MURANGA UNIVERSITY COLLEGE

(A constituent College of Jomo Kenyatta University of Agriculture & Technology)

MAIN CAMPUS

ORDINARY UNIVERSITY EXAMINATIONS

2015/2016 ACADEMIC YEAR

THIRD YEAR FIRST SEMESTER EXAMINATIONS
FOR THE DEGREE
OF
BACHELOR OF PURCHASING AND SUPPLIES MANAGEMENT

COURSE CODE: HPS 2307

COURSE TITLE: INVESTMENT MANAGEMENT

DATE: 15th DECEMBER, 2015 **TIME: 2 HOURS**

INSTRUCTIONS TO CANDIDATES

Question ONE (1) is compulsory

Answer TWO (2) questions

MRUC observes ZERO tolerance to examination irregularities

QUESTION ONE
The following are the financial statements for X Ltd. and Z Ltd. for the current financial year. Both the firms operate in the same industry in the city of Mombasa.

Statement of Comprehensive Income

	X Ltd.	Z Ltd.
	Kshs.	Kshs.
Net sales	69, 000,000	17, 000,000
Cost of goods sold	55, 200,000	13, 600,000
Gross profit	13, 800,000	3, 400,000
Operating expenses	4, 000,000	1, 000,000
Interest	1 ,400,000	420,000
Earnings before taxes	8,400,000	1, 980,000
Taxes (50%)	4,200,000	990,000
Earnings after taxes (EAT)	4,200,000	990,000

Statement of Financial Position

	X Ltd.	ZLtd.
	Kshs.	Kshs.
Total current assets	28,000,000	20, 000,000
Total fixed assets	20,000,000	10, 000,000
	48, 000,000	30, 000,000
Equity capital (of 10 each)	20, 000,000	16, 000,000
Retained earnings	4, 000,000	-
14% Long-term debt	10, 000,000	6, 000,000
Total current liabilities	14, 000,000	8, 000,000
	48, 000,000	30, 000,000

Additional information

	A Ltd	**B Ltd**
Number of equity shares	1,000,000	800,000
Dividend payment ratio (D/P)	40%	60%
Market price per share (MPS)	Kshs. 400	Kshs. 150

X ltd and Z ltd are in the process of negotiating a merger through an exchange of equity shares and you have been asked to assist in establishing equitable exchange terms.

Required

i. **Analyze** by taking apart the share prices of both the companies into EPS and P/E components, and also segregate their EPS figures into return on equity (ROE) and book value/intrinsic value per share (BVPS) components. **(12 marks)**

ii. Estimate future EPS growth rates for each firm. **(3 marks)**

iii. Based on expected operating synergies, A Ltd. estimates that the intrinsic value of B's equity share would be Kshs. 200 per share on its acquisition. You are required to develop a range of justifiable share exchange ratios that can be offered by A. Ltd. to B Ltd.'s shareholders. Based on your analysis in parts (i) and (ii) would you expect the negotiated terms to be closer to the upper, or the lower exchange ratio limits? Why? **(6 marks)**

iv. Calculate the post-merger EPS based on an exchange ratio of 0.4:1 being offered by A Ltd. Indicate the immediate EPS accretion or dilution, if any, that will occur for each group of shareholders. **(6 marks)**

v. Based on a 0:4:1 exchange ratio, and assuming that A's pre-merger P/E ratio will continue after merger, estimate the post-merger market price. Show the resulting accretion or dilution in pre-merger market prices. **(3 marks)**

(Total 30 Marks)

QUESTION TWO

The directors of Mosobeti Ltd are considering a takeover bid for Musoma Tea Factory . However, they recognize that there are potential problems with any bid proposed. Firstly, the directors of Mosobeti Ltd believe that any takeover bid would be resisted by the directors of Musoma Tea Factory. Secondly, Mosobeti Ltd is short of cash and so any offer to the shareholders of Musosma Tea factory would have to be either in form of a share exchange or a loan capital for share exchange.

Required

a) Discuss reasons why a company seeking to maximize the wealth of its shareholders may wish to take over another company. **(15 Marks)**

b) Evaluate the share for share exchange and loan capital for share options as methods of purchase consideration from the view point of the shareholders of both the companies. (**05 Marks)**

QUESTION THREE

The following information is supplied to you regarding an asset

Currently the risk free rate is 8%,

The market return is 12% and,

The beta of Asset A is 1.10.

Required

a. Show the security market line (SML) on a set of no diversified risk and required rate of return. (5 **Marks)**

b. Using CAPM calculate the required return on the asset and depict the asset A beta and required return on the SML drawn in part a. **(5 Marks)**

c. Assume that results of recent economic events, inflationary expectations have declined by 2% lowering both the required return and market return. Draw the new SML and calculate the new required return for asset A. **(5 Marks)**
d. Assume that as a result of recent events; investors have become more risk averse, causing the market return to rise by 1% to 13%. Ignoring the shift in part c, draw the new SML and calculate the new required rate of return. (**5 Marks)**

(Total: 20 marks)

QUESTION FOUR

Write short notes on any four of the following **5 marks each**

a. Factors that affect the value of a particular company's shares
b. Random walk theory
c. Markowitz efficient theory
d. Capital Asset Pricing Theory
e. Dow Jones Theory
f. Factors that affect investment in Kenya
g. Objectives of Investment Management

(Total: 20 marks)