Strathmore UNIVERSITY

STRATHMORE UNIVERSITY BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION
BFS 2202: FINANCIAL MANAGEMENT II

Date: 2nd December 2022 **Time:** 2 Hours

Instructions
1. This examination consists of **FIVE** questions.
2. Answer Question **ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE

a) Read the **Case extract** below and answer the questions that follow:

DLT a worldwide producer of chemicals and high-performance products, offered to acquire Gelhard Corporation for Kshs. 37 cash per share. Gelhard, a manufacturer, and developer of value-added technologies determined that the Kshs.37 offer was inadequate and decided to defend itself against the unwanted takeover attempt. Prior to the DLT takeover offer, Gelhard had participating preferred stock purchase rights in place. These rights acted as a poison pill by allowing Gelhard to issue shares at a discount if triggered by a takeover that was unsupported by Gelhard's board of directors. Additionally, in advance of the takeover attempt, Gelhard restated its certificate of incorporation to include a supermajority provision. It stated that business combinations with a holder of more than 5 percent of Engelhard's outstanding shares would require an affirmative vote of both the holders of 80 percent of the outstanding shares and at least 50 percent of the outstanding shares not held by the acquirer unless the board of directors approved the business combination. After the tender offer was commenced by DLT, Gelhard also pursued a recapitalization plan that involved the repurchase of approximately 20 percent of Gelhard's outstanding shares through a tender offer at Kshs.45 per share, a price superior to DLT's tender offer. Together these pre- and post-offer defenses made it very difficult for DLT to succeed with its Kshs.37 cash tender offer.

Although Gelhard did not complete the tender for its own shares, the recapitalization plan was incentive enough for DLT to increase its offer. Takeover targets frequently use their takeover defenses to negotiate a better deal for their shareholders. After much negotiation, DLT increased its tender offer and Gelhard withdrew all takeover defenses. On 30 May 2021, the companies announced a definitive merger agreement under which DLT would acquire all outstanding shares of Gelhard for Kshs.39 per share in cash.

Required

i. The terms "takeover", "tender offer", "acquisition", "merger" are mentioned in the case extract above. Using examples from the case extract, briefly explain the terms

(8 Marks)

ii. Discuss the pre- defense tactics and post – defense tactics adopted by the company (Clearly illustrate from the case extract). **(4 Marks)**

iii. Explain how the defense tactics employed by the company in the case extract above were beneficial **(3 Marks)**

b) The CFO of Jiunge Ltd is evaluating two mutually exclusive projects. Project A will cost Kshs.10,000 now and will generate cash inflows of Kshs.4500 each year over its life of four years. Project B will cost Kshs.2500 and will generate cash inflows of Kshs.3000 each year over its life of 2 years. Which project would you select assuming a risk-free cost of capital of 10%

Required:

i. Use the law of multiples method for projects with different lives **(10 Marks)**

ii. Use the annual equivalent value (AEV) method **(5 Marks)**

{TOTAL: 30 MARKS}

QUESTION TWO

Multiple choice questions: Each 2 marks (Marks allocated to questions showing the workings)

i. Suppose three countries produce rulers and pencils with output per worker per day in each country as follows:

Country	**Rulers**	**Pencils**
Mexico	20	40
Brazil	30	90
China	40	160

Which country has the greatest comparative advantage in the production of rulers?

a. China.
b. Brazil.
c. Mexico.

ii. An exchange rate:

a. Is most commonly quoted in real terms.
b. Is the price of one currency in terms of another?
c. Between two currencies ensures they are fully convertible.

iii. The Balance of payments (BOP) is composed of the current account that measures

a. Transfers of capital
b. Flow of goods and services
c. Records investment flows

iv. The US dollar is selling for Kshs.103.88 and the buying rate for the Euro is USD 1.10, what is the EUR/KES cross rate?

a. 0.00876
b. 114.1538
c. 94.4436

v. Which of the following examples has been placed correctly with its international business method?

   a. Licensing – Microsoft office
   b. Strategic Alliances - McDonalds
   c. Franchising - Starbucks and Barnes & Noble

vi. Financial markets continue to evolve, grow globally and exchange rates keep playing an increasingly large role in day-to-day global investment transactions. Which of the currency pairs below indicate one of the “Major pairs?

   a. USD/CHF - Swissie
   b. AUD/USD - Aussie
   c. USD/CAD – Loonie

vii. In order to minimize the foreign exchange exposure on a euro-denominated receivable due from a German company in 100 days, a British company would most likely initiate a:

   a. Spot transaction.
   b. Forward contract.
   c. Real exchange rate contract.

viii. Which type of trade restriction would most likely increase domestic government revenue?

   a. Tariff.
   b. Import quota.
   c. Export subsidy.

ix. Which of the following international trade organizations regulates cross-border exchange among nations on a global scale?

   a. World Bank Group (World Bank).
   b. World Trade Organization (WTO).
   c. International Monetary Fund (IMF).

x. A portfolio manager is considering the purchase of a bond with a 5.5% coupon rate that pays interest annually and matures in three years. If the required rate of return on the bond is 5%, the price of the bond per Kshs.100 of par value is closest to:

   a.Kshs.98.65
   b. Kshs.101.36
   c.Kshs.106.43

{TOTAL: 20 MARKS}

QUESTION THREE

a) The company's management should maintain the right amount of working capital on a continual basis and only then would business operations function properly.

Required

Briefly discuss dangers of inadequate working capital for a company? **(6 Marks)**

b) Miss Chacha was applying for an analyst position in a leading investment bank. In an interview she was given the following scenario to evaluate. Firms X (levered) and Y (unlevered) have the same net operating income of Kshs. 10,000. Firm X has Kshs. 50,000 debt at 6% interest. Firm X: Cost of equity = 11.7%, Firm Y: Cost of equity = 10%.

Required:

i. Compute the value for both firms and their weighted average cost of capital (**6 Marks**)

ii. Briefly explain which option maximizes shareholders wealth **(2 Marks)**

iii. Distinguish using graphical illustrations the Net income approach and the Net operating income approach **(6 Marks)**

{TOTAL: 20 MARKS}

QUESTION FOUR

a) Fabu Ltd. has earned Kshs.8 per share and paid a dividend of Kshs. 2 per share. The following are the expected annual growth rates for the dividends

Year	**Dividend growth rate**
1 – 3	20%
4 – 6	15%
7 – 9	12%
10 - perpetuity	9%

Required

Determine the price of the share today, if the capitalization rate is 14%? **(14 Marks)**

b) The CEO of Kakuza Ltd has asked you for financial advice on how to shorten the working capital cycle for his company.

Required

Discuss on how you would advice the CEO of Kakuza Ltd**.** **(6 Marks)**

{TOTAL: 20 MARKS}

QUESTION FIVE

The financial management class implemented the financial principles and techniques they learned to Multinational Corporations (MNC). The different groups in class prepared Case Studies on each of the MNC. The following are some of the questions related to dividend policy they responded to in the Case Study:

- What were the firm's financial needs given its investment opportunities? (Mature companies generally have fewer investment opportunities hence higher payout ratios as compared to growth companies)
- Who were the firm's shareholders and what are their preferences with regard to dividend payments? (Ownership concentration in a firm may define the shareholders expectations. Shareholders may be divided into: small, retired, wealthy and institutional shareholders)
- Was the firm following a stable dividend policy or a Constant payout policy

Required:
You have been requested to prepare a report from your Group Case Study based on the following:

i. Brief description of the MNC for your case study and its operations **(4 Marks)**

ii. The financial dilemmas experienced by the Multinational Corporations **(6 Marks)**

iii. The solutions proposed by your group to the MNC **(6 Marks)**

iv. From the questions above, distinguish between the dividend policies indicated **(4 Marks)**

{TOTAL: 20 MARKS}