PAN AFRICA CHRISTIAN UNIVERSITY

SCHOOL OF LEADERSHIP, BUSINESS & TECHNOLOGY

END OF SEMESTER EXAMINATION FOR THE DEGREE OF

BACHELOR OF COMMERCE

BACHELOR OF BUSINESS LEADERSHIP

BACHELOR OF BUSINESS INFORMATION TECHNOLOGY

SEPTEMBER – DECEMBER 2017

CAMPUS: VALLEY ROAD

DEPARTMENT: BUSINESS

COURSE CODE: BCM302|BUS4213

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM DATE: MONDAY4th DECEMBER 2017

TIME: 5.30PM-8.30PM

INSTRUCTIONS

- Read all questions carefully before attempting.
- Write your **student number** on the answer booklet provided.
- Answer **QUESTION ONE and any other FOUR questions**

QUESTION ONE: COMPULSORY

a) Differentiate between debt finance and equity finance as a source of finance to your business. (4 Marks)

b) Explain three goals of a firm. (6 Marks)

c) Discus three characteristics of capital budgeting decisions (6 Marks)

d) Mwamba Ltd dividends are expected to grow at a constant growth of 8% into the foreseeable future. The company paid last year a dividend shs. 5.40 Per share. Each share is currently valued at shs. 90 per share. Calculate the market value of the share.(4 Marks)

e) Ngata Ltd has issued a five year bond with a face value of Shs. 1,000,000 which is earning a coupon interest of 9%. The coupon interest payments are made annually. The require rate of returns is expected to remain at 12% during the period.

Required

i. Determine the value of the bond (5 Marks)

ii. Calculate the new value of the bond if the required rate of return declines to 8% (5 Marks)

f) Ramex Ltd has just paid a dividend of shs. 4.00 per share which is expected to grow at 18% for the next four years, after which the growth rate is expected to fall to 12% for another four years. Thereafter the growth rate is expected to remain at 6% for ever into the future. The investor's required rate of return is 15%. Determine the value of the company's share (10 Marks)

QUESTION TWO

Wendy limited has the following capital structure:

Debt capital	35%
Equity (Ordinary share capital)	50%
Preference share capital	15%

The management of the company has provided the following data

i. The market price of an ordinary share is 30shs per share.
ii. Currently paid dividends are at shs 1.20 per share which has an annual growth of 9%.
iii. The market price of the preference shares is shs. 100 per share
iv. Dividends of shs. 8.50 of the preference shares are paid.
v. Flotation cost of the preference shares is 2%.
vi. Debt interest is 9%.
vii. Corporate tax rate is 30%.

Required

i. Calculate each component cost of capital. (10 Marks)

ii. Determine the weighted average cost of capital (WACC) using the markets weights. (5 Marks)

QUESTION THREE

Davis Limited has approached you for advice on an equipment to be purchased for use in a 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	70,000
2	750,000	80,000
3	900,000	60,000
4	1,200,000	85,000
5	1,100,000	95,000

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) The net present value (NPV) of the investment. (7 Marks)

b) The Internal Rate of Return for the investment (8 Marks)

QUESTION FOUR

a) Outline the functions of a financial manager. (5 Marks)

b) 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.

Required:

(i) Distinguish between the goals of profit maximization and shareholder wealth maximization. (4 Marks)

(ii) Explain three limitations of the goal of profit maximization. (6 Marks)

QUESTION FIVE

a) Define agency relationship from the context of a public limited company. (2 Marks)
b) Briefly explain two ways in which this agency relationship arises in the context of a company. (4 Marks)
c) Outline four advantages of leasing as a source of finance. (4 Marks)

d) ABC Power and lighting has a preference share that pays currently dividends of shs. 12 per share and its market price is shs 100 per share. If the company issues new preference shares, it will incur a flotation cost of 25%. Determine the cost of preference share. (5 Marks)

QUESTION SIX

a) Outline two advantages and two disadvantages of the pay-back period. (4 Marks)
b) PAC Ltd is analyzing two mutually exclusive projects whose details are given below:

Year	**Project A**	**Project B**
	Cash flow (sh)	**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

Additional information:

i. The above cash flows have been stated on **after** tax and depreciation.
ii. Each of the projects will cost Shs.8 million at commencement.
iii. The company‘s cost of capital is 10% p.a.

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

i. Pay –back period approach (4 Marks)

ii. Discounted payback period approach (7 Marks)