THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

A. M. E. C. E. A.

P.O. Box 62157
00200 Nairobi - Kenya
Telephone: 891601-6
Fax: 254-20-891084
E-mail: academics@cuea.edu

SPECIAL/SUPPLEMENTARY EXAMINATION

1ST SEMESTER 2008/2009

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

CFI 311: CORPORATE FINANCE

Date: February 2009 **Duration: 2 Hours**

Instructions: Answer Question ONE and any other TWO. Show workings where necessary.

1. a) Giving an example of each distinguish between a Vertical and Horizontal merger. **(5 marks)**

b) Company B is a key play in the Food Industry. It is considering acquiring company C and subsequently merge their operations after the merger. After approaching Company C, the shareholders of Company C have indicated that it could decide depending on the mode of payment for the acquisition.

Additional information regarding the two companies is as follows:-

	Company B	Company C
Market price per share	Sh.150	Sh.90
No. of shares outstanding	1 Million	0.5 million
	sh150m	sh. 45m

Estimated synergies from the acquisition amount to Sh.16 million. The shareholders of Company C have further indicated a price of Sh.120 per share which can be paid either via cash or by shares of Company B.

Required:

Calculate the NPV from the acquisition for Company B if

i) it is a cash acquisition **(4 marks)**

ii) stock acquisition **(5 marks)**

iii) if you worked for an investment bank advising Company B would you negotiate for a cash or a stock acquisition? If instead you were advising Company C, what would you negotiate for and why? **(5 marks)**

c) Sagat Ltd is an all-equity company and its cost of equity is 12%. Micra Ltd is similar to Sagat except that it is leveraged, financed by Sh.100,000, 3% debentures and 100,000 ordinary shares whose market price is Sh.1.50 per shares.

Required:
Calculate Micra Ltd's cost of equity and its Weighted average cost of capital. **(7 marks)**

d) Suppose a company has invested in a portfolio consisting of four company stocks as follows.

Company Stock	Investment Amount	Stock beta
A	Sh.40,000	1.5
B	Sh.60,000	0.5
C	Sh.100,000	1.25
D	Sh.120,000	0.75

Calculate the Beta of this portfolio. **(4 marks)**

Q2. TLC Ltd is a key player in the Telecommunications sector. Mr. Kaligola is an investor who owns 10% of shares of TLC Ltd. The investor would like to know if he will receive any dividends next year from TLC Ltd. You do not know how much dividends will be paid by the company but you are provided with the following information.

1. The company has 12 million shares outstanding.
2. The company adopts a residual dividend policy.
3. The company has an optimal Equity Debt ratio of 1.5
4. Expected Net Income next year is Sh60 million and the planned capital budget is Sh80 million.

Required:

a) What is residual dividend policy? **(2 marks)**
b) Calculate the maximum funds available without selling new equity and maintaining the above Equity debt ratio. **(4 marks)**
c) Will TLC pay any dividends? Calculate the dividend per share and payout ratio. **(7 marks)**
d) How much will Kaligola receive? **(3 marks)**
e) What is the actual borrowing in (c) above? **(1 mark)**
f) Would dividends paid change if the net income forecasted is Sh40 million instead? **(3 marks)**

Q3. A Company wants to replace a machine that was acquired 4 years ago, at a purchase price of Sh550,000 to purchase and a further Sh50,000 to transport it. The machinery had an expected life of 8 years when acquired and a nil residual value at the end of its economic life. This machine can be sold at a current market value of Shs380,000 today. The company uses straight-line method to depreciate its assets.