



# **GRETSA UNIVERSITY - THIKA**

## **UNIVERSITY EXAMINATIONS JANUARY - APRIL 2025 SEMESTER**

### **BACHELOR OF COMMERCE**

**COURSE CODE: BCFI 300**

**COURSE TITLE: CORPORATE FINANCE**

**DATE:**

**TIME:**

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#### **INSTRUCTIONS TO CANDIDATES**

1. SECTION A IS **COMPULSORY**.
2. SECTION B: ANSWER ANY OTHER **THREE** QUESTIONS.
3. **DO NOT** WRITE ANYTHING ON THIS QUESTION PAPER AS IT WILL BE AN EXAM IRREGULARITY.
4. ALL ROUGH WORK SHOULD BE AT THE BACK OF YOUR ANSWER BOOKLET AND CROSSED OUT.

**CAUTION:** *All exam rooms are under CCTV surveillance during the examination period.*

## SECTION A: COMPULSORY

### Question One

Kithino coffee millers Ltd. have decided to install a new milling machine. The machine costs shs. 2,000, 000 and it would have a useful life of five years with a salvage value of shs. 400, 000 at the end of the fifth year. Additional cash flows from the machine would be shs. 800, 000 a year for five years. A decision has now to be taken on the method of financing the project. Two methods of finance are being considered.

- (i) The company could purchase the machine for cash, using bank loan facilities on which the current rate of interest is 13% before tax.
- (ii) The company could lease the machine under an agreement which would entail payment of shs. 480, 000 at the end of each year for the next five year. The company's weighted average cost of capital, normally used for project evaluating, is 12% after tax. The rate of company income tax is 30%. If the machine is purchased, the company will be able to claim an annual tax depreciation allowance of 25% on cost.

### Required:

- a) Advise the management on whether to acquire the machine [2 marks]
- b) The most economical method of financing [10 marks]
- c) Explain the importance of using the security market indices [8 marks]
- d) Explain the 4 Agency problems in relation to financial management [10 marks]
- e) Explain the 5 assumptions of Modigliani and Miller in capital budgeting [10 marks]

## SECTION B: ANSWER ANY THREE QUESTIONS

### Question Two

- a) Explain why the weighted average cost of capital of a firm that uses relatively more debt capital is generally lower than that of a firm that uses relatively less debt capital. [6 marks]
- b) Company xyz wants to invest in 2 projects: investment A requires an outlay of Sh. 1,000,000 and is expected to produce a net cash flow at the end of the year one of Sh. 1,200,000 producing a rate of return of 20%, while investment B requires an outlay of Sh 500,000 and is expected

to produce a net cash flow at the end of year one of Sh. 625,000 producing a return of 25%..  
Calculate which investment is viable using

- (i) NPV [2 marks]
- (ii) IRR [2 marks]
- (iii) Explain the 5 differences between the Internal Rate of Return method and the Net Present Value method [10 marks]

a)

**Question three**

- (a) Discuss six factors that influence the cost of finance [12 marks]
- (b) Discuss 4 disadvantages of using weighted average cost of capital (WACC) [8marks]

**Question Four**

- (a) Explain five factors to consider when buying shares of a company (10 marks)
- (b) Explain five functions of Central Depository System (CDS) (10 marks)

**Question Five**

(a) Elema Company will employ total assets of Sh. 800,000. 50% of the assets are financed by borrowed capital at an interest cost of 8%. Tax rate is assumed to be 50%.

	Sh.	Sh.
Sales		720,000
Direct Cost		480,000
Gross profit		240,000
Operating expenses	80,000	
Interest charges	32,000	(112,000)
Profit before tax		
Taxes		(64,000)
Net profit after taxes		64,000

Calculate:

- i. Net Profit margin. [4 marks]
- ii. Return on Assets. [3 marks]

iii. Assets turnover. **[3 marks]**

iv. Return on equity. **[4 marks]**

**(b)** A company has the following capital structure as at 30th June 2019;

Source	Amount
Ordinary share	4,000,000
10% preference share	1,000,000
14% Debentures	3,000,000

The share of the company sells for shs 20 and it is expected that it will pay next year a dividend of sh 2 per share which will grow at 7% forever. Assume a 50% tax rate; compute the weighted Average cost of capital (WACC) based on the existing capital structure.

**[6 marks]**