PAN AFRICA CHRISTIAN UNIVERSITY

BACHELORS OF COMMERCE

END OF TERM EXAMINATION

CAMPUS: ROYSAMBU WEEKEND

DEPARTMENT: BUSINESS

COURSE CODE: BIT209 / BUS3213

COURSE TITLE: BUSINESS FINANCE

EXAM DATE: SATURDAY 1st August, 2015

TIME: 0830HRS – 1130HRS

INSTRUCTIONS

- Read all questions carefully before attempting.
- Answer any 5 questions
- Write your **student number** on the answer booklet provided.

QUESTION ONE

a) Define the following terms giving examples of items traded in each market.
   i. Money markets (3 Marks)
   ii. Capital markets (3 Marks)

b) Explain three benefits a company quoted in the Nairobi Stock Exchange enjoys.(3 Marks)

c) Discuss three factors that may hinder companies from being listed at the stock exchange. (6 Marks)

d) Discuss the functions of Central Depository system (CDS) in the Nairobi Stock exchange. (5 Marks)

QUESTION TWO

a) Discuss three objectives of a firm. (6 Marks)

b) Kabu Ltd Finance Manager is considering buying stocks X and Y being sold in Nairobi Stock Exchange.The stocks have the following distribution of returns:

State of Economy	**Probability**	**Stock X (%)**	**Stock Y (%)**
A	0.1	-8	14
B	0.2	10	-4
C	0.4	8	6
D	0.2	5	15
E	0.1	-4	20

Required:

(i) Calculate the expected returns and risks of each stock. (4 Marks)

(ii) Calculate the following for the two stocks.

a) Standard deviation (6 Marks)

b) Covariance (4 Marks)

QUESTION THREE

a) Explain three limitations of using ratios to analyze financial statements (6 Marks)

b) Discuss four reasons an investor would consider when considering to receive some funds now or in the future. (4 Marks)

c) PAC Hardware Tools Company Limited sells plumbing fixtures. Its financial statements for the last three years are as follows:

	2012	**2013**	**2014**
	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:

For each of the three years, calculate the following ratios:

i.	Current ratio	(2 Marks)
ii.	Inventory turnover	(2 Marks),
iii.	Total debt/equity	(2 Marks)
iv.	Net profit margin	(2 Marks)
v.	Return on Assets (ROA)	(2 Marks)

QUESTION FOUR

a) Briefly compare debt finance and equity finance (6 Marks)

b) Explain the nature of capital budgeting decisions (8 Marks)

c) State and explain the three attribute towards risk (6 Marks)

QUESTION FIVE

Bidii Limited is considering investing in two mutually exclusive projects, each project will generate cash flows over a period of 5 years.

CASH FLOWS

Year	**PROJECT 1**	**PROJECT 2**
0	**(12,000,000)**	**(14,000,000)**
1	1,200,000	3,600,000
2	3,600,000	4,800,000
3	4,000,000	6,000,000
4	6,000,000	3,600,000
5	4,800,000	3,200,000

Bidii's cost of capital is 12% per annum.

Required:

a)	Compute the net present value of each machine.	(8 Marks)
b)	Advise the company on which project to implement	(1 Mark
c)	Compute the profitability index for each machine	(4 Marks)
d)	Advise the company on which on which project to implement	(1 Marks)

d) Outline any three advantages and any three disadvantages of the Net Present Value method of capital budgeting. (6 Marks)

QUESTION SIX

a) 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) Determine the present value of the share if the discount rate is 9 per cent. (5 Marks)

(ii) If the share is held for three years, determine its present value (3 Marks)

b) A company is evaluating its cost of capital under two alternative financing arrangements shown below. In consultation with investment bankers, the company expects to issue new debt securities with a coupon rate of 10% and to issue new preferred stock at Kshs 25 per share that pays an annual dividend of Kshs 4.00 per share. The common stock of the firm is currently selling for Kshs 20.00 a share and the firm expects to pay a dividend of Kshs 2.50 per share next year. The analysts have forecasted a growth in dividends at a rate of 5% per year. The firm's marginal tax rate is 40%.

Financing plan	Proportion of Debt	Proportion of Preferred stock	Proportion of Common stock
1	20%	30%	50%
2	50%	30%	20%

Determine the cost of capital for the firm under each financing arrangement and advice the management on which is the best plan (12Marks)

QUESTION SEVEN

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

<u>**Year**</u>	<u>**Project A**</u> **Cash Flow (Shs.)**	<u>**Project B**</u> **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 (4 Marks)

ii. Discounted payback period approach (6 Marks)

iii. Explain two merits and demerits of the payback period approach of capital budgeting. (4 Marks)

b) 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 10thyear. (6 marks)