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University Examinations 2024/2025

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

BFS 5103: ANALYTICAL CORPORATE FINANCE

DATE: JANUARY 2025

TIME: 3 HOURS

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

QUESTION ONE (30 MARKS)

- a) Discuss firm's dividend policy and explain its significance in corporate finance (8 marks)
- b) Discuss the types of mergers and their strategic motivations. (8 marks)
- c) Explain the concept of financial distress and how it affects a firm's value when leverage is high. (8 marks)
- d) Calculate the optimal capital structure for a firm with the following information:

Cost of equity (K_e) = 12%

Cost of debt (K_d) = 8%

Current debt = Kshs200,000

Current equity = Kshs 800,000

Tax rate = 30%

Assume that the firm is considering increasing its debt to Kshs400,000. (8 marks)

e) Given the following information, calculate the expected return and risk of a portfolio consisting of two assets:

Asset A:

- Expected Return (E(RA)): 8%
- Standard Deviation (GA): 10%
- Weight in Portfolio (WA): 60%

Asset B:

- Expected Return (E(RB)): 12%
- Standard Deviation (OB): 15%
- Weight in Portfolio (wB): 40%
- Covariance between A and B (Cov(RA, RB)): 0.005 (8 marks)

QUESTION TWO (12 MARKS)

- a) Explain the difference between systematic and unsystematic risk and how they can be managed. (6 marks)
- b) A company is considering acquiring a target firm with an EBIT of Kshs 1,000,000 and a tax rate of 30%. The required return on assets is 10%, and the expected synergies from the merger are Kshs 500,000 annually. Calculate the value of the target firm pre and post-merger (6 marks)

QUESTION THREE (12 MARKS)

- a) A company is exposed to interest rate risk on a Kshs50 million loan with a floating interest rate. The company expects interest rates to rise. How can the company hedge this risk (8 marks)
- b) Discuss the importance of managing cash in an organization (6 marks)

QUESTION FOUR (12 MARKS)

- a) Explain the importance of importance in business operations (6 marks)
- b) Calculate the expected dividend for a company with a current dividend of Kshs3.00, a growth rate of 5%, and a required rate of return of 10%. (6 marks)

QUESTION FIVE (12 MARKS)

- a) Discuss the implications of Agency Theory for corporate governance. (6 marks)
- b) Explain the factors the firm should consider when making capital structure decisions (6 marks)