



FACULTY OF BUSINESS SCIENCES AND MANAGEMENT

DEPARTMENT OF ACCOUNTING

BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING

PART II FIRST SEMESTER EXAMINATION

CORPORATE FINANCE I [BAC2102]

INSTRUCTIONS

1. Answer **all** questions in **Section A**, and any **three** questions from **Section B**.
2. Begin each question on a new page.
3. Show all your workings.
4. Please indicate your study format (Conventional/Block) on the cover of your answer script.

INFORMATION

1. Questions may be answered in any order
2. You may use a scientific calculator.

This paper consists of 7 printed pages including cover page

SECTION A COMPULSORY (Answer all questions) [40 marks]

Each question carries 2 marks

1. Persons who take the procedural steps to set up a company and who make business preparations for the company are known as:

- A. Directors.
- B. Shareholders.
- C. Registrars.
- D. Promoters.

2. Companies set up under the provisions of the Companies Act Chapter 24-03 have one major constitutional document called:

- A. The Company Constitution.
- B. The Memorandum of Association.
- C. The Articles of Association.
- D. The Object Clause.

3. When a corporation continues to operate regardless of changes in ownership, this is known as:

- A. the right of perpetual succession.
- B. perpetual shares.
- C. perpetual trading.
- D. unlimited succession.

4. Which one of the following statements relating to debentures is incorrect?

- A. Debenture stock is transferable.
- B. A company may not purchase its own debentures.
- C. A debenture holder is a creditor of the company.
- D. A debenture is the written document issued by a company setting out the terms of a loan.

5. Which one of the following is not a right of a shareholder?

- A. To receive a dividend declared by the company
- B. To attend and vote in meetings
- C. To receive the company's accounts
- D. To manage company affairs

6. Shares issued with special rights attached to them are known as:

- A. Ordinary shares
- B. Preference shares
- C. Rights shares
- D. Debenture shares

7. A business formed between two or more individuals who each have unlimited liability for all of the firm's business debts is called a

- A. corporation.
- B. sole proprietorship.
- C. general partnership.
- D. limited liability company

8. Financial Management is mainly concerned with _____.

- A. arrangement of funds
- B. all aspects of acquiring and utilizing financial resources for firm's activities
- C. efficient Management of every business.
- D. profit maximization

9. In their traditional role finance managers are responsible for _____.

- A. arrange of utilization of funds.
- B. arrangement of financial resources.
- C. acquiring capital assets of the organization.
- D. effective management of capital.

10. Capital budgeting is related to _____.

- A. long terms assets.
- B. short term assets.
- C. long terms and short terms assets.
- D. fixed assets.

11. Internal rate of return is ...

- A. Rate at which discounted cash inflow is more than discounted cash outflow
- B. Rate at which discounted cash inflow is less than discounted cash outflow
- C. Rate at which discounted cash inflow is equal to the discounted cash outflow
- D. Rate for discounting cash inflows without including outflows

12. The weighted average cost of capital for a firm is the:

- A. Discount rate which the firm should apply to all of the projects it undertakes.
- B. Rate of return a firm must earn on its existing assets to maintain the current value of its stock.
- C. Coupon rate the firm should expect to pay on its next bond issue.
- D. Maximum rate which the firm should require on any projects it undertakes.

13. A profitability index (PI) of .92 for a project means that _____.

- A. the project's costs (cash outlay) are (is) less than the present value of the project's benefits
- B. the project's NPV is greater than zero
- C. the project's NPV is greater than 1
- D. the project returns 92 cents in present value for each current dollar invested (cost)

14. The LMN Corporation is considering an investment that will cost \$80,000 and have a useful life of 4 years. During the first 2 years, the net incremental after-tax cash flows are \$25,000 per year and for the last two years they are \$20,000 per year. What is the payback period for this investment?

- A. 3.2 years.
- B. 3.5 years.
- C. 4.0 years.
- D. 5.2 years

15. Corporate wealth maximization is the value maximization for _____

- A. Equity shareholders
- B. Stakeholders
- C. Employees
- D. Debt capital owners

16. Payback period is superior to other methods, if the objective of the investor is to _____.

- A. consider cash flow in its entirety
- B. consider the present value of future cash flows
- C. consider the liquidity.
- D. consider the inflows in its entirety.

17. A secondary market would be utilized when:

- A. investors buy or sell existing securities.
- B. shares of common stock are exchanged.
- C. securities are initially issued.
- D. a commission must be paid on the transaction.

18. Efficient markets are defined as markets in which

- A. the bid-ask spreads are small.
- B. a market order to buy or sell a stock at the best available price can be executed quickly.
- C. investors are able to sell an asset on short notice at close to the market price.
- D. prices reflect all available information

19. Gwanda State University Investments just paid a dividend of \$1.15. Its stock has a required rate of return of 13.49 % and investors expect a dividend to grow at a constant 8% rate in the future. Calculate the dividends for year 1 and 2 respectively.

- A.\$1.23 and \$1.43
- B.\$1.42 and \$1.43
- C.\$1.24 and \$1.34
- D.\$1.26 and \$1.36

20. Assume a dividend has just been paid. The next dividend, to be paid in a year, is forecast at Dividend = \$3, the growth rate of dividends is 8% and the discount rate is 12%. What is the value of the stock?

- A. \$56
- B. \$75
- C. \$57
- D. \$80

SECTION B Answer any (3) three questions from this section

QUESTION 2 [20 MARKS]

- a. Explain what is meant by the Agency problem in finance and why it arises **[3 marks]**
- b. Seth Hoffman, the owner of Hoffman Gold Mining, is evaluating a new tantalite mine in South Africa. Dan Droit, the company's geologist, has just finished his analysis of the mine site. He has estimated that the mine would be productive for five years, after which the tantalite would be completely mined. If the company takes up the mine, it will cost \$10,000 today. The expected cash flows from the mine are \$2,000 per year for the first two years, \$4,000 per year for the next two, and \$5,000 in the last year. The discount rate is 10 percent; what's the Net Present Value of the proposed mine? **[9 marks]**
- c. Discuss the advantages of getting listed on a stock exchange **[8 marks]**

QUESTION 3 [20 MARKS]

- a. Financial intermediaries play a number of special roles, and help solve a number of special problems in the financial system as a whole. Discuss any four roles played by financial intermediaries. **[12 marks]**
- b. Explain any four reasons a business might have for seeking a stock market listing?

[8 marks]

QUESTION 4 [20 MARKS]

The table below provides a probability distribution for the returns on stocks A and B.

State	Probability	Return on Stock A	Return on Stock B
1	20%	5%	50%
2	30%	10%	30%
3	30%	15%	10%
4	20%	20%	-10%

- Calculate the expected return for company A and B respectively. **[6 marks]**
- Calculate the variance and standard deviation of returns for stock A **[5 marks]**
- Calculate the variance and standard deviation of returns for stock B **[5 marks]**
- Although investment appraisal forces a complete financial analysis of any proposed investment, there are other factors that also need to be considered before a decision to invest is made. Discuss any two qualitative factors. **[4 marks]**

QUESTION 5 [20 MARKS]

- Discuss any three measures shareholders can use to encourage their managers to act in a way which is consistent with the objective of shareholder wealth maximization **[12 marks]**
- Imela Co and Marlon Co have the following capital structures

	Imela Co.	Marlon Co.
Market Value of Equity (E)	300000	500000
Market Value of Debt (D)	200000	100000
Cost of Equity (Re)	4%	5%
Cost of Debt (Rd)	6%	7%
Tax Rate	35%	35%

Required:

- i. Calculate Imela and Marlon companies' weighted average cost of capital. **[6 marks]**
- ii. Advise the directors of the companies on the suitability of using the WACC calculated in (i) above to discount the expected cash flows of the project **[2 marks]**

END OF EXAMINATION PAPER