**BINDURA UNIVERSITY OF SCIENCE EDUCATION**

**FACULTY OF COMMERCE**

**DEPARTMENT OF BANKING AND FINANCE**

**CORPORATE FINANCE (BS246)/ (BS 213)**

**FINAL EXAMINATION**

**DURATION: THREE HOURS**

JUN 2023

## INSTRUCTIONS TO CANDIDATES:

1) Section A **compulsory** and choose **any three questions** Section B

2) Candidates will need non-programmable calculators.

3) Each question carries equal marks as indicated in square brackets.

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## SECTION A

### QUESTION ONE

Suppose Josh Ltd's financial statements indicate the following financial ratio values;

$X_1 = 10\%$, $X_2 = 15\%$, $X_3 = -5\%$, $X_4 = 40\%$, $X_5 = 1.05$

a) Calculate and comment the Z-Score using the Altman Model (5)

b) Based on the data in Table 1 below, calculate the Altman Z score for each company and state which, if any, are potentially failing companies and why? (10)

Table 1:

| | Company W $m | Company X $m | Company Y $m | Company Z $m |
|---|---|---|---|---|
| Current assets | 100 | 56 | 200 | 400 |
| Current liabilities | 56 | 100 | 200 | 400 |
| Total assets | 600 | 400 | 800 | 1200 |

| | | | | |
|---|---|---|---|---|
| Retained earnings | 400 | 200 | 100 | 400 |
| Profit before interest and tax | 56 | 12 | 60 | -60 |
| Market value of equity | 600 | 400 | 200 | 600 |
| Book value of debt | 100 | 0 | 100 | 200 |
| Sales | 200 | 100 | 100 | 400 |

c) K Ltd has estimated a standard deviation of its daily cash flows to $\sigma = \$50{,}000$ per day. The cost of buying and selling marketable securities is \$100. It faces annual interest rate of 10%. Because of its liquidity requirement and compensating balance agreements, K Ltd has a LCL of \$100,000 on its cash balance, using the Miller-Orr model calculate

i. K Ltd's Spread, (3)

ii. upper control limit (UCL), (3)

d) Fort Ltd is acquiring CAT LTD .Prior to the merger Fort ltd equity had a total of \$340 million and CAT ltd equity was worth \$120 million .After the merge Fort ltd is expected to have a market value of \$500 million. Fort ltd is giving CAT LTD shareholder a premium of \$40 million for their shares. In additional Fort ltd incurred \$6 million for acquisition cost.

i. Calculate the synergies effect in their merge (4)

ii. Calculate the net advantage of merging for Fort ltd (3)

iii. Should Fort ltd acquire CAT ltd justify your answer (4)

e) Discuss three strategies that can be employed to reduce the Cash Conversion Cycle. (8)

**[40 Marks]**

## SECTION B

### QUESTION TWO

a) With reference to Zimbabwe, explain three reasons why companies would merge. (6)

b) With the aid of relevant examples, discuss the three types of mergers. (6)

c) Management of RTG, a listed company on the Zimbabwe Stock Exchange observes that there are a significant number of their shares being bought by an unknown investor. It later emerges that the buyer of these shares is linked to BZC, a major competitor of RTG in the tourism sector. In his statement accompanying the 2008 financial statements, BZC Chief Executive Officer, indicated that the company intends to expand presence in the local market ahead of the 2025 Soccer World Cup.

(i) Define the term 'hostile takeover'. (2)

(ii) Discuss three strategies that RTG management could employ to fight a possible takeover by BZC (7)

**[20Marks]**

## QUESTION THREE

a) Jay Ltd manufactures planks. The single raw material used in making planks is dint. For each plank manufactured, 20 dints are required. Assume that the company manufactures 200,000 planks per year, and the demand for planks is perfectly steady throughout the year. Also assume that it costs $2280 each time dints are ordered and carrying costs are $15 per dint per year.

**Required:**

Using Economic Order Quantity (EOQ) model, calculate the total inventory costs for Jay Ltd. (5)

b) The directors of Owen Ltd are considering changing their credit policy to attract customers who moved to their competitors with favourable credit terms. The current credit policy of Owen Ltd calls for ''1/10, net 30''. All sales are on credit and at the present 50% of the customers use discount facility.

The new policy calls for ''2/10, net 35''. The directors expect that the new policy will result in 40% of the customers taking advantage of the cash discount. They also forecast that bad debts will increase from present level of 3% to 4% of credit sales. The credit sales are anticipated to increase from $60 million per annum to $75 million per annum based on the new credit policy.

Gross profit margin will remain unchanged at 10%. The opportunity cost associated with an investment in working capital is 10%. Assume 360 days in the year.

**Required:**

Establish whether or not the proposed credit policy should be implemented. (8)

c) Discuss the demerits of using ratios analysis in lending decision by the financial institutions (7)

**[20Marks]**

## QUESTION FOUR

a) Discuss any four dividend policies that a company may adopt. (8)

b) Discuss what do you think is the typical stock market reaction to the announcement that a firm will increase its dividend payment? Why? (2)

c) Describe the different alternatives to cash dividends that the company can offer to its shareholders. (6)

d) Examine any two cash management techniques that a firm can employ in its working capital management. (4)

**[20Marks]**

## QUESTION FIVE

a) The credit controller of Naki Ltd. has established the following data relating to the working capital cycle:

| | |
|---|---|
| Inventory days | 90 days |
| Receivables collection days | 90 days |
| Payable deferral period | 40 days |

**Required:**

i. Calculate the period for which financing of working capital is needed. (3)

ii. Explain three ways the company could use to reduce the cash conversion cycle indicating the implication of each strategy. (3)

b) Debt financing is cheaper than Equity financing ,discuss (10)

c) The company on March 1, 2017 declares a 10% stock dividend when the current market price for the stock is $40.00 per share.This stock dividend will increase the number of shares outstanding by 10%. This means issuing 21,500 shares. Calculate the value of the share (4)

**[20Marks]**

## END OF PAPER