



(Knowledge for Development)

KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS
2020/2021 ACADEMIC YEAR
SPECIAL/SUPPLEMENTARY EXAMINATION
BACHELOR OF COMMERCE

COURSE CODE: BCF 312

COURSE TITLE: CORPORATE FINANCE

DATE: 28TH SEPTEMBER, 2021 **TIME: 2.00PM – 4.00PM**

INSTRUCTIONS TO CANDIDATES

1. Answer a total of **three** questions; question **one** and any other **two** questions.
2. Question **one** carries **30** marks and each of the other two questions carry **20** marks each.
3. This examination has six printed pages.

Question One (Compulsory)

a) Corporate finance covers every decision a firm makes that may affect its finances. Reference to this statement:

- i) Discuss five financial decisions of a firm **(5 marks)**
- ii) Profit maximization as one of the objectives of a firm has attracted a number of criticisms. Explain any six of these criticisms. **(3 marks)**

b) Distinguish between the following as applied in corporate finance:

- i) Finance structure and capital structure of a firm **(2 marks)**
- ii) Capital gearing and Financial leverage **(2 marks)**
- iii) Compounding and discounting of cash flows **(2 marks)**
- iv) Mutually exclusive and independent investments **(2 marks)**

c) Achievers Limited is considering the following investment projects – Amounts in Kshs.

Project	Initial cash outlay	Cash inflow 1	Cash inflow 2	Cash inflow 3
Period (Years)	0	1	2	3
A	100,000	100,000	-	-
B	100,000	75,000	75,000	-
C	100,000	20,000	40,000	120,000
D	100,000	100,000	30,000	30,000

Required:

- i) Compute the payback period for each of the investments **(2 marks)**
- ii) Compute the Accounting Rate of Return of each of the projects. Comment on rankings. **(2 marks)**

d) Twin brothers' investment Limited is considering to purchase a five year Kshs 100,000 par value of a bond. The normal rate of interest is 7% per annum. The investors required rate of return is 8%.

Required:

Compute the amount that Twin brothers will pay now to purchase the bond if it matures at par. **(4 marks)**

- e) Explain the primary drivers of international capitalmarkets.(**3 marks**)
 f) Discuss the assumptions of Modigliani and Miller's hypothesis of dividend payments. **(3 marks)**

Question Two

- a) With the help of a graph, define Security Market Line and show how it relates to the beta factor. **(5 marks)**
 b) Zebra Limited has four subsidiaries in which it has invested in the following properties:

Subsidiary	Proportion of investment - %	Beta
Lion	60	0.7
Buffalo	20	0.9
Elephant	15	1.3
Chita	5	1.5

Required:

- i) Holding Company's beta **(2 marks)**
 ii) Assuming that the risk free rate is 6% and the market risk premium is 5%. Determine the holding company's rate of return. **(3 marks)**
 c) Shines Limited has investment capital of Kshs 10,000,000. It wishes to invest in two A and B in the following proportion Kshs 2 million in A and Kshs 8 million in B. The returns on these securities depend on the state of the economy as shown below:

State of the economy	Probability	Returns of A	Returns of B
Boom	0.4	18%	24%
Normal	0.5	14%	22%
Recession	0.1	12%	21%

Required:

- Compute the expected portfolio returns **(4 marks)**
 d) Discuss the limitations of portfolio analysis **(6 marks)**

Question Three

- a) Clean Traders Limited dealing with imported garments had beginning inventory of 200 rolls of cotton material as at January 2016 valued at USD 10 per roll. It purchased 500 rolls between 2016 and 2019 and the price for

each roll purchased was rising in each year. As at 31st December 2019, it had a stock of 300 rolls. The number of rolls sold was 400.

Required

You are required to compute the cost of goods sold and ending inventory using FIFO, LIFO and weighted average cost. **(8 marks)**

- b) Discuss the principles of working capital management **(5 marks)**
- c) In cash flow analysis, the relevance of cash is an important component. Distinguish between liquidity, solvency and financial flexibility. **(3 marks)**
- d) Explain the determinants of working capital **(4 marks)**

Question Four

- a) Zion Limited is considering to invest in three risky projects namely White, Blue and Red. You have obtained the following information:

White:

The project will require initial investment of Kshs 100 million. The estimated annual net cash inflows over the next five years under three environmental factors are as follows:

Environmental factor	Probability	Amount '000
Most pessimistic	0.25	27,000
Most likely	0.5	36,000
Most optimistic	0.25	40,000

Concerns have been raised by National Environment Management Authority (NEMA) on the environmental impact assessment of this project. The estimated cost to be paid to NEMA is Kshs 200 million in the 3rd year and there is a probability of 0.1 that this will happen.

Blue

Will require initial capital outlay of Kshs 100 million spread in equal instalments for the next 3 years for research work. If the project is successful and there is a probability of 0.5. If so, it will lead to a issuance of patent rights with estimated value at end of 3 years of Kshs 400 million. If not successful the whole expenditure will be written off.

Red

The project will have an initial cost of Kshs 40 million and is expected to yield annual cash flows of Kshs 16 million in each of its first two years. Thereafter the outcome is uncertain that no estimate can be given.

The company cost of capital is 14%.

Required:

Advice Zion on whether they should undertake the projects. **(12 marks)**

- b) Makutano Limited is a cement distributor and is planning to buy a warehouse for storage of its cement for Kshs 100 million through a 30 year loan offered by KCB Bank. The loan agreement requires equal annual payments and the interest rate is 8% per annum. KCB requires that Makutano pays 20% of purchase price as down payment and borrows only Kshs 80 million.

Required:

Compute annual loan repayment

(3 marks)

- c) You have been appointed as the Finance Director of XYZ Limited. The Directors have various investment options as part of their capital budgeting to present before strategic partners for funding consideration. They asked for your guidance.

Explain the criteria they can use to evaluate the investment **(5 marks)**

Question Five

- a) Discuss the functions of investment banks **(5 marks)**
- b) Advance the criticisms of Modigliani and Miller's dividend irrelevancy theory **(5 marks)**
- c) Define capital market segmentation and explain its causes **(8 marks)**
- d) Evamba limited distributes all its earnings as dividends. During the financial year that ended on 30th June 2018, the earnings per share were Kshs 5 and the return to equity was 20%. Compute the share price. **(2 marks)**