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University Examinations 2011/2012

THIRD YEAR, FIRST SEMESTER EXAMINATIONS FOR THE DEGREE OF BACHELOR OF COMMERCE AND YEAR TWO, SEMESTER TWO, BACHELOR OF BUSINESS INFORMATION AND TECHNOLOGY.

HBC 2119: BUSINESS FINANCE

DATE: APRIL 2012 **TIME: 2 HOURS**

INSTRUCTIONS: *Answer questions **one** and any other **two** questions*

QUESTION ONE (30 MARKS)

a. Critically discuss the following financial goals of the firm.
   i. Profit maximization (5 Marks)
   ii. Shareholders wealth maximizing (5 Marks)
b. A company is considering invest in a project whose cost is sh. 10,000 and useful life is estimated to be five years. The project promises a profit before depreciation and tax of sh. 4000 per annum. The project is depreciated on straight line basis and the corporate tax rate is 50%
   Required:
   Calculate the IRR of the project (5 Marks)
c. Argue out a case for financial markets institutions in the economy (8 Marks)
d. Explain briefly the following sources of fund
   i. Invoice discounting (2 Marks)
   ii. Commercial papers (2 Marks)
   iii. Institutional investors (3 Marks)

QUESTION TWO (20 MARKS)

a. The following is an abstract of the balance sheet of Shauri Moyo Ltd as at December2005.

Capital and liability	**sh.(000)**
Ordinary share capital 1 million	10,000
Ordinary shares of sh. 10 each	20,000

Capital reserves	90,000
Revenue reserves	30,000
	150,000

Additional information:

1. The profit before interest and tax for the year ended 31 December 2005 was sh. 9,000,000
2. The dividend payment rates for the year 2005 was 40%
3. The market price per share as at 31 December 2005 was sh. 36
4. The corporation tax rate is 30%

Required:

Compute the following ratios:

i. Gearing ratio (2 Marks)
ii. Dividend yield ratio (2 Marks)
iii. Times interest earned ratio (2 Marks)
iv. Return on capital employed (2 Marks)
v. Return on equity (2 Marks)
vi. Price earnings ratio (2 Marks)

b. Discuss the main problems a sole trader encounter in a bid to raise finance in Kenya (4 Marks)

c. Compare and contrast discounting criteria and non discounting criteria in investment evaluation (4 Marks)

QUESTION THREE (20 MARKS)

a. Distinguish between compounding and discounting (4 Marks)

b. Chogoria ltd is considering the launch of a new product ‘excel’ for which an investment of sh. 6,000,000 in plant and machinery will be required. The production of excel is expected to last five years after which the plant and machinery would be sold for sh. 1,500,000.

Additional information:

1. Excel would be sold at sh. 600 per unit with a variable cost of sh. 240 per unit.
2. Fixed production costs (excluding) depreciation would amount to sh. 600,000 per annum.
3. The company applies the straight line method of depreciation.
4. The cost of capital is 10% per annum.
5. The units of excel expected to be sold per annum for the next five years are as shown below

Year	units expected to be sold
1	8,000
2	7,000
3	7,000
4	5,000
5	3,000

6. The corporation tax rate is 30%

Required:

Calculated the NPV of the project and advice the management on the appropriate course of action (10 Marks)

c. Discuss the role of money markets and capital markets (6 Marks)

QUESTION FOUR (20 MARKS)

a. The following information relates to the firm's capital structure:

	Sh.
Ordinary shares (sh. 25 per value)	800,000
8% preference shares (sh. 24 per value)	600,000
10% preference shares (sh. 24 per value	600,000
10% debentures (sh. 20 each)	400,00
	2,400,000

The current market prices of each of the above sources of finance are:

i. Sh. 31 for ordinary shares and this is inclusive of floatation cost of sh. 1 per share
ii. The 8% preference shares were issued 10 years ago and are currently selling for sh.20 per share
iii. The 10% preference shares that were issued five years ago are currently selling for sh. 25 per share
iv. The 10% debentures are currently selling for sh.25 per debenture

The ordinary shareholders expect cash dividends of sh. 3.80 per share at the end of the year. The dividend is expected to g row at 5% into perpetuity. The corporation tax rate is 30%.

Required:

a. The weighted average cost of capital of the firm (12 Marks)
b. Distinguish between marginal cost of capital and weighted average cost of capital (3 Marks)
c. State five applications of the weighted average cost of capital (5 Marks)