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MAIN EXAMINATION

MAY – AUGUST 2019 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR PROGRAMME

CFI 311: CORPORATE FINANCE

Date: JULY 2019	Duration: 2 Hours
INSTRUCTIONS: Answer Question ONE and any other TWO Questions	

Q1. a) Explain the following terms with appropriate examples
- **(i)** Capital markets **(3 marks)**
- **(ii)** Agency problems **(3 marks)**

b) With examples distinguish between a horizontal merger and conglomerate **(6 marks)**

c) Kakuzi wants to replace an existing machine that was bought 6 years ago at a cost of Kshs 8 m including installation cost of Kshs1m. At the
time of purchase the machine has a useful life of 10 years. No salvage value was expected at the end of its life. This machine can be sold at Kshs.2m today if a new machine is bought.
The purchase price of a new Machine is Kshs. 3m and a further Kshs. 700,000 as installation costs. The firm uses a straight line depreciation method.
Initial increase in inventories amount to Kshs. 300,000 while accounts payable amounts to Kshs. 80,000
The overall cost of capital is 15%. Corporate income tax rate is 30% while capital gain/losses are charged at 25%
Required
Calculate the initial Investment Outlay **(8 marks)**

d) Ujuzi Ltd is evaluating a new project that will generate cash inflows of Kshs.3m , Kshs.5m, Kshs.4m, Kshs.6m and Kshs. 7 m in year one to five respectively. These cash inflows are considered risky. The risk free ate is 15% while adjusted discount rate is 17%. The initial outlay for this project Kshs. 12 m.

(i) Using appropriate discount rate should the project be accepted? **(8 marks)**

(ii) What is the risk premium associated with this project?

(2 marks)

Q2. a) Explain the term Leverage Buyout **(3marks)**

b) KCB ltd wants to acquire national bank Ltd. Further information relating to the two companies is as follows.

	National bank	KCB
After tax cash flows per year forever	Kshs. 15 m	Kshs. 25 m
No. of Ordinary Shares outstanding	8 m	20m
Market capitalization (Total Value of equity)	Kshs. 160m	Kshs.800m

Estimated synergies from the acquisition are currently valued at Kshs. 200m

(i) Calculate the stand alone value per share of National bank Ltd **(3 marks)**

(ii) Calculate the stand alone value per share of KCB Ltd **(3 marks)**

(iii) Calculate the Exchange ratio based on stand Alone Value **(4 marks)**

(iv) How many new shares will KCB Ltd need to issue to acquire National Bank Ltd **(3 Marks)**

c) If instead KCB Ltd pays a cash price of Kshs. 178 m to acquire national bank Ltd, calculate the total acquisition premium. **(4 marks)**

Q3.

Naivas ltd has a debt –equity ratio of 0.2:0.8. At this level the capital structure it can raise Kshs 60M from Equity and Kshs. 12.5 M from debt. The firm is listed in the stock exchange with %m shares currently selling at Kshs. 70 each. Net income expected next year is Kshs. 60m. Naivas ltd adopts a residual delivered policy.

Required:

a) Calculate the maximum capital that the firm can raise maintaining the current financing mix **(3 marks)**

b) If the next year the firm expects to spend kshs.30m on capital projects, calculate

(i) Total amount of dividends next year **(5 marks)**

(ii) Expected dividend per share **(3 marks)**

(iii) Expected intention Ratio **(2 marks)**

c) How much will the firm need to borrow to meet its capital expenditure next year **(2 marks)**

d) Calculate the current market capitalization of Naivas Ltd **(3 marks)**

e) If George owns 3000 shares of Naivas Ltd, how much will he get in Dividends **(2 marks)**

Q4. a). What are the various methods that a company may use to finance its operations, discus their advantages and disadvantages **(10 marks)**

b). A company negotiates a Sh 30 million loan for eight years from a financial institution. The interest rate is 14% per annum on the outstanding balance of the loan. The principal and interest will be repaid in eight equal year-end instalments.

Required

Prepare a loan repayment schedule **(10 marks)**

END