THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

A. M. E. C. E. A

P.O. Box 62157
00200 Nairobi - KENYA
Telephone: 891601-6
Fax: 254-20-891084
E-mail:academics@cuea.edu

MAIN EXAMINATION

JANUARY – APRIL 2017 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR PROGRAMME

CBF 322: INVESTMENT BANKING

Date: April 2017	Duration: 2 Hours
INSTRUCTIONS: Answer Question ONE and any other TWO Questions	

Q1. a) PLC recently paid a dividend of sh 18 per share. Dividends are expected to grow at 5% till infinity. The shares of PLC are currently selling at sh 200 each.The firm pays an interest rate of 18% before taxes on its outstanding debt. Its capital structure is made up of 30% debt and 70% equity. The tax rate is 30%. Calculate PLC's

i) Cost of equity **(6 marks)**
ii) Effective cost of debt **(3marks)**
iii) Weighted average cost of capital **(5marks)**

b) ABC Ltd intends to raise sh 50m through public offering of 5-year bonds. It will pay interest at a rate of 8% p.a. The underwriting fee would be 2% of the total amount to be raised. Related out of pocket costs amount to sh 1.5m. The required return is 12% per year. **Required** Calculate the total costs to be incurred today by ABC Ltd **(8 marks)**

c) Explain the meaning of the following terms
i) Full service investment bank **(2 marks)**
ii) Underwriting syndicate **(2 marks)**
iii) Investment management **(2 marks)**
iv) Best efforts underwriting **(2 marks)**

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Q2. a) The retail industry has enterprise value to sales multiple of 5, enterprise value to earnings multiple of 7 and a Price to book value of 10. USM Ltd which operates in the retail industry has sales of sh 80m, net profit of sh 20m and cash flows of sh 40m. It has a book value per share of sh 4. It also has debt currently valued at sh 30m.

Required.
Using Enterprise value to sales multiple calculate:

i) Enterprise value of USM **(4 marks)**
ii) Equity value of USM ***(4 marks)***
iii) Value per share of USM **(4 marks)**
iv) If UMS intends to do an IPO, how would the value per share in *iii* above be useful in the IPO process? **(4 marks)**

b) Explain the following terms
i) Public offering **(2 marks)**
ii) Venture capital **(2 marks)**

Q3. TLC Ltd has engaged CBA Capital to raise sh.30million on a firm committment basis. TLC Ltd is considering two options as follows:

Option one: To sell 2 million ordinary shares at a price of 20 to the public. CBA Capital will buy the entire issue at sh 15 per share from TLC and sell to the investing public.

Option two: Sell 30,000 bonds to the public at sh.1,100 each. TLC will receive a net price of sh.1000 per bond from CBA capital.

Required
a) Calculate the underwriting spread per bond if option two is chosen **(4 marks)**
b) Calculate the underwriting spread per share if option one is chosen **(4 marks)**
c) Which option is better for TLC? Explain your answer **(4 marks)**
d) Is the difference in spread normal between the two options? **(2 marks)**
e) If option one is chosen and CBA Capital is able to sell only 1.5 million shares,

calculate
i) Total net proceeds received by TLC **(3 marks)**
ii) Total fees earned by CBA Capital **(3 marks)**

Q4. Casa Ltd sold 20million shares during an Initial Public Offer at a price of sh 5 per share 5 years ago. Currently, the shares are selling at sh 15 on the stock exchange.The management of Casa Ltd is buying out the existing shareholders by paying a price of sh 20 per share. This is a highly leveraged acqusition with 90% of the purchase cost coming from debt and the rest from equity.

Required.

a) i) Explain the meaning of leveraged buyout **(2 marks)**

ii) How much will it cost the management to buy all the outstanding shares? **(4 marks)**

iii) How much of the total cost will come from equity? **(3 marks)**

iv) How much will the management need to borrow? **(3 marks)**

b) If Casa Ltd has a current net profit amounting to sh 100m, calculate

I) The earnings per share **(4marks)**

ii) The price earnings ratio at the price of sh 20 per share **(4 marks)**

Present value interest factors

1) Present value interest factor for an annuity = $\frac{1-(1+r)^{-n}}{r}$

2) Present value factor for a single amount = $(1+r)^{-n}$

END

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