

CHUKA



UNIVERSITY

**UNIVERSITY EXAMINATION  
RESIT/SUPPLEMENTARY / SPECIAL EXAMINATIONS  
EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE**

**BCOM 332: CORPORATE FINANCE**

**STREAMS:**

**TIME: 2 HOURS**

**DAY/DATE: WEDNESDAY 11/08/2021**

**11.30 A.M - 1.30 P.M.**

**INSTRUCTIONS**

- **Answer question one and any other two questions**

**Question One:**

a) Explain any four defensive mechanisms by firms against hostile takeover. (6 marks)

b) ABC Ltd intends to raise additional share capital through a rights issue. The number of issued ordinary shares currently stands at 100 million shares. Each shareholder will have a right to purchase one share for every five shares currently held. The current market price per share is Sh.60 while the rights price has been fixed at sh.50 per share.

Required:

i).The theoretical value of a right in ABC (3 marks)

ii).If a shareholder has one million shares, show the effect of the rights issue on this particular shareholder's wealth assuming:

- He sells the rights,
- He exercises one half of the rights and sells the other half
- He does nothing at all. (10 marks)

c) Explain any six factors that determine the dividend payable by a firm. (6 marks)

d) The Earnings per Share of ABC limited is sh 12. The dividend payout is 60%, return on equity is 14% and the capitalization rate is 15%. Calculate the value of the equity share using Gordon's model. (5 marks)

**Question Two:**

a) Due to COVID 19 effects on businesses, many firms have embarked on corporate restructuring decisions. Describe what corporate restructuring is and explain any three different forms of corporate restructuring that firms adopt. (8 marks)

b) The following information relates to a company that is considering whether it would be financially advisable to retire its existing long term debt with a cheaper debt

**Existing bond issued information**

Par value	Sh.75 million
coupon rate	12%
original maturity	30
remaining maturity	25
original flotation costs	Sh.5 million
Call premium	12%

**New issue information**

Coupon rate	10%
Maturity	25
flotation costs	Sh.5 million

Time between issues (months)	1
rate of interest on surplus funds (annual)	6%

Required:

Advise whether refunding is advantageous (assume tax rate at 30%). (12 marks)

**Question Three**

a) ABC Ltd currently has no debt. Its earnings before interest and tax stand at sh. 3 million. If ABC Ltd decides to use debt, it can borrow sh. 10 million at 8% p.a. The amount raised would be used to buy back common stock hence the assets would remain constant. Shares for companies in this risk class require a return of 12% if no debt is used. Assume initially no taxes and that the assumptions of MM hypothesis hold. Calculate

(i) The value of unlevered firm (4 marks)

- (ii) The value of the levered firm (3 marks)
- (iii) Cost of equity of the levered firm (3 marks)
- (iv) The levered firm's weighted average cost of capital (4 marks)

b) Using illustrations, distinguish between vertical merger and horizontal merger. (6 marks)

**Question Four**

a) With the help of a well labeled diagram, describe the intermediate approach of capital structure.

(6 marks)

b) Hero Ltd contemplates to acquire Small limited. The following financial data is available for the two companies:

	Hero Ltd	Small Ltd
Total current earnings	Sh.50 million	Sh.20 million
Number of outstanding shares	20 millions	10 millions
Market Per share	Sh.30	Sh.20

Required:

- i. Maximum exchange ratio Hero Ltd should agree to if it expects no dilution in its EPS(4 Marks)
- ii. The earnings per share of hero Ltd after merger. (5 Marks)
- iii. Hero's post-acquisition earnings per share if every 50 ordinary shares of small limited were exchanged for one 10% debentures of a par value of Sh. 1,000 each. (5 marks)

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