



# MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

THIRD YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF COMMERCE

AGB 412: CORPORATE AND INTERNATIONAL FINANCE

DATE: 19/01/2021

TIME: 2.00-4.00 PM

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## INSTRUCTIONS:

*Answer question one and any other two questions.*

### QUESTION ONE

- a) The following statement of financial position relates to the Zoma Ltd. for the year ended 31 December 2017

Assets	Shs.	Liabilities & Net worth	Shs.
Cash		Trade creditors	116,250
Debtors	28,500	Notes payable (9%)	54,000
Stock		Other current liabilities	100,500
Total current assets	270,000	Long term debt (10%)	300,000
Net fixed assets		Net worth	<u>663,000</u>
	<u>649,500</u>		<u>1,233,750</u>
	948,800		
	<u>285,750</u>		
	<u>1,233,75</u>		
	<u>0</u>		

### Required:

Calculate the Working Capital of Zoma Ltd.

( 5 Marks)

- b) Identify and explain five factors that determine capital structure of firms. (10 marks)
- c) ABC Ltd needs Shs. 10M for the installation of a new factory. The new factory expects to yield annual earnings before interest and tax of Shs. 500,000. In choosing the financial plan, ABC Ltd has an objective of maximizing earnings per share.(EPS) The Company proposes to issue ordinary shares and raising debt of Shs.300,000, Shs.1,000,000 and Shs. 1,500,000. The current market price per share is Shs.250 and is expected to drop to Shs.200 if funds are borrowed in excess of Shs.1,200,000. Funds can be raised at the following rate:

0 - Upto Shs.300,000	8%
Shs.300,000 - Shs.1,500,000	10%
Shs.1,500,000 - And above	15%

Assume a tax rate of 30%,

- i. Advise the Company. (5 marks)
- ii. How many shares of common stock should the company issue to maximize EPS? (5 marks)
- iii. What would be the market price for the shares in (ii) above? (5 marks)

## QUESTION TWO

- a) Dividend policy refers to the explicit or implicit decision of the board of directors regarding the amount of residual earnings (past or present) that should be distributed to shareholders of the corporation.. What basic considerations should firms make when making this important decision. (5 marks)
- b) P and Q two firms that are operating in the same industry and have the following characteristics.

	Firm A	Firm B
Selling price per unit	Shs.3	Shs.3
Variable cost per unit	Shs.1.80	Shs.2.30
Fixed costs	Shs.30,000	Shs.70,000

For the year 2017, the their level of output had reached 120,000 units and it seems that market conditions for the year 2018 had greatly improved necessitating the output level to be increased to 150,000 units per year.

**Required:**

- i. Calculate the degree of Operating Leverage for both firms for the year 2018. (6 marks)
  - ii. From your results above, which business has a higher business risk and why? (4 marks)
- c) Explain the following dividend theories.
- i. Tax preference Theory
  - ii. Signaling Hypothesis.
  - iii. Bird –in-hand Theory
  - iv. Clientele Effect.
  - v. Dividend irrelevant Theory (5 marks)

**QUESTION THREE**

- a) Normal Business Failure starts with simple poor under performance that result in poor profitability. Over time, continued under performance translates into reduced reserves and investment and the balance sheet starts to show signs of distress. Explain five symptoms of normal business failure. (5 marks)
- b) Many firms locate their production overseas rather than producing goods in their own country and exporting from their home country or licensing production to a local firm in their domestic country. Explain five key factors that are important in firms' decisions to invest overseas. (15 marks)

**QUESTION FOUR**

- a) The following information relate to a ABC Company Ltd. for the year ended 31 December 2019.

Annual Sales Shs.10,000,000

Cost of Sales 75% of sales

Purchases 65% of Cost of Sales

Average age of inventory 60 days

Average Collection Period 40 days

Average Payment Period 35 days

### Required

- a) Calculate the amount of resources ABC Ltd. has invested in the Cash Conversion Cycle.  
(5 marks)
- b) The domestic Australian beta of Billiton Ltd is 1.4 which is above beta risk level. The expected return on the Australian market portfolio is 10% and that the risk free rate is 5%. Calculate the expected return on Billiton Ltd stock if the Australian Capital Markets are segmented from the rest of the world.  
(5 marks)
- c) If Australian Capital Markets are integrated with the rest of the World and that the World beta measure of Billiton Stock is 1.1, assuming that the risk free rate is 5%, and the expected return on the world market portfolio is 10%, calculate the expected return on the Billiton Stock.  
(10 marks)

### QUESTION FIVE

- a) Identify and explain the benefits of and the disadvantages of debt financing to a business.  
(5 marks)
- b) The following are the financial statements of ABC Ltd. For the year ended 31st December, 2017.

#### Statement of Financial Position as at 31st December, 2017:

	Sh. '000'		Sh. '000'
Cash	480,000	Trade creditors	860,000
Debtors	640,000	Short-term notes Payable	840,000
Stock	2,080,000	Long-term debt	1,600,000
Equipment	1,600,000	Shareholders' equity	1,500,000
Motor vehicles	<u>1,000,000</u>	Retained earnings	<u>1,000,000</u>
	5,800,000		5,800,000

Income Statement for the year ended 31st December, 2017

	Sh.'000	Sh.'000
Sales		6,000,000
Less: Cost of sales		3,600,000
Gross profit		2,400,000
Deduct: Selling expenses	600,000	
Administrative & gen. Expenses	1,120,000	
Interest charges	235,600	1,955,600
Profit before taxation		444,400
Taxation		177,760
Net profit		266,640

**Additional information:**

The firm has 100,000 ordinary shares. The current market price per share is Sh. 18.

**Required:**

Using **Altman's Z-score** assess the firm's probability of failure

(15 marks)