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UNIVERSITY OF KABIANGA

UNIVERSITY EXAMINATIONS
2016/2017 ACADEMIC YEAR
THIRD YEAR FIRST SEMESTER EXAMINATION

FOR THE DEGREE OF
BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 310

COURSE TITLE: BUSINESS FINANCE

DATE: 20TH JUNE, 2017 TIME: 2.00 P.M - 5.00 P.M.

INSTRUCTIONS TO CANDIDATES

- SEE INSIDE

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UNIVERSITY OF KABIANGA

SCHOOL OF BUSINESS AND ECONOMICS

FIRST SEMESTER EXAMINATIONS-2016/2017 MAIN EXAMS

BBM 310 BUSINESS FINANCE

INSTRUCTIONS TO CANDIDATES: ANSWER ALL QUESTIONS IN SECTION A AND ANY THREE QUESTIONS IN SECTION B

SECTION A

QUESTION ONE

(a)Malikia Investments Ltd wishes to raise funds amounting to Ksh.10 million to finance a project in the following manner: Sh.6 million from debt and Sh.4 million from floating new ordinary shares. The present capital structure of the company is made up as follows:

600,000 fully paid ordinary shares of Sh.10 each.

Retained earnings of Sh.4 million.

200,000, 10% preference shares of Sh.20 each.

40,000, 6% long term debentures of Sh.150 each.

The current market value of the company's ordinary shares is Sh.60 per share. The expected ordinary share dividends in a year's time is Sh.2.40 per share. The average growth rate in both dividends and earnings has been 10% over the past ten years and this growth rate is expected to be maintained in the foreseeable future. The company's long term debentures currently change hands for Sh.100 each. The debentures will mature in 100 years. The preference shares were issued four years ago and still change hands at face value.

Required:

Compute the component cost of:

(i)Ordinary share capital (2mks)

(ii)Debt capital (2mks)

(iii)Preference share capital (2mks)

(iv)Compute the company's current weighted average cost of capital (5mks)

(v)Compute the company's marginal cost of capital if it raised the additional Sh.10 million as envisaged. (Assume a tax rate of 30%) (3mks) (b)Explain the importance of cost of finance (5mks)

(c) Compare and contrast the services offered by the Kenyan capital and money markets and clearly differentiate the two markets. (6mks)

SECTION B

QUESTION TWO

(i) An extract from the finance statements of Kenyango Fisheries Ltd is shown below:

	Shs.
Issued share capital:	
150,000 ordinary shares of Sh.10 each fully paid	1,500,000
10% loan stock 1999	2,000,000
Share premium	1,500,000
Revenue Reserve	7,000,000
Capital employed	12,000,000

- The profits after 30% tax is Sh.600,000. However, interest charge has not been deducted.
- Ordinary dividend payout ratio is 40%.
- The current market value of ordinary shares Shs.36

Required

a) Return on capital employed (2mks)

b) Earnings per share (2mks)

c) Price earnings ratio (2mks)

d) Dividend Yield (2mks)

e) Gearing ratio (2mks)

(ii)Explain the some of the users of financial analysis

QUESTION THREE

(a)Outline two limitations and two advantages of the Accounting rate of return method. (2mks)

(b)The management of Kericho Ltd is considering two machines A and B. The following information is available

(i) A costs Sh.380,000 and will be in use for four years.

(ii) B costs Sh.800,000 and will be in use for six years.

(iii) Both machines do not have salvage value.

(iv)The pre-tax cash flows for each machine are as follows:

YEAR	MACHINES	
	A	B
1	259,000	430,000
2	288,000	329,000
3	305,000	320,000
4	295,000	370,000
5	-	485,000
6	-	442,000

(v)The cost of capital is 12% and tax rate is 30%.

Required:

(a)Calculate the undiscounted payback period of each machine (2mks)

(b)Calculate the net present value for each machine and advise the management the machine they should consider. (4mks)

(c) Calculate the internal rate of return for each machine (5mks)

(d)) Calculate the profitability index for each machine (2mks)

QUESTION FOUR

(a)Chebet Ltd has estimated that the standard deviation of its daily net cash flows is Sh.2,500. The firm pays Sh.50 in transaction costs to transfer funds into and out of this money market. The rate of interest in the money market is 7.465% p.a. Chebet uses the Miller-Orr **Model to set its target cash balances.**

Required

(i) What is Chebet's target cash balance?(4mks)
(ii) What are the lower and upper cash limit?(4mks)
(iii) Determine Chebet's expected average cash balance. (2mks)

(b)Explain why proper working capital management is important for the financial success of a company. (5mks)

QUESTION FIVE

(a)Explain four sources of finance available to small and medium sized enterprises for financing acquisition of non-currents. (5mks)

(b)Explain the advantages of use ofratios in interpretation of financial statements. (5mks)

(c) Elaborate the superiority of NPV over IRR. (5mks)

QUESTION SIX

(i)Lucas wishes to determine the future value at the end of two years 0f a Sh.150, 000 deposit made today into an account paying a nominal interest rate of 12%. Find the future value of Lucas' deposit assuming that interest rate is compounded:

(a)Annually (2mks)

(b)Quarterly. (2mks)

(c)Monthly. (2mks)

(ii)Explain the differences between capital structure and financial structure. (4mks)

(iii)Explain the benefits of capital budgeting. (5mks)