MACHAKOS UNIVERSITY

University Examinations for 2016/2017 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR FIRST SEMESTER EXAMINATION FOR DEGREE IN

BACHELOR OF ECONOMIC AND FINANCE

BAC 203: BUSINESS FINANCE 1

DATE:6/6/2017 **TIME: 2.00-4.00 PM**

INSTRUCTIONS

Answer Question One and Any Other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Identify and describe **THREE** sources of long- term finance available to a business (6 marks)

b) Discuss the following risk behaviours:

i. Risk averse (2 marks)

ii. Risk Indifference (2 marks)

iii. Risk seeking (2 marks)

c) An asset has the following possible returns with associated probabilities:

Possible returns	20%	18%	8%	0%	-6%
Probability	0.10	0.45	0.30	0.05	0.10

Required:

Calculate:

i. Expected rate of return (4 marks)

ii Standard deviation of the rate of return. (4 marks)

d) Suppose you bought a share of Simba Cement on 31 March 2017 for Sh.225. You expect to receive a dividend of Sh.3.50 and sell the share for Sh.280 after one year. What is your expected rate of return? (5 marks)

e) A firm's total current assets are Ksh.200, 000/= and total liabilities are Ksh.50, 000/=. The industry average 2.5. Determine the current ratio and comment on you result. (5 marks)

QUESTION TWO (20 MARKS)

The information below relates to B.Com Enterprises Ltd.

	2015	**2014**
	Sh.'000'	**Sh.'000'**
Current assets	26,400	15,600
Current liabilities	(13,160)	(6,400)
Net working capital	13,240	9,200
Sales	120,000	96,000
Gross profit	54,000	40,000
Net profit	36,000	12,000

Inventory in 2014 and 2015was Shs.5,000,000 and Shs.3,000,000 respectively. In the year 2014, B.Com Enterprises had Sh. 5.2 million of debt in form of 8% coupon bonds. It has Sh.6.4 million of common stock in form of 320,000 shares and the payout ratio is 50%. Assume taxation is at the rate of 30%.

Required: for the years

a) Calculate: (i) Current ratio (2 marks)

(ii) Acid test ratio (2 marks)

(iii) Debt /Equity Ratio (4 marks)

(iv) Net Profit Margin (3 marks)

(v) Times interest earned ratio (4 marks)

b) Calculate:

B.Com's Earnings Per Share (5 marks)

QUESTION THREE (20 MARKS)

(a) The capital of Moige Ltd is all equity and consists of 800,000 shares of Ksh.120/= each. The expected growth rate is 10%. Last year's dividend was Ksh.4 /= per share Calculate the cost of equity (4 marks)

(b) Moige Ltd. has decided to adjust its capital structure proportions to 25% debt of 36,000 irredeemable debentures and 25% of preferred stock in form of 200,000preferrence shares and 50% equity shares while maintaining the same level of capital. The firm expects the same growth rate as in (a) above, given that interest rates are 10% and 6% for preferred stock and debentures respectively, corporation tax is 30%.

  (i) Calculate the cost of equity capital (3 marks)

  (ii) Calculate the dividend per share of preferred stock (3 marks)

  (iii) Calculate the cost of debt (3 marks)

  (iv) What is the WACC for Moige Ltd. (7 marks)

QUESTION FOUR (20 MARKS)

(a) What do you understand by the term "time value for money"? (4 marks)

(b) Jane decided to invest Sh.500,000 in a savings account paying 8% compounded semi-annually. If she leaves the money in the account for 8 years, how much will she have in the account at the end of the 8 years? (6 marks)

(c) ABC Company dividends are expected to grow at constant rate of 5% into the foreseeable future. The company has just paid Shs.3.5 per share as dividends. The par value for shares is Shs. 10 but they are selling at Shs.50 per share with floatation cost being 10%. Calculate the cost of equity. (10 marks)

QUESTION FIVE (20 MARKS)

(a) A Ksh.1000/= bond is currently selling for Ksh.1200/=. It has an 8% coupon and 10years to maturity. The firm's tax rate 30%. Calculate the after-tax cost of this debt. (6 marks)

(b) Briefly explain the merits and demerits of equity share capital. (14 marks)