

**UGANDA MARTYRS UNIVERSITY, NKOZI/LUBAGA
CAMPUS**

**FACULTY OF BUSINESS ADMINISTRATION AND
MANAGEMENT**

DEPARTMENT OF ACCOUNTING AND FINANCE

BAM III SEMESTER ONE 2022/2023

CODE: 3209. COURSE: CORPORATE FINANCE II

DATE: Tuesday, 16th May 2023

Time allowed: 9:30am -12:30pm

Instructions to Candidates:

Read the following before answering the examination questions.

- 1) Do not write anything on this question paper.
- 2) Write neatly and show all workings clearly.
- 3) Start every question on a new page
- 4) Section **A** has one compulsory question carrying 25marks
- 5) Section **B** has five numbers and only three are to be attempted. Each question carries 25marks
- 6) Any malpractices will **LEAD** to the **CANCELLATION** of the **RESULTS**
- 7) Clearly state the question number & sections attempted

SECTION A

This section has one compulsory question to be attempted

Question 1

a) Chap Chap (U) Ltd (CCUL) is a company dealing in electronics in Kampala. It is considering expanding its operations beyond the boundaries to take advantage of East African Community Common Market Protocol where goods, services and workers can move freely without any hindrance. The finance manager cautioned the board against expanding beyond borders since it would require huge sums of capital. Yet the sources of this capital are difficult to come by and the cost is high. He suggested that before any step to expand is taken, the company should examine the following:

- (i) Different sources of finance to fund the expansion.
- (ii) The cost of capital of the existing funds the company is currently employing.
- (iii) The overall cost of capital of CCUL.

The company currently has a total capital composed of:

| | |
|-------------------------|-------|
| 25% long-term bank loan | 60.5m |
| 15% preference shares | 30.5m |
| Common shares | 50.5m |
| Retained profits | 40m |

The business anticipated that dividends on ordinary shares will be shs. 10,000 per share and the market value is shs 25,000 per share. The dividends are expected to grow at a rate of 7% per year forever and the company is in the 30% tax bracket.

Required

- a) Determine the weighted average cost of capital Chap Chap Ltd **(12marks)**
 - b) QPR group of companies shares have a beta value of 1.2 and alpha of 2%. The market return is 10% and the risk free rate of return is 6%. Using Capital Asset Pricing Model (CAPM) calculate the expected return for the QPR group of companies **(5marks)**
 - c) Critically examine the Modigliani Miller assumption of capital structure **(8 marks)**
- (Total 25 Marks)**

SECTION B

Attempt any three of the five questions in this section

Question 2

- a) Balongolo Company Ltd issued 12% debenture of Shs. 200,000 face value of the debenture is Shs. 100. Required compute cost of debenture if
- a) issued at par tax rate of 30%
 - b) issued at 10% premium at tax rate of 30%
 - c) issued at 10% discount, tax rate of 30%
- (15 marks)
- b) Joke company ltd expects annual net operating income of shs. 3,000,000. It has Shs. 6,000,000 outstanding debt; cost of debt is 12%. If the overall capitalization rate is 12.5%. Calculate the total value of the firm and the equity capitalization rate according to the Net operating income approach.

(10marks)

(Total 25 marks)

Question 3

- a) Assuming that JOJO Ltd earns Shs. 10,00per share. Capitalization rate and return on investment are 10% and 12 % respectively. As a head of finance department, you have been charged with a responsibility of determining the optimum dividend payout ratio and the price of the share at the payout ratio

Required

Calculate the price per share by Gordon's model if the dividend payout ratios are using 25%, 50%, 75 % and 100%

(10 marks)

- b) LALE and LALE (U) Ltd has equity share outstanding at the beginning of the year 2022. The current market price per share is US\$ 12,000. The board of directors of the Company is contemplating declaring a dividend of US\$ 640 per share. The rate of return on equity appropriate to the risk class to which the company belongs is 10%.

Required

Determine the market price of the shares of the company when the dividend is DECLARED and NOT declared

(8 marks)

- d) Explain the management of Jojo why the company should adopt dividend policy

(7 marks)

(Total marks 25)

Question 4

- a) Kasoko group of companies in their meeting with the board of directors are reached a dilemma of what strategies to be adopted with regards to purchase of company by management. They required more knowledge the two major concepts of **Management buyout** and **Management by in**. As an expert in corporate finance the management of Kasoko group of companies has tasked you to give a presentations on the about two concepts spelling out two advantages for each before making a final investment decision. **(6 marks)**
- b) 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)**
- c) Briefly 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 **(7marks)**
- d) Vita Form U Ltd. has a share capital of 20,000 Equity shares of Shs.20 each having a market value of Shs.20 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 **(6marks)**

Question 5

- a) Explain the concept of **Foreign Exchange Risk** and state any five factors responsible for foreign exchange fluctuation in any given economy **(8marks)**
- b) Assume it's now November 2022, Yolele Group of companies, a UK company, owes Interclays Inc. a US supplier \$ 370,000 payable three months later in January 2023. The spot rate in October 2022 is \$ 1.5766 - \$ 1.5775/ £ and BVX is concerned that the \$ may strengthen against the £ before payment is made.

Required

- I. Calculate the sterling cost of the transaction if Yolele decides not to hedge (insure) the currency and the spot rate in January 2023 turn out to be:

| | | | |
|-----------|---|---------------|-----------------|
| \$ 1.3800 | - | \$ 1.3809 / £ | |
| \$ 1.8500 | - | \$ 1.8510 / £ | (6marks) |

- II. Use the information in (b) about (Yolele) together with the following forward quote obtained from the company's banker in October 2022.

| | |
|------------------|---------------------|
| 3 months forward | \$1.5680 - \$1.5830 |
|------------------|---------------------|

Calculate the amount that Yolele will have to pay if the currency risk is hedged using a forward contract. **(6marks)**

- c) Explain why Yolele group of companies prefers international of it business (5marks)

(Total 25 marks)

Question 6

- a) Discuss the causes and strategies that organizations undergoing financial distress can adopt to remain competitive in their business operations **(10 marks)**

- b) Explain the various types of corporate restructuring strategies that a company can use to gain competitive advantage in the market **(5 marks)**

- c) As one of the new recruit in Cole group of companies which is sourcing for short term best option to undertake in widening its revenue stream. With the knowledge in corporate finance you have been tasked to come up with the report to management in the following short-term financial instruments and their significance of each to the business.

- a) Treasury Bills,
- b) Commercial papers,
- c) Certificate of deposit,
- d) Bank acceptances

(10 marks)

Success!