



PAN AFRICA CHRISTIAN UNIVERSITY

**END OF SEMESTER EXAMINATION FOR THE DEGREE
OF BACHELOR OF COMMERCE**

BACHELOR OF BUSINESS LEADERSHIP

MAY-AUGUST 2017

CAMPUS: VALLEY ROAD

DEPARTMENT: BUSINESS

COURSE CODE: COU3323

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM DATE: TUESDAY 25TH JULY 2017

TIME: 5.30PM-8:30PM

INSTRUCTIONS

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

QUESTION ONE

- (a) Highlight three advantages and three disadvantages of the payback period method of capital budgeting. (6 Marks)
- (b) Motor Works 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. (6 Marks)
- (c) Joel borrowed a three year loan of shs 1,500,000 at an interest rate of 9% per annum from his employer to buy a saloon car. His employer expects a three equal payment at the end of three years. Determine the amount of this annuity (6 Marks)
- (d) A debenture has the following characteristics
Principal amount Shs. 100,000, maturity is seven years, coupon interest is 16% and the payment is semi-annually

Required

Determine the price of the debenture if the expected rate of return is

- i. 20% per annum (4 Marks)
 - ii. 16% per annum (4 Marks)
 - iii. 12% per annum (4 Marks)
 - iv. Comment on the results above (2 Marks)
- (e) Jamal a financial manager l is considering an investment project whose initial cash outlay is Shs. 1,300,000 and whose cash flows after tax and depreciation are projected as below:

End of Period	Cash flow (Kshs)
1	400,000
2	300,000
3	450,000
4	500,000
5	700,000

- i. Determine the ordinary payback period for the project. (3 Marks)
- ii. Assuming a required rate of return of 12% determine the discounted payback period for the project. (5 Marks)

QUESTION TWO

The following information was extracted from the books of Kongello Ltd. as at 31st March 2014.

	Shs.
Ordinary share capital (par value Shs. 25)	8,000,000
8% Preference share capital (par value Shs. 24)	6,000,000
10% Preference share capital (par value Shs.20)	4,000,000
10% Debentures	4,000,000

Additional information

1. The market prices as at 31st March 2014 were as follows:

Ordinary share capital	Shs.30
8% preference share capital	Shs.20
10% Preference Share Capital	Shs 25
2. The market value of the 10% debentures as at 31st March 2014 was shs 5,000,000
3. The corporation tax is 30%
4. The company has maintained a payment of an ordinary dividend per share of Shs. 3.80 over the five years.

Required

- a) Calculate each component of cost of capital (10 Marks)
- b) Determine the Weighted Average Cost Of Capital (WACC) using the Market weights. (5 Marks)

QUESTION THREE

Mawingo Limited has approached you for advice on an equipment to be purchased for use in five year project.

The investment will involve an initial capital outlay of Shs. 1.4 million and the expected cash flows are given below:

Year	Cash inflows	Cash outflows
	Shs.	Shs.
1	800,000	65,000
2	750,000	80,000
3	900,000	50,000
4	1,200,000	55,000
5	1,100,000	70,000

The equipment is to be depreciated on a straight line basis over the duration of the project with a nil residual value.

The cost of capital and the tax rate are 12% and 30% respectively.

Required:

- (a) Determine the Net Present Value (NPV) of the investment. (7 Marks)
- (b) Determine the Internal Rate of Return (IRR) (8 Marks)

QUESTION FOUR

- a) PAC Company Ltd. currently pays a dividend of Sh.2 per share and this dividend is expected to grow at an annual rate of 15% for the first 3 years then at a rate of 10% for the next 3 years after which it is expected to grow at a rate of 5% thereafter.

Required

Calculate the value that would be placed on the stock if an 18% rate of return were required (10 Marks)

- b) Calculate the intrinsic value of a preference share that has par value of Kshs 80 and earns dividend at a fixed rate of 8% p.a. given that the market required rate of return is 14% P.a (5 Marks)

QUESTION FIVE

- a) Define agency relationship from the context of a public limited company (2 Marks)
- b) Briefly explain how the agency relation arises. (6 Marks)
- c) Discuss the various measures that would minimize agency problems between the owners and the management. (7 Marks)

QUESTION SIX

- a) Determine the current market value of a straight coupon bond that pays interest semi-annually and with the following additional features:
Maturity value = Kshs 1,000,000
Coupon rate per year = 12%
Required rate of return = 10%
Remaining period to maturity = 10 years (9 Marks)
- c) If your required rate of return per year in the above circumstance rose to 14%, determine the maximum price you would be willing to pay for the bond (6 Marks)