



SOUTH EASTERN KENYA UNIVERSITY

UNIVERSITY EXAMINATIONS 2015/2016

MAY-AUGUST 2016 (PRACTICUM) SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

DFI 601: CORPORATE FINANCE (Machakos Campus)

DATE: 3RD AUGUST, 2016

TIME: 9.00-12.00 NOON

INSTRUCTIONS

- 1. ATTEMPT ALL the questions**
- 2. DO NOT WRITE on the question paper**
- 3. Mobile phones and written materials are not allowed in the examination room**

QUESTION ONE

- a)** A limited has a debt equity ratio of 5.2. The firm weighted average cost of capital is 15% and its pre-tax cost of debt is 10%. A limited is subject to corporate tax rate of 35%

Required:

- i. Determine A limited cost of equity capital. **(4 Marks)**
- ii. Determine A limited unlevered cost of equity capital **(6 Marks)**
- iii. Determine A limited WACC of the firm's debt-equity ratio value 3:4 and 3:2

(8 Marks)

b) Identify and explain the capital Structure Theories

(7 Marks)

QUESTION TWO

a) The return of a share of Kerigen a company quoted on the NSE and 20 share index for the past five years is as given below:

Kerigen (%)	NSE-20 (%)
-5.1	-12.5
6.7	1.7
7.1	7.2
18.9	11.5
11.9	6.3

Required:

- i. Determine the covariance of the returns of Kerigen and the market portfolio **(6 Marks)**
 - ii. Determine the Beta of Kerigen **(6 Marks)**
- b) Suppose the risk free rate is 6% and market portfolio has an expected return of 14%. The market portfolio has a variance of 0.0498. Portfolio Z has a correlation coefficient with the market of 0.45 and a variance of 0.1783.

Required:

- i. Determine the expected return on portfolio Z using the capital asset pricing model **(5 Marks)**
- c) Explain 3 broad categories of covariance between returns of two assets. Discuss how the different covariances could impact on the portfolio risk of two assets. **(8 Marks)**

QUESTION THREE

- a) Capital rationing is inconsistent with the maximization of wealth. It should never therefore voluntarily be improved. Discuss **(10 Marks)**
- b) As a financial analyst at MBA limited, you are conducting an analysis of four alternative investment projects. Each project has a holding period of one year. The estimated rates of return for three alternative states of the economy are as shown in the table:

State	Probability	Rate of Return (%)			
		A	B	C	AS
Recession	0.2	10%	6	22	5
Average	0.6	10%	11	14	15
Boom	0.2	10%	31	-4	25

- i. Determine the expected rate of return, variance, standard deviation and coefficient of variation of each project. **(10 Marks)**

- ii. Your boss the company financial manager has asked you to assess total risk of the 4 investment alternatives using the mean-variance criterion. Determine whether any of the alternative projects can be eliminated(5 Marks)

QUESTION FOUR

Kinatwa SACCO limited expects a net operating income of Ksh.2, 000,000 for the coming year. Firm capital structure consists of 40% debt and 60% equity. Marginal tax is 40%.Cost of equity is 14% and the company pays 10% rate on its Ksh.5, 000,000 long term debt. 1000,000 shares of common stock are outstanding. In its next capital budgeting cycle, the firm expects to find one large positive net present value in accordance to its target capital structure of the firm which follows residual dividends policy and has no any other project. Value of the project is 600,000 million.

Required:

What is its expected dividends payout ratio? (25 Marks)