

UNIVERSITY OF ESWATINI
DEPARTMENT OF BUSINESS ADMINISTRATION
EXAMINATION PAPER FEBRUARY 2021

PROGRAMME : MASTER OF BUSINESS ADMINISTRATION

TITLE OF PAPER : ADVANCED CORPORATE FINANCE

COURSE CODE : ACF643

TOTAL MARKS : 100 MARKS

TIME ALLOWED : THREE (3) HOURS

- INSTRUCTIONS
- 1 This paper consists of **eight (8)** numbered pages, including this page and Appendix A which contains useful formulae.
 - 2 There are **FIVE (5)** questions of 25 marks each. Answer **ANY FOUR (4)** questions.
 - 3 Begin solutions to each question on a new page.
 - 4 Show all the necessary workings.
 - 5 Round off all prices to the nearest cent, values to the nearest lilangeni and decimalized interest rates to four decimal places, and decimalized weightings to four decimals.

Note: You are reminded that in assessing your work, account will be taken of accuracy of the language and general quality of expression, together with layout and presentation of your answer.

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

Question 1 (25 marks)

Manzini Investments is strongly diversified firm and has been experiencing amazing growth over the past six years. However, the firm's growth is now moderating because it is facing stiff competition mainly from imports from China and South Africa. Although Manzini has consistently paid very low dividends but it has more free cash flow to equity. The following information relates to Manzini Investments.

Current information (2018)

Revenue per share	E60
Capital expenditure per share	E10
Depreciation per share	E3
EPS	E20

Inputs for the high growth

Duration of the high growth	3 years
ROE	30%
Payout ratio	30%

Inputs for the stable growth period

ROE	10%
Retention ratio	50%

The following information applicable to both the high growth and stable growth period

Beta	1.8
Treasury bills rate	4.5%
Return on the market	7.5%
Working capital requirements	25% of revenues
Debt to equity ratio	25%

Required:

(a) Calculate the value of Manzini Investments using the relevant approach.

[17 marks]

(b) Discuss some the scenarios where it is difficult or impossible to use the valuation approach model you used in (a).

[8 marks]

Question 2 (25 marks)

You have been presented with the financial statements of a grocery store Tanaka Stores Ltd. The firm's latest abridged financial statements are as follows:

Tanaka Stores Ltd		
Statement of Comprehensive Income for the year ending 28 February 2020		
	2020	2019
	(R 000's)	(R 000's)
Turnover	96 100	124 900
Cost of Sales	44 170	59 920
Selling, general & admin expenses	32 630	39 380
PBIT	19 300	25 600
Interest paid	6 300	7 500
PBT	13 000	18 100
Taxation	3 900	5 430
NPAT	9 100	12 670

Tanaka Stores (Pty) Ltd		
Statement of Financial Position as at 28 February 2020		
	2020	2019
	(R 000's)	(R 000's)
Equity & Liabilities		
Shareholders' equity	64 900	73 100
Share capital @ E1.00 each	50 000	52 500
Retained earnings	14 900	20 600
Liabilities	106 950	106 700
Long-term liabilities	78 750	81 000
Overdraft	1 000	0
Accounts payable	27 200	25 700
Total Equity & Liabilities	171 850	179 800
Assets		
Non-current assets	109 600	106 700
Current assets	62 250	73 100
Inventory	32 750	38 500
Accounts receivable	26 400	30 550
Cash	3 100	4 050
Total Assets	171 850	179 800

Additional information

- Tanaka Stores is able to sustain the current growth rate of 20% in EVAs for the next four years after which the growth rate will slow down to 1% for the foreseeable future.
- Tanaka Stores' current beta is 1.5, the cost of debt is 5%, the risk free rate is 2.5% and the market risk premium is 5%.
- The current total debt ratio is considered optimal and will not change in the foreseeable future and the tax rate is 30%.

Required

Calculate the firm value of Tanaka Stores Ltd based on the Economic Value Added (EVA) model.

Question 3 (25 marks)

Fine Fashion Ltd (FFL) a listed company with clothing retail company wants to merge with Royal Blue Fashion Ltd (RBFL), a young and dynamic exclusive and designer clothes company.

The following current financial information is provided for the two companies:

Sky Blue Ltd and Fine Fashion Ltd**Income Statements for the year ending 28 February 2020**

	RBFL (R 000's)	FFL (R 000's)
Turnover	46 800	120 900
Cost of Sales	22 220	66 495
Selling, general & admin expenses	10 420	30 657
Depreciation	2 260	9 240
PBIT	11 900	26 598
Interest paid	2 600	7 988
PBT	9 300	18 610
Taxation	2 790	5 583
NPAT	6 510	13 027

Royal Blue Fashion Ltd and Fine Fashion Ltd**Balance Sheets as at 28 February 2020**

	RBFL (R 000's)	FFL (R 000's)
<u>Equity & Liabilities</u>		
Shareholders' equity	37 900	86 100
Share capital	28 000	62 500
Retained earnings	9 900	23 600
Liabilities	18 550	53 150
Long-term liabilities	8 750	31 000
Overdraft	4 500	12 640
Accounts payable	5 300	9 510
Total Equity & Liabilities	56 450	139 250
<u>Assets</u>		
Non-current assets	29 900	80 370
Current assets	26 550	58 880
Inventory	7 200	18 500
Accounts receivable	11 420	30 650
Cash	7 930	9 730
Total Assets	56 450	139 250

Additional Information:

	RBFL	FFL
Current share price	E10	E5
Number of issued shares	10 million	80 million

(continued overleaf...)

RBFL

1. Non-current assets as at 28 February 2019 was E29 000 000.
2. Total current assets and total current liabilities as at 28 February 2019 were E24 450 000 and E4 000 000 respectively.

FFL

1. Non-current assets as at 28 February 2019 was R86 650 000.
2. Total current assets and total current liabilities as at 28 February 2019 were E56 880 000 and E8 510 000 respectively

It is thought that combining the two companies will result in several benefits. The combined firm will generate extra free cash flows to the firm (FCFF) of E5 million, in addition to the two firms' combined current FCFF. The new FCFF of the combined firm will enjoy an annual growth rate of 5% in perpetuity.

The corporation tax rate is 30%, the current risk free rate of return is 4% and the market risk premium is 4%. The combined company's cost of debt will be 5%.

The debt-to-equity ratio of the combined company will be 50:50 in market value terms. Assume that the combined company's asset beta is 1.0167.

Required:

- (a) Calculate the current FCFF of each of the two firms, RBFL and FFL.
- (b) Calculate the discount rate to be used in discounting the merged cashflows of the two firms.
- (c) Calculate the additional equity that will be created by merging the two firms, RBFL and FFL.

(25 marks)

Question 4 (25 marks)

Tasty Pies Limited has been exploring expansion opportunities and have identified the acquisition of King Burger Outlets as an alternative. They have observed that King Burger Outlets has enjoyed rapid growth in snacks' highly competitive industry. If the acquisition is made, Tasty Pies Limited plans to operate King Burger Outlets as a separate, wholly owned subsidiary.

You have been approached by the Board of Directors of Tasty Pies Limited which is considering the acquisition of King Burger Outlets. Both Tasty Pies and BG are all equity firms. The Board believes that the incremental value of the acquisition is E200million.

The following information has also been given to you.

	Tasty Pies Limited	King Burger Outlets
Current market price per share	E40	E10
Number of outstanding shares	50 000 000	20 000 000
Unlevered beta	1.2	1.4
EPS	E15	E6
Payout ratio	80%	50%

The Board of Directors of Tasty Pies Limited is prepared to pay E300 million in cash or shares for acquisition of King Burger.

Required

- (a) Calculate the value of King Burger Outlets to Tasty Pies
(2 marks)
- (b) Calculate the merger premium and the merger NPV of the cash acquisition.
(4 marks)
- (c) Assuming that Tasty Pies acquires King Burger Outlets for cash, calculate post-merger market value of Pearson and the post-merger price per share.
(4 marks)
- (d) Assuming that Tasty Pies acquires King Burger Outlets through exchange of shares worth E300 million, calculate post-merger market value of Tasty Pies and the post-merger price per share.
(8 marks)
- (e) Given your answer in (d) what is the merger NPV of the share acquisition?
(2 marks)
- (f) Calculate the number of shares have to be given to King Burger Outlets shareholders if Tasty Pies wants to achieve the same NPV and post-merger share price as with a cash acquisition.
(5 marks)

Question 5 (25 marks)

In the early 2000s, HP and Compaq were the two giants of the personal computer business, but they were rapidly losing market share to lower-cost rivals such as Dell. HP's Carly Fiorina believed the merged company, with annual sales of approximately \$90B, would give HP a greater economy of scale in the PC business, allowing it to compete in an increasingly commoditized industry. While the merger may have made sense on paper, the problem was integrating two separate, highly complex entities. HP and Compaq's core businesses overlapped, and one of the key reasons for the merger was that it would enable cost-cutting. The company cut 15,000 employees, nearly 10% of its workforce, by 2005. Before the merger, HP's share price sat at around \$10 per share. A year later, it dropped to \$6.

<https://www.cbinsights.com/research/merger-acquisition-corporate-fails/>

Required

With reference to the article above;

- (a) Provide a detailed report stating the key aspects of the due diligence process and how this process might help to make this acquisition a success. **(9 marks)**
- (b) Discuss the role of post-merger integration in the M&A process, its key aspects and how it can be conducted. **(8 marks)**
- (c) List and explain the reasons why some mergers and acquisitions fail or perform poorly or below their anticipated potential. **(9 marks)**

APPENDIX A: SELECTED FORMULAE

$$V_{0t-1} = FCF_t / (R - g)$$

$$WACC = \left(\frac{E}{V} \times R_E \right) + \left(\frac{P}{V} \times R_P \right) + \left(\frac{D}{V} \times R_D \times (1 - T_c) \right)$$

$$R_E = R_F + \beta_E \times (R_M - R_F)$$

$$\beta_{ASSET} = \frac{\beta_{EQUITY}}{(1 + [(1 - T_C)(D / E)])}$$

$$\beta_{EQUITY} = \beta_{ASSET} \times \left(1 + \left((1 - T_C) \times \frac{Debt}{Equity} \right) \right)$$

$$\alpha = \frac{\text{No. of new shares issued}}{\text{No. of old shares} + \text{No. of new shares issued}}$$

$$\bullet \text{ Firm value} = \sum_{t=1}^T \frac{FCF_t}{(1+WACC)^t} + \frac{\frac{FCF_{T+1}}{(WACC-g)}}{(1+WACC)^T}$$

$$\bullet \text{ ROA} = \text{NPAT} / \text{Total Assets}$$

$$\bullet \text{ Net Profit Margin} = \text{NPAT} / \text{Sales}$$

$$\bullet \text{ Total Debt ratio} = \text{Total debt} / \text{Total Assets}$$

$$\bullet \text{ ROE} = \text{NPAT} / \text{Equity}$$

$$\bullet \text{ Debt: Equity ratio} = \text{Total Debt} / \text{Total Equity}$$

$$\bullet \text{ ROE} = \text{PM} \times \text{TAT} \times \text{EM}$$

$$\bullet R_P = D / P_0$$