****

**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR THREE**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 312**

**COURSE TITLE: CORPORATE FINANCE**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 01/04/2021 TIME: 12.00-2.00 PM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of FIVE (5) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. I). Ismalure Ltd’s share has a nominal value of ksh. 100. The company pays 20% of the nominal value of the share as dividend for the year. The current market price of the share is sh. 180 with 18% earning yield.

Required:

* 1. Earnings per share **[2 marks]**
  2. Dividend cover **[2 marks]**
  3. Price – earnings ratio **[1 mark]**

1. The following data was extracted from the financial statement of Ahsan co. ltd for the year ended 31st December, 2020.

EPS for the year 2020 sh. 5

DPS for the year 2014 sh. 1.20

Target payout ratio 0.6

Adjustment rate 70%

Required

Using the lintner’s model, determine the dividend per share of Ahsan co. ltd for the year ended 31st December, 2020 **[3 marks]**

1. Discuss the agency relationship that exists between and in each case identify the conflicts that may arise and suggest the solutions to those conflicts
2. Shareholders and debt holders **[2 marks]**
3. Top management and subordinates **[2 marks]**
4. Shareholders and management **[2 marks]**
5. Afufey Ltd anticipates Sh.300 million in cash outlays during the next year. The outlays are expected to occur equally throughout the year. The company’s treasurer reports that the firm can invest in marketable securities yielding 8% and the cost of shifting funds from marketable securities portfolio to cash is Sh.15,000 per transaction. Assume the company will meet its cash demands by selling marketable securities.
6. Determine optimal size of the company’s transfer of funds from marketable securities to cash. **[5 marks]**
7. What will be the company’s average cash balance **[1 mark]**
8. How many transfers from marketable securities to cash will be required during the year **[3 marks]**
9. Determine the cash conversion cycle **[1 mark]**
10. What will be the total cost associated with the company’s cash requirement  **[3 marks]**
11. Outline three key sources of long term capital **[3 marks]**

**QUESTION TWO**

1. Migori Ltd maintains a minimum cash balance of sh. 1,500,000. The standard deviation of the daily cash is sh. 800,000. The annual interest rate is 12%. The transaction cost of buying and selling of marketable securities is Sh. 200 per transaction. Assume that one year has 365 days.

Required

Using the miller-Orr cash management model, determine:

1. The return point **[2 marks]**
2. Average cash balance **[2 marks]**
3. The upper cash limit. **[2 marks]**
4. A company in need of additional funding may issue shares to obtain the funds. Describe any five ways through which shares may be issued **[5 marks]**
5. Two firms’ X and Y are identical in all important respects except financial structure. Firm X has Sh 8 million of 7.5% debt, while Firm Y uses only equity. Both firms have EBIT of Sh 1,800,000 and the firms are in the same business risk class. Both firms have the same equity capitalization rate of 10%.

**Required**:

1. Determine the value of each firm and explain the action of the investors. **[5 marks]**
2. Highlight four key fundamental responsibilities of finance manager in an institution **[4 marks]**

**QUESTION THREE**

1. The following was the capital structure of Bamachoge Ltd as at 31 October, 2020.

|  |  |
| --- | --- |
|  | **Sh** |
| Ordinary Share Capital | 10.0 million |
| 12% Preference share capital (sh. 20 par) | 4.8 million |
| 10% debentures (sh. 1,000 par) | 3.6 million |

**Additional information**

1. The market price per ordinary, preference share and debentures were sh. 45, sh. 30 and sh. 1,200 respectively on 31 October 2020.
2. The dividend per ordinary share for the year ended 31 October 2019 was sh. 8.00. Dividends are expected to grow at an annual rate of 12 percent
3. The rate of corporation tax is 30%

**Required:**

The weighted average cost of capital (WACC) of Bamachoge Ltd. Use market value weights.

**[8 marks]**

1. Company y has issued and financed its investment through equity capital. The treasury bills are currently placed at 9%. The average market return is 20%. The beta of the company share is 1.2.

**Required:**

1. Calculate the cost of equity capital using CAPM method. **[4 marks]**
2. Discuss four main basic importance of cost of capital **[4 marks]**
3. Explain four (4) fundamental goals of a firm **[4 marks]**

**QUESTION FOUR**

1. Sugoi Limited is considering investing in the following two mutually exclusive projects whose data were given as follows

**Year Project X cashflow Project Y cashflow**

1 120,000 130,000

2 160,000 190,000

3 150,000 180,000

4 170,000 130,000

However, each of the projects requires an initial cash outlay of ksh 420,000

**Required**

1. Calculate the payback period of each of the project **[6 marks]**
2. Explain four weaknesses of the payback period method **[4 marks]**
3. Consider a four year project whose initial cash outlay is 500,000 and a scrap value of 45,000. The project is expected the following profit after tax

Year Profit after tax

1. 150,000
2. 90,000
3. 80,000
4. 50,000

**Required**

1. Calculate the average rate of return of the project [**3 marks]**
2. Given that management has set a return on investment at 39%. With clear justification state whether the project would be accepted or rejected **[2 marks]**
3. The payment of dividend by firms is based on various theories. Discuss any three dividend theories **[5 marks]**

**QUESTION FIVE**

1. Elucidate any four key assumptions underlying investment Decisions [**8 marks]**
2. Waberi Investments wishes to choose one project among three projects which are mutually independent. The cash flows for each project are estimated to be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Project X | Project Y | Project Z |
| 1 | 100,000 | 70,000 | 60,000 |
| 2 | 60,000 | 100,000 | 60,000 |
| 3 | 90,000 | 100,000 | 60,000 |
| 4 | 120,000 | 80,000 | 60,000 |
| 5 | 30,000 | (20,000) | 60,000 |
| 6 | - | - | 60,000 |

The initial capital outlay for the three projects is as follows

Capital outlay (kes)

Project A 320,000

Project B 240,000

Project C 200,000

**Required**

1. If the firms cost of capital is 14% determine the Net Present Value of each **[9 marks]**
2. Which project should be undertaken and why **[3 marks]**