CCOLLEGE OF BUSINESS AND MANAGEMENT SCIENCES

NMAC 309: FINANCIAL MANAGEMENT

END OF SEMESTER EXAMINATION

NOVEMBER 2024

LECTURER: MR R CHIHOWA

DURATION: 3 HOURS

INSTRUCTIONS

Answer **ALL** questions

Start **each** question on a new page in your answer booklet

Credit will be awarded for logical, systematic and neat presentations

Tax tables are provided

QUESTION 1 (25 Marks)

ZimLiners is considering a $5 billion investment in developing a new jet airliner. The company aims to enhance its market position and increase shareholder value, but it faces uncertainties regarding market demand, technological challenges, and potential regulatory hurdles. The management team is preparing a detailed analysis to present to the board of directors.

a) What strategies could stockholders of ZimLiners implement to motivate management to focus on long-term value creation regarding this substantial investment? (4 Marks)

b) When making decisions about the new jet airliner, should the management of ZimLiners prioritize the current market price of their stock or its intrinsic value? Provide a rationale for your answer. (4 Marks)

c) What essential risks should the management at ZimLiners take into account when assessing the potential effects of the new jet airliner project on future profitability? (4 Marks)

d) How should ZimLiners balance the needs and interests of shareholders with those of other stakeholders, such as employees, customers, and regulators, in relation to this investment? (4 marks)

e) What capital budgeting methods could ZimLiners employ to determine the feasibility of the $5 billion investment? Discuss at least two approaches. (4 Marks)

f) In what ways might the market respond to ZimLiners announcement of the investment, and what potential effects could this have on the company's stock price?(5 Marks)

QUESTION 2 (25 Marks)

Kamuri ltd is a fast growing agricultural company that has discovered the use of new technology that would increase production. The management team is considering various financing options to fund the expansion of their operations, which requires an investment of $2 million. They are weighing the advantages and disadvantages of issuing new equity versus taking on debt. The company has a solid track record of profitability but is also concerned about the potential impact of their financing decisions on stockholder value and future growth**.**

a) How does the Modigliani and Miller irrelevance theorem apply to the company as it considers its financing options? What key assumptions must the company consider? (3 Marks)

b) Based on the static trade-off theory, what factors should Kamuri Ltd consider when determining their optimal capital structure for the $2 million investment? (3 Marks)

c) If Kamuri Ltd decides to follow the pecking order theory, what financing option would they likely choose first? Explain your reasoning.(3 Marks)

d) How might market timing theory influence Kamuri Ltd decision to issue equity or take on debt at this stage of their growth? (3 marks)

e) In what way could signaling theory impact Kamuri ltd’s stock price if they choose to issue new equity? (3 Marks)

f) Discuss how agency theory might play a role in company' capital structure decisions, particularly regarding conflicts between management and shareholders.(3 marks)

g) Considering the life-cycle theory, how might the stage of Kamuri ltd business influence their financing strategy for the expansion? (3 marks)

h) What potential risks might the business face if they choose to finance their expansion primarily through debt, based on the theories discussed?(5 Marks)

QUESTION 3 (25 Marks)

A company is a financial analytics firm that has been closely monitoring stock price movements in the technology sector. Recently, the company has been analyzing whether stock prices reflect all available information, especially in light of new data from tech earnings reports and economic indicators. The management team is debating how to adjust their investment strategies based on their findings related to the Efficient Market Hypothesis (EMH).

a) Define the Efficient Market Hypothesis (EMH). What are its three forms, and how do they differ from one another? (5 Marks)

b) In the context of the company, how would the semi-strong form of EMH affect their ability to earn excess returns based on publicly available information? (5 Marks)

c) Discuss how the strong form of EMH challenges the effectiveness of fundamental analysis as a strategy for the company in making investment decisions. (5 Marks)

d) Explain how the company could use technical analysis if they operate under the assumption of weak-form efficiency. What limitations would they face? (5 Marks)

e) How does the concept of market anomalies, such as the January effect or momentum investing, challenge the principles of EMH? What implications does this have for the company? (2 Marks)

f) Discuss the role of insider information in relation to the strong form of EMH. How might the company need to adjust their strategies if they suspect insider trading is prevalent in the market? (2 Marks)

QUESTION 4 (25 Marks)

a. Water power Ltd Solutions, a leading renewable energy company, is considering a merger with Solar power ltd, a smaller firm specializing in cutting-edge solar technology. Both companies see this as an opportunity to enhance their market presence and combine resources to innovate more effectively. However, Solar power ltd has also attracted interest from a larger competitor, Giant Ltd, which is looking to acquire them. Water power Ltd must navigate the complexities of mergers and acquisitions while considering various motives, types, and defensive tactics.

i. Define mergers and takeovers and what are some key characteristics that distinguish a merger from a takeover in the context of Water power Ltd Solutions and Solar power ltd? (3 marks)

ii. What are some common motives for mergers? Discuss at least three specific reasons that might drive Water power Ltd Solutions to pursue a merger with Solar power ltd. (4 marks)

iii. If Giant Ltd attempts a hostile takeover of Solar power ltd, what defensive tactics could Water Power Ltd implement to protect their merger interests? Explain the effectiveness of at least two of these tactics. (5 marks)

b. The following information on Solar Power Ltd

- Average operating profit for the last three years is $300m.
- Assets base is $600m (average of last three years).
- Growth rate is predicted at 4% over next few years.
- WACC of the company is 9%.

For the purpose of CIV, a suitable competitor for benchmarking has been identified as Air Power Plc. The following information relates to Air Power Plc.

- The average operating profit for the last three years is $650m.
- Assets employed in the business $3.200m (average of last three years).
- Corporation tax has been at 30% for the last four years.

i. Calculate the value of the intangible assets using the CIV method. **(8 marks)**

ii. Calculate the value of Solar Power Ltd**. (5 Marks)**

END OF EXAMINATION