



PAN AFRICA CHRISTIAN UNIVERSITY
SCHOOL OF LEADERSHIP, BUSINESS & TECHNOLOGY
END OF SEMESTER EXAMINATION FOR THE DEGREE OF
BACHELOR OF BUSINESS LEADERSHIP
BACHELOR OF COMMERCE
JANUARY-APRIL 2019 SEMESTER

CAMPUS: VALLEY ROAD

DEPARTMENT: BUSINESS STUDIES

COURSE CODE: BUS4213 | BCM302

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM DATE: FRIDAY 12th APRIL 2019

DURATION: 3 HOURS

TIME: 5:30PM-8:30PM

INSTRUCTIONS

- Read the instructions and questions carefully before you write the answers.
- Write your **STUDENT NUMBER** in the Answer Booklet given
- *Write clearly and legibly.*
- Answer **Question ONE** and any other **FOUR** questions
- *ALL PAC University's examination rules and regulations apply*

QUESTION ONE: COMPULSORY

- a) Define agency theory (2 Marks)
- b) Discuss any three measures that would minimize agency problems between the owners and the management. (6 Marks)
- c) Highlight three advantages and three disadvantages of the payback period method of capital budgeting. (6 Marks)
- d) A politician intends to contest for elections at the end of the year 2022. To raise funds, he decides to invest in a fixed deposit account. He intends to deposit Shs. 7,000,000 at the end of each year commencing 2019 to 2022 inclusive. The rate of interest on his deposits is 6 per cent per annum. Determine the amount of annuity accumulated to the end of 2022 (5 Marks)

- e) A company is interested in investing any one of the following assets whose return is given below.

State of the economy	Probability	Possible returns (%) for Asset A	Possible returns (%) for Asset B
1	0.05	10%	-13%
2	0.10	20%	8%
3	0.20	40%	12%
4	0.30	19%	10%
5	0.20	14%	18%
6	0.10	20%	16%
7	0.06	28%	23%

Required

- Determine the expected return for each asset (4 Marks)
 - Compute the risk for each asset using standard deviation (8 Marks)
 - Using coefficient variation, determine which asset the company should invest in. (3 Marks)
- f) Mavazi Limited intends to raise additional capital through an issue of ordinary shares. The company promises to pay dividend currently at the rate of Shs. 8 per share and the dividend is expected to grow at a constant rate of 7% per annum forever. If the required rate of return is assumed to be 10%. Determine the market price of the share. (5 Marks)

QUESTION TWO

- a) A bond has a face value of Shs.1, 000,000 with a time to maturity five years. The required rate of return is expected to remain at 10%.
- Determine the price of the bond if it pays a coupon interest rate 10% p.a (3 Marks).
 - Determine the price of the bond if it pays a coupon interest of 14% p.a(3 Marks)
 - Determine the price of the bond if it pays a coupon interest of 8% p.a (3 Marks)
 - Determine the price of the bond if it pays 8% coupon rate semi-annually(3 Marks)

QUESTION THREE

- a) Suppose you are offered an investment that will pay you Shs, 250,000 in one year, shs 450,000 the next year, shs 650,000 the next year and shs 850,000 at the end of the fourth year. The investment is expected to earn an interest of 12% per annum. Determine the present value of the amount. (5 Marks)
- b) Kangaa Company Ltd. currently pays a dividend of Sh.9 per share and this dividend is expected to grow at an annual rate of 12% for the first 4 years then the rate is expected to decline to 10% forever.

Required

Calculate the value of the share if a 15% rate of return was required (10 Marks)

QUESTION FOUR

- a) Equipment X has a cost of ksh.75, 000 and its expected future net cash flow of ksh 20, 000 per year for four years. A substitute equipment Y would cost ksh.50, 000 and is expected to generate net cash flow of ksh.24, 000 per year for four years. The required rate of return of both equipment is 10 per cent per annum.

Required:

- Calculate the Internal Rate of Return (IRR) for each project (6 Marks)
 - Determine the equipment which should be accepted (1 Mark)
- a) The director of Charter Bank is intending to make the bank deposits as attractive as possible. He concludes that he must compound the rate of interest. To be profitable he finds that he must accept deposits of at least Shs. 500,000 for three years. As part of an advertisement strategy, he has requested you to work out the resulting amounts if the rate of return is 12% per annum. These amounts are to be included in a brochure and send to the member of public.
- Compounded annually (2 Marks)

- ii. Compounded semiannually (3 Marks)
- iii. Compounded quarterly (3 Marks)

QUESTION FIVE

- a) Explain any three features of capital budgeting decisions (3 Marks)
- b) The estimated after-tax cash inflows for each of the machines are shown below:

Year	Machine	
	A	B
	Shs.	Shs.
1.	2,590,000	4,300,000
2.	2,880,000	3,290,000
3.	3,050,000	3,200,000
4.	2,950,000	3,700,000
5.	2,000,000	4,850,000
6.	1,500,000	4,420,000

The cost of capital to the company is 12%.

Required:

- (i) Calculate the undiscounted payback period for each machine. (4 Marks)
- (ii) Calculate the net present value (NPV) for each machine model. (6 Marks)
- (iii) Using the net present values computed in (ii) above, advise the management on which model to purchase. (2 Marks)

QUESTION SIX

The following information was extracted from the books of Marble Ltd;

	shs
Ordinary shares (Shs.20 par value)	8,000,000
8% preference shares (shs 24 par value)	1,200,000
10% debentures (shs 100 par value)	<u>2,000,000</u>
Total capital employed	<u>11,200,000</u>

The current market prices of the above finances are as follows:

- 1. Ordinary shares, shs 32 per share inclusive of shs 2 as floatation costs. Ordinary shareholders expect cash dividends of shs. 4 per share and a dividend growth at the rate of 5% at the end of every year.
- 2. The 8% preference shares currently sell at shs. 20 per share
- 3. The 10% debentures currently sell for shs.100
- 4. The corporate rate of tax is 30% per annum.

Required:

- a) Compute the component cost of:
 - i. Ordinary share capital; (3 Marks)
 - ii. Debt capital (3 Marks)
 - iii. Preference share capital. (3 Marks)
- b) Compute the company's current weighted average cost of capital. (6 Marks)