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MAIN EXAMINATION

AUGUST - DECEMBER 2018 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

ODEL / REGULAR PROGRAMME

CFI 311: CORPORATE FINANCE

Date: DECEMBER 2018	Duration: 2 Hours
INSTRUCTIONS: Answer Question ONE and ANY OTHER TWO Questions	

Q1. a) Firm L has 10 million shares currently selling at sh 50 per share in the stock exchange. Firm U has 40 million shares trading at sh 20 each. Firm U intends to acquire firm L via a stock acquisition. Calculate

i) The exchange ratio at the current market prices. **(4 marks)**

ii) Total new shares to be issued by U to acquire Firm L. **(3marks)**

b) A company is expanding its operations. The firm intends to buy a new machine at a price of sh. 2 million. An additional sh. 150,000 would be spent to install the new machine. If it buys the new machine it will sell an existing machine at sh 500,000 today. The old machine has a book value of sh 750,000. The firm uses straight line depreciation method to depreciate its fixed assets. Intitial investments in current assets amount to sh 300,000 while resulting current liabilities amount to sh 200,000. The tax rate is 30% while the overal cost of capital is 20%. Calculate the initial investment outlay. **(6marks)**

c) Firm Y is financed by 100% equity at cost of equity of 20%. Firm X is similar to Y except that X uses debt to partially finance its long term needs. Therefore, the capital structure of X is made up of 62.5% equity and 37.5% debt. It pays an interest rate of 10% on debt.

Required: Using MM II without taxes, calculate:

i) The cost of equity of Firm X. **(6 marks)**

ii) The overall cost of capital of Firm X. **(5 marks)**

d) Explain the meaning of the following terms:

i) Venture capital **(2 marks)**

ii) Agency problem **(2 marks)**

iii) Capital budgeting decision **(2 marks)**

Q2. a) With an example explain the meaning of an horizontal merger. **(4 marks)**

b) Firm L has 10 million shares currently selling at sh 50 per share in the stock exchange. Firm U has 40 million shares trading at sh 20 each. Firm U intends to acquire firm by paying a cash price of sh 65 per share of Firm L. Further, this is a leveraged buyout acquisition financed by 90% debt.

i) Explain the meaning of acquisition premium. **(2 marks)**

ii) Calculate the total acquisition premium paid by Firm U. **(4 marks)**

iii) Calculate the total amount received by shareholders of Firm L. **(4 marks)**

iv) Calculate the amount of debt that Firm U will need to raise to acquire Firm L. **(3 marks)**

v) Calculate the amount of equity that Firm U will need to raise to acquire Firm L. **(3marks)**

Q3. a) Explain the meaning of a stock dividend **(2 marks)**

b) TLC Ltd is considering doing a 4:1 share split. It has 10 million shares currently selling at sh 200 in the secondary market.

Required: Calculate

i) TLC Ltd's market capitalization before the split **(3marks)**

ii) Number shares outstanding after the split **(3 marks)**

iii) Expected share price after the split **(3 marks)**

c) JIT Ltd has 20 million ordinary shares currently trading at sh 15 each at the stock exchange. In the last financial year it realized a net income of sh 80 million and sales revenues of sh 500 million. On average it adopts a payout ratio of 40%.

Required: Calculate:

i) Total dividends paid. **(3 marks)**

ii) Dividend per share. **(3 marks)**

iii) Amount of profits reinvested in the business. **(3 marks)**

Q4. Jeilo Ltd shares are currently trading at sh. 80 in the stock market. The firm wants to raise additional equity capital of sh 700 million through sale of additional shares. PKF Ltd will underwrite the issue through a firm committment basis. PKF Ltd has advised that due to the declining trend in the stock market, the new shares would be underpriced by 10% compared to the current share price. PKF will earn an underwriting spread of 5% of the issue price to the public.

Required:

a) Explain the meaning of underwriting syndicate. **(3 marks)**

b) Calculate the price at which the new shares will be sold to the investing public. **(3 marks)**

c) i) Calculate the net price per share that Jeilo Ltd will receive. **(4 marks)**

ii) How many shares must Jeilo Ltd sell to raise the sh 700 million? **(4 marks)**

d) Calculate the absolute underwriting spread per share. **(3 marks)**

e) Calculate the total underwriting fee that PKF Ltd will earn if all shares are sold. **(3 marks)**

<u>Present value interest factors</u>

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

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

END