THARAKA UNIVERSITY COLLEGE

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.**

INSTRUCTIONS:

- **Answer question ONE any other TWO questions**
- **Do not write on the question paper**
- **Discounting tables are attached**

QUESTION ONE

(a) Explain the motives of leasing as a source of finance for expansion [5 marks]

(b) Differentiate between rights issue and bonus issue [3 marks]

(c) Explain any three importance of corporate finance [3 marks]

(d) The following information has been extracted from the books of XYZ ltd for the year ended 30th June 2018

Earnings after tax ksh. 7500000

Total dividends paid ksh. 4500000

Number of outstanding ordinary shares: 1 million

Cost of capital 10%

Internal rate of return from investment 12%

Required:

(i) Calculate the market value of the company's share using Walter's model [5 marks]

(ii) State any two limitations of using Walter's model in determining the market value of the firm [2 marks]

(e) State and explain any four factors that must be taken into consideration in making financing decisions of a firm [8 marks]

(f) A company expects a net operating income of ksh. 200000. It has ksh. 600,000 6% debentures and the overall capitalization rate is 10%

Required:

(i) Calculate the total market value of the firm using NOI approach [2 marks]

(ii) Calculate the equity capitalization rate under NOI approach [2 marks]

QUESTION TWO

(a) Mr. Wanja's investment portfolio comprises of 490 shares in ABC ltd and ksh 20,000 deposited in a savings account. ABC ltd has declared a rights issue of one share for every five shares held at an issue price of ksh. 20 per share. The current market price per share of ABC ltd is ksh. 35. Mr. Wanja obtains the funds required to exercise the rights from the savings account. Similarly, proceeds from sale of rights would be credited to the savings account.

Required:

(i) Calculate the value of each right [3 marks]

(ii) Analyze the effect of rights issue on the value of Mr. Wanja's investment portfolio and hence advise him on the investment decision he should undertake. [6 marks]

(b) Briefly state the proposition of the following dividend theories

(i) Walter's dividend theory [2 marks]

(ii) Modigliani and Miller dividend theory [3 marks]

(iii) Signaling theory [3 marks]

(iv) Clientel effect theory [3 marks]

QUESTION THREE

(a) The management of Chuka ltd wants to establish the amount of financial needs for the next year. The balance sheet of the firm as at 31st December 2001 is as follows:

	Sh "000"
Net fixed assets	124,800
Stock	38,400
Debtors	28,400
Cash	7,600
	199,200
Financed by:	
Ordinary share capital	84000
Retained earnings	35200
12% long term debt	20000
Trade creditors	36000
Accrued expenses	24000
	199200

For the year ended 31st December 2001, sales, amounted to ksh. 300 millions. The firm projected sales will increase by 20% in 2002. After tax profit on sales has been 11% but the management is pessimistic about the future operating costs and intends to use an after tax profit on sales at a rate of 9% per annum.

The firm intends to maintain a dividend payout ratio of 70%. Assets are expected to vary directly with sales while trade creditors and accrued expenses form the spontaneous sources of financing. Any external financing will be effected through the use of commercial paper

Required:

(i) Determine the amount of external financial requirements for the year 2002 [5 marks]

(ii) Prepare a proforma balance sheet as at 31st December 2002 [6 marks]

(b) Explain any three features of a term loan [6 marks]

(c) Differentiate between financial leverage and operating leverage [3 marks]

QUESTION FOUR

(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.)	350000	45000
PAT (sh)	28130	3750
Number of shares	7500	1500
EPS (sh.)	3.75	2.5
DPS (sh.)	1.3	0.6
Total market capitalization (sh)	420000	45000

Required:

(i) Pre-merger market price per share for each of the companies [2 marks]

(ii) Post-merger EPS of the combined firm [3 marks]

(iii) Post-merger MPS of the combined firm [2 marks]

(iv) Post-merger P/E ratio of the combined firm [3 marks]

(v) Total market capitalization of the combined firm [2 marks]

(b) Explain any four factors that determined the capital structure of a firm [8 mark]
