UGANDA MARTYRS UNIVERSITY

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

DEPARTMENT OF ACCOUNTING AND FINANCE

ACADEMIC YEAR: 2023/2024 SEMESTER: TWO

COURSE CODE: COR3207

COURSE NAME: CORPORATE FINANCE II

BAM III

DATE: Monday, 20th May 2024

Time allowed: 3 Hours (9:30am 12:30pm)

INSTRUCTIONS:

Read the following before answering the examination questions

- Do not write anything on this question paper.
- Attempt any FOUR questions of your choice.
- Your work should be neat and tidy
- Clarity of expression will give you more credit
- See examination answer booklet for further instructions

Question One:

a) Given the following economic outcomes and forecasted returns of security X and Y.

State of the economy	Probability	Returns (X)	Returns (Y)
Boom	0.3	10%	12%
Slow down	0.1	5%	3%
Recession	0.3	-2%	-10%
Recovery	0.3	2%	0.9%

Determine the following and their implications:

i. Expected return on each security. **(5 marks)**
ii. Risk associated with investing in each security. **(5 marks)**
iii. Covariance amongst the two securities **(5 marks)**
iv. The correlation of the portfolio **(5 marks)**
v. If you invest 60% of funds in A and remainder in B. Calculate the expected return of the portfolio and the overall risk of the portfolio **(5 marks)**

Question Two:

a) With use of relevant examples distinguish between systematic and unsystematic risk **(5 marks)**

b) The following data has been extracted for 5 companies. The respective beta values for each stock is provided.

S/N	Stock	Beta
1	Tik	0.7
2	amazon.com	1.0
3	facebook	1.15
4	Google	1.40
5	NVIDIA	-0.3

The market conditions provide a ten-year Treasury bond rate at 6% and market return of 12%

Required

i) Using the capital Asset pricing Model (CAPM), compute the expected return of each stock of the companies above and advise the prospective investor on which stock to invest in **(8 Marks)**

ii) What is the beta for the portfolio assuming a 20% commitment of funds in each stock above? **(2 marks)**

iii) What is the expected return of the portfolio? **(5 marks)**

v) Briefly state the assumptions of capital asset pricing model (CAPM) and discuss the validity of each stated assumption of CAPM. **(5 marks)**

Question Three

The management of POTA Ltd has estimated that in the coming year, Shs 250,000,000 will be available for investment. The company's cost of Capital is 20%. They are currently considering four independent and divisible projects.

Project	**Investment required (Shs)**	**NPV at 20%**
Poultry	200,000,000	96,000,000
Dairy Farming	40,000,000	32,000,000
Horticulture	60,000,000	36,000,000
Bee keeping	90,000,000	(42,000,000)

Required

(a) Explain what is meant by capital rationing & discuss the causes of soft and hard capital rationing **(7 marks)**

(b) Which investments above can the company invest in under the capital rationing situation?**(7 marks)**

c) Assuming the projects above are indivisible determine the best optimal project combination that should be undertaken by Pota Ltd. **(6 marks)**

d) KK Ltd bought a motor vehicle at Ugx 20,000,000/=

The following information is also available.

Running costs payable at the end of the year.

Year 1 Ugx 5,000,000

Year 2 Ugx 5,500,000

Scrap proceeds

Disposal after	Year 1	Ugx 16,000,000
	Year 2	Ugx 13,000,000

Required

i) Calculate the optimal replacement cycle if the cost of capital is 10% **(5 marks)**

Question Four

a) Twins Ltd. is currently using the following source of funds;

Bonds	400,000,000
Preference Shares	300,000,000
Ordinary Shares	500,000,000
Reserves	300,000,000
	1,500,000,000

The bonds/debentures were issued as irredeemable bearing an interest rate of 25% and have a nominal value/face value of Shs.200,000 each. The going market rate for these debentures is Shs.280,000. The preference shares are in denominations of Shs.20,000 per share and with a dividend rate of 12½%. Ordinary shares were issued at a face value of Shs.80,000 per share and initial dividends were estimated at 16%. The shares are trading for Shs.110,000 in the market and are anticipated to grow at a rate of 12% p.a. Floatation cost on these shares are Shs.2,000 per share and the business is in the 30% tax bracket.

Required:

Determine the overall cost of capital for Twins Ltd. **(12 Marks)**

b) With illustrations and assumptions where necessary, explain whether capital structure is relevant or irrelevant for the firm's success in achieving intended objectives **(13Marks)**

Question Five

a) What is the difference between financial distress and business failure? **(5Marks)**
b) Explain the nature and causes of financial distress in a firm? **(8 Marks)**
c) Given the following cases, identify the nature of financial distress and suggest possible ways to address it.
   i. ABC Ltd. has total current assets of Shs.400m, net fixed assets of Shs.300m, current obligations of Shs.500m and long-term debt of Shs.400m. **(4 marks)**
   ii. DEF Ltd, which has current assets of Shs.1.8bn. Net fixed assets of Shs 3.9Bn, current liabilities of Shs. 1.6Bbn. And long-term debts of Shs.3.3bn. The business has consistently reported losses over the last four years with last years losses alone standing at Shs.500m. **(4 Marks)**

iii. GHF Ltd. Has current assets of Shs.800m, net fixed assets of Shs.1.5bn, current liabilities of Shs.500m and long-term debt of Shs.400m. The business is growing rapidly and previous years profits were Shs.200m. However, it is behind in payment schedules for its suppliers. It has a Shs.50m overdue tax payment and is one week behind in its payroll payment. **(4 Marks)**

Question Six

(a) Distinguish between Mergers and Corporate Alliances. **(4Marks)**

(b) Company A is considering the acquisition by shares of Company B. The following information is also available.

	COMPANY A	COMPANY B
Present earnings(Shs)	20,000,000	5,000,000
No of Shares	5,000,000	2,000,000
Earnings per Share(Shs)	4	2.5
Price Earnings Ratio	16	12
Share Prices(Shs)	64	30

Company B has agreed to an offer of Shs 35 a share to be paid in Company A shares.

Required

i. Considering the effect of the acquisition to the earnings per share, is it a worthy investment option? **(6Marks)**

ii. As a Finance Expert, explain the acquisition process that Management needs to go through to effectively decide and benefit from the merger. **(10Marks)**

iii. What could be reasons behind failed mergers **(5Marks)**

Question Seven

Write short notes on the following

(a) Reasons why business go international (10Marks)

(b) Criticisms against Profit maximization as a business objective (5Marks)

(c) Solution to conflicts between managers and shareholders (4Marks)

(d) Types and solutions for foreign exchange exposures (6Marks)

END