



KABARAK

UNIVERSITY

**UNIVERSITY EXAMINATIONS
2010/2011 ACADEMIC YEAR**

**FOR THE DEGREE OF BACHELOR OF BUSINESS
MANAGEMENT AND INFORMATION TECHNOLOGY
COURSE CODE: BMIT 222**

COURSE TITLE: BUSINESS FINANCE

STREAM: Y2S2

DAY: WEDNESDAY

TIME: 2.00 – 5.00 P.M

DATE: 15/12/2010

INSTRUCTIONS:

1. Answer questions **ONE** and any other **THREE** questions only.
2. ALL necessary workings must be carefully shown.

PLEASE TURNOVER

QUESTION ONE (COMPULSORY)

a) Distinguish between the following terms:

- Independent projects and mutually exclusive projects (2marks)
- Annuity and perpetuity (2marks)
- Compound interest and simple interest (3marks)
- Opportunity cost and sunk cost (3marks)

b) An investor can get an annual interest rate of 12% on a deposit in a bank. Assuming he deposits sh.10, 000 and leaves it for 3years, what is the amount at the end of the third year if interest is compounded:

- i. Semi annually (3marks)
- ii. Quarterly (3marks)

c) Complete the following Table, solving for PV and FV.

CASE	FV	INTEREST RATE %	YEARS	PV
A	SH.20,000	10	5	?
B	?	12	4	20,000
C	SH.10,000	?	3	6000

(5marks)

d) ABC Ltd is considering an expansion of the installed capacity of one of its projects. The firm is considering two mutually exclusive projects whose expected cash flows are given below:

Year	Project A	Project B
	Cash flows(sh)	Cash flows (sh)
0	10,000,000	10, 000,000
1.	3,000,000	5,000,000
2.	2,000,000	4,000,000
3.	4,000,000	5,000,000
4.	5,000,000	2,000,000
5.	6,000,000	3,000,000

Additional information

- The above cash flows have been stated on after tax basis.

- The company's cost of capital is 12% p.a.

Required:

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

- (i) Net present value method (4marks)
- (ii) Profitability Index(Net) method (2marks)
- (iii) IRR Approach (3marks)

[TOTAL: 30Marks]

QUESTION TWO

a) Distinguish between each of the following terms as used in business finance:

- (i) Leasing and Hire purchase (2 Marks)
- (ii) Debentures and Mortgage finance. (3 Marks)
- (i) Money market and Capital market (3 Marks)

b i) Explain the reasons that may drive a company to raise long term capital by issuing equity shares and Debentures. (8 marks)

- i) Briefly explain any **four** problems faced by small and medium sized enterprises while sourcing for funds for financing business ventures (4 marks)

[TOTAL: 20Marks]

QUESTION THREE

a) Highlight the importance of capital budgeting in modern organizations. (5marks)

b) The Directors of Kabu Ltd are considering which of the two mutually exclusive Projects, A or B, should be undertaken by the company.

The probability distributions of the net present values for each project are shown below:

<i>Year</i>	<i>Project A</i>		<i>Project B</i>	
	<i>Net present value</i>	<i>Probability</i>	<i>Net Present Value</i>	<i>Probability</i>
	Sh.		Sh.	
1	(2,000)	0.1	500	0.2
	1,500	0.3	1000	0.2
	2,000	0.4	2,000	0.4
	4,000	0.3	2,500	0.1

- (i) Determine the expected net present value for each project. (6 Marks)

- (ii) Compute the standard deviation of the net present value for each project. (5 Marks)
- (iii) Using the coefficient of variation criterion, advice the management Of Tayari Ltd on which project to pursue (4 Marks)

[TOTAL: 20Marks]

QUESTION FOUR

- a) Discuss the factors which influence capital structure decisions. (6marks)
- b) The following is the capital structure of a company

Source	Amount
Ordinary shares	2,000,000
10% preference shares	1,000,000
6% debentures	800,000
Bank loan	<u>1,200,000</u>
Total	<u>5,000,000</u>

The following additional information is available:

- Ordinary shares are sh.10 each with a market price of sh. 16 per share.
- Preference share nominal and market price is sh.10.
- Debenture nominal price is sh.12 while the marked price is sh.10.
- Ordinary shares floatation cost per share is sh.1.
- Corporation tax rate is currently at 30%.
- Bank loan interest is 14%
- Equity dividend is currently sh.1 per share and is expected to grow at 6%p.a.

Required:

- i) Compute the component cost of capital (8marks)
- ii) Compute the company's weighted average cost of capital (4marks)
- iii) The relevance of the WACC computed in (ii) above in making decisions (2marks)

[TOTAL: 20 Marks]

QUESTION FIVE

- a) Briefly explain the following defense strategies applicable in a hostile takeover situation:
- Crown jewels strategy (2marks)
 - Poison pill strategy (1marks)
 - Golden parachutes strategy (1marks)
- b) Briefly explain **four** reasons why a company seeking to maximize the wealth of its shareholders may wish to take over another company. (4marks)

c) Stocks A,B and C have the following probability distributions:

Probability	Estimates of Returns (%)		
	A	B	C
0.2	14	13	12
0.2	19	7	10
0.1	16	5	12
0.3	3	5	4
0.4	20	11	15

Required:

- i) Compute each project's expected rate of return, variance, standard deviation and coefficient of variation (10marks)
- ii) Compute expected return for a portfolio consisting of 60% of A, 20% of B and 20% of C (2Marks)

[TOTAL: 20 Marks]