



TECHNICAL UNIVERSITY OF MOMBASA
SCHOOL OF BUSINESS
DEPARTMENT OF ACCOUNTING & FINANCE
UNIVERSITY EXAMINATION FOR:
BACHELOR OF COMMERCE &
BACHELOR OF IN BUSINESS ADMINISTRATION
BFI 4304: CORPORATE FINANCE
SPECIAL/SUPPLEMENTARY EXAMINATION
SERIES: JULY, 2025
TIME: 2HOURS
DATE: DECEMBER, 2024

Instructions to Candidates

You should have the following for this examination

-Answer Booklet, examination pass and student ID

This paper consists of **FIVE** questions. Attempt question ONE (Compulsory) and any other TWO questions.

Do not write on the question paper.

Question One

- (a) Financial markets have to be efficient for them to play the important role in economic growth of every economy. Briefly describe the various aspects of market efficiency. **(10 marks)**

- (b) Mash Bus PLC wanted to raise sh.15 million for a new Bus to improve its presence along Kisumu - Mombasa route. They have decided to issue rights issue so as to avoid diluting the ownership. Their shares are currently selling at sh. 80 and they intend to sell them at sh.62.50 each. One right buys three new shares.

Required;

- (i) How many shares would Mash Bus PLC to realize their target fund? **(3 marks)**.
(ii) Currently, Mash has issued 4.8 million shares. Calculate the value of each right. **(6 marks)**
(iii) Kasusa owns 260 shares, calculate his wealth after rights issue assuming that he exercised his rights and the market price after the rights. **(6 marks)**
- (c) Firm A holds preferred stock with a dividend yield of 7%, as well as 9% coupon bond with similar risk from the same company. The firm's marginal tax rate is 35%. Assuming the

dividend received deductions (DRD) is 15%: Calculate the after-tax yield of the preferred stock and the bond. **(5 marks)**

Question two.

You have been asked to analyze the capital structure of Stevenson Steel. The company has supplied you with the following information:

- There are 100 million shares outstanding, trading at sh. 10 a share
- The firm has debt outstanding of sh. 500 million, in market value terms.
- The beta for the firm currently is 1.04, the risk free rate is 5% and the market risk premium is 5.5%.
- The effective tax rate is 20%, but the marginal tax rate is 40%.

Required;

- a. Estimate the current cost of capital for Stevens Steel. **(8 marks)**
- b. Now assume that you have computed the optimal debt-to-capital ratio to be 50%. If the pre-tax cost of debt will rise by 0.25% if it moves to the optimal, estimate the new cost of capital at the 50% debt –capital- ratio **(12 marks)**

Question Three.

- (a) A preferred stock has a coupon rate of 8% and par value of sh.25. Currently it is trading at a price of sh.27.50 per share. Calculate the dividend yield. **(5 marks)**
- (b) Assume that two firms the levered firm (L) and the unlevered firm (U) are identical in all important respects except financial structure. Firm L has Sh 4 million of 7.5% debt, while Firm U uses only equity. Both firms have EBIT of Sh 900,000 and the firms are in the same business risk class. The cost of equity is 10%

Required;

Calculate the value of each firm. **(10 marks)**

- (c) Assume that call currency option enable to buy of dollar for sh. 50.00 while it is quoted at sh. 50.70 in the spot market, and premium paid for call currency option is sh. 1.00. Calculate the intrinsic value of the call? **(5 marks)**

Question Four

A company paid a dividend of 450,000 this year. The current return to shareholders of

companies in the same industry is 13.6%, although it is expected that an additional risk premium of 1.4% will be applicable to the company. Compute the expected valuation of the company, if:

- i. The current level of dividend is expected to continue into the foreseeable future, or (5 marks)
- ii. The dividend is expected to grow at a rate of 5% pa into the foreseeable future. (5 marks)

(c) Briefly describe the factors affecting pricing of a currency option (10 marks)

Question Five.

(a) Zombie Inc., a manufacturer of Voodoo dolls for medicinal purposes, is being forced into involuntary liquidation. Ernst & Young is brought in to handle the sale of assets and distribution of proceeds. E&Y estimates that accounts receivable can be collected for 80% of amounts due, inventory can be sold at 50% of book, and the market value of PPE is about 75% of its depreciated value. The liquidators' fees are 500,000 and other bankruptcy-related cost amount to sh.700,000. Federal taxes due are sh.2 million, and a wrongful death lawsuit is being brought against the company in Haiti.

How much can the banks expect to get? (10 marks)

<i>Assets</i>		<i>Liabilities</i>	
Cash	100000	Accounts payable	1000000
Accounts receivable	900000	Short term secured debt	100000
Other short term assets	5100000	Long term bank debt	9000000
Property, plant and equipment	8000000	Shareholders equity	4000000
Total	14100000	Total	14100000

(b) The Black and Scholes model of valuing options has been hailed as the best one. Briefly explain the assumptions underlying this model. (10 marks)