



(Knowledge for Development)

KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS
2015/2016 ACADEMIC YEAR
FIRST YEAR SECOND SEMESTER

MAIN EXAMINATION

FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

COURSE CODE: MBA 832

COURSE TITLE: CORPORATE FINANCE

12.5.2016

DATE: 2016

TIME: 2pm

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 3 Hours

KIBUCO observes ZERO tolerance to
examination cheating

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SECTION A

QUESTION ONE (COMPULSORY 30MARKS)

- a) Cost of capital constitutes the major part for deciding the capital structure of a firm. Normally long-term finance such as equity and debt consist of fixed cost while they are mobilised. The firm must take careful steps to reduce the cost of capital. Explain five major considerations to achieve an optimal capital structure.

(10Marks)

- b) ABC Ltd. needs Kshs. 900M for the installation of a new production line. The new production line expects to yield annual earnings before interest and tax (EBIT) of Kshs.150M. In choosing a financial plan, XYZ Ltd., has an objective of maximizing earnings per share (EPS). The company proposes to issuing ordinary shares and raising debt of Kshs.90, 000,000 or Kshs. 300,000,000 or Kshs.450, 000,000. The current market price per share is Kshs 250 and is expected to drop to Kshs 200 if the funds are borrowed in excess of Kshs 360,000,000. Funds can be raised at the following rates.

–up to Kshs 90Million at 8%

–over Kshs 300 Million to Kshs. 440 Million, at 10%

Between Kshs.441-450 Million at 15%

Assuming a tax rate of 50% advice the company on the best financial plan

(12marks)

- c) **MM dividend irrelevancy Theory** posits that the value of the firm is determined by the basic earning power and the firm's risk and not by the distribution of earnings. Explain four assumptions of this theory.

(8marks)

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SECTION B (CHOOSE TWO QUESTIONS)**QUESTION TWO**

- a) Outline four assumptions of CAPM
 b) Three assets have the following distribution of returns.

(4Marks)

<i>Probability Occurrence</i>	<i>Rate of return (%)</i>		
	<i>A</i>	<i>B</i>	<i>C</i>
0.1	10.0%	6.0%	14.0%
0.2	10.0	8.0	12.0
0.4	10.0	10.0	10.0
0.2	10.0	12.0	8.0
0.1	10.0	14.0	6.0

REQUIRED:

- a. Compute the expected return and standard deviation of each asset. **(6marks)**
 b. Compute the covariance of asset
 i. A and B
 ii. B and C **(6marks)**
 c. Compute the correlation coefficient of the combination of assets in (b) above **(2marks)**
 d) What management inference can be drawn from the three securities? **(2marks)**

QUESTION THREE

- a) List **four** type's dividend policy that a value maximizing manager will pursue in a firm. **(5marks)**
 b) The earnings per share of a company are Kshs.10 and the rate of capitalization applicable to the company is 12%. The company has before it an option of adopting a payment ratio of 25%. Using Walter's formula of dividend pay -out, compute the market value of the company's share of the productivity of retained earnings
 (i) 12% (ii) 8%. **(10marks)**
 c) Outline five signs that indicate that a firm is experiencing financial distress **(5marks)**

QUESTION FOUR

- a) Discuss five major factors that will guide a company board on dividend policy. **(10marks)**
 b) Mergers and acquisitions are extremely difficult process. Expected synergy values may not be realized and therefore, the merger is considered a failure. Explain any five reasons that may cause mergers failure. **(10marks)**

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QUESTION FIVE

Company A is considering the acquisition by shares of Company B. The following information is also available.

	Company A	Company B
Present earnings	Kshs 30,000,000	Kshs 7,500,000
Shares	7,500,000	3,000,000
Earnings per share	Kshs 6	Kshs 3.75
Price/earnings ratio	24	18
Price of shares	Kshs 64	Kshs 30

Company B has agreed to an offer of Kshs 52.5 a share to be paid in Company A shares.

REQUIRED:

- Consider the effect of the acquisition to the earnings per share. (10marks)
- Corporate organizations in Kenya in the recent past have increasingly turned to Capital market to raise long term funds through issuance of debentures. Explain five reasons that Motivated KENGEN and Barclays bank invest in a debenture. (10marks)

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