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University Examinations 2023/2024

FIRST YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF
SCIENCE IN FINANCE

BFS 5103: ANALYTICAL CORPORATE FINANCE

DATE: APRIL 2024

TIME: 3 HOURS

INSTRUCTIONS: Answer question *one* and any other *three* questions

QUESTION ONE (24 MARKS)

- a) Discuss the benefits to a firm for launching takeover bids (5 marks)
- b) Discuss the motivation for firms to explore cross border listing (5 marks)
- c) You have the following information about the returns for the securities of Super Lux plc and the returns for the market:

Time	Return of Super Lux (%)	Return of the market (%)
t_1	18	10
t_2	21	11
t_3	20	8
t_4	25	12
t_5	26	14

Given that the rate of return on Treasury bills is 8 per cent and that the correlation coefficient between the security and the market is 0.83, calculate the required rate of return on Super Lux's shares using the CAPM. (6 marks)

d) Following is EPS record of AB list over the past 10 years

Year	EPS	Year	EPS
10	Ksh 205		Ksh 12
9	19	4	6
8	16	3	9
7	15	2	(2)
6	16	1	1

Determine the annual dividend paid each year in the following cases:

- i If the firms dividend policy is based on a constant dividend payout ratio of 50% for all the years (2 marks)
- ii If the firm pays a dividend at Kshs 8 per share and increases to Kshs 10 per share when earnings exceed Kshs 14 per share for previous consecutive years (2 marks)
- iii If the firm pays dividend at Kshs 7 per share each year except when the PS exceed Kshs 14 per share when an extra dividend equal to 80% of earnings beyond Kshs 14 would be paid (2 marks)
- iv Which type of dividend policy will you recommend to the company and why (6 marks)

QUESTION TWO (12 MARKS)

- a) Explain the causes of 'failure' of takeovers (6 marks)
- b) Discuss any four techniques used by a multinational company to hedge against the foreign exchange risk involved in foreign trade (6 marks)

QUESTION THREE (12 MARKS)

As treasurer of Holiday Ltd , you are investigating the possible acquisition of Leisure Ltd. You have the following basic data:

	Holiday	Leisure
Earnings per share (expected next year)	Kshs 5	Kshs 1.50
Dividends per share (expected next year)	Kshs 3	Kshs 0.80
Number of shares	1 million	0.6 million
Share price	Kshs 90	Kshs 20

You estimate that investors currently expect a steady growth of about 6 per cent in Leisure's earnings and dividends. Under new management, this growth rate would be increased to 8 per cent per year, without any additional capital investment required.

Required:

Calculate

- i) The gain from the acquisition (3 marks)
- ii) Cost of the acquisition if Holiday pays Kshs 25 in cash for each Leisure share (3 marks)
- iii) Cost of the acquisition if Holiday offers one of its own shares for every three shares Leisure (3 marks)
- iv) How would the cost of the cash offer and the share offer alter if the expected growth rate Leisure were not changed by takeover (3marks)

QUESTION FOUR (12 MARKS)

- a) Explain the differences between financial and operating leverage (2 marks)
- b) A plastic manufacturing company is planning to expand its assets by 50%. All this expansion will come from external sources. A firm wants to invest Ksh 500,000 and expects a return of 24%

It is considering two options:

Option 1: Issuing 50,000 ordinary shares at Ksh 10 per share

Option 2: Issuing 25,000 ordinary shares at Ksh 10 per share and borrowing Ksh 250,000 at 15% rate of interest.

If tax rate equal 30%

- i Determine the number of shares to be raised if B is adopted (4 marks)
- ii Determine the indifference point between plan A and B (6 marks)

QUESTION FIVE (12 MARKS)

- a) By use of diagram, distinguish between Harry Markowitz model from William Sharpe single index model (6 marks)
- b) You want to invest in two financial assets, namely bond and shares. The expected return of the bond is 8% while that of a share of stock is 15%. The total risk measured in standard deviation were 10% and 20% respectively for bond and stock.

Required:

Find the Expected return of the portfolio and standard deviation of portfolio consisting of bonds and shares that will minimize risk (6 marks)