

**CHUKA**



**UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE**

**BCOM 332: CORPORATE FINANCE**

**STREAMS: BCOM Y3S1 (ODEL)**

**TIME: 2 HOURS**

**DAY/DATE: MONDAY 29/03/2021**

**2.30 P.M. – 4.30 P.M.**

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**INSTRUCTIONS:**

- **Attempt question one and any other two questions.**

**QUESTION ONE**

- (a) Explain any four reasons why a company may adopt leasing as a source of long terms financing. (6 marks)
- (b) Explain any four defensive mechanisms by firms against hostile takeover. (6 marks)
- (c) Online Ltd has announced a rights offer to raise Sh. 60 million for a new journal, the Journal of Financial trends. This journal will review potential articles after the author pays a nonrefundable reviewing fee of Sh. 5,000 per page. The shares currently sells for Sh.60 per share at the securities exchange and there are 4.8 million shares outstanding. The price for the new share has been fixed at Sh. 50 per share. An investor with 1,000 shares of the company has contacted you for investment advice. He is undecided whether to take up the rights issues, sell the rights, or allow the rights offer to lapse.

**Required**

- (i) Theoretical Ex-rights price. (2 marks)
- (ii) Calculate the value at which the rights are likely to be traded. (2 marks)
- (iii) Evaluate each of the options being considered by the owner of 1,000 shares. (6 marks)

- (d) Companies A and B are identical in every respect except for their capital structure. A Ltd is financed using a Sh. 100 million worth of ordinary shares while B Ltd is financed using Sh. 50 million worth in ordinary shares and 7%, Sh. 50 million debt.

The earnings before interest and tax for both companies are Sh. 10 million. The earnings are expected to remain constant indefinitely. The cost of equity for company A is 10% and the corporate tax rate is 30%

**Required,**

- (i) Value of A Ltd and B Ltd (2 marks)
- (ii) Cost of equity for A Ltd and B Ltd (3 marks)
- (iii) WACC for A and B Ltd (3 marks)

**QUESTION TWO**

- (a) Explain any six factors that determine the dividend payable by a firm. (12 marks)
- (b) Due to COVID 19 effects on businesses, many firms have embarked on corporate restructuring decisions. Describe what corporate restructuring is and explain the different forms of corporate restructuring that can be adopted by firms. (8 marks)

**QUESTION THREE**

- (a) Distinguish between finance lease and operating lease. (6 marks)
- (b) Hero Ltd contemplates to acquire Small Limited. The following financial data is available for the two companies.

	Hero	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 earning per share of small Ltd after merger. (5 marks)
- (iii) Hero's post-acquisition earning 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)

**QUESTION FOUR**

- (a) Discuss the bird in the hand argument and the information signaling theory of dividend. (12 marks)
- (b) Trend is an internet service retail firm. The company has Sh. 500,000 6% debenture outstanding and earns before interest and taxes Sh. 1 million. The firms weighted average cost is 10%.  
Required: compute the firm's market value and cost of equity using the net operating income approach. (8 marks)
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