OFFICE OF THE DEPUTY CHANCELLOR
ACADEMICS, STUDENT AFFAIRS AND RESEARCH

UNIVERSITY EXAMINATIONS

2023/2024 ACADEMIC YEAR

THIRD YEAR FIRST SEMESTER MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 312

COURSE TITLE: CORPORATE FINANCE

DATE: 15TH DECEMBER 2023   TIME: 2.00   TO 5.00 P.M

INSTRUCTION TO CANDIDATES

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MAIN EXAM
BBM 312: CORPORATE FINANCE

STREAM: BBM   DURATION: 3 Hours

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INSTRUCTIONS TO CANDIDATES
   i.   *Answer Question **ONE** and any other **TWO** questions.*

  ii.   *Maps and diagrams should be used whenever they serve to illustrate the answer.*

 iii.   *Do not write on the question paper.*

QUESTON ONE (30 MARKS)

a) Outline and explain FIVE factors that inform Corporate Dividend Decisions (10 marks)

b) Jeremy limited wishes to expand its output by purchasing a new machine worth 170,000 and installation costs are estimated at 40,000/=. In the 4th year, this machine will call for an overhaul to cost 80,000/=. Its expected inflows are:

YEAR	1	2	3	4	5	6
INFLOWS sh.	60,000	72,650	35,720	48,510	91,630	83,715

This company can raise finance to purchase machine at 12% interest rate. Compute NPV and advise management accordingly. (10 marks)

c) A company is faced with the following 5 investment opportunities:

Investment	Cost	NPV	Profitability index
1	500,000	150,000	1.3
2	100,000	40,000	1.4
3	400,000	40,000	1.1
4	200,000	100,000	1.5
5	160,000	90,000	1.6

This company has ksh.750, 000available for investment projects, 3 and 4 are mutually exclusive. All of the projects are divisible. Which group should be selected in order to maximize the NPV. Indicate this NPV figure. (10 Marks)

   d) Assume that two firms the levered firm (L) and the unlevered firm (U) are identical in all important respects except financial structure. Firm L has Sh 4 million of 7.5% debt, while Firm U uses only equity. Both firms have EBIT of Sh 900,000 and the firms are in the same business risk class. Initially assume that both firms have the same equity capitalization rate $K_{eul} = K_{el} = 10\%$.

Required: determine the market value of equity. (10 marks)

QUESTION TWO(20 MARKS)
   a) Explain the position of Modigliani and Miller (MM) with respect to the use of leverage in a firm. (8marks)

b) The financial manager of ABC Ltd expects earnings before interest and taxes of £50,000 in the current financial year and pays interest of 10% as long-term loan of £200 000. The company has 100 000 ordinary shares and the tax rate is 20%. The finance manager is currently examining 2 scenarios.
A case where EBIT is 25% less than expected.
A case where EBIT is 25% more than expected.

Required; Compute the EPS under the 3 cases and the degree of financial gearing for both scenario 1 and 2. (12 marks)

QUESTION THREE (20 MARKS)
a) In the context of capital budgeting, explain the difference between "hard rationing" and "soft rationing". (10 marks)
b) XYZ Ltd wants to raise new capital to finance a new project. The firm will issue 200,000 ordinary shares (Sh.10 par value) at Sh.16 with Sh.1 floatation costs per share, 75,000 12% preference shares (Sh.20 par value) at Sh.18 with sh.150,000 total floatation costs, 50,000 18% debentures (sh.100 par) at Sh.80 and raised a Sh.5,000,000 18% loan paying total floatation costs of Sh.200,000. Assume 30% corporate tax rate. The company paid 28% ordinary dividends which is expected to grow at 4% p.a. Required;-
Determine the total capital to raise net of floatation costs (10 marks)

QUESTION FOUR (20 MARKS)

a) Discuss the risk return – trade off and its significance in corporate investment decisions (10 marks)
b) Highlight and explain the advantages of the Economic Value Added Model as compared to traditional corporate valuation models . (10 marks).

QUESTION FIVE (20 MARKS)
a) Consider the following cash flow estimates from project X and Y

Period	0	1	2	3	4
X	100,000	20,000	65000	55000	90000
Y	100,000	45000	22000	34000	30000

WACC = 10%

Required; Evaluate the Projects the NPV rule, and discuss the shortcoming of NPV based on your answer (10 marks)
b) Show agency problems that may arise between shareholders and management, explain how they can be mitigated (10 marks).

Present value Annuity Table

Period (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9259	0.9091	0.8929	0.9901	0.9804	0.9709
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.7833	1.7355	1.6906	1.9704	1.9416	1.9135
3	.9410	2.8839	2.8286	2.7751	2.7233	2.6730	2.5771	2.4869	2.4018	.9410	2.8839	2.8286
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3121	3.1699	3.037	3.9020	3.8077	3.7171
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	3.9927	3.7908	3.6048	4.8534	4.7135	4.5797
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.6229	4.3553	4.1114	5.7955	5.6014	5.4172
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.2064	4.8684	4.5638	6.7282	6.4720	6.2303
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.7466	5.3349	4.9676	7.6517	7.3255	7.0197
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.2469	5.7590	5.3283	8.5660	8.1622	7.7861
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	6.7101	6.1446	5.6502	9.4713	8.9826	8.5302