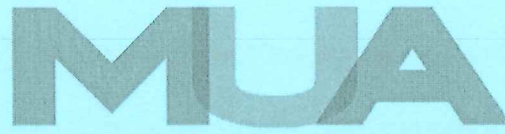


The
Management
University
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POST GRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF MASTER OF BUSINESS ADMINISTRATION

BFO 501: CORPORATE FINANCE

DATE: 6th AUGUST 2018

DURATION: 3 HOURS

MAXIMUM MARKS: 60

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **FOUR (4)** questions.
4. Question **ONE** is **compulsory**.
5. Answer any other **TWO** questions.
6. Question **ONE** carries **30 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided**

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow

SLEEK INNOVATION LTD

Sleek Innovation Ltd plans to design a new hiking gear. The Company would need to invest Kes 10,000 at the beginning of the first year for the design and model testing of the new gear. The director estimates a 0.6 probability that this phase will be successful and the project will continue. If phase 1 is not successful the project will be abandoned with zero salvage value.

The next phase, if undertaken would consist of making the prototype gear. This would cost Kes 500,000 at the end of the first year. If the gear works well, Sleek would go into production. If it doesn't, the prototype could be sold for Kes 100,000. The director estimates that the probability is 0.8 that the gear will pass testing and that Phase 3 will be undertaken.

Phase 3 consists of changing over one current production line to produce the new design. This would cost Kes 1 million in Year 2. If the economy is strong at this point, the net value of sales would be Kes 3 million, while if the economy is weak the net value would be Kes 1.5 million. Both net values occur during Year 3, and the two states of the economy are equally likely. Sleek's cost of capital is 12%.

Required:

- (a) Determine the project's expected NPV assuming that the project has average risk
(18 marks)
- (b) Calculate the project's standard deviation of NPV and coefficient of variation of NPV.
(8 marks)
- (c) If Sleek's average project had a coefficient of variation of between 1.0 and 2.0, would this project be of high, low or average stand-alone risk?
(4 marks)

QUESTION TWO

- (a) Demonstrate graphically the three attitudes towards risk as applied in utility theory **(9 marks)**
- (b) Using appropriate examples in the Kenyan financial market discuss three common approaches to investing in the market **(6 marks)**

QUESTION THREE

- (a) Explain the salient features between a foreign bond and an Euro bond **(6 marks)**
- (b) Discuss the factors that affect the capital structure of a firm **(9 marks)**

QUESTION FOUR

Sisals Ltd is planning entry in three different regions. The estimates of probability of success and associated additional profits in each of the three markets expected from advertising are as follows:

	Market A		Market B		Market C	
State	Profit KES	Probability	Profit KES	Probability	Profit KES	Probability
Fair	10,000	0.40	5,000	0.20	16,000	0.50
Normal	18,000	0.50	8,000	0.60	20,000	0.30
Excellent	25,000	0.10	12,000	0.20	25,000	0.20

- (i) Compute the expected value and standard deviation of profits resulting from advertising in each of the market areas. **(9 marks)**
- (ii) Rank the three markets according to riskiness using the coefficient of variation **(6 marks)**

