CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS
THARAKA CAMPUS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 231: BUSINESS FINANCE

STREAMS: BCOM Y2S2 **TIME: 2 HOURS**

DAY/DATE: THURSDAY 06/12/2018 **11.30 A.M – 1.30 P.M**

INSTRUCTIONS

- **Answer question one and any other two questions**
- **Do not write on the question paper**

1. (a) Critically discuss the following financial goals of the firm:

   (i) Profit maximization [5 marks]

   (ii) Wealth maximization [5 marks]

   (b) Discuss the agency theory in financial management and explain how you would resolve the agency conflict between management and shareholders. [7 marks]

   (c) Andress company ltd currently pays a dividend of ksh 2 per share and this dividend is expected to grow at an annual rate of 15% for the first 3 years then at a rate of 10% for the next 3 years after which it is expected to grow at a rate of 5% thereafter.

   Required :

   (i) What value would you replace on the stock if an 18% rate of return was required? [7 marks]

   (ii) Would your valuation change if you expected to hold the stock for only 3 years? Explain. [3 marks]

   (c) Write short notes on any 3 restricted covenants that debt holders may use to protect their wealth from management and shareholder raid. [3 marks]

2. (a) The following information was extracted from the books of Mwalema limited.

	Ksh
Ordinary share capital (ksh 25 par)	800,000
8% preference share capital (ksh 24 par)	600,000
10% prefence share capital (ksh 20 par)	400,000
10% debentures (ksh 20 par)	400,000
	2,200,000

The capital employed is in book value. Assume that the market prices of the above finances are as follows;

(i) The market prices of ordinary shares is ksh 30 a flotation cost of ksh 1 is incurred in issuing each ordinary share.
(ii) The 8% preference shares are currently selling at ksh 20 each.
(iii) 10% preference shares were issued 10 years ago and currently sells at ksh 25 each.
(iv) The 10% debentures were issues 9 years ago and are perpetuies and currently sell for ksh 25 each.
(v) Ordinary shareholders expect a cash dividend of ksh 3.80 per share and a capital appreciation of ksh 1 per share at the end of every year.

Required :

Calculate the firm's overall cost of capital (WACC) assuming corporation tax rate is 40% . [15 marks]

(b) Outline the uses of weighted average cost of capital. [5 marks]

3. (a) The following information relates to the cash flows of two projects x and y .

		Project x	project y
Initial cash outlay		ksh 20,000	30,000
Estimated economics life		5 years	5 years
Cash in flows year	1	5,000	2,000
	2	10,000	10,000
	3	10,000	5,000
	4	3,000	3,000
	5	2,000	2,000

The required rate of return for such projects is 10% . Project x has a salvage value of ksh 500 while project y has salvage value of ksh 600.

Required ;

(a) Calculate the NPVs for both projects and advice the management on which project to undertake. [10 marks]

(b) State the cases where internal rate of return IRR conflicts with that present value NPV method of project appraisal. [4 marks]

(c) Outline any four characteristics of a sound investment evaluation criterion. [6 marks]

4. (a) Distinguish between compounding and discounting of cash flows. [4 marks]

(b) The following information relates to Bamco company.

	Ksh
Credit sales	1,200
Cash sales	600
Total assets	1,500
Fixed assets	900
Stock	400
Current liabilities	500
Reserves	300
Ordinary shares (ksh 40 par)	800
Cost of goods	40% of total sales
Profit after tax	60% of cost of goods sold
Dividends for the year	30% of profit after tax

Required;

Calculate :

(i) Return on assets [2 marks]
(ii) Dividend per share [2 marks]
(iii) Earnings per share [2 marks]
(iv) Return on equity [2 marks]

(c) Explain the following sources of finance:

(i) Venture capital [2 marks]

(ii) Mortgage finance [2 marks[

(d) Discuss the managerial functions of a finance manager. [4 marks]
