MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

SECOND YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 203: BUSINESS FINANCE 1

DATE: 26/7/2019 **TIME: 8.30-10.30 AM**

INSTRUCTIONS: Attempt Question One and any other Two Questions

QUESTION ONE

a) Explain the types of agency costs that arise in agent-principal relationship that exist between shareholders and managers. (5 marks)

b) Outline FOUR main objectives of a firm, which conflict and at the same time overlap – explain these overlap and conflicts. (5 marks)

c) Laula limited issued 1million ordinary shares of Ksh 10 each and selling at sh 15 each at a cost of 12%. The company paid divided at the rate of Ksh 4 per share. Calculate the cost of equity capital. (5 marks)

d) State five disadvantages of debentures as a source of finance (5 marks)

e) An employer offers to start a pension plan for your 45-year-old father. The plan is to place Kshs.10,000 at the end of each year in an account that earns 6% annually. Your father wants to know how much will be in the account by retirement age at 65 years. He has asked you to assist him in his dilemma. Calculate the amount that will be in the account at retirement. (5 marks)

f) Peleka stores intend to buy a car in three years' time .The car will cost Ksh870 100. Peleka deposited Ksh200 000 in Hela bank at the beginning of the first year and sh 240 000 at the beginning of the second year. The bank pays10% interest on deposits. Calculate the amount the business should deposit in the same bank account at the beginning of the third year so as to be in a position to buy the car. (5 marks)

g) Investors and managers may not have a consensus of opinion towards risk when it comes to investment decisions. With the aid of a diagram, explain their attitudes towards risk. (5 marks)

QUESTION TWO (20 MARKS)

You are the Financial Manager of Swift Ltd. situated at the heart of Kisumu City. The, Company though very ambitious in diversifying its portfolio is also keen in the choice of the investments it makes. It intends to invest its resources in stocks that are less risky. You have been given the task of analyzing and advising on the choice of stocks to invest in. You have seen two securities being offered for subscription with the respective characteristics.

State of the Economy	Possibility of occurrence	Security X	Security Y
P	0.2	10%	16%
Q	0.15	20%	18%
R	0.25	30%	15%
S	0.3	20%	20%
T	0.1	10%	21%

a) Calculate the expected return on each security. (6 marks)

b) Calculate the standard deviation of the returns on security X and Y (10 marks)

c) Which security do you recommend for the company to invest in and why? (4 marks)

QUESTION THREE (20 MARKS)

a) The capital of a Mjengo Co. Ltd. is all Equity and consists of 600,000 shares of Shs.120. each. The anticipated growth rate is 12% and last year's dividend was Shs.5 per share. What is the cost OF Equity? (3 marks)

b) Its is common knowledge that ordinary shares are very risk and therefore Mjengo Co. Ltd has decided to adjust its capital structure proportions to 25% debt of 18,000 irredeemable debentures, 25% preferred stock in form of 100,000 preference shares and 50% equity while maintaining the same level of capital. The company anticipates the same growth rate as above and its preferred stock and 10% and 6% respectively. The corporate income tax rate is 30%.

i. Calculate the cost of equity. (4 marks)

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

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

c) What is Mjengo Co. Ltd. Weighted Average cost of Capital(WACC) ? (7 marks)

QUESTION FOUR (20 MARKS)

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

b) Jane after her retirement received her benefits and 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? (6marks)

c) Solar Panel Company recently invested in a huge technology that gave it comparative advantage over its competitors. As a result, sales are expected to increase by over 200%. Because of this, the Co. management ratified to increase DPS by 10% into the foreseeable future.

Assume the investors require 11% rate of return. How much is the solar Panel Co. stock worth today if the Company just paid a dividend of Shs.1.8 per share? (10 marks)

QUESTION FIVE (20 MARKS)

The following financial statements relate to the KOPO Company:

Assets	**Shs.**	**Liabilities & Net worth**	**Shs.**
Cash	28,500	Trade creditors	116,250
Debtors	270,000	Notes payable (9%)	54,000
Stock	649,500	Other current liabilities	100,500
Total current assets	948,800	Long term debt (10%)	300,000
Net fixed assets	285,750	Net worth	663,000
	1,233,750		1,233,750

Income Statement for the year ended 31 March 1995

	Shs.
Sales	1,972,500
Less cost of sales	1,368,000
Gross profit	604,500
Selling and administration	498,750
expenses	105,750
Earning before interest and tax	34,500
Interest expense	71,250
	28,500
Estimated taxation (40%)	42,750
Earnings after interest and tax	

Required

a) Calculate:

- i) Inventory turnover ratio; (3 marks)
- ii) Times interest earned ratio; (3 marks)
- iii) Total assets turnover; (3 marks)
- iv) Net profit margin (3 marks)
- v) Current Ratio (2 marks)

(Note: Round your ratios to one decimal place)

b) Explain three weaknesses associated with profit maximization goal? (6 marks)