MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

FOURTH YEAR SPECIAL/ SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF SCIENCE (IN AGRIBUSINESS MANAGEMENT)

AGB 412: CORPORATE AND INTERNATIONAL FINANCE

DATE: 25/3/2021 **TIME: 8.30-10.30 AM**

INSTRUCTIONS:

Answer question one and any other two questions.

QUESTION ONE (30 MARKS)

a) i What is capital budgeting and what is its significance to a corporation? (4 marks)

ii Explain the following Dividend theories:

I. Dividend Irrelevance Theory

II. Bird-In-The-Hand Theory

III. Tax Preference Theory (6 marks)

b) The following information below relates to Excel Ltd. for last year.

Description	Amount (in millions)
Purchase of raw materials	67
Usage of raw materials	65
Credit sales (of finished goods)	250
Cost of sales of finished goods	180
Average trade payables	20
Average raw materials inventories	15
Average work in progress	10
Average finished goods inventories	25
Average trade receivables.	45

Calculate the firms operating cycle in days. (10 marks)

c) Malili Flyers Ltd. uses a component which it buys from a supplier in its manufacturing process. The estimated annual usage is 23,000 units and these are used fairly steadily throughout the year. It is estimated that the various inventories holding costs amount Shs.1.5 per unit per year. Investigations indicate that it costs about Shs.50 to process each order for the component. Experience shows that delivery always occurs within one week of placing an order.

Required:

i. Calculate the Economic Order Quantity of the Component. (6 marks)

ii. Determine what inventories level the order should be placed in order to be confident that delivery would occur before the existing inventories of the components is all used. (4 marks)

QUESTION TWO (20 MARKS)

a) Amodil Manufacturing Co. is a reputable company operating in the heart of Nairobi city. It starts each period with 10,000 units in stock. This stock is depleted each month and is re-ordered. If the carrying cost per unit is Shs.100, and the fixed order cost is Shs.500, Calculate the Economic Order Quantity of Amodil Manufacturing.

Required:

i. Determine the total carrying cost. (5 marks)

ii. Determine the total restocking cost (5 marks)

iii. Is Amodil following an economically advisable strategy? (4 marks)

b) Using the EOQ Model, determine the optimal inventory level for Amodil Manufacturing Co. (6 marks)

QUESTION THREE (20 MARKS)

a) Explain the following theories of capital Structure

i. The pecking order theory

ii. The trade-off theory (6 marks)

b) ABC Company has reported EBIT of Shs.120,000 in the current year and is forecasting that due to improved market conditions, it will increase this amount by Shs.60,000 in the following year. It has a Shs.200,000 bond with a 12% coupon rate of interest and 6,000 shares of Shs.20 each preferred stock with annual dividend per share of Shs. 4. It also has 10,000 shares of Shs. 15 par value common stock outstanding. Assume a tax rate of 30%.

Required

i. Calculate earnings per share for the two EBIT levels. (10 marks)

ii. Calculate the degree of Financial Leverage. (4 marks)

QUESTION FOUR (20 MARKS)

The domestic Australian beta of Billiton Ltd is 1.4whis is above beta risk level. The expected return on the Australian market portfolio is 10%and that the risk-free rate is 5%.

a) Calculate the expected return on Billiton Ltd stock if the Australian Capital Markets are segmented from the rest of the world. (5 marks)

b) If Australian Capital Markets are integrated with the rest of the Word 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)

c) The ordinary shares of a Company are currently trading at Shs.20 (ex dividend) each in the capital market. Next year's dividend is expected to be Shs.1.4 per share and subsequent dividends are expected to grow at an annual rate of 5% of the previous year's dividend. What is the cost of equity? (5 marks)

QUESTION FIVE (20 MARKS)

a) Explain the three basic forms of Acquisition. (6 marks)

b) Explain how companies achieve efficient asset allocation (6 marks)

c) Describe eight factors that determine capital structure in Corporations (8 marks)