(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2019/2020 ACADEMIC YEAR

THIRD YEAR FIRST SEMESTER

MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCF 303

COURSE TITLE: CORPORATE FINANCE

DATE: 13/12/2019 **TIME: 9.00 am**

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

Question one

a) Two organizations are each pursuing two mutually exclusive projects in different ways. Organization A is a not-for profit making while organization B is profit making.

A: profit max: | B: - Profit maximization. - Shareholders wealth maximization. - Market share maximization. - corporate wealth maximization.

Required:

i) How does the objectives of company A differ from objectives of company B (6mks)

ii) Explain whether the investment planning and appraisal techniques are likely to differ between the two organization (4mks)

b) Scrip dividend are paid through issue of ordinary shares of a company. State and explain important points that should be noted by the company before scrip issue is recommended (8mks)

c) An investor made an initial deposit of ksh. 50 000 at the beginning of 2007. While this amount remains invested, he plans to be adding kshs.5000 on January 1st each subsequent year starting from January 1, 2008. Assuming interest is compounded each year at the rate of 12% per annum. What will be the value of his investment on January 1, 2011 (12mks)

$(P_0 + \frac{P}{r})(1+r)^n - \frac{P}{r}$. 2008 2009 2010 2011 4 years.

Question Two

The ABC Company and the XYZ Company belong to the same risk class. They are identical in all aspects except that ABC Company has no debt in its capital structure, whereas XYZ Company employs debt in its capital structure. Relevant financial particulars of the two companies are given below

	ABC COMPANY	XYZ COMPANY
Net operating income	Shs. 500 000	Shs. 500 000
Debt interest	-	Shs. 200 000
Equity earnings	Shs. 500 000	Shs. 300 000
Equity capitalization rate	12%	14%
Market value of equity	Shs. 4,166,667	Shs. 2, 500,000
Market value of debt (Debt capitalization rate 8%)	-	Shs. 2,500,000

- Restrictive cover credit policy
- Availability of credit
- Legalities.

Total market value of the firm	Shs. 4,166,667	Shs. 4,642,857
Average cost of capital	12%	10.77%

a) You own shs. 10,000 worth of XYZ equity. Show what arbitrage you would resort to (7mks)

b) When will according to Modigliani and Miller this arbitrage cease (5mks)

c) State and explain motives for a company going into merger arrangement (8mks)

Question Three

Four assets have the following distribution of returns

Probability of occurence	**Rate of return** A	B	C	D
0.1	10%	6.0%	14.0%	2.0%
0.2	10%	8.0%	12.0%	6.0%
0.4	10%	10.0%	10.0%	9.0%
0.2	10%	12.0%	8.0%	15.0%
0.1	10%	14.0%	6.0%	20.0%

Required:

a) Compute the expected return and standard deviation of each asset (10mks)
b) Compute the covariance of asset
   i) A and B (2mks)
   ii) B and C (2mks)
   iii) B and D (2mks)
c) Compute the correlation coefficient of the combination of assets in b above (4mks)

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Question Four

a) Examine the implications of foreign exchange risk to financial management of multinational firms (12mks)

- working capital mgt.
- Capital structure.
- Cost of capital
- Capital

- Valuation of debt | equity
- Borrowing international debt and equity.
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b) Recommend ways in which managers of multinational firms can manage foreign exchange risks (8mks)

Question Five

i) ABC LTD invested the sum of ksh. 800 000 in dairy project. He estimates that the project will yield the following after tax returns annually for the next five years, i.e ksh. 20 000, ksh. 40 000, ksh. 60 000, ksh. 80 000 and ksh. 120 000 respectively. The dairy house is expected to be depreciated on a straight line basis.

Required

a) Provide the accounting rate of return of the project (10mks)

b) Evaluate the accounting rate of return in relation to other project appraisal methods (5mks)

ii) State and explain atleast five reasons why companies invest abroad (5mks)

- Political safety.
- Management expertise and technology
- Benefits from variations in exchange rate.
- Tax avoidance.
- Ineffeciencies
- Profit Margin.

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