

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATION

RESIT /SPECIAL EXAMINATION

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 332: CORPORATE FINANCE

STREAMS:

TIME: 2 HOURS

DAY/DATE: THURSDAY 04/11/2021

2.30 P.M – 4.30 P.M

INSTRUCTIONS:

Answer Question ONE and any other TWO questions

QUESTION ONE

- (a) Explain three forms of dividends payable to shareholders of a firm. (6 marks)
- (b) 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. (6 marks)
- (c) Explain any four defense strategies that can be adopted by a firm in situations of hostile takeover. (6 marks)
- (d) Two firms U and L are in the same risk class and both have profit before interest and tax of Kshs.40 million. Firm U is all equity financed and its cost of equity is 18%. Firm L has Kshs.80 million outstanding debt at a cost of 12%. Corporation tax amounts to 30%.
Required: The value and weighted average cost of capital of firms U and L. (6 marks)
- (e) Explain the pecking order theory of capital structure (6 marks)

QUESTION TWO

(a) Describe any six factors that generally influence the dividend policy of a firm (6 marks)

(b) A Ltd has decided to acquire B Ltd. The following are the relevant data for the two companies:

	A	B
Net sales (Million Kshs)	350	45
Profit after-tax (Million Kshs)	28.1	3.75
Number of shares (millions)	7.5	1.5
Earnings per share (ksh)	3.75	2.5
Dividend per share (ksh)	1.3	0.6
Total Market Capitalization (Million Kshs)	420	45

Calculate:

- i) Post-merger market value per share (4 marks)
- ii) Post-merger Earnings per share (4 marks)
- iii) A's EPS if B's shareholders are offered and accepts one 15 per cent convertible debenture (par value sh.100) for each 3 shares held in B. (6 marks)

QUESTION THREE

(a) Outline four reasons why shareholders may support a proposal for merger of their firm with another. (6 marks)

(b) XYZ limited has 900,000 outstanding shares at current market price of sh 130 per share. The company needs sh 22,500,000 to finance its proposed project. The board of directors have decided to issue rights for raising the required funds. The subscription price has been fixed at sh 75 per share.

Required

- i). How many rights are required to purchase one new share? (3 marks)
- ii). What is the price of one share after rights issue? (3 marks)
- iii). Compute the theoretical value of the share? (3 marks)

(c) A company expects a net operating income of sh 900,000. It has 200,000 8% debentures. The equity capitalization rate of the company is 10%.

Required

The value of the firm and the overall capitalization rate according to the Net Income hypothesis.

(5 marks)

QUESTION FOUR

(a) Explain any four reasons why a company may adopt leasing as a source of long-term financing (8 marks)

(b) ABC Ltd currently has no debt. Its earnings before interest and tax stand at sh. 3 million. If the company 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.

Required

- (i) The value of unlevered firm (3 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 (3 marks)
-
-