



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

SEPTEMBER – DECEMBER 2019 TRIMESTER

SCHOOL OF BUSINESS

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR/ODEL PROGRAMME

CFI 311: CORPORATE FINANCE

Date: DECEMBER 2019

Duration: 2 Hours

INSTRUCTIONS: Answer Question ONE and any other TWO Questions

Q1. a) A firm is evaluating cash inflows two different projects. Project Q will cost sh.100,000 and generate cash in flows of sh. 25,000, sh. 100,000, and sh 60,000 in years one to three respectively. Project P will cost sh. 300,000 and generate cash inflows of sh. 100,000 each year for five years. The overall cost of capital is 10%. The firm uses the Equivalent Annual Annuity method to evaluate projects with unequal lives.
Required.

i. Calculate the equivalent annual annuity for project Q (6 marks)

ii. Calculate the equivalent annual annuity for project P (4 marks)

iii. Which project should the firm choose? (2 marks)

b) CAST Ltd has a cost of capital of 20% while it pays an interest rate of 10% per year on debt. The firm's total capital is Sh. 500m. Equity capital amounts to Sh. 300 million while the rest is debt capital.

i. What percentage of CAST Ltd's assets is financed by debt finance? (4 marks)

ii. Using MMII without taxes calculate CAST's cost of equity. (6 marks)

c) Explain how managerial compensation is used as a mechanism to minimise the agency problem between shareholders and managers. (2 marks)

d) Explain the meaning of the following terms:
i) Stock dividends (2 marks)

ii) Leveraged buyouts (2 marks)

iii) Primary markets (2 marks)

Q2. You are provided with the following information for two all-equity firms, X and Y.

	Firm X	Firm Y
Shares outstanding	2m	6m
Price per share	sh. 40	sh.30

Firm X estimates that the value of synergistic benefits from acquiring Firm Y is sh.10m. Firm Y has indicated that it would accept a cash purchase offer of sh. 35 per share.

Required:

a) Using an example explain the meaning of an horizontal merger (3 marks)

b) Calculate the Total amount to be paid to shareholders of Firm Y

(3 marks)

c) Calculate the NPV to the shareholders of Firm X and advice whether Firm X should proceed with the acquisition (8 marks)

d) Calculate the acquisition premium per share to be received by firm Y (3 marks)

e) Using an example explain why diversification is not a good reason for a merger. (3 marks)

Q3. MPI Ltd recently went public via an initial public offer (IPO) by issuing 11m equity shares .The equity issue was sold by an underwriting syndicate led by LEE Capital Ltd as the lead underwriter on a firm committment basis. MPI sold the shares to LEE Capital at sh.6.50 each. The price paid by the public investor was sh.7.50 per share. MPI Ltd spent sh.560,000 as listing fees. Further, it spent sh. 250,000 on accounting to obtain the necessary audits. Advertising costs amounted to sh.100,000 while legal fees amounted to 220,000.

Required:

- a) Explain the meaning of an initial public offer (4 marks)
- b) Calculate the absolute spread per share (3 marks)
- c) Calculate the percentage underwriting spread (3 marks)
- d) Calculate the total costs of going public incurred by MPI Ltd (4 marks)
- e) Calculate the total costs as a percentage of the issue proceeds (6 marks)

Q4. CIC Ltd has 10m shares outstanding currently trading at Sh. 20 each at the stock market. It recently announced a net profit of sh.120m. The firm has a dividend payout ratio of 25%.

- a) Calculate the dividend per share (6 marks)
- b) How much will it add to its retained earnings? (3 marks)
- c) Calculate CIC's dividend yield (4 marks)
- d) Calculate the Market capitalisation of CIC Ltd (3 marks)
- e) Explain what is typical of dividend payout ratios for firms that are at growth stage of the life cycle (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