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 204: BUSINESS FINANCE II

DATE: 27/9/2019 **TIME: 8.30-10.30 AM**

INSTRUCTIONS:

ANSWER QUESTIONS ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE

(a) What is capital budgeting and what are its significance to the firm? (3 marks)

(b) A project is in the consideration of a firm. The initial outlay of the project is ksh. 10000/= and is expected to generate cash inflows of ksh.4000/=, ksh.3000l=, ksh.5000/= and ksh.2000/= in the four years to follow. Assuming a 10% rate of discount, calculate the net present value (NPV) and the profitability index (PI) and comment on your results. (8 marks)

(c) BXM LTD, unprepared to invest more than ksh. 500 million in the current year, but has the following projects available to it:

Project.	Initial investment in ksh.Millions	NPV in Ksh. Millions
A	100	15
B	150	29
C	140	31
D	210	22
E	180	36

Which of these projects should the company invest in? (8 marks)

(d) X Company Ltd has 100,000 shares outstanding; the current market price of the share is Ksh.15 each. The company expects the net profit of Ksh.200, 000/= during the year and it belongs to a rich class for which the appropriate capitalization rate has been estimated to be 20%. The company is considering a dividend of Ksh. 2.50/= per share.

Required: What will be the price of the share at the end of the year if:

(i) Dividend is paid

(ii) Dividend is note paid (8 marks)

(e) "The sum of the current assets is the working capital of the business" In the light of this statement, state and explain the three primary components of working capital. (3 marks)

QUESTION TWO

Zee Company Ltd is evaluating the following seven investment proposals. The company has capital expenditure ceiling of Ksh. 2000, 000/= and therefore can accept just enough proposals. Cost of capital is 12%:

Project	Cash outlay Ksh. "000"	NPV Ksh.
O	100	18
P	500	80
Q	200	40
S	600	36
T	1000	250
U	800	180
V	400	40

You are required:

(a) To rank the proposals according to profitability index (PI) and indicate the group of proposals to be accepted (10 marks)

(b) If projects T and U were mutually exclusive would this change your answer to (a) above? If yes indicate which projects would be accepted. If no, why? (10 marks)

QUESTION THREE

(a) What are the benefits of MIRR over IRR? (3 marks)

(b) Engineering Company is currently contemplating four projects: A, B, C, and D, which requires an initial investment of Ksh. 36,000,000/=. The projected cash flows for each project are as shown in the table below:

Year	Cash inflows Ksh. "000)			
	A	B	C	D
1	18000	2000	24000	16000
2	6000	16000	6000	20000
3	12000	0	12000	2000
4	4000	0	0	2000

Required:

i. Calculate the payback period for each project (12 marks)

ii. If the minimum standard payback period is two years which projects, you recommend? (8 marks)

QUESTION FOUR

(a) For each of the following companies described below, state whether and why you would expect to have high or dividends out ratio:

(i) A company with a large proportion of inside ownership, all of whom are high income individuals (2 marks)

(ii) A growth company with an abundance of good investment opportunities (2 marks)

(iii) A company experiencing ordinary growth that has high liquidity and unused borrowing capacity (2 marks)

(iv) A dividend paying company that experience an unexpected drop in earnings from trend (2 marks)

(v) A company with volatile earnings and high business risk (2 marks)

(b) State and explain the major determinants of capital structure of a company (10 marks)

QUESTION FIVE:

(a) Explain the following dividend theories:

i. Dividend Irrelevance Theory

ii. Bird in Hand Theory

iii. Tax Preference Theory

iv. Clientele Effect

v. Information Content Hypothesis (10 marks)

(b) A firm has in its books the following amounts and specific costs of each type of capital:

Type of capital	Book value in Ksh.	Market value in Ksh.	Specific cost %
Debt	400,000	380,000	5
Preference	100,000	110,000	8
Equity	600,000	900,000	15
Retained earnings	200,000	300,000	13
Total	1300,000	1690,000	

Required: Determine the weighted average cost of capital (WACC) using:

i. Book value weights

ii. Market value weights (10 marks)

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SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

FOURTH YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC408: APPLIED INVESTMENT

DATE: **TIME:**

INSTRUCTIONS:

Answer Questions One and Any Other Two

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Name and explain any two fixed income securities. (6 marks)

b) Discuss the difference between the terms investment and speculation (6 marks)

c) State and explain the four common basic characteristics of all investments (6 marks)

d) Discuss is the purposes of personal investments (6 marks)

e) From the following data, evaluate the portfolios using Sharpe's and Jensen's Models:

	Portfolios		
	A	B	C
Return	21%	25%	20%
Beta	0.9	1.6	1.0
Standard deviation	5%	6%	9%
Market return		12%	
Risk free rate		8%	

QUESTION TWO:

a) Discuss the Capital Asset Pricing Model (CAPM), its assumptions and formulations (12 marks)

b) Do you agree that this model, CAPM is still applicable in estimating assets return? Explain you answer (8 marks)

QUESTION THREE:

a) Closed- end-funds generally invest in securities and financial instruments that are relatively illiquid, whereas most mutual funds invest in widely traded stocks and bonds. Discuss the differences between closed-end and open-end funds and why this liquidity distinction matters? (12marks)

b) The following parameters are available for the five mutual funds:

Fund	A	B	C	D	E
Expected return %	15	18	17	16	20
Beta	0.5	0.8	0.7	0.6	1.0

Required: Calculate Treynor's performance index and rank the funds on the assumption that risk free rate is 8% (8 marks)

QUESTION FOUR:

a) Distinguish between a growth scheme and an income scheme of a mutual fund (8 marks)

b) "The investment process involves a series of activities starting from the policy formulation "Discuss this statement. (12 marks)

QUESTION FIVE (20 MARKS)

a) What is portfolio diversification? (4 marks)

b) How can an efficient portfolio diversification achieved? Explain. (16 marks)

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University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

THIRD YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 308: CORPORATE FINANCE

DATE: 27/9/2019 **TIME: 8.30-10.30 AM**

INSTRUCTIONS:

ANSWER QUESTION ONE AND ANY OTHER TWO

QUESTION ONE

a) Why is the goal of maximizing owners' wealth helpful in analysing capital investment decisions? What other goals should be considered? (marks)

b) Corporate finance covers a wide range of areas and functions within an organization. Explain the three main questions that corporate finance seeks to answer. (6 marks)

c) Poor ltd is expecting to pay a dividend of Ksh. 20 this year, increasing at a rate of 5% p.a. If its shareholders have a required return of 15%, what is the current market price? (6 marks)

d) Mr Trollope holds the following shares in his portfolio which have these expected returns:

Share	proportion %	expected return %
A	25	20
B	15	10
C	30	15
D	30	25

You are required to calculate the expected return for Mr Trollope's portfolio (6 marks)

e) Discuss the difference between the capital structure and financial structure of the business firm (6 marks)

QUESTION TWO

a) Bear ltd is proposing to acquire Lions ltd who is currently just breaking even. Bear feels that the investments it plans to make should lead to the following after tax figures (ignoring any price paid) for Lion:

Year	Earnings (ksh. "000")
1	85000
2	88000
3	92000
4	96000
5	96000

Bear wishes to recover its investment within five years. If the after tax cost of capital is 12.5 %, what is the maximum price should be prepared to pay? (16 marks)

b) Explain what is wrong with the following argument; "If a firm issues debt that is risk free, because there is no possibility of default, the is of the firm's equity does not change. Therefore, risk free debt allows the firm to get the benefit of a low cost of capital of debt without raising its cost of capital equity" (4 marks)

QUESTION THREE

a) Star Alexander is considering to invest the following amounts at the beginning of each of the next five years in a venture that will earn 9% annually:

Year	Amount (ksh. "000")
1	900
2	1000
3	1200
4	1500
5	1800

You are required to determine the amount of money Star Alexander will have at the end of five years (16 marks)

b) Why is that for a given firm, that the required rate of return on equity is always greater than the required rate of return on debt? (4 marks)

QUESTION FOUR

a) State and explain the assumptions on which the dividend valuation and growth model is anchored on (12 marks)

b) A five-year bond pays interest annually. The par value is ksh. 1000 each and the coupon rate equals 7%. If the market's required return on the bond is 8%, what is the bond's market price? (8 marks)

QUESTION FIVE

a) The company's shares have a beta of 1.2 and an alpha of 2%. The market return is 10% and the risk free rate is 6%. You are required to calculate the expected return for this company using CAPM (4 marks)

b) Describe the assumptions of the Capital Asset Pricing Model. (16 marks)