



MASENO UNIVERSITY

UNIVERSITY EXAMINATIONS 2012/2013

FIRST YEAR FIRST & SECOND SEMESTER EXAMINATIONS FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH INFORMATION TECHNOLOGY (CITY CAMPUS - DAY/EVENING)

ABA 202: INTRODUCTION TO FINANCE

Date: 24th July, 2013

Time: 5.30 – 7.30 p.m.

INSTRUCTIONS:

- ◆ Answer Question ONE (COMPULSORY) and any other TWO questions.
- ◆ Show all your workings clearly.



QUESTION ONE

A) Aus limited Company intends to purchase a machine worth Shs.1, 500,000 which will have a residue value Shs.200, 000 after 5 years useful life. The saving in cost resulting from the use of this machine are:

| | Shs. |
|--------|---------|
| Year 1 | 800,000 |
| Year 2 | 350,000 |
| Year 3 | - |
| Year 4 | 680,000 |
| Year 5 | 775,000 |

Using NPV method, advice the company whether this machine should be purchased if the cut off rate is 14% and acceptable saving in cost is 12% of the cost of the investment.

(10 marks)

B) Outline the functions of a financial manager in a contemporary corporate set-up.

(8 marks)

C) Explain at least six principles of Corporate Governance as given by the Common Wealth Association of Corporate Governance (CACG) in 1999 and the Private Sector Corporate Governance Trust (PSCGT) in 1999.

(12 marks)

QUESTION TWO

The management of Dwell Angels Company Ltd. wants to establish the amount of financial needs for the next two years. The balance sheet of the firm as at 31 December 2010 is as follows:

| | Sh.'000' |
|------------------------|-----------------|
| Net fixed assets | 124,800 |
| Stock | 38,400 |
| Debtors | 28,800 |
| Cash | <u>7,200</u> |
| Total assets | <u>199,200</u> |
| Financed by: | |
| Ordinary share capital | 84,000 |
| Retained earnings | 35,200 |
| 12% long-term debt | 20,000 |
| Trade creditors | 36,000 |
| Accrued expenses | <u>24,000</u> |
| | <u>199,200</u> |

For the year ended 31 December 2010, sales amounted to Sh.240, 000,000. The firm projects that the sales will increase by 15% in year 2011 and 20% in year 2012.

The after tax profit on sales has been 11% but the management is pessimistic about future operating costs and intends to use an after-tax profit on sales rate of 8% per annum.

The firm intends to maintain its dividend payout ratio of 80%. Assets are expected to vary directly with sales while trade creditors and accrued expenses form the spontaneous sources of financing. Any external financing will be effected through the use of commercial paper.

Required:

Determine the amount of external financial requirements for the next two years.

(20 marks)

QUESTION THREE

- a) XYZ Ltd is expected to pay a DPS of Sh.6 in one year's time. The dividend payout ratio is 60% and the Return on Equity is 15%. Determine whether the share is overvalued if the MPS is Sh.40.
(6 marks)
- b) Explain the significance of valuation securities?
(5 marks)
- c) ABC Ltd has issued a 5 year zero coupon rate bond with maturity value of Sh.100, 000. The bond is issued at a discount of 32%. Determine the rate of return of the bond.
(4marks)
- (d) Janam Ltd is an all equity firm whose Beta factor is 1.2, the interest rate on T. bills is currently at 8.5% and the market rate of return is 14.5%. Determine the cost of equity K_e , for the company.
(5marks)

QUESTION FOUR

- (a) List and explain five factors that should be taken into account by a businessman in making the choice between financing by short-term and long-term sources.
(10 marks)
- (b) Explain five advantages of convertible bonds from the point of view of the borrower.
(10 marks)

QUESTION FIVE

The following is the existing capital structure of Winam Gulf Company Ltd.

| | Shs. |
|----------------------------------|------------------|
| Ordinary shares at Shs.10 par | 1,000,000 |
| Retained | 800,000 |
| 12% preference shares Shs.10 par | 400,000 |
| 16% loan Shs.100 par | <u>300,000</u> |
| Total capital employed | <u>2,500,000</u> |

The company's ordinary shares have a dividend cover of 3 times and pays a dividend of 10% on its ordinary share capital.

Ordinary shares sell at Shs.18

Preference shares sell at Shs.15

Debentures are selling at par. The tax rate is 30%

Required:

- a) Calculate Growth in Equity. (10 marks)
- b) Compute W.A.C.C. (10 marks)