UNIVERSITY OF ESWATINI

SECOND SEMESTER RE-SIT EXAMINATION PAPER, JULY 2020

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

COURSE CODE: ECO428

CORPORATE FINANCE II

TIME ALLOWED: 2 HOURS

Instructions
1. This paper consists of Section (A) and (B);
2. Section A is compulsory and carries 40 marks;
3. Answer any two (2) questions from Section B.
4. All questions in Section B carry equal marks of 30 each

Special Requirements
1. Scientific Calculator

Additional Material (s)
   None

Candidates may complete the front cover of their answer book when instructed by the Chief Invigilator and sign their examination attendance cards but must NOT write anything else until the start of the examination period is announced.

No electronic devices capable of storing and retrieving text, including electronic dictionaries and any form of foreign material may be used while in the examination room.
DO NOT turn examination paper over until instructed to do so

SECTION A

Question 1 (Compulsory and Carries 40 Marks)

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) One year ago, Regina purchased E1, 050 worth of Elite Electrician's common stock for E42 per share. During the year, Regina received two dividend payments, each equal to E0.05 per share. The current market value of the stock is E44 per share. What yield did Regina earn on her investment during the year?   [4]

d) **Write short notes on the following:**
   i.   Risk Premium
   ii. Differentiate between systematic and unsystematic risk
   iii. Capital structure
   iv. Security market line (SML)
   v.   Mutually exclusive projects

[4 Marks each]

SECTION B (ANSWER ANY TWO QUESTIONS)

QUESTION 2 [30 Marks]

a) The CFO of SRA wants to calculate next year's EPS using different leverage ratios. SRA's total assets are E5 million, and its marginal tax rate is 40%. The company has estimated next year's EBIT for three possible economic states: E1.2 million with 0.2 probability, E800, 000 with a 0.5 probability, and E500, 000 with a 0.3 probability. Calculate SRA's expected EPS, standard deviation, and coefficient of variation for each of the following capital structures. Which capital structure do you recommend? [20]

Leverage (Debt/Assets)	Interest Rate	Shares of stock Outstanding
20%	6%	300,000
50	10	200,000

b) Describe how conflicts that might arise when using the NPV and IRR techniques can be resolved using the modified internal rate of return (MIRR) technique. [10]

QUESTION 3 [30 Marks]

One year ago, James bought Dell Computer common stock for E20 per share. Today the stock is selling for E19 per share. During the year, James received four dividend payments, each in the amount of E0.20 per share.

a) What rate of return did James earn during the year? [5]

b) What were the (i) the dividend yield and (ii) capital gains yields associated with the stock for the year? [4]

c) Elaborate on the Theories of Dividend Policy and Empirical Evidence. [15]

d) Stock A has an expected return of 10% and a standard deviation of 5%. Stock B has an expected return of 15% and a standard deviation of 20%. The correlation between the two shares is 0.25. You can invest risk free at a 5% interest rate. What is the standard deviation for a portfolio with weights 25% in A, 25% in B and 50% in the risk free asset? [6]

Question 4 [30 Marks]

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) What are the essentially required principles of capital structure management? [15]