PAN AFRICA CHRISTIAN UNIVERSITY

BACHELORS OF COMMERCE

END OF TERM EXAMINATION

DEPARTMENT: BUSINESS

COURSE CODE: /BUS 3213

COURSE TITLE: BUSINESS FINANCE

EXAM DATE:
TIME:

INSTRUCTIONS

- Read all questions carefully before attempting.
- Answer any **Five** Questions.
- Write your **student number** on the answer booklet provided.

QUESTION ONE

a) Define agency relationship from the context of a public limited company (3 Marks)

b) Explain two ways in which agency relationship arises. (4 Marks)

c) Highlight **four** functions of a finance manager in a corporate firm (4 Marks)

d) Calculate the future value of shs.200,000 compounded at 8% p.a for 4 years if compounding is done

(i) Half yearly (3 Marks)

(ii) Quarterly (3 Marks)

(iii) Monthly (3 Marks)

QUESTION TWO

Rafiki Hardware Tools Company Limited sells plumbing fixtures on terms of 2/10 net 30. Its financial statements for the last three years are as follows:

	2010	**2011**	**2012**
	Sh.'000'	**Sh.'000'**	**Sh.'000'**
Cash	30,000	20,000	5,000
Accounts receivable	200,000	260,000	290,000
Inventory	400,000	480,000	600,000
Net fixed assets	800,000	800,000	800,000
	1,430,000	1,560,000	1,695,000
Accounts payable	230,000	300,000	380,000
Accruals	200,000	210,000	225,000
Bank loan, short term	100,000	100,000	140,000
Long term debt	300,000	300,000	300,000
Common stock	100,000	100,000	100,000
Retained earnings	500,000	550,000	550,000
	1,430,000	1,560,000	1,695,000

Additional information:

Sales	4,000,000	4,300,000	3,800,000
Cost of goods sold	3,200,000	3,600,000	3,300,000
Net profit	300,000	200,000	100,000

Required:

a) For each of the three years, calculate the following ratios:
   - (i) Acid test ratio (2 Marks)
   - (ii) Average collection period (2 Marks)
   - (iii) Inventory turnover (2 Marks)
   - (iv) Total debt/equity ratio (2 Marks)
   - (v) Net profit margin (2 Marks)
   - (vi) Return on assets. (2 Marks

b) From the ratios calculated above, comment on the
   - i. Liquidity position of the company (2 Marks)
   - ii. Profitability positions of the company (2 Marks)

c) List four limitations of using ratio analysis in the evaluation of the performance of a company. (4 Marks)

QUESTION THREE

The balance sheet of ABC Limited as at 31st Dec 2014 was as follows:

Net fixed assets	12,000	Ordinary share capital	8,000
Current assets	4,000	Retained earnings	5,000
		12%debt	2,000
	16,000	Current liabilities	1,000
			16,000

Additional information

1. For the year 2014 sales amounted to 20,000. The sales are expected to increase by 40% during the year 2015.

2. The after tax profit on sales is 15%.

3. The firm has a dividend payout ratio of 70% which is expected to be maintained during the year 2015.

Required:

(i) Determine the external financial requirement of the firm. (7 Marks)

(ii) Prepare a proforma balance sheet as at 31/12/2015. (5 Marks)

(iii) State any assumptions made in your computations above. (2 Marks)

(b) Outline any 3 methods of forecasting. (6 Marks)

QUESTION FOUR

a) Although profit maximization has long been considered as the main goal of a firm, shareholder wealth maximization is gaining acceptance amongst most companies as the key goal of a firm. Distinguish between the goals of profit maximization and shareholder wealth maximization. (4 marks)

b) Discuss three advantages and three disadvantages of payback period method of capital budgeting. (6 Marks)

c) Discuss the attitudes investors have towards risk and return (6 Marks)

d) Calculate the present value of an investment which promises equal receipts of shs. 20,000 each year for the next 2 years if the discounting rate is 12% p.a assuming: The cash inflows are receivable at the end of each year (4 Marks)

QUESTION FIVE

a) Discus three characteristics of capital budgeting decisions (3 Marks)

b) Zawadi Ltd. is analyzing two mutually exclusive projects whose details are shown below:-

Year	Project A	Project B
	Cash Flow (Shs.)	Cash Flow (Shs.)
1	3,000,000	6,000,000
2	1,000,000	5,000,000
3	4,000,000	4,000,000
4	5,000,000	3,000,000
5	6,000,000	1,000,000

Addition Information

1. The above cash flows have been acted on after-tax basis.
2. Each of the projects will cost Shs. 10,000,000 at commencement. The company intends to raise this finance through an issue of debentures at an interest rate of 10% per annum.

Required:

Advise the management of Zawadi Ltd. on which of the two projects to undertake using:

(i) Payback period approach (5 Marks)

(ii) Net present value approach (7 Marks)

(iii) Profitability Index approach (5 Marks)

QUESTION SIX

As the financial analyst at PAC Ltd. you are conducting an analysis of four alternative investment projects. Each project has a holding period of one year. The estimated rates of return for three alternative states of the economy are show in the table below:

State of the Economy	Probability	A	B	C	D
Recession	0.20	10%	5%	22%	5%
Average	0.60	10%	11%	14%	15%
Boom	0.20	10%	31%	4%	15%

Required:

a) Determine

   (i) The expected rate of return (4 Marks)

   (ii) Variance (8 Marks)

   (iii) Standard deviation (4 Marks)

   (iv) Coefficient of variation for each project. (4 Marks)