

CHUKA



UNIVERSITY

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UNIVERSITY EXAMINATIONS

THIRD YEAR EXAMINATION FOR THE AWARD OF DEGREE  
OF BACHELOR OF COMMERCE

BCOM 332: CORPORATE FINANCE

STREAMS: BCOM (Y3S1)

TIME: 2 HOURS

DAY/DATE: WEDNESDAY 15/04/2020

11.30 A.M. – 1.30 P.M.

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INSTRUCTIONS: Answer question ONE and any other TWO questions

QUESTION ONE (30 MARKS)

- (a) In relation to sources of company finance, explain the following terms;
- (i) Sale and lease back [3 marks]
  - (ii) Mortgage
  - (iii) bonus issues [3 marks]
- (b) Distinguish between financial lease and operating lease [4 marks]
- (c) Briefly discuss the factors affecting capital structure decisions [6 marks]
- (d) A company has a net operating income of sh. 50,000, it has 12% 250,000 bond, the equity capitalization rate is 10%
- (i) Calculate the value of the firm and the overall capitalization rate using the net income approach [5 marks]
  - (ii) What will be the effect on the value of the firm and the overall capitalization rate if bond is increased to sh. 300,000 [4 marks]

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- (e) The following information has been extracted from the books of Bimbo limited

	Sh
Earnings after tax	10,000,000
Number of outstanding shares	1,000,000
Total dividends paid	4,000,000
Internal rate of return	10%
Cost of equity	12%

### Required

- (i) Calculate the value of the term using Walters model [5 marks]  
(ii) Criticize Walter divided relevance theory [3 marks]

### QUESTION TWO

- (a) Explain the following dividend theories
- (i) The bird in hand theory [2 marks]
  - (ii) Signaling effect theory [2 marks]
  - (iii) M.M dividend irrelevance theory [2 marks]
  - (iv) The clientele theory [2 marks]
- (b) An industrial and desires to acquire a diesel generating set costing sh.2 million which as an economic life of 10 years with no scrap value. The unit is considering choices of taking machinery on lease or purchasing the asset by raising a loan of 16%. Lease payments are made at the end and will yield a return of 10%, tax rate is 50%, the firm uses straight line method of depreciation. As a financial consultant indicate what advice you will give to the industrial unit. [12 marks]

### QUESTION THREE (20 MARKS)

- (a) Explain 5 anti-takeover defenses that a firm can implement [10 marks]

- (b) X ltd intends to take over Y ltd by offering two of its share for every five shares in Y Company limited. The relevant financial data is as follows:

	X ltd	Y ltd
EPS	Sh. 2	Sh. 2
Market price per share	Sh. 100	Sh. 40
No. of shares	100,000	250,000
Price earnings ratio	50	20
Total earnings	Sh. 200,000	Sh. 500,000
Total market value	Sh. 10,000,000	Sh. 10,000,000

**Required:**

- (a) Compute the combined EPS & MPS [8 marks]
- (b) Has wealth been created for shareholders? [2 marks]

**QUESTION FOUR (20 MARKS)**

- (a) Explain the disadvantages of equity financing [5 marks]
- (b) The following information relates to ABC company ltd

EBIT	= sh. 15,152,000
Total cost	=0.34
Debt (D)	Sh. 500,000
Unlevered cost of capital (Rv)	= 0.20
Cost of debt capital	= 10%

**Required:**

Determine

- (i) The value of ABC's equity
- (ii) The cost of equity capital
- (v) The WACC [15 marks]