



**MASINDE MULIRO UNIVERSITY OF
SCIENCE AND TECHNOLOGY
(MMUST)**

**MAIN, WEBUYE, BUNGOMA, BUSIA, MUMIAS, NAIROBI AND KAPSABET
CAMPUS**

**UNIVERSITY EXAMINATIONS
2016/2017 ACADEMIC YEAR**

SUPPLEMENTARY EXAMINATIONS

**FOR THE DEGREE
OF
BACHALELOR OF COMMERCE**

COURSE CODE: BCF 303

COURSE TITLE: CORPORATE FINANCE

DATE: Wednesday 27th September 2017 TIME: 12pm -2pm

INSTRUCTIONS TO CANDIDATES

Answer Question ONE and any OTHER TWO

TIME: 2 Hours

MMUST observes ZERO tolerance to examination cheating

This Paper Consists of 3 Printed Pages. Please Turn Over. ►

QUESTION ONE

You have been appointed as an investment and portfolio analyst by a client in Rwanda. The client has identified two stocks on the Nairobi stock Exchange. Company X and Company Y. The client has provided the following data on returns on the two companies for 10 years.

% returns

Comp	Yrs	1	2	3	4	5	6	7	8	9	10
X		37	24	-7	6	18	32	-5	21	18	6
Y		32	29	-12	1	15	30	0	15	27	10

Required

- Calculate the standard deviation of each company return (**5 marks**)
- How do the two stocks relate? Would you invest in them? (**2marks**)
- Explain the two methods an analyst would use to interpret the behavior on stocks on a market(**4marks**)
- Discuss the conditions of an efficient market? Are these conditions met at the NSE? (**6 marks**)
- Differentiate between APT and CAPM (**3 marks**)
- Outline four goals of a firm, highlighting which of the goals is the more superior one. (**5 Marks**)
- Dividends play major role in Corporate Finance for finance managers. Explain five factors to be considered on whether or not to pay dividends. (**5 Marks**)

Tabby your friend argues that capital budgeting decisions are very simple for finance managers. Write a brief report to Marion highlighting the features of capital budgeting decisions. (**5 Marks**)

(Total marks: 30mks)

QUESTION TWO

- Dividends play major role in Corporate Finance for finance managers. Explain five reasons that would motivate a firm to declare dividends at the end of a financial year (**5 Marks**)
- Tabby your friend argues that capital budgeting decisions are very simple for finance managers. Write a brief report to Marion highlighting the features of capital budgeting decisions. (**5 Marks**)
- Differentiate between the following
 - Systematic risk and unsystematic risk (**4 Marks**)
- A company negotiates a Sh 20 million loan for eight years from a financial institution. The interest rate is 12% per annum on the outstanding balance of the loan. The principal and interest will be repaid in eight equal year-end installments.

Required: Prepare a loan repayment schedule (**4 Marks**)
- A stock has an expected return of 17 percent, a beta of 1.9 and an expected return of the market is 11 percent. Calculate the risk free rate. (**3 Marks**)
- In what ways do companies change the composition of their ownership or management? (**2mks**)

QUESTION TWO

a) Highlight three important financial decisions a manager should make in order to maximize shareholder wealth. **(3 Marks)**

b) Why could a company still fail despite making huge profits over the years? **(5mks)**

c) Kilimanjaro Limited is a company involved in the processing of milk. The management is considering whether to replace an existing cooler with a new one. The old cooler is fully depreciated and has no salvage value. If not replaced, the company will continue to incur Sh.1,2 million as annual operating expenses and an additional Sh300,000 in repair costs per annum over the next fifteen years.

The new cooler costs Sh.3 000 000. Its annual operating expenses and repair costs are estimated at Sh.1.1 million and Sh.400,000 respectively over its estimated economic life of fifteen years. It is expected to be worthless after the expiry of this period.

The cost of capital is 10% and the company depreciates its assets using the straight-line method.

Assume a 30% corporation tax rate.

Required:

i) Compute the incremental net annual cash flows if the old cooler is replaced. **(10 marks)**

ii) Using the net present value (NPV) method, advice the management on whether or not to replace the old cooler. **(2 marks)**

(Total marks: 20mks)

QUESTION THREE

a) Highlight the factors to be considered in choosing the source of financing. **(10 Marks)**

b) Write short notes on the capital structure theories **(10 Marks)**

QUESTION FOUR

a) Calculate the cost of equity (ke) given the following information **(5mks)**

Flotation cost=15% of issue price

Dividend- 5.10

Growth $g= 5\%$

Po=Kshs.50

b) Discuss three motives for corporate takeovers. **(5 marks)**

c) According to Modigliani and Miller, capital structure policy and payout policy are irrelevant. Explain. **(5mks)**

d) Explain the signaling theory of dividends. **(5mks)**

Total marks: 20mks