



*(Knowledge for Development)*

**KIBABII UNIVERSITY  
UNIVERSITY EXAMINATIONS**

**2021/2022 ACADEMIC YEAR**

**THIRD YEAR SECOND SEMESTER**

**MAIN EXAM**

**FOR THE DEGREE OF BACHELOR COMMERCE**

**COURSE CODE: BCF312**

**COURSE TITLE: CORPORATE FINANCE**

**DATE:** 24<sup>TH</sup> JANUARY, 2022      **TIME:** 9.00AM - 11.00AM

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**INSTRUCTIONS TO CANDIDATES**

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B
2. Question **one** carries **30** marks and each of the other two questions carry **20** marks each.

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

## SECTION A

### QUESTION ONE (COMPULSORY)

a) As a managerial activity concerned with planning and controlling functions, Corporate Finance cuts across the entire spectrum of business operations of an entity. Reference to this statement:

- i) Discuss five functions of Corporate Finance ( 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) Using relevant examples, distinguish between the following as applied in corporate finance:

- i) Debt Vs Equity market ( 2 marks)
- ii) Spot Vs Futures markets ( 2 marks)
- iii) Compounding and discounting of cash flows ( 2 marks)
- iv) Mutually exclusive and independent investments ( 2 marks)

c) Excel publishers 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. ( 3 marks)

- d) The Big Five investment Limited is considering to purchase a five year Kshs 100,000 par value of a bond. The normal rate of interest is 10% per annum. The investors required rate of return is 12%.

**Required:**

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

- e) Explain the importance of international capital budgeting. **(5 marks)**

**SECTION B**

**QUESTION TWO**

- a) You have been appointed as the Corporate Finance Manager of Zion Venture capitalists. The Board of Directors are contemplating to carry out an investment into milk processing plant. Advise them on the investment criteria they can use. **(4 marks)**
- b) Dividend policy depends on availability of investment opportunities and the relationship between firm's internal rate of return and cost of capital. Discuss this statement. **(6 marks)**
- c) Exotic bank is expected to pay you dividend of Kshs7.60 per share in the coming year and to trade for Kshs55.50 per share at the end of the year. Investment with equivalent risk to Exotic bank have expected return of 8.8%.

**Required:**

- i) Compute the price you would pay today for Exotic bank share **(2 marks)**
- ii) Calculate the dividend yield and capital gain if any that you would expect. **(3 marks)**
- d) ZC Limited has total investment of Kshs 1,000,000 in assets and Kshs 100,000 outstanding shares@ 10/= per share. It earns a rate of 20% on its investments and has a policy of retaining 50% of its earnings. The appropriate discount rate is 15%.

**Required:**

Determine the price of ZC share using Gordon's model.

**(5 marks)**

### QUESTION THREE

- a) Mali Mingi Limited intends to install two mutually exclusive equipments X or Y. You have gathered the following information: Equipment X costs Kshs 75 million and can generate net cash flow of Kshs 20 million per year for 6 years. Equipment Y costs Kshs 50 million and can generate net cash flow of Kshs 14 million per year for 6 years. The required rate of return of both equipments is 11%.

#### Required

Compute the Internal Rate of Return and Net Present Value for both equipments and advice Mali Mingi the equipment to install. ( 10 marks)

- b) Discuss the principles of working capital management ( 5 marks)  
c) Explain the limitations of portfolio analysis ( 5 marks)

### QUESTION FOUR

- a) Perform Limited is considering to invest in three risky projects namely North, East and West. You have obtained the following information:

#### North:

The project will require initial investment of Kshs100 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 Kshs10 million in the 3<sup>rd</sup> year and there is a probability of 0.1 that this will happen.

#### East

Will require initial capital outlay of Kshs150 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 Kshs450 million. If not successful the whole expenditure will be written off.

### **West**

The project will have an initial cost of Kshs50 million and is expected to yield annual cash flows of Kshs20 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 16%.

### **Required:**

Advice Perform on whether they should undertake the projects. **(16 marks)**

- b) Discuss the assumptions of Capital Asset Pricing Theory (CAPM) as a measure of expected return of an investment. **( 4 marks)**

### **QUESTION FIVE**

- a) With the help of a graph, distinguish between systematic and unsystematic risk **( 5 marks)**
- b) Advance the criticisms of Modigliani and Miller's dividend irrelevancy theory **( 5 marks)**
- c) Reference to valuation theory, discuss six concepts of value **( 6 marks)**
- d) Discuss four features of a bond **( 4 marks)**