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CITY CAMPUS

MAIN EXAMINATION

AUGUST - DECEMBER 2014 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

EVENING PROGRAMME

CFI 311: CORPORATE FINANCE

Date: DECEMBER 2014	Duration: 2 Hours
INSTRUCTIONS: Answer Question ONE and ANY OTHER TWO Questions	

Q1. a) Tel Ltd is financed by 100% Equity with a cost of equity of 20%. BET Ltd is Similar to Tel Ltd except that Bet Ltd has a different financing mix comprising of Sh. 300 million debt at an interest rate of 10% p.a and 25 million ordinary shares currently selling at Sh 20 each.

Required:

Using MMII without takes, calculate

i) BET Ltd's cost of equity. **(7 marks)**

ii) BET Ltd's overall cost of capital **(4 marks)**

iii) Explain how much of TEL Ltd's risk is attributed to Business risk and how much to financial risk? **(3 marks)**

b) A firm is considering two projects whose expected cash flows are as follows:

7497 0.1071 17844 0.2028 25936 0.2882 34626 0.36448 41959 0.42257 0.49336 48844

Period	1	2	3	4	5	6
Project. A	Sh. 70,000	Sh. 88,000	Sh. 90,000	Sh. 95,000	Sh. 97,000	Sh. 99000
B	Sh. 80,000	Sh. 100,000	Sh. 120,000			

8568 + 20280 + 34584

K3290

The initial cost of project A is Sh. 220,000 while project B will cost Sh. 150,000. The firm uses the Equivalent annual annuity method when assessing projects with different lives. If the cost of capital is 12%, which project should be taken and why? **(8 marks)**

c) A company has 3m shares currently trading at Sh. 100. It intends to do a 4:1 stock split. Calculate the company's market capitalization before the split. **(2 marks)**

3 x 4 = 12 shares

Share pr = 100/4 = 25 Sh

M = 25 x 12 = 300M

d) Explain the following terms:
   i) Primary markets **(2 marks)**
   ii) Agency problem **(2 marks)**
   iii) Public offering of corporate bonds. **(2 marks)**

Q2. TPS Ltd needs to raise new capital to finance its investment projects. The company has chosen to do a rights offer instead of a secondary offering. The company has 60m 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 5m new shares is to be sold.

Required:

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

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

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

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

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

f) What is the value per right? **(3 marks)**

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

Q3. TLC Ltd has indentified UCM Ltd, as a potential target for acquisition and subsequently merge their operations. The shareholders of UCM Ltd though interested in the transaction have indicated that their final decision will depend on the payment method by TLC Ltd. The shareholders of UCM ltd have quoted a price of Sh200m which can be paid either by cash or by shares of TLC Ltd issued to shareholders of UCM Ltd.

Further information relating to the two companies is as follows:-

	TLC Ltd	**UCM Ltd**
Current market price per share	Sh40	Sh15
No. of shares currently outstanding	20 million	10 million
Cost of capital	10%	12%
Total sales revenue	Sh500m	Sh400m

The value of estimated synergies is Sh120m at today's value.

Required:

a) If it's a cash acquisition calculate:
   i) the acquisition premium **(3 marks)**
   ii) the NPV to TLC Ltd **(5 marks)**

b) If it is a stock acquisition
   i) How many shares will TLC Ltd have to issue? **(3 marks)**
   ii) Calculate the NPV to TLC Ltd **(7 marks)**

c) If it is a hostile takeover, explain how UCM Ltd would use crown jewel as a defensive mechanism. **(2 marks)**

Q4 a) TLC is considering a public offering of ordinary shares.Its investment banker has informed the company that the retail price will be Sh. 18 per share for 600,000 shares. TLC Ltd will receive Sh. 16.50 per share from the investment bank and will incur Sh. 150,000 in registration, accounting and printing costs.

8.3%

   i) What is the spread on this issue in percentage terms? **(3 marks)**

   ii) What is the return to the investment bank in percentage terms? 9.1% **(3 marks)**

iii) If the firm wanted to net Sh. 18 million from this issue, how many shares must be sold. **(6 marks)**

b) A firm has 10M shares outstanding. It expects to realize Sh. 80m as net profit next year. The firm has a retention ratio of 75%.

Divd 0.75x 80 = 60m 60/10 = sh.6 2m

i) Calculate the expected dividend per share next year. **(3 marks)**

ii) How much will it add to its retained earnings next year? **(3 marks)**

iii) Explain the meaning of cash dividend. **(2 marks)**

PRESENT VALUE INTEREST FACTORS

1) For an annuity = $\frac{1-(1+r)^{-n}}{r}$

2) For a single amount = $(1+r)^{-n}$

END