



MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS 2020/2021 ACADEMIC YEAR THIRD YEAR SECOND SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS BSC. FINANCIAL ECONOMICS

COURSE CODE: ECF 3203

COURSE TITLE: CORPORATE FINANCE II

DATE: 8TH OCTOBER, 2021

TIME: 1430 – 1630HRS

INSTRUCTIONS TO CANDIDATES

- *Answer question ONE (compulsory) and any other THREE questions.*
- *Question one carries 25 marks*
- *All other questions carry 15 marks*

Question one

- a) Clearly discuss the steps to be undertaken in capital budgeting
(5 marks)
- b) Distinguish between stock dividends and bonus issue. **(2 marks)**
- c) Discuss five external hedging techniques in international investment and business
(5 marks)
- d) Discuss the professional functions of the finance manager that enable him/her make decision in a corporation
(4 marks)
- e) A project requires an initial investment of Ksh. 500,000. Its expected cash inflows are Ksh. 200,000 every year for five years. The risk free rate of interest is 5%. The market risk premium is 9%. The estimated beta is 1.2 for this project. The firm is indifferent between a certain sum of 181,347 at the end of first year and the expected sum of Ksh. 200,000. Determine the NPV using
- i) Certainty equivalent method **(5 marks)**
 - ii) Risk adjusted discount rate **(4 marks)**

Question Two

- a) Clearly discuss the areas of conflict that exist between NPV and IRR as methods of evaluating projects and hence mention the most preferred method and why
(6 marks)
- b) ABC limited is contemplating a replacement cycle for new machinery. This machinery will cost 100 million to purchase. The operating and maintenance costs for the future years are as follows:

Year	0	1	2	3
Operating and maintenance costs(Ksh.000)	0	120,000	130,000	140,000

The resale values of the machinery in the second hand market are as follows:

Year	0	1	2	3
Resale value(Ksh.000)	0	80,000	65,000	35,000

Assume:

- i) The replacement by an identical machine
- ii) There is no inflation tax or risk
- iii) The cost of capital is 12%

Required advise ABC limited on whether to replace this new machine on a one, two or three-year cycle. Use equivalent annual cost method **(9 marks)**

Question three

a) Discuss five factors to be considered when capital structure decisions. **(5 marks)**

b) A company proposes to invest in two divisible projects. A project can be accepted in part, both cash flows and subsequent receipts are valued pro-rata (proportionately). The two projects and their associated cash flows are shown below.

Cash flows (Ksh."000")

	Project A	Project B
0	(10,000)	(20,000)
1	(20,000)	(10,000)
2	(30,000)	-
3	100,000	60,000

The cost of capital applicable for both companies is 10%. The cash flows occur in exactly 12 months intervals. No profit can be deferred. The funds available are restricted as follows:

Year	Funds available (Ksh. "000")
0	20,000
1	25,000
2	15,000

Funds not utilized in one year will not be available in subsequent years.

Required:

a) Formulate a linear programming model to solve the above problems **(4 marks)**

b) Solve the problem graphically **(6 marks)**

Question four

- a) State and Explain four factors that may influence dividend policy of a company **(8 marks)**
- b) Consider a company with Ksh. 500,000 shares currently trading at Ksh 150 each in the Nairobi Securities Exchange. Let the dividend to be received in one years' time be Ksh.3 per share, the investment opportunities be worth Ksh. 25M, the profit to be earned at the end of the current year be Ksh.15M and cost of capital be 10%.

Required:

Show that the payment of dividends does not affect the value of the firm using MM theory.

(7 marks)

Question five

Mara Ltd is an equity financed company with a cost of capital of 18.5%. The company is considering the following one-year investment projects.

Project	outlayKsh."000"	Annual cashflowsKshs."000"	beta
A	1,000	1095	0.3
B	1,000	1,130	0.5
C	1,500	1,780	1.0
D	2,000	2,385	1.5
E	2,000	2,400	2.0

The risk free rate of return is 8% and market rate of return is 15%.

Required

- i) Beta factor of Mara Limited **(3 marks)**
- ii) The required rate of return and expected return of each of the above projects indicating which project the company should undertake and which ones to reject **(7marks)**
- iii) The Beta factor of the investment in the accepted projects. **(5 marks)**

Candidate Name

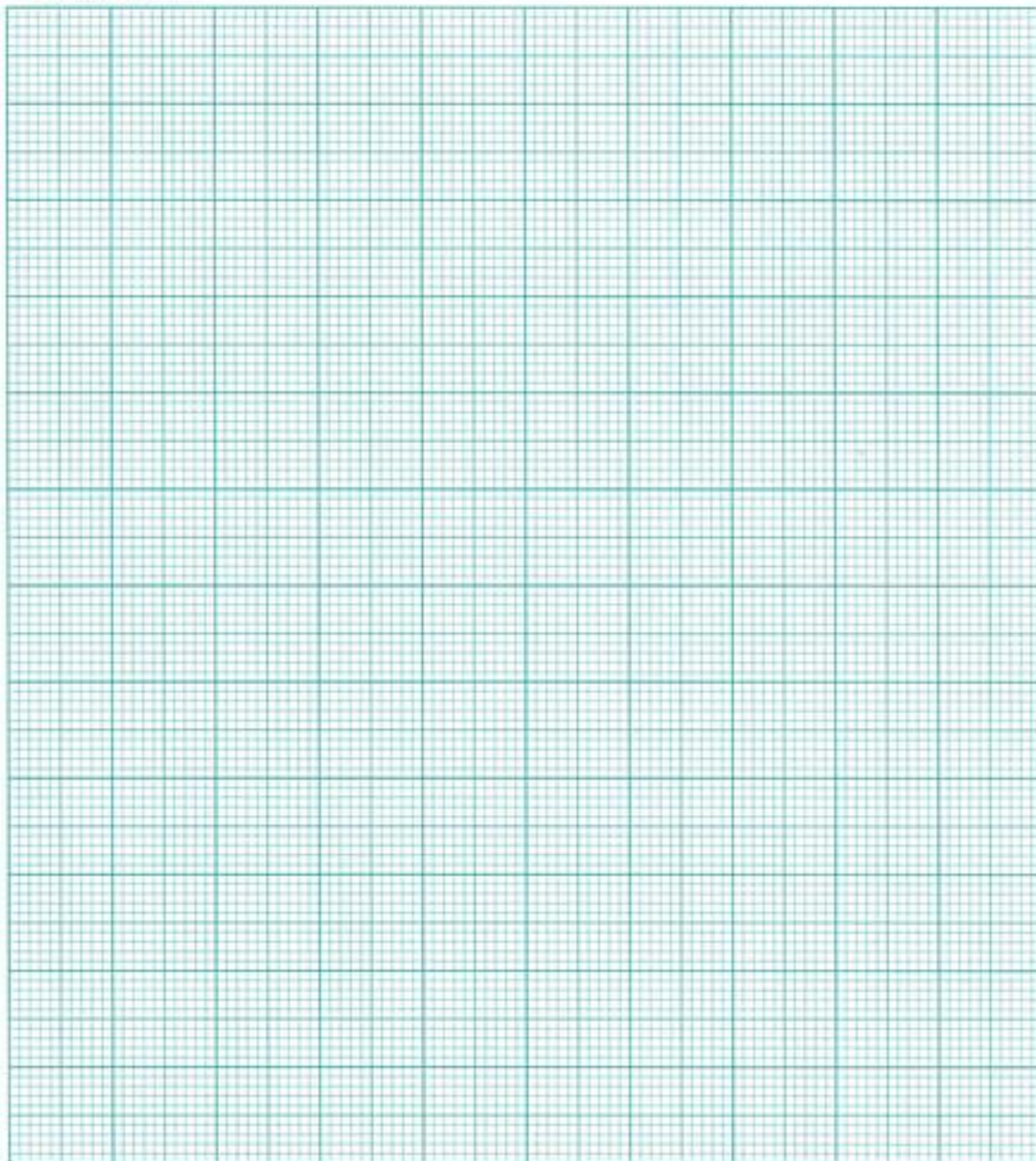
Centre Number

Candidate Number

Subject Paper

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Question No.



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