JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENEC & TECHNOLOGY

(KISII LEARNING CENTRE)

UNIVERSITY EXAMINATIONS 2014

FOURTH YEAR FIRST SEMESTER FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

ABA420 :CORPORATE FINANCE

DATE: …………………………………………………   TIME:…………………………..

INSTRUCTIONS

1. Answer question ONE and any other TWO questions
2. Question ONE carries 30 marks and the other questions carry 20 marks each
3. Do not write anything on this question paper

QUESTION ONE (30MARKS)

a) Explain Three key differences between leasing and hire purchase as asset-based sources of finance (6 marks)

b) (i). Differentiate between accretive mergers and dilutive mergers (4 marks)

(ii). Highlight three defensive tactics against takeovers (3 marks)

c) Mashambani limited has decided to go for a milk cooling plant costing Kshs50 million. They are considering leasing the plant. ABC Ltd is willing to lease the plant to Mashambaniat an annual lease rental of Kshs14 million for 5 years, the lease rental being payable in arrears. The tax-relevant depreciation on the plant is 25% as per the written down value (WDV) method. The net salvage value of the plant after 5 years is expected to be Kshs10 million. Mashambani's marginal rate of tax is 35% and its post-tax cost of debt is 8%.

Required:

Calculate the Net Advantage of Leasing (NAL) for Mashambani (8marks)

d) (i). Outline the two main components of a security's return (3marks)

(ii). There are two competing shares M and K. the shares managed to sell at Kshs420 in July 2013. The shares are expected to receive dividends of Kshs8.50 each and they are expected to sell for Kshs510 and Kshs380 for M and K respectively.

Required:

Determine the returns of M and K (6marks)

QUESTION TWO (20 MARKS)

a) Explain the assumptions of Capital Asset Pricing Model(CAPM) (8marks)

b) Appex Limited is considering investing in a new milk cooling plant. The following estimates have been provided to the company's financial analyst about the project.

1. An initial capital outlay of Kshs7 million is required for the purchase of the machine.
2. The machine has an estimated economic life of 5 years and straight line method of depreciation with a zero salvage value
3. The estimated annual sales volume is 1,000,000 units.
4. The selling price per unit is Kshs15.
5. A variable cost per unit of Kshs 10.
6. Annual fixed costs excluding depreciation of Kshs1 million.
7. A required rate of return of 10%.
8. Tax rate 30%.

Required:

i. Determine the Net Present Value (6mks)

ii. Undertaken a break-even sensitivity analysis on the bases of Sales volume (6mks)

QUESTION THREE (20 MARKS)

a) (i). Differentiate between bonus shares and Stock Splits (4marks)

(ii). Despite the tax disadvantage of dividends and the costs associated with external equity issue, firms have to pay dividends and investors generally regard such payments positively. Why is it necessary for firms to pay dividends? (6marks)

b) Creation of shareholder value has become a generally accepted corporate objective. To facilitate the realization of this objective value based management systems which integrate finance theory and strategic management thinking have been developed by Explain Five factors that have stimulated the increased interest by companies in value based management systems (10 marks)

QUESTION FOUR (20 MARKS)

a) Outlinethecomponents of the Capital Asset Pricing Model (CAPM) (6 marks)

b) You have been provided with the following data regarding to Swift Holdings Ltd returns and the corresponding market returns for the five years 2005 – 2009

Year	Probability	Return on Swift holdings	Return on the market
2005	0.2	12%	20%
2006	0.2	14%	26%
2007	0.2	8%	24%
2008	0.2	16%	28%
2009	0.2	14%	26%

Required :

i. Determine the **beta** of Swift Holdings Ltd (10 marks)

ii. Determine the required rate of return of Swift Holdings Ltd if the risk free rate is 5% (4 marks)

QUESTION FIVE (20MARKS)

a) Recently, Kisii Bottlers, Mt. Kenya Bottlers and Rift Valley bottlers to merged to form ALMASI Beverages.
Explain**Four**possible motives behind theirMerger (8 marks)

b) X Ltd is contemplating a complete share acquisition of Y Ltd. X Ltd is offering 3 of its shares for every 2 shares of Y Ltd. The data relating to the two companies are shown below:

	X LTD Kshs	**Y LTD** Kshs
Earnings	5,190,360.00	2,340,000.00
Earnings Per Share	14.80	29.25
Market Price Per share	222.00	322.00

Required:

i. Determine the effect of the acquisition of each company's earnings per share. (8marks)

ii. Given that the growth rate of X ltd is 8% and that of Y ltd is 12%; compute the combined growth rate of the two companies. (4marks)