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MAIN EXAMINATION

JANUARY - APRIL 2015 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR PROGRAMME

CFI 311: CORPORATE FINANCE

Date: APRIL 2015	**Duration: 2 Hours**
INSTRUCTIONS: Answer Question ONE and ANY OTHER TWO Questions	

1i) **Q1.** a) Kibor Ltd is considering two projects with different economic lives. Project Q with cash out lay of Sh 220,000 and cash inflows of Sh 70,000, Sh 88,000, Sh 90,000 and Sh 100,000 in years 1 to 4 respectively. Project R with an initial outlay of Sh 150,000 and cash inflow of Sh 80,000 per year the year for three years. Kibor Ltd uses the equivalent Annual Annuity method to 3 evaluate projects with unequal lives. If the required return is 12% which project should be chosen and why?

(11 marks)

12) b) Company T and P have similar operations. However firm T finances its operations with 100% equity while P uses 40% debt and 60% equity. The cost of equity of firm T is 20%. Firm P pays an interest rate of 12% per annum.

Required: 12% = (

Using MM II without taxes, calculate

i The cost of equity of firm P. 1533 **(3 marks)**

ii The weighted average cost of capital of firm P. **(3 marks)**

13) c) TLC is issuing sharers through an IPO at a price of Sh 20 to the public investors. TLC intends to issue 4 million shares and ABC Capital will

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underwrite the issue on a best-effort basis.ABC capital will be paid for each share sold.

i Calculate the total net proceeds to TLC if only 3.5 million s. are sold. 3.5(20-2)=63M **(4 marks)**

ii Calculate the total commission to ABC if it sells 3.5 million shares. 3.5×2=7M **(3 marks)**

d) Explain the following terms

i Agency problem. is a conflict of interest between the [illegible] **(2 marks)**

ii Capital markets. is a financial market for shares trading, bonds, shares **(2 marks)**

iii Venture ca[ital. → is a medium to long term investment and consist of a package of debt and [illegible] **(2 marks)**

Q2. TPS Ltd needs to raise new capital to finance its investment project. The company has chosen to do a rights offer instead of a secondary offering. The company has 60 million shares currently trading at Sh 60 in the stock exchange. In the rights issue, existing shareholders have one right for each share currently held. The additional shares will be sold at Sh 40 each. A total of 5 million new shares is to be sold.

Required:

i Why can't TPS Ltd use IPO to raise capital now? **(2 marks)**

ii How much capital will TPS Ltd raise in the rights issue? **(3 marks)**

iii How many rights will be issued? **(2 marks)**

iv How many rights will be required to buy one new share? **(3 marks)**

v) What is the expected value of the share after rights issue? **(5 marks)**

638.25

vi What is the value per right? → 60×6M = 360,000,000 + 5,000,000 shares ×40 = 200,000,000 = Total [illegible] **(3 marks)** 3.800,000 / 6M

vii What is the highest price should a right sell for? **(2 marks)**

Q3. a) Explain the meaning of conglomerate merger giving an example. **(3 marks)**