



*(Knowledge for Development)*

**KIBABII UNIVERSITY  
UNIVERSITY EXAMINATIONS  
2021/2022 ACADEMIC YEAR  
THIRD YEAR FIRST SEMESTER  
MAIN EXAMINATION**

**FOR THE DEGREE OF BACHELOR OF COMMERCET**

**COURSE CODE: BCF 312**

**COURSE TITLE: CORPORATE FINANCE**

**DATE: 6<sup>TH</sup> AUGUST 2021**

**TIME: 2.00PM – 4.00PM**

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**INSTRUCTIONS TO CANDIDATES**

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

TIME: 2 Hours

**KIBU observes ZERO tolerance to examination cheating**

*This Paper Consists of 3 Printed Pages. Please Turn Over.*

## SECTION A

### QUESTION ONE

- a) Analyze five ways in which international banks help multinational enterprises in the international financial markets (5mks)
- b) Distinguish between market value and intrinsic value as explained in valuation of securities (4mks)
- c) Alpha company is contemplating conversion of 500 14% convertible bonds of Ksh.1,000 each. Market price of bond is Ksh. 1,080. Bond indenture provides that one bond will be exchanged for 10 share. Price earnings ratio before redemption is 20:1 and anticipated price earnings ratio after redemption is 25:1. Number of shares outstanding prior to redemption are 10,000. EBIT amounts to Ksh. 2,00,000. The company is in the 35% tax bracket. Should the company convert bonds into share? Give reasons. (8mks)
- d) You won ksh. 7M from betting. Being unemployed you wish to have a regular income over the next ten years. You have been approached by a life insurance company that sells annuity contracts and will pay you a fixed amount annually for ten years. Your opportunity cost of funds is 12%. How much annual income will you be receiving? (5mks)
- e) Describe four principles of corporate finance (8mks)

## SECTION B

### QUESTION TWO

- a) Describe four types of Euro currency loans (8mks)
- b) XYZ plc. 18% debenture stock has 7 years to maturity. Interest is paid semiannually. If the nominal required rate of return is 20% p.a Calculate the value of Sh. 1000 face value debenture (6mks)
- c) Discuss six essential features of a sound capital mix (6mks)

### QUESTION THREE

Four assets have the following distribution of returns.

<i>Probability Occurrence</i>	<i>Rate of return (%)</i>			
	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>
0.1	10.0%	6.0%	14.0%	2.0%
0.2	10.0	8.0	12.0	6.0
0.4	10.0	10.0	10.0	9.0
0.2	10.0	12.0	8.0	15.0
0.1	10.0	14.0	6.0	20.0

#### REQUIRED:

- a. Compute the expected return and standard deviation of each asset. (5mks)
- b. Compute the covariance of asset (10mks)
  - i. A and B
  - ii. B and C
  - iii. B and D
- c. Compute the correlation coefficient of the combination of assets in b above. (5mks)

### QUESTION FOUR

- i) Discuss how diversification helps to in risks management in a portfolio (5mks)
- ii) Discuss the problem of Capital Asset Pricing Model in portfolio risk and management (5mks)

- iii) Describe the Arbitrage Pricing Theory in relation to expected return of a financial asset (5mks)
- iv) Briefly explain the Arbitrage mechanics in the context of trading in two assets (5mks)

### QUESTION FIVE

A company is considering two mutually exclusive projects requiring an initial cash outlay of Sh 10,000 each and with a useful life of 5 years. The company required rate of return is 10% and the appropriate corporate tax rate is 50%. The projects will be depreciated on a straight line basis. The before depreciation and taxes cashflows expected to be generated by the projects are as follows.

<i>YEAR</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
Project A	Shs 4,000	4,000	4,000	4,000	4,000
Project B	Shs 6,000	3,000	2,000	5,000	5,000

**Required:** Calculate for each project

- i. The payback period (5mks)
- ii. The average rate of return (8mks)
- iii. The net present value (5mks)
- iv. Profitability index (2mks)

Which project should be accepted? Why?