UNIVERSITY OF ESWATINI

DEPARTMENT OF ECONOMICS

RE-SIT/ SUPPLEMENTARY EXAMINATION: JULY 2019

PAPER TITLE : CORPORATE FINANCE I

COURSE CODE : ECO 428

INSTRUCTIONS:

1. ANSWER THREE QUESTIONS.
2. QUESTION ONE IS COMPULSORY.
3. TIME ALLOWED: TWO (2) HOURS

REQUIREMENTS

1. SCIENTIFIC CALCULATORS

This paper is not to be opened until permission has been granted by the invigilator.

QUESTION 1 (COMPULSORY AND CARRIES 40 MARKS)

Part A

Write short notes on the following:

i. Principles of diversification
ii. Security market line (SML)
iii. Mutually exclusive projects
iv. Mergers and acquisitions
v. Real options

[4 Marks each]

Part B

a) Currently, the risk-free rate return is 3%, and the expected market rate of return is 9%. What is the expected return of the following three stock portfolio? [8]

Amount Invested	Beta
E350,000	1.0
250,000	0.2
400,000	2.5

b) Describe how business risk and financial risk affect a firm's capital structure. [8]

c) How are Treasury bills different from other forms of bonds? [4]

QUESTION 2

a) Eswatini Mobile (EM) has E6 million in assets, E700, 000 EBIT, 80,000 shares of stock outstanding, and marginal tax rate equal to 40%. If EM's debt-to-total-assets ratio (D/TA) is 70%, it pays 12% interest on debt, whereas if the D/TA ratio is 40%, interest is 9%. Calculate ES's EPS and ROE (Net income/Equity) for each capital structure. Which capital structure is better? [15]

b) Deliberate on the importance of capital budgeting. [15]

QUESTION 3

a) Senior Management of SEC has determined that there is a 20% chance EPS will be E4.50 next year, there is a 60% chance that EPS will be 1.50, and there is a 20% chance EPS will be –E1.80. Calculate the expected value, standard deviation, and coefficient of variation for SEC's forecasted EPS. [7]

b) Discus the steps involved in the evaluation of capital projects. [8]

c) What is the expected return of the following portfolio of investment? [7]

Investment	$\hat{r}$	Amount Invested
DEF	4%	E30,000
JKL	24	25,000
TUV	14	45,000

d) Discus the steps involved in the evaluation of capital projects. [8]

QUESTION 4

a) Discuss five (5) factors that lead to financial distress for a company. [25]

b) Suppose the risk-free rate of return is 4%. The market risk- premium is 7%. The beta is 2.0. What is the expected rate of return on return on this stock? [5]