KABARAK UNIVERSITY

UNIVERSITY EXAMINATIONS

2009/2010 ACADEMIC YEAR

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: FNCE 220

COURSE TITLE: BUSINESS FINANCE

STREAM: Y2S2

DAY: MONDAY

TIME: 9.00 – 11.00 A.M.

DATE: 02/08/2010

INSTRUCTIONS

1. The paper contains **FIVE** questions
2. Question **ONE** is compulsory
3. Answer any other two questions from the remaining four.

PLEASE TURNOVER

QUESTION ONE

a) Identify and explain any four ways in which management actions may compromise the attainment of shareholders objectives for the firm. **(8mks)**

b) ABC Company has issued a bond with face value of Kshs. 300,000. The coupon rate is 10% and the bonds maturity period is 5 years. If the required rate of return is 12%

   i. Determine the value of the bond. **(4mks)**

   ii. Determine the value of the bond if the required rate of return is 8%. **(3mks)**

   iii. Comment on the results. **(2mks)**

c) Explain the factors that should be taken into consideration by an investor when making a choice between financing by short term and long term sources. **(8mks)**

d) A share is currently selling at Kshs. 80 and has annual dividends of Kshs. 15. In three years time the share price is expected to increase to Kshs. 95. Determine the expected rate of return for this share. **(3mks)**

e) Difference between profit maximization and wealth maximization objectives of the firm. **(2mks)**

QUESTION TWO

a) What is capital Budgeting? **(2mks)**

b) The finance manager of a company has identified two investment opportunities that are independent of each other. The company has no cash has flow problem and can undertake both projects if they turn out to be value adding to the company. The net cash flow estimates for the two projects are as follows:

Project	NDX 210	VRS 211
Initial out lay	Kshs. 2000,000	Kshs. 2,400,000
End of year	Cash Flows	Cash Flows
1	500,000	800,000
2	450,000	600,000
3	300,000	500,000
4	400,000	400,000
5	450,000	350,000
6	300,000	350,000

The company's rate of return is 12%

i. Determine the NPVs of the projects and advice the company's financial manager. **(10mks)**

ii. Using the payback period approach, advice the manager. **(5mks)**

c) Outline the demerits of using the internal Rate of Return as a criterion for evaluating projects. **(3mks)**

QUESTION THREE

a) Distinguish between systematic risk and Unsystematic risk. **(2mks)**

b) What are the determinants of the price of a bond? **(2mks)**

c) Alfred wants to invest in bond with possible returns distributed as follows:

Return	8%	11%	13%	16%	20%	24%
Probability	0.15	0.20	0.30	0.20	0.15	0.10

i) Determine the expected return and standard deviation of this security. **(6mks)**

ii) Suppose Alfred has Kshs. 1,500,000 to invest in a portfolio of two securities one of which is the bond above. The other security has an expected return of 10% and a standard deviation of 4%. Determine his portfolio expected return and portfolio standard deviation if he invested Kshs. 900,000 in the bond. **(6mks)**

d) If the two above securities have a correlation co efficient of 0.4, determine the Co Variance between these securities. **(2mks)**

QUESTION FOUR

a) Explain ways in which managers can maximize the value of the firm. **(4mks)**

b) In the real world, people prefer money of the same value today than tomorrow such that for a person to forego money now he/she has to be compensated. Explain the reasons for this time preference of money. **(6mks)**

c) ABC company is considering a project with the following cash flows for five years. The first two years Kshs. 200,000 per year and the remaining years Kshs. 600,000 per year. Compute the present value of this project if the discount rate is 15%. **(6mks)**

d) Giving appropriate examples explain Agency cost. **(4mks)**

QUESTION FIVE

a) Explain the main features of common stock holders in a company. **(4mks)**

b) Differentiate between retained earnings and trade credit as sources of finance for firms. **(4mks)**

c) A company sold 50,000 shares at 80/= each. The par value of the stock is 20/=. At the end of that year, the company made a net profit of 2million. If no dividends was paid at the end of the year,determine the book value of this stock. **(6mks)**

d) Laura wants to buy 8% perpetual bond of Kshs. 10,000 par value. The bonds required rate of return is 10%. If the bond is currently selling at Kshs. 9,000 should Laura buy this bond or not? **(3mks)**

e) What are Debentures? **(3mks)**