MASENO UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

SECOND YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH INFORMATION TECHNOLOGY

CITY CAMPUS – DAY & EVENNING

ABA 202: INTRODUCTION TO FINANCE

Date: 9th June, 2017 Time: 5.30 - 8.30pm

INSTRUCTIONS:

- Answer Question ONE and any other THREE.

QUESTION ONE

a) Royal City Hotel is considering an investment project which requires an initial cash outlay of Kshs. 450,000. It is expected to generate an annual net cash inflow of Kshs. 150,000 for 7 years. The hotels target debt ratio is 50%. The flotation costs of debt and share issues are estimated at 10% of the amount raised. The firm is considering issuing a 7 year 15% debentures of Kshs. 250,000 with face value of Kshs. 100 at par and new shares worth Shs. 250,000. The issue price per share is Shs. 20. The dividend per share next year is Shs. 1.80. Dividends are expected to grow at a compound rate of 7% for ever. Assuming a corporate tax rate of 50%. What is the NPV of the project? (10mks)

b) Explain the functions of a finance manager in a corporate company (10mks)

c) Discuss the agency problems that may occur in the relationship between shareholders and creditors and generate possible solutions to these agency problems (5mks)

QUESTION TWO

a) Discuss payback technique as a decision making criteria (9mks)

b) XYZ is considering an investment proposal which requires an initial outlay of Kshs. 320,000. The investment has a salvage value of Kshs. 80,000 and promises to generate the following earnings after tax for year 1 to 4

Year	**1**	**2**	**3**	**4**
Cash Flow	98,000	89,000	88,000	86,000

Calculate the accounting rate of return for the investment (6mks)

QUESTION THREE

a) Explain the importance of ratio analysis to the various interested parties (10mks)

b) Explain five sources from where a company may raise funds for investment giving at least one merit and one demerit of each source (5mks)

QUESTION FOUR

Royal Hotel has the following balance sheet as at 31st December, 2002

	Shs. 000
Net Fixed Asset	300
Current Assets	100
	400
Financed by:	
Ordinary Share Capital	100
Retained Earnings	70
10% Debentures	150
Trade Creditors	50
Accrued Expenses	30
	400

Additional Information

i. The sales for year 2002 amounted to 500,000. The sales will increase by 15% during year 2003 and 10% during year 2004.

ii. The after tax return on sales is 12% which shall be maintained in future.

iii. The company's dividend payout ratio is 80%. This will be maintained during forecasting period.

iv. Any additional financing from external sources will be affected through the issue of commercial paper by the company

Required:

a. Determine the amount of the external fiancé for 2 years upto 31st December, 2004 (8mks)

b. Prepare a proforma statement of financial position as at 31st December 2004 (7mks)

QUESTION FIVE

a) Lolia Chemicals Ltd has the following book value capital structure on 31st March 2004

Source of Finance	Amount (Kshs.000)	After Tax Cost (%)
Share Capital	450,000	18
Reserves and Surplus	150,000	18
Preference Share Capital	100,000	11
Debt	300,000	8
	1,000,000	

Required

Compute the weighted average cost of capital of Lolia Chemicals Ltd based on the existing capital structure (7mks)

b) Assuming that a firm pays tax at a 50% rate, compute the after tax cost of capital in the following cases.

i. A 8.5% preference share capital sold at par (1mk)

ii. A perpetual bond sold at par, with coupon rate of interest being 7% (2mks)

iii. An ordinary share of a company which engages no external financing and is selling at Shs. 50 per share. The earnings per share are Shs. 7.50 of which 60% is paid in dividends. The company reinvests retained earnings at a rate of 10% (5mks)

QUESTION SIX

a) Discuss the benefits and limitations of budgets and budgetary control (10mks)

b) Distinguish profit maximization from wealth maximization goals of a firm (5mks)