BOWEEN UNIVERSITY, IWO

FACULTY OF SOCIAL AND MANAGEMENT SCIENCES

DEPARTMENT OF BANKING AND FINANCE,

B.Sc DEGREE PROGRAM.

FIRST SEMESTER EXAMINATION 2013/2014 SESSION

COURSE TITLE: THEORY OF CORPORATE FINANCE

COURSE CODE: BFN 410 **TIME ALLOWED: 3 HOURS**

INSTRUCTION: ANSWER QUESTION ONE AND ANY OTHER THREE QUESTIONS

QUESTION 1

The relevant data for 2 companies are as following:

	AJOKE	ANIKE
Current Earnings	N800,000	N350,000
Number of shares issue	1 million	1Million
Proportion of Earnings retained	----	40%
Return on Investment	----	25%
Required return of ordinary shares	15%	18%

Both dividends have just been paid. Anike desires to take over Ajoke, it will retain the same dividend policy but the return earned on new investment will fall to 20% and the required rate of return of ordinary share will be 16%

Required:

1. Calculate the existing price of Ajoke and Anike
2. Evaluate the maximum price which Anike will pay for Ajoke
3. Calculate the numbers of shares issued to the shareholders of Ajoke if the takeover price is agreed at N5.5m. (25marks)

QUESTION 2.

Rebate Ltd is considering the manufacture of a new product which would involve the use of both a new machine (costing N150,000) andan existing machine which cost N80,000 two years ago and has a current net book value of N60,000. There are sufficient capacity on this machine which has so far been under utilized.

Annual sales of the product would be N5,000 units at a selling price of N32 per unit cost would be:

	N
Direct Labour (4hrs@N2)	8
Direct material	7
Fixed costs including depreciation	9
	24

The project would have a five year life after which the new machine would have a net residual value of N10,000. Because direct labour is continually in short supply labour resources would have to be directed from other work which currently earns a contribution of N1.50 per direct labour hour. The fixed overhead absorption rate would be N2.25 per hour (N9 per unit) but actual expenditure on fixed overhead would not alter.

Working capital requirement would be N10,000 in the first year, rising to N15,000 in the second year and remaining at this level until the end of the project when it will be recovered. The cost of capital is 20% ignore taxation. Is the project worthwhile? (15 marks)

QUESTION3:

3a. Oyedele Ltd, is considering acquiring Aiyeoribe Ltd At present Aiyeoribe Ltd is earning an average of N480,000 after tax.

The directors of Oyedele Ltd feel that after reorganization this figure could be increased to N600,000. All the companies in the Oyedele group are expected to yield a post tax return of 15% on capital employed.

REQUIRED:

What is the highest sum that Oyedele Ltd should pay for the acquisition of Aiyeoribe Ltd. Using Earning Basis method?

3b. The estimate of maintainable profits for Stephen .O. Ltd is #275,000 per year. The expected yield on tangible assets is 10% and on intangible assets is 15%. The value of tangible asset is #2,000,000.

REQUIRED:

What is the value of Stephen .O. Ltd under the dual capitalization of profits?

3c. Koroplc wishes to make a bid for the entire company of Kanmi Ltd. Kanmi Ltd makes after tax profits of N 40,000 per annum. KoroPlc believes that by spending further money on additional Investments, the after tax cash flows would be.

year	cash slow (net of tax)
0	(100,000)
1	(80,000)
2	60,000
3	100,000
4	150,000
5	150,000

The after -tax cost of capital of koro plc is 15% and the company expects all its investment to payback in discounted value terms, within 5years.

REQUIRED:

What is the maximum price that the company should be willing to pay for the shares of Kanmi Ltd. using discounted future profit method? (15 marks)

QUESTION 4

Transparency and disclosure of information are key attributes of good corporate governance which corporate entities must cultivate with zeal and renewed vigor so as to provide stakeholders with the necessary information to judge whether their interests are being taken care of or not.

Required:

What are the possible benefits of corporate governance? (15 marks)

QUESTION 5

(a) List and explain the two major types of Capital Rationing

(b)Why does Capital Rationing cause problems for the NPV decision rule? (15 marks)

QUESTION 6

(a) Describe in brief "offer for sale" and "Offer for Subscriptions" as a method of raising funds in the capital market.

(b) What is Stock Dividend (Bonus Issue) and what are its advantages to the company and the individual shareholders? (15 marks)