

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 332: COOPERATE FINANCE

STREAMS: BCOM Y3S1 (ODEL)

TIME: 2 HOURS

DAY/DATE: TUESDAY 06/08/2019

2.30 P.M. – 4.30 P.M.

INSTRUCTIONS:

- Answer question ONE and any other TWO questions
- Do not write on the question paper

QUESTION ONE

- (a) Differentiate between capital structure and financial structure. (4 marks)
- (b) ABC Ltd belongs to a risk class for which the appropriate capitalization rate is 10%. It currently has 5000 outstanding shares selling at sh. 100 each. The firm is contemplating declaration of a dividend of sh. 6 per share at the end of the current financial year. The company expects to have a net income of Ksh. 50,000 and has a proposal of making new investment of Ksh. 100,000.
Required:
 Show under MM hypothesis that the payments of dividend does not affect the value of the firm. (7 marks)
- (c) Draw an appropriate diagram and use it to explain the efficient set of investment for a portfolio consisting of many assets. (5 marks)
- (d) The following information relates to a portfolio of two assets A and B

Probability of occurrence	A (%)	B (%)
0.1	6	14
0.2	8	12
0.4	10	10
0.2	12	8
0.1	14	8

The assets are held in a portfolio consisting of 40% A and 60% B.

Required:

- (i) Compute the portfolio expected return. (4 marks)
- (ii) Compute the portfolio risk. (8 marks)
- (c) Explain the term trading on equity. (2 marks)

QUESTION TWO

- (a) Mr. Njue's investment portfolio comprises of 490 shares in ABC Ltd and Ksh. 10,000 deposited in a savings account. ABC Ltd has declared rights issue of one share for every 5 shares held at an issue price of Sh. 20 per share. The current market price per share of ABC Ltd is Ksh. 35. Mr. Njue would obtain the funds needed to exercise the rights from the savings account. Similarly, proceeds from sale of rights would be credited to savings account.

Required:

- (i) Calculate the value of each right. (4 marks)
- (ii) Analyse the effect of rights issue on the value of Mr. Njue's investment portfolio and hence advise him on whether to exercise, sell or ignore rights issue. (8 marks)
- (b) Company U and L are identical in every aspect, except that the former does not use debt in its capital structure, while the later employs Ksh 600,000 of 15% debt.

Assuming that:

1. All the MM assumptions are met
2. The corporate tax rate is 35%
3. The EBIT is Ksh. 200,000
4. The Equity capitalization rate of the unlevered firm is 20%

Required:

- (i) Determine the value of firms U and L (2 marks)
- (ii) The overall cost of capital for both firms. (4 marks)
- (c) State any two criticisms of Walter's dividend relevance model. (2 marks)

QUESTION THREE

- (a) A Ltd has decided to acquire B Ltd by offering 2 shares for every 5 shares of B Ltd. The following are the relevant data for the two companies.

	A Ltd	B Ltd
Net sales (sh)	350,000	45,000
Profit after tax	28,130	3,750
Number of shares	7,500	1,500
EPS (Sh)	3.75	2.5
DPS (sh)	1.3	0.6
Total market capitalization	420	45
MPS	56	30

Required

- (i) Post merger EPS for the combined firm. (4 marks)
- (ii) Post merger MPS for the combined firm. (3 marks)
- (iii) Post merger P/E ratio of the combined firm. (3 marks)
- (iv) Total market capitalization of the combined firm. (2 marks)
- (b) Explain the three types of mergers. (6 marks)
- (c) Explain the term corporate finance. (2 marks)

QUESTION FOUR

- (a) Outline the steps involved in financial planning. (7 marks)
- (b) Explain any five benefits of leasing as a source of finance. (8 marks)
- (c) The following information has been extracted from the books of XYZ Ltd for the year ended 30th June 2012.

EAT Ksh. 7.5 million
 Total dividend paid Ksh. 4.5 million
 No. of outstanding shares: 1 million
 Cost of capital 10%
 Internal rate of return from investment 12.5%

Required:

- Calculate the market value of the company's share using Walter's model. (5 marks)
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