



**Riara School of Business**  
*Nurturing business innovators*

**SEPTEMBER – DECEMBER 2022 TRIMESTER  
EXAMINATION FOR BACHELOR OF BUSINESS ADMINISTRATION (FINANCE  
OPTION)  
DAY/EVENING PROGRAMME  
RFN 303: CORPORATE FINANCE**

**DATE: 29<sup>TH</sup> NOVEMBER 2022**  
**HOURS**

**TIME: 2**

**SPECIAL INSTRUCTIONS**

1. Write your REGISTRATION NO. Clearly on the answer booklet(s).
2. Answer Question One and ANY other TWO questions.
3. Questions in all sections should be answered in answer booklet(s)
4. PLEASE start the answer to EACH question on a NEW PAGE.
5. For the questions, write the number of the question on the answer booklet(s) in the order you answered.
6. Write on both sides of each leaf and indicate number of each question at the top of each page.
7. Write the answers in a paragraph form unless stated otherwise.
8. Marks allocated to each question are shown at the end of the question.
9. All rough work must be done on the answer booklet and crossed through!
10. Use supplementary pages only when you have exhausted those in the book.
11. Fasten the supplementary pages to the inside back cover of the booklet

**QUESTION ONE: COMPULSORY (30 MARKS)**

- a) Explain the Efficient Market Hypothesis **(10 marks)**
- b) XYZ Ltd is considering an investment in an office block. The office block is expected to deliver rental income of KShs. 50 million per year for five years after which XYZ Ltd expects to sell off the asset at KShs. 400 million. The XYZ required rate of return is 10%. Assume no taxation is applicable.  
Required:
- i) Compute the maximum price that it should pay for the office block now? **(5 marks)**
- ii) Explain the meaning and types of capital rationing **(5 marks)**
- c) Explain **five** reasons why a firm may NOT pay dividends **(10 marks)**

**QUESTION TWO (20 MARKS)**

- a) Explain **five** characteristics of capital projects. **(10 marks)**
- b) Alps Limited has three potential projects to invest in. The cashflows for each project are as shown below.

(All figures in Kshs. “000”)

Project	Year 0	Year 1	Year 2	Year 3
A	-20,000	5,000,	10,000	10,000
B	-20,000	10,000	10,000	5,000
C	-20,000	10,000	20,000	-5,000

**Required:**

- i) If the cost of capital is 10%, advise the management on which project to undertake based on the Net Present Value approach **(5 marks)**
- ii) Which project(s) should be undertaken under the payback period method assuming a 2 year target period? **(5 marks)**

**QUESTION THREE (20 MARKS)**

- a) Robotics Limited uses both equity and debt to finance its operations. The company has a 15% corporate bond with a current market value of KShs. 80 million outstanding. The company has 12 million shares outstanding. The price per share is KShs. 10.00. The cost of equity capital is 18% and the corporation tax rate is 30%.

Required:

- i) Discuss **seven** considerations that the finance manager of Robotics needs to take into account when determining the optimal capital structure. **(14 marks)**
- ii) Compute the Weighted Average Cost of Capital for Robotics Ltd **(6 marks)**

#### QUESTION FOUR (20 MARKS)

You have been recently employed as a Corporate Finance Analyst at Kenya Moja Limited, a company that is listed at the Nairobi Securities Exchange. The finance manager has given you the following statements for analysis:

<b>Kenya Moja Limited</b>	
<b>Income Statement for the year ended 31st December</b>	<b>2017</b>
	<b>KShs. "000"</b>
Net Sales	35,753
COGS	-15,762
Selling, G&A expenses	-11,357
Depreciation expense	-1,406
EBIT	7,228
Net interest expense	-239
Taxable Income	6,989
Income Taxes	1,347
Net Income	<b>5,642</b>

<b>Kenya Moja Ltd</b>		
<b>Statement of Financial Position</b>		
<b>As at 31st December</b>	<b>2016</b>	<b>2017</b>

	<b>KShs. "000"</b>	<b>KShs. "000"</b>
Total Non Current Assets	14,385	16,130
Current Assets	10,454	9,130
Total Current Liabilities	(9,406)	(6,860)
Other Assets	6,888	4,670
<b>Total Assets</b>	<b>22,321</b>	<b>23,070</b>
Shareholders' Equity	14,251	15,368
Long Term debt	2,313	2,550
Other Liabilities	5,757	5,152
Total Liabilities and Shareholders' equity	<b>22,321</b>	<b>23,070</b>

**Additional information:**

- Inventory was KShs. 1,693,000 and Kshs. 1,926,000 in 2016 and 2017 respectively.
- Ken Limited shares traded at Kshs. 62.55 on 31st December 2017 and there were 1,638,000 shares in issue.
- Ken's cost of capital is 9.5%.

**Required:**

a) Compute Ken Limited's:

- Market Capitalization **(1 marks)**
- Residual income **(3 marks)**
- Return on Equity **(3 marks)**
- Long term debt to equity ratio **(3 marks)**
- Times Interest earned ratio **(3 marks)**
- Quick ratio **(3 marks)**

b) Evaluate **TWO** main limitations of ratio analysis **(4 marks)**

