UGANDA MARTYRS UNIVERSITY, LUBAGA CAMPUS

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

DEPARTMENT OF ACCOUNTING & FINANCE

COR 2201: CORPORATE FINANCE II FINAL ASSESSMENT 2017/18

BAM 3 EVENING LUBAGA

DATE: 8th August 2018

Time allowed: 3 hours

Instructions to Candidates:

Read the following before answering the examination questions.

1) Do not write anything on this question paper.
2) Attempt any **four (4)** questions of your choice

Question One

(a) Differentiate between weighted cost of capital and marginal cost of capital.

(02 Marks)

(b) Dosh Ltd currently has a total capital of Shs 200m composed of :

Details	Amount
20% Long term Bank Loan	80m
10% Preference Shares	20m
Common Shares	60m
Retained profits	40m
Total	200m

The business anticipates that dividends on ordinary shares will be Shs 6,000 per share and the market value of the share is Shs 23,000 per share. The dividends are expected to grow at a rate of 7% per year forever and the company is in a 40% tax bracket.

Required:

Determine the weighted average cost of capital for the firm.

(07 Marks)

c) The capital structure debate relates to the question whether the employment of leverage in financing an entity has any relevance to the firm.

Using relevant illustrations where possible discuss the arguments of the following in the capital structure debate.

- The Traditional or Classical School's view. **(08 Marks)**
- The Modern or Neo-Classical School's view. **(08 Marks)**

Question Two

Companies raise long-term funds in the form of equity and debt from capital markets. Finance managers should therefore know the ways in which securities are traded and priced in the capital markets. They should also know the procedures followed in issuing securities:

Required:

(a) What is capital markets efficiency?

(05 Marks)

(b) Discuss the three forms of capital markets efficiency.

(10 Marks)

(c) What is meant by perfect capital markets? What are their attributes?

(10 Marks)

Question Three

a) Define financial distress and discuss the causes of financial distress in organizations

(16 Marks)

b) Describe 3 expansion and 3 contraction strategies in corporate restructuring

(09 Marks)

Question Four

(a) Linzo Ltd currently has a total capital structure of Shs 160 million made up of 2,000 shares of shs 40,000 each, 10% preference shares worth shs 20,000,000 and 14% Debentures covering the rest. The company's shares presently fetch Shs 40,000 on the market and a dividend of shs 4,000 is paid and is expected to grow at a rate of 5% perpetually. The firm is in a 50% tax bracket.

Required:

Determine the weighted cost of capital basing on the existing capital structure of Linzo Ltd. **(12 Marks)**

b) Tedron Ltd has in issue 10% bonds of a nominal value of ugx. 100. The market price is ugx. 90 ex-interest. Calculate the cost of this capital if the bond is:

i) Irredeemable **(04 Marks)**

ii) Redeemable **(09 Marks)**

Question Five

(a) Explain why businesses decide to go international. **(08 Marks)**

(b) Differentiate between transactions exposure, operating exposure and translation exposure. **(08 Marks)**

(c) Discuss any three (3) ways through which a coffee dealer in Uganda who exports his coffee to Russia can manage foreign exchange rate exposure.

(08 Marks)

<u>Question Six</u>

Islamic finance is finance that is compliant with Sharia'a law. Islamic finance has gone through an exceptional growth period in recent years. The number of fully Sharia'a compliant banks continues to increase worldwide.

Required:

a) Briefly describe how the following Islamic finance contracts work;

   i) Mudaraba contract

   ii) Musharaka partnership contract

   iii) Ijara contract

(12 Marks)

b) Riba (interest) is forbidden in Islamic finance. It is generally interpreted as the predetermined interest collected by a lender, which the lender receives over and above the principal amount it has lent out.

   Required:

   i) Briefly explain the three different perspectives under which riba can be viewed as unacceptable basing on the Quranic ban. **(06 Marks)**

   ii) Explain any conditions that are required for a Murabaha contract to exist as prescribed in the Sharia'a law

(07 Marks)

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