) Calculate the annual instalment that would be payable under the bank loan. **(6.5 marks)**

(ii) Compute the proportion of principal repayment, interest charges, in each of the four years and in total. **(10 marks)**

(iii) Discuss the qualitative factors to be considered in evaluating a lease proposal from the lessee perspective. **(8.5 marks)**

END OF PAPER