LAIKIPIA UNIVERSITY COLLEGE

CORPORATE FINANCE: CAT 2 TAKE AWAY

ATTEMPT ALL QUESTIONS

1. **Dividend Discount Model.**
2. Amazon.com has never paid a dividend, but its share price is Ksh. 66 and the market value of its stock is Ksh. 22 billion. Does this invalidate the dividend discount model? (4 mks)
3. **Constant-Growth Model.**

Fincorp will pay a year-end dividend of Ksh. 4.80 per share, which is expected to grow at a 4 percent rate for the indefinite future. The discount rate is 12 percent. What is the stock selling for? If earnings are Ksh. 6.20 a share, what is the implied value of the firm’s growth opportunities? (4 mks)

1. **Non constant Growth.**

A company will pay a Ksh. 1 per share dividend in 1 year. The dividend in 2 years will be Ksh. 2 per share, and it is expected that dividends will grow at 5 percent per year thereafter. The expected rate of return on the stock is 12 percent.

* What is the current price of the stock? (4 mks)
* What is the expected price of the stock in a year? (2 mks)
* Show that the expected return, 12 percent, equals dividend yield plus capital appreciation (2 mks)

2. This question tests your understanding of financial distress.

**a.** What are the costs of going bankrupt? Define these costs carefully.(6 mks)

**b.** “A company can incur costs of financial distress without ever going bankrupt.” Explain how this can happen.(6 mks)

**c.** Explain how conflicts of interest between bondholders and stockholders can lead to costs of financial distress. (6 mks)