MASENO UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

FOURTH YEAR SECOND SEMESTER EXAMINATIONS FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH INFORMATION TECHNOLOGY

HOMA-BAY CAMPUS

ABA 420: CORPORATE FINANCE

Date: 11th June, 2017 Time: 9.00 - 12.00 noon

INSTRUCTIONS:

- Answer question ONE and any other THREE questions.

QUESTION ONE

Sony Sugar Company is considering undertaking a 5 year project which will be used to convert saw dust into animal feeds. The project is expected to generate the following sales revenue

Year	**1**	**2**	**3**	**4**	**5**
Sales Revenue in Shs. '000'	750	780	700	900	950

The project will require an initial cash outlay of Shs. 1 million and annual operating expenses of Shs. 300,000 p.a. The project will have a salvage value of Shs. 200,000 at the end of its economic life. The company uses straight line method of depreciation on all its new projects. The tax rate is 40% and the cost of capital is 12%

Required:

i. Compute the cash flow statement for the project for the 5 years (9mks)
ii. Using Net present Value (NPV) advise the company whether to invest in the project or reject it (8mks)
iii. Using Internal Rate of Return (IRR) advise the company on whether to accept or reject the project (8mks)

QUESTION TWO

Creation of shareholder value has become a generally accepted corporate objective. To facilitate the realization of this objective, value based management systems (VBMs) which integrate finance theory and strategic management Blinking have been developed by scholars.

Required:

a) Explain the main determinants of shareholder value. (6mks)
b) Discuss six factors that have stimulated the increased interest by companies to value based management systems, (9mks)

QUESTION THREE

a) (i) Within corporate financial management context, discuss the problems that might exist in the relationships between the head office and branch/subsidiary office (5mks)

ii) How might a company attempt to minimize such problems? (5mks)

b) Lake Fish Mongers Ltd is considering the acquisition of Nyalenda Ltd, Currently lake has annual earnings of Kshs.51 million, 20 million ordinary shares outstanding and each share sells for Kshs 130. Likewise the annual earnings for Nyalenda are Kshs.9 million, 6 million ordinary shares outstanding and a market price per share of Kshs.160. Whereas the earnings of lake are expect 10 grow at the rate of 5 % p.a those of Nyalenda Ltd. would grow at the annual rate of 12% p,a in the absence of any mergers. Lake offers 1.5 shares for each share of Nyalenda. Assume that there are 110 synergistic effects likely from the merger.

Required:

Determine the effect of the acquisition on each company's earnings per share (5mks)

QUESTION FOUR

You have been provided with the following data regarding Telebank Ltd's returns and the corresponding market returns from 2002 to 2009

Year	Return on Telebank Ltd	Return on the Market
2002	12%	20%
2003	14%	26%
2004	8%	24%
2005	16%	28%
2006	14%	26%
2007	10%	18%
2008	18%	20%
2009	20%	24%

Required:

a) Calculate the standard deviations of Telebank Ltd's returns and the market returns (10mks)
b) Determine the beta of Telebank Ltd and interpret your result (5mks)

QUESTION FIVE

a) Describe the three forms of efficiency in the efficient market hypothesis (6mks)
b) The financial manager of Textile Company is considering the installation of a plant. The expected values of the underlying variables are given as follows:

i. Initial capital outlay is Kshs. 150,000 with zero salvage value
ii. Total revenue per annum is Kshs. 375,000
iii. Total variable costs per annum is Kshs. 300,000
iv ~~Economic useful life of 10 years is expected~~
v. Depreciation is on a straight line basis
vi. Fixed costs are estimated at Shs. 30,000
vii. Tax rate associated with the project is 50%
viii. The cost of capital is 10%

Required:

Carry out:

a) Financial break even analysis (4mks)
b) Sensitivity analysis with respect to the initial capital outlay (5mks)

QUESTION SIX

Mumias Sugar Company is considering investing Kshs. 30 million on a two year project in the development of a new product. The cash flows expected to be generated by the product for the two years will depend on the level of demand which can either be high or low.

The following information relates to the expected cash flows:

i. It is estimated that there is a 60% probability of high demand in the first year with a resulting cash flow of Kshs. 27 million. In the second year, cash flows would increase to Kshs. 32 million. If demand is still high with a probability of 55%, otherwise they would reduce to Kshs. 18 million if it is low
ii. If the demand in the first year is low, then the cash flow would be expected to be Kshs. 5 million, however in the second year, the cash flows would increase to Kshs. 15 million if the demand is high with a probability of 30%. If the demand is still low in the second year, then the cash flows would remain at Kshs. 5 million
iii. Mumias Sugar Company's cost of capital is 12% per annum

Required:

a) Draw a decision tree to represent the above scenario (6mks)
b) Determine the probability that the projects' NPV will be positive (9mks)

ABA 420: CORPORATE FINANCE
Course outline;
Course Instructor: Robby Tabitha
Objectives:

i) Undertake evaluation of capital investment decisions under situations of uncertainty and risk;
ii) Use the existing theories of dividend to formulate value adding dividend policies for corporations;
iii) Make informed decisions on long-term financing methods and strategies available to corporations;
iv) Appreciate the dynamic nature of the world of business and evaluate the strategies in use for value maximization;
v) Engage in effective management of risk.

WEEK	TOPIC	ACTIVITY	ASSESSMENT
1	Nature and Scope of Corporate Finance	Definition of Corporate Finance, roles of corporate manger.	Interactive discussion on the various meanings especially with regard to Corporate Finance
2	Capital Budgeting Under Uncertainty(a)	Review of discounting Technique, replacement decisions	Review Questions to be submitted for evaluation
3	Capital Budgeting Under Uncertainty(b)	Sensitivity analysis, Scenario analysis	Review Questions to be submitted for evaluation.
4	Capital Budgeting Under Uncertainity (c)	Simulation analysis Decision trees analysis	Review Questions to be submitted for evaluation
5	Dividend decisions (a)	Dividend policy	Interactive discussion
6	Dividend decisions (b)	Dividend theories	Interactive discussion
7	Mergers and Acquisitions	Mergers and acquisitions, Corporate restructuring and control	Interactive discussion
8	Financial risk management (a)	Sources and types of risk, options	Review Questions to be submitted for evaluation.
9	Financial risk management (b)	Futures, SWAPs	Review Questions to be submitted for evaluation.
10	Revision	Sample exams question.	revision

REFERENCES

1. Pandey Im (2010) 10th Ed. Vikas Publishers.
2. Srivastara R.M (2011) Essentials of Business Finance 7th Ed. Himalaya Publishing House.
3. R. Brackington (1993) Financial Management 6th Edition.