SCHOOL OF PROFESSIONAL STUDIES

BACHELOR OF BUSINESS ADMINISTRATION

UNIT CODE/NAME: BAF 302 - CORPORATE FINANCE

January – April 2018/2019 End Semester Exam - Time: 2 Hours

Instructions: Answer Question ONE (Compulsory) and any other TWO questions.

QUESTION ONE

a) What do you understand by the term cost of capital **(4 marks)**

b) A firm's cost of capital is the weighted arithmetic average of the cost of different sources of long term finance used by it. Assume a company uses equity costing 16% and debt costing 9%. If the proportions in which debt and equity are used are respectively 40% and 60% the cost capital would be? **(10 Marks)**

c) Why is the calculation cost of capital important? **(6 marks)**

d) The management a Textile company is considering to replace an old machine with a new one. The new machine will be capable of performing some tasks much faster than the old one. The installation of machine will cost Ksh 8417 and will reduce the annual labor cost by shs 1500. The useful life of the machine will be 10 years with no salvage value. The minimum required rate of return is 15%. Should the company return the machine? Use IRR. **(10 marks)**

QUESTION TWO

a) It is a common misconception that equity capital has no concrete cost that the company must pay after it has listed its shares on the exchange. In reality, there is a cost of equity. What is the importance of this cost in business? **(5 marks)**

b) As of October 2018, the risk free rate, represented by annual return on 20-year treasury bond was 3.3 percent, beta value for ABC ltd stood at 0.51, while the average market return, represented by average annualized total return for the S&P 500 index over the past 90 years, is 9.8 percent. From the balance sheet, the total shareholder equity for ABC ltd for the 2018 fiscal year was $77.87 billion (E), and the long term debt stood at $36.83 billion (D). The total for overall capital for Walmart comes to V = (E+D) = $114.7 billion. Calculate WACC.

(10 Marks)

QUESTION THREE

a) A bond of face value of Ksh 1000 and a maturity of 3 years pays 15% interest annually. What is the market price of the bond if YTM is also 15 %. **(5 Marks)**

b) Discuss the sources of capital of a company. Analyse the factors that affect the capital structure. **(10 Marks)**

QUESTION FOUR

a) When a firm follows wealth maximization goal, it achieves maximization of market value of a share. Do you agree? Substantiate your arguments. **(5 marks)**

b) A project costs Kshs 50,000. It is expected to generate cash inflows as shown in table. If the risk free rate is 10%, compute NPV. **(10 marks)**

Year	Cash inflows	Certainty equivalent
1	32000	0.9
2	27000	0.6
3	20000	0.5
4	10000	0.3

QUESTION FIVE

a) Explain the four important managerial finance functions. **(8 marks)**

b) Explain the principles of corporate governance **(7 marks)**