MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

FOURTH YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF SCIENCE (AGRIBUSINES MANAGEMENT)

AGB 412: CORPORATE AND INTERNATIONAL FINANCE

DATE: 29/4/2019 **TIME: 2.00-4.00 PM**

INSTRUCTIONS: Attempt Question One and any other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Explain Six factors that influence payment of Dividends by Corporations. (6 marks)

b) What are the advantages and disadvantages of use of debentures as a source of Finance? (8 marks)

c) When investing in foreign projects, the multinational corporations have to consider certain political risks. Identify and explain any six of such factors that expects of political risk analysis might focus on. (6 marks)

c) ABC Ltd needs Shs. 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%

Assuming a tax rate of 30%, advise the Company.

QUESTION TWO (20 MARKS)

a) Capital structure refers to the specific mixture of long - term debt and equity the firm uses to finance its operations. Explain five factors that should be considered when making this important decision. (5 marks)

b) P and Q two are firms that are operating in the same industry and have the following characteristics.

	Firm A	Firm B
Selling price per unit	Shs.2	Shs.2
Variable cost per unit	Shs.1.50	Shs.1.80
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. (5 marks)

QUESTION THREE (20 MARKS)

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) 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	1,000,000	Retained earnings	1,000,000
	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)

QUESTION FOUR (20 MARKS)

a) The following information relate to a Company that is operating in an economy where annual interest rate is 7%. Fixed transaction cost for the company is Shs.10m. The total cash needed for transactions over the relevant planning period is Shs.10,000m

Required:

Calculate i) The target cash balance using the Baumol Model (4 marks)

ii) The opportunity cost of maintaining this cash balance (4 marks)

iii) The trading cost (3 marks)

iv) The total cost (3 marks)

b) Identify and explain three limitations of the Baumol Model of Cash management. (6 marks)

QUESTION FIVE (20 MARKS)

a) When investing in Foreign Projects, the Multi-national Corporations have to consider certain political risk factors. Identify and explain any five of such factors that experts of political risk analysis might focus on. (15 marks)

b) Explain the following terms as used in Foreign Direct Investments

i) Greenfield Investments

ii) Cross-Border Mergers and Acquisitions (5 marks)