

CHUKA



UNIVERSITY

**UNIVERSITY EXAMINATIONS**

**EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE  
AND PROCUREMENT AND LOGISTICS MANAGEMENT**

**BCOM 231: BUSINESS FINANCE**

**STREAMS: BCOM Y2S2**

**TIME: 2 HOURS**

**DAY/DATE: THURSDAY 23/09/2021**

**11.30 A.M – 1.30 P.M.**

**INSTRUCTIONS:**

Answer question ONE and any other TWO questions.

**QUESTION ONE**

- (a) Bimbo limited is considering investing in an equipment that costs Sh. 360,000. The equipment is expected to produce 1,500, 1,300, 1, 200, 900, 800 and 1,000 units from year one to year six respectively. Each unit can be sold at Sh. 150 and incurs a variable cost of Sh. 60 per unit and the fixed cost incurred each year is Sh. 10,000. Cost of capital is 11%, tax rate is 30%, depreciation is on straight line method and the scrap value is Sh. 60,000. Required
- (i) NPV, P1 and IRR (15 marks)
- (ii) State the significance of investment decision (3 marks)
- (b) Discuss the functions of the finance manager in the contemporary organization. (6 marks)
- (c) What will be the amount that will be deposited each year so as to accumulate to Sh. 500,000 in 13 years at an interest rate of 15%. (3 marks)
- (d) Explain the sources of funds (3 marks)
- (i) Mortgage
- (ii) Venture capital

**QUESTION TWO**

(a) The following information has been extracted from the books of Andrea limited

Earnings before interest and tax	12,000,000
10% debenture	20,000,000
Tax rate	40%
Ordinary shares @50	5,000,000
Ordinary dividends	60% of Earnings after tax
10% preference shares	10,000,000
Market price per share	Sh 100

**Required**

(10 marks)

- (i) Dividend per share
- (ii) Earnings per share
- (iii) Earnings yield
- (iv) Dividend cover
- (v) Dividend yield

(b) Discuss the limitations of ratio analysis

(6 marks)

(c) Rael is considering investing in a 8 year 12% Sh. 10,000 bond currently selling at Sh. 15,000 in the market. Calculate the intrinsic value of the bond if the required rate of return is 15% and advice Rael since she intends to sell the bond.

(4 marks)

**QUESTION THREE**

(a) Explain the factors that influence the cost of finance.

(5 marks)

(b) The following is the capital structure of Shirandula Company

	Sh (000)
Ordinary shares (sh 30 par)	9,000
12% preference shares (sh 15 par)	6,000
10% Debentures (Sh 100 par)	4,000
15% Medium Term Loan	5,000
Retained Earnings	<u>4,000</u>
	<u>28,000</u>

**Additional information**

(i) The company expects to pay a dividend of Sh. 15 per share which is expected to grow at 10%. The current market price of the ordinary shares is Sh. 75 including Sh. 15 as floatation cost.

- (ii) The 12% preference shares were issued 5 years ago and currently sell for Sh. 30
- (iii) The 10% debentures currently sell for Sh. 150 and will mature in 20 years
- (iv) The medium term loan currently sell at Sh. 4,000,000
- (v) The tax rate is 30%

**Required:** Calculate the weighted average cost of capital (WACC) (10 marks)

- (c) Agency problem exists when agents pursues their own interests rather than the interest of their principles. Discuss the causes of conflicts that occurs when managers pursues their own interest rather than the interest of shareholders. (5 marks)

#### QUESTION FOUR

- (a) A company currently pays a dividend of 15 per share. The dividend is expected to grow at 10% for 4 years, 15% for 3 years and 20% for 2 years after which it will fall to a constant rate of 11%. Calculate the intrinsic value of the share if the risk premium is 6% and risk free rate is 9%. (11 marks)
  - (b) A company is considering investing in a project that promises profit before depreciation and tax of Sh. 40,000 each year for 4 years. The cost of the project is Sh, 120,000 with Sh. 20,000 as the scrap value. Tax rate is 30%, depreciation is on straight line method. Required:
    - (i) Accounting rate of return (3 marks)
    - (ii) Payback period (3 marks)
    - (iii) State the disadvantages of accounting rate of return. (3 marks)
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