PAN AFRICA CHRISTIAN UNIVERSITY

END OF TERM EXAMINATION

BCM202/BUS3213: BUSINESS FINANCE

MONDAY NOVEMBER 24TH, 2014

1100HRS – 1400HRS

INSTRUCTIONS

- This exam paper has **Six** Questions
- Answer **Any Five** Questions
- Write your **student number** on the answer booklet provided.
- Read all questions carefully before attempting.

Answer Five Questions Only

QUESTION ONE

(a)

i. Define agency relationship (2 Marks)

ii. Discuss the various measures that would minimize agency problems between the owners and the management. [6 marks]

(b) Assume that Safaricom Ltd Company is paying a dividend of Kshs 2.00 per share. The dividend is expected to grow at a 15 per cent annual rate for three years, then at 10 per cent for the next three years, after which it is expected to grow at a 5 per cent, rate forever.

i. Calculate the present value of the share if discount rate is 9 per cent.(7 Marks)

(c) Juma would like to purchase a house some time in future from his savings. He deposits Kshs. 15,000 at the beginning of each year for the next 10 years which attracts interest of 12% compounded semi annually. Determine the value of his account at the end of the 10th year. (5 Marks)

QUESTIO TWO

a) Highlight the importance of capital budgeting in a business organization.(5 Marks)

b) Kiwanda Ltd. is considering the purchase a new machine. Two alternative machines Pesi TZD and Upesi MO2, which will cost Shs. 6,000,000 and Shs. 7,000,000 respectively, are available in the market. The cash flows are as follows

Year	Cash flow Shs	
	Pesi TZO	Upesi MO2
1	600,000	1,800,000
2	1,800,000	2,400,000
3	2,000,000	3,000,000
4	3,000,000	1,800,000
5	2,400,000	1,600,000

Kiwanda's cost of capital is 12 percent per annum.

Required:

i. Compute the Net Present Value for each machine(5 Marks)
ii. Compute the payback period for each machine(4 Marks)
iii. Compute the IRR- internal rate of return(6 Marks)

QUESTION THREE

a) Distinguish between money and capital market (2 Marks)

b) Describe the three attitudes towards risk by investors (6Marks)

c) Maisha Mazuri Investment Co. ltd wants to raise further finance from the following sources

• To issue 500,000 ordinary shares of Kshs. 10 at Kshs. 15 each

• To issue 600,000 10% preference shares of Kshs. 10 at Kshs. 12 each

• To issue 400,000 15% debentures of Kshs. 100 at Kshs. 90 each

• To raise a medium term loan of Kshs. 5,000,000 at an interest rate of 20%

The company will pay an annual dividend to ordinary shares of 14%. Assume a corporate tax of 50%

Required:-

Calculate the average cost of additional finance (11 Marks)

QUESTION FOUR

a) Discuss briefly the role of Kenya capital market authority (6 Marks)

b) The current market value of the company's ordinary shares is Sh.30. The expected dividend per share at the end of the year is sh.1.20. The average growth rate in dividends has been 10% and this is expected to be maintained in the foreseeable future. The debentures of the company have a face value of sh.150; however they currently sell for sh.100 in the market. The debentures will mature in 100 years time. The preference shares of the company still sell at their par value. Assume a tax rate of 30%. Calculate the weighted average cost of capital for this company. (9 Marks)

c) A commercial farmer plans to purchase a harvester costing kshs5, 200,000 and he applies

for a loan to be repaid over 6 years time at a 12% interest rate. Determine the annual installments that he will pay for him to clear the loan (5 marks)

QUESTION FIVE

a) Discuss four goals of a business (8 Marks)

b) As a financial analyst at KABU 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**	**M**
Recession	0.20	10%	5%	22%	5%
Average	0.60	10%	11%	14%	15%
Boom	0.20	10%	31%	4%	15%

Required:

i. Determine the expected rate of return for each project (4 Marks)
ii. Standard deviation (6 Marks)
iii. Coefficient of variation for each project. (2Marks)

QUESTION SIX

a) Distinguish between Independent projects and mutually exclusive projects (3marks)

b) PAC Ltd is analyzing two mutually exclusive projects whose details are given Below:

Year	Project Alpha Cash flow (sh)	Project Beta Cash flow (sh)
1.	2,000,000	5,000,000
2.	1,000,000	4,000,000
3.	3,000,000	3,000,000
4	4,000,000	2,000,000
5.	5,000,000	1,000,000

Each of the projects will cost Sh8 million at commencement. The company‘s cost of capital is 10% p.a.

Required

Advice the management of Kabu Ltd on which of the two projects to undertake using:

i. Pay –back period approach (4Marks)
ii. Net present value approach (4Marks)
iii. Profitability Index method (4 Marks)
iv. Internal rate of return (5 Marks)