(*Knowledge for Development*)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

THIRD YEAR FIRST SEMESTER

SPECIAL EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE / BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBF311

COURSE TITLE: CORPORATE FINANCE

DATE:24TH NOVEMBER,2022 **TIME:2.00 – 4.00PM**

INSTRUCTIONS TO CANDIDATES

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

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

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

QUESTION ONE

a) Examine the implications of foreign exchange risk to financial management of multinational firms (6mks)

b) XYZ wants to purchase a maize milling machine at a cost of sh. 570,000. He can borrow an amortizable five-year loan at 20% per annum. Prepare a loan repayment plan if money is borrowed to buy plant (10mks)

c) Scrip dividend are paid through issue of ordinary shares of a company. State and explain important points that should be noted by the company before scrip issue is recommended (8mks)

d) Assume that two firms the levered firm (L) and the unlevered firm (U) are identical in all important respects except financial structure. Firm L has Sh 4 million of 7.5% debt, while Firm U uses only equity. Both firms have EBIT of Sh 900,000 and the firms are in the same business risk class. Initially assume that both firms have the same equity capitalization rate $K_{e(u)} = K_{e(L)} = 10\%$. Calculate the value of the two firms under these conditions. (6mks)

(Total 30Marks)

QUESTION TWO

a) Filla company is contemplating conversion of 500 14% convertible bonds of Sh.1,000 each. Market price of bond is sh. 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 Sh. 200,000. The company is in the 35% tax bracket. Should the company convert bonds into share? Give reasons. (10mks)

b) There are four major dividend policies that can be followed by a firm. Using graphical illustration discuss these policies (10mks)

(Total 20Marks)

QUESTION THREE

a) Two organizations are each pursuing two mutually exclusive projects in different ways. Organization A is a not-for profit making while organization B is profit making.

Required:

i) How does the objectives of company A differ from objectives of company B (6mks)

ii) Explain whether the investment planning and appraisal techniques are likely to differ between the two organization (4mks)

b) A company has 10% perpetual debt of Ksh. 1,000,000. The tax rate is 35%. Determine the cost of capital (before tax as well as after tax) assuming the debt is issued at

i) Par (3mks)

ii) 10% discount (3mks)

iii) 10% premium (4mks)

(Total 20Marks)

QUESTION FOUR

a) Recommend ways in which managers of multinational firms can manage foreign exchange risks (8mks)

b) The capital structure of a concern depends upon a large number of factors. Discuss six factors influencing the capital structure of a firm (12mks)

(Total 20Marks)

QUESTION FIVE

Alpha Ltd has 900,000 shares outstanding at current market price of Sh 130 per share. The company needs Sh 22,500,000 to finance its proposed expansion. The board of directors has decided to issue rights for raising the required funds. The subscription price has been fixed at Sh 75 per share.

Required:

(a) How many rights are required to purchase one new share? (3mks)

(b) What is the price of one share after the rights issue (Ex-right price)? (4mks)

(c) Compute the theoretical value of each right (4mks)

(d) Consider the effect of the rights issue on the shareholders' wealth under the three options available to the shareholders (Assume he owns 3 shares and has Sh 75 cash on hand). (9mks)

(Total 20Marks)

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