

# CENTRAL UNIVERSITY

RESIT EXAMINATIONS - 2021/2022



CENTRAL BUSINESS SCHOOL

DEPARTMENT OF BANKING AND FINANCE

CORPORATE FINANCE - CBBF 301

LEVEL 300

TIME ALLOWED: 3 HOURS

STUDENT ID NO:.....

## INSTRUCTIONS

Answer ANY FOUR questions

LECTURER

J. E. TETTEH

### Question 1

- a. Sylvanus Company liberalizes the credit term it grants to its customers and thereby increases sales by Gh¢15m. Calculate the current sales figure if increase in sales is one tenth of the sales figure prior to the extension of credit. (5 marks)
- b. Define Economic Order Quantity? (4 marks)
- c. Monthly demand for a product is 10,000 units. The purchase price is Gh¢10/unit and the company's cost of finance is 15% pa. Warehouse storage costs per unit pa are Gh¢2/unit. The supplier charges Gh¢200 per order for delivery. Calculate the Economic Order Quantity. (4 marks)
- d. A company's annual sales are Gh¢8 million with a mark – up on cost of 60%. It normally settles payables two months after purchases are made, holding one month's worth of demand in inventory. It allows receivables 1½ month's credit and its cash balance currently stands at Gh¢1,250,000.
- i. Calculate the current and quick ratios of the company. (10 marks)
- ii. Comment on the company's liquidity. (2 marks)

(Total marks - 25)

### Question 2

- a. State and provide the implications (in words and formulae) the Miller and Modiglianni (M&M) proposition I and II with taxes. (5 marks)
- b. Dahwenya Construction has a debt to equity ratio of 1/3, Weighted average cost of capital: 20.5%, cost of debt: 9.8%, and tax rate: 42%. Determine the cost of common equity of the company. (5 marks)
- c. Mataheko Company has a corporate tax rate of 32% and a debt component of Gh¢325,000 in its capital structure.
- i) Calculate the tax shield of the company if interest rate on debt is 25%. (3 marks)
- ii) Determine the present value of the tax shield. (2 marks)
- d. Lash Company Ltd has a perpetual earnings before interest and tax of Gh¢10,000,000 per year. The after tax all equity discount rate is 28% and the cost of debt is 15%. Lash has Gh¢16,000,000 debt in its capital structure. Corporate tax rate and cost of leveraged equity are 30% and 32% respectively. Determine the weighted average cost of capital of Lash. (10 marks)

(Total marks - 25)

### Question 3

- a. What is financial analysis? (4 marks)
- b. Explain the difference between aggregation and planning horizon within the context of financial planning. (6 marks)
- c. Two companies have the following financial information:

	Miot Company (Gh¢'m)	Mata Company (Gh¢'m)
Working capital	10,000	-1,200
Total assets	50,000	21,000
Total liabilities	22,000	13,000
Market value of equity	38,000	5,200
Retained earnings	19,000	3,000
Sales	86,000	23,000
Earnings before interest and taxes	12,000	2,600

- i) Using Altman's model for predicting bankruptcy, determine the Z-score index for each company.



- ii) On the basis of these indexes, is either company likely to go into bankruptcy? Why? (2 marks)  
(Total marks - 25)

#### Question 4

- a) Distinguish between Operating Lease and Capital Lease. (6 marks)
- b) What is the 'leasing paradox'? (4 marks)
- c) Under what conditions can leasing be financially advantageous for both the lessor and the lessee? (5 marks)
- d) Lids Pastries is considering either leasing or buying a new oven. The lease payments would be Gh¢7,200 a year for 3 years. The purchase price is Gh¢20,000. The equipment has a 3-year life and then is expected to have a resale value of Gh¢2,000. Lids Pastries uses straight-line depreciation, borrows money at 9.5 percent, and has a 34 percent tax rate. Determine the net advantage to leasing. (10 marks)

(Total marks - 25)

#### Question 5

Given the information below, prepare a cash budget for the Kanshie Multistores for the first six months of 2022 under the following assumptions.

- a) All prices and costs remain constant.
- b) Sales are 60% for credit and 40% for cash
- c) Fifty percent of the credit sales are collected in the month after the sale, and 50% in the second month. Ignore bad debt.
- d) Sales estimates are as follows:
- |               |           |            |           |
|---------------|-----------|------------|-----------|
| November 2021 | Gh¢17,500 | April 2022 | Gh¢15,000 |
| December 2021 | Gh¢20,000 | May 2022   | Gh¢12,500 |
| January 2022  | Gh¢7,500  | June 2022  | Gh¢10,000 |
| February 2022 | Gh¢10,000 | July 2022  | Gh¢15,000 |
| March 2022    | Gh¢10,000 |            |           |
- e) Payments for purchases of merchandise are 80% of the following month's anticipated sales.
- f) Wages and salaries are
- |               |          |            |          |
|---------------|----------|------------|----------|
| January 2022  | Gh¢1,500 | April 2022 | Gh¢2,500 |
| February 2022 | Gh¢2,000 | May 2022   | Gh¢2,000 |
| March 2022    | Gh¢2,500 | June 2022  | Gh¢2,000 |
- g) Rent is Gh¢1,000 a month.
- h) Interest of Gh¢3,000 is due at the end of each calendar quarter of 2022.
- i) A tax payment of Gh¢2,500 is due in April 2022.
- j) A capital investment of Gh¢1,000 is planned in June 2022.
- k) The company has a cash balance of Gh¢6,000 at December 31, 2021, which is the minimum desired level for cash. Funds can be borrowed in multiples of Gh¢500 on a monthly basis. Ignore interest on borrowings.

(Total marks - 25)

#### Question 6

- a. Explain the term bankruptcy. (3 marks)
- b. Explain how a firm loses value during the bankruptcy process from both a creditor and a shareholder perspective. (4 marks)

- c. List three merits and three demerits of paying dividends. (6 marks)
- d. Onaapo Enterprises has planned investments of Gh¢2,250 for next year and an after-tax net income of Gh¢1,400 this year. The company has a residual dividend policy and maintains a debt-equity ratio of .80.  
Calculate the new equity required to fund the investments for next year. (4 marks)
- e. Explain the term residual dividend policy. (3 marks)
- f. Rado Company maintains a debt-equity ratio of 0.50 and follows a residual dividend policy. The firm needs Gh¢2,700 for new investments next year. The after-tax earnings this year are Gh¢1,700.  
Determine the amount that Rado Company will pay out in dividends for this year. (5 marks)
- (Total marks- 25)**