UGANDA MARTYRS UNIVERSITY: NKOZI CAMPUS DAY

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

DEPARTMENT OF ACCOUNTING AND FINANCE

CODE: 3209. COURSE: CORPORATE FINANCE 11

Date: 12th July, 2022

Time allowed: Time allowed: 3 hours

9:30 am-12.30 pm

Instructions to candidates:

Read the following before answering the examination questions

1) Attempt **FOUR** Questions
2) All questions carry equal marks
3) Indicate the questions attempted at the top of the page
4) Any malpractices will **LEAD** to the **CANCELLATION** of the RESULTS

QUESTION ONE

a) Explain the concept of cost of capital and the various categories of cost capital

[8marks]

b) Mabati Uganda Limited (MUL) deals in manufacture and supply of iron sheets in Uganda. At its recently concluded Board meeting, it was resolved that the company expands its operations to include production of roofing tiles effective 1st January 2021. The Board however directed that the company's Managing Director should assess the viability of the proposed investment prior to committing funds. It was also resolved that since the project will be financed by both debt and equity, a weighted average cost of capital should be determined and be applied in evaluating the project's viability.MUL has hired you as a financial consultant to help in determining the cost of capital suitable for evaluating the proposed investment. The company currently has a total capital of 24.5Million composed of:

	UGX Million
25% Long term bank loan	6.7
20% preference shares	5.5
Common stock	7.8
Retained profit	4.5

Additional information

1. MUL anticipates that the dividends on ordinary shares will be UShs. 10,000 per share and the market value of the share is UShs 32,000 per share.
2. The dividends are expected to grow at a rate 8% per year with a tax bracket of 30%.

Required:

1) Compute individual cost of capital **[2 marks]**
2) The weights of each source of capital **[4 marks]**
3) Weighted cost of capital using the book value weights and explain the significance of your answer on the company's financial decisions **[7 marks]**

c) Golobola Group of companies anticipates investing in a project whose current market price return on risky investment of 135 compared with 5% on treasure bills. The company has a beta of 1.9

Required

Calculate the cost of equity of the company **[4marks]**

QUESTION TWO

a) Yiya Sente (U) Ltd has equity share outstanding at the beginning of the year 2021. The current market price per share is UShs 12,000. The board of directors of the company is contemplating declaring a dividend of UShs. 640 per share. The rate of return on equity appropriate to the risk class to which the company belongs is 10%.

Required:

i. Based on Modigliani and Miller approach, determine the market price of the shares of the company when the dividend is declared and not declared **[8 marks]**

ii) Critically examine the Modigliani Miller Hypothesis of capital structure **[7marks]**

B) WXY Ltd specializes in productions processed coffee for export, and expects annual net operating income of Shs. 4,000,000. It has Shs. 5,000,000 outstanding debt; Cost of debt is 10%. If the overall capitalization rate is 12.5%

Required:

Calculated the total value of the firm and the equity capitalization rate according to the Net operating Income approach **[6marks]**

d) Briefly explain concept of capital structure and financial structure to the management of Yiya Sente U Ltd **[4 marks]**

QUESTION THREEE

a) Explain the concept of Rights -issues and Ex – rights with examples and discuss the three choices the investor has when the company announces a right issue **[8marks]**

b) Vita Form U Ltd. has a share capital of 20,000 Equity shares of Shs.20 each having a market value of Shs.16 per share. The company raises funds through rights issue by offering one new share for every six shares hold at a price of Shs.15

Required

Calculate the value of right as well as the ex-rights value of a share **[4marks]**

c) Discuss the concept of Management buyout and management buy in and giving two advantages of each to the business **[7 marks]**

d) Explain the concept of debt issue and the three major types of debt issues used by companies in raising funds for their operations **[6 marks]**

QUESTION FOUR

a) Discuss the external factors that influence Dividend Policy of an organization in its decision making **[6marks]**

b) Explain what is meant by the following schemes in addressing the dividend questions in an entity: Share re-purchase and stock split and reason for share repurchase in business entity **[7marks]**

c) Assuming Kalolo Ltd has a cost of equity 11% rate of return on investment is 12%, and earnings per share is Shs. 12.

Required

Calculate the price per share by Gordon's model if the dividend payout ratios are 10% and 30% **[6marks]**

d) The common situation that financial executive is faced with at the end of every financial period, is on the dividend declaration to the shareholders. The management is required to recommend to the board of directors whether dividends for the period should be declared or not. You have been consulted to review the financial statements and advise on the rational of declaring dividends to the shareholders. **[6marks]**

QUESTION FIVE

a) Explain the difference between currency swaps and currency options as approaches for managing transaction exposure **[4 marks]**

b) With examples, explain the meaning of the following terms in relation to hedge accounting. **[10marks]**

i. Leading and lagging
ii. Matching
iii. Economic exposure
iv. Transaction exposure
v. Translation exposure

c) Assume it now October 2021, BVX PLC, a UK company, owes Interclays Inc. a US supplier $ 370,000 payable three months later in January 2022. The spot rate in October 2021 is $ 1.5766 - $ 1.5775/ £ and BVX is concerned that the $ may strengthen against the £ before payment is made.

Required;

Calculate the sterling cost of the transaction if BVX decides not to hedge (insure) the currency and the spot rate in January 2022 turns out to be:

(a) $ 1.3800 - $ 1.3809 / £ **[6Marks]**

(b) $ 1.8500 - $ 1.8510 / £

d) Use the information in c about (BVX PLC) together with the following forward quote obtained from the company's banker in October 2021.

3 months forward	\$1.5680 - \$1.5830

Required

Calculate the amount that BVX will have to pay if the currency risk is hedged using a forward contract. **[5marks]**

QUESTION SIX

a) Explain the nature and causes of financial distress and how it can be addressed by an organization **[12 marks]**

b) Why do many organizations hoped for corporate restructuring instead of distress restructuring? **[5 marks]**

c) Discuss the following short term investments financing and off balance sheet financing can be adopt in financing various financial needs in different business sectors giving a justification of each. **[8marks]**

   i. Treasury Bills,
   ii. Commercial papers,
   iii. Certificate of deposit,
   iv. Bank acceptances

Success!