(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

MAIN EXAMINATIONS

BACHELOR OF COMMERCE

COURSE CODE: BCF 312/BBM312

COURSE TITLE: CORPORATE FINANCE

DATE: 19TH DECEMBER ,2022 TIME: 9.00AM – 11.00AM

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.

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Question One (Compulsory)

a) The modern U.S. Corporation was born in a courtroom in Washington, D.C., on February 2, 1819. On that day the U.S. Supreme Court established the legal precedent that the property of a corporation, like that of a person, is private and entitled to protection under the U.S. Constitution. Based on the concept of a firm, assess three corporate entity theories. **[6 marks]**

b) Reference to objectives of a firm:

i) Distinguish between wealth maximization and value maximization objectives of a firm **[2 marks]**

ii) Critique the profit maximization objective of a firm. **[4 marks]**

c) You have been provided with the following information regarding proposals to source for funds by Maxim Ltd a financial consultant in Down Town City::

Interest = 10%
Tax rate = 30%

<u>CompanyAB</u>
<u>Sh.'000' Sh.'000'</u>

10% debt	1,000	-
Equity	- 1,000	

<u>1,0001,000</u>

The earnings before interest and tax amount to Ksh.400,000. All earnings are paid out as dividends.

Required:
Compute the cost of each firm and comment on your findings **[6 marks]**

d) Jamhuri Commercial bank has entered into a loan agreement with Madaraka Manufacturing limited. The bank has advanced a loan of Kshs 100 million to Jamhuri at an annual interest rate of 10% payable within four year period.

Required:

Calculate the annual amount which Madaraka manufacturing should pay so as to enable Jamhuri bank recover the loan. **[5 marks]**

e) Dividend policy depends on availability of investment opportunities and the relationship between firm's internal rate of return(r) and cost of capital (k). Evaluate this statement. **[3 marks]**

f) Justify the relevance of international capital budgeting. **[4 marks]**

Question Two

a) KumiKumi Garments Ltdd intends to install two mutually exclusive equipments X or Y. You have gathered the following information: Equipment X costs Kshs 80 million and can generate net cash flow of Kshs 20 million per year for 6 years. Equipment Y costs Kshs 60 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 equipment and advice KumiKumi the equipment to install. **[10 marks]**

b) Discuss the assumptions of Capital Asset Pricing Theory (CAPM) as a measure of expected return of an investment. **[10 marks]**

Question Three

a) Distinguish between the following terms as they are applied in dividend theory:

- Stock Splits and stocks repurchase
- Constant payout ratio and fixed dividend per share
- Dividend yield and dividend payout **[6 marks]**

b) Ongoza Company Ltd has the following capital structure:

Ordinary shares (Sh.20 par)	Kshs 8,000
Share premium	Kshs 3,600

Retained earnings	Kshs 2,400
	Kshs 14,000

The company shares have been selling in the market for sh.60. The management has declared a share split of 4 shares for every one share held. Assume that the shares are expected to sell at sh17 after the stock split.

Required

i) Prepare the capital structure of the company after the company's stock split. **[6 marks]**

ii) Compute the capital gain for a shareholder who held 40,000 shares before the split. **[3 marks]**

c) Faulu Ltd is an all equity firm whose Beta factor is 1.2, the interest rate on T. bills is currently at 8.5% and the market rate of return is 14.5%.

Required:

Determine the cost of equity Ke, for the company **[5 marks]**

<u>Question Four</u>

a) Asante Company Limited has the following capital structure.

Source	Amount
Debentures	8,000,000
Preference capital	2,000,000
Retained earnings	4,000,000
Ordinary share capital	6,000,000
	20,000,000

The component costs of capital are;

Cost of debt 6%, cost of preference share capital 10.5%, retained earnings 14% and external equity 17.2%.

Required:

i) Compute the WACC **[4 marks]**

ii) Examine the weaknesses of WACC as a discounting rate **[4 marks]**

b) The Zigma investment Limited is considering purchasing 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 Zigma Investments will pay now to purchase the bond if it matures at par. **(6 marks)**

c) Angua 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 Angua Limited share using Gordon's model. **[6 marks]**

Question Five

a) Mapema limited a tour guide company has appointed you as the Corporate Finance Manager.The Board of Directors are contemplating to expand their business and carry out an investment into milk processing plant. Advise them on the investment criteria they can use. **[4 marks]**

b) Despite criticismraised against Capital Asset Pricing Theory (CAPM), it still stands out as a strong measure of risk. Evaluate this statement with reference to the assumptions of CAPM. **[6 marks]**

c) Reference to valuation theory, discuss five concepts of value **[10 marks]**