MUEO

MOI UNIVERSITY

OFFICE OF THE CHIEF ACADEMIC OFFICER

UNIVERSITY EXAMINATIONS

2012/2013 ACADEMIC YEAR

THIRD YEAR END OF SEMESTER I EXAMINATIONS

FOR THE DEGREE OF
BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 310

EXAM TITLE: BUSINESS FINANCE

DATE: 13TH JULY, 2012 TIME: 9.00 A.M. –12.00 NOON.

INSTRUCTION TO CANDIDATES

- **SEE INSIDE.**

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BBM 310: BUSINESS FINANCE

INSTRUCTIONS: ANSWER QUESTION ONE AND ANY OTHER THREE

QUESTION 1:

a) Describe in details the different types of Financial Markets and the securities offered in each market. (10 Marks)

b) Longstreet Communications has the following capital structure:

Debt	35%
Preferred Stock	15%
Common Stock	50%
	100%

The company is considering raising new capital to finance a new project. New common stock will have a floatation cost of Ksh. 5, and the stock's current stock price is Ksh. 85 per share. Longstreet paid a dividend of Ksh. 4.60 per share last year and dividends are expected to grow at a constant rate of 7% in the future. New 11% preferred stock would be sold to the public at a price of Ksh. 150 per share and floatation costs of Ksh. 5 would be incurred.

ebt will have an interest rate of 14%. The marginal tax rate is 40%. Treasury bonds yield is 12%. An average sto has an expected return of 16% and Longstreet's beta is 1.45.

Required:

i. Calculate the cost of capital for Debt, Preferred Stock, retained earnings and common stock. (10 Marks)

ii. What is the Weighted Average Cost of Capital (WACC) (5 Marks)

QUESTION 2

a) Define Business Finance and the function of finance in an organization. (6 Marks)

b) Dunia Manufacturing has issued a bond security with a face value of Ksh. 100,000, with a coupon rate of 12% and 15 years to maturity. What is the price of the bond if the Yield to Maturity (required return) is;
i) 14%,
ii) 10%,
iii) 12%. (6 Marks)

What is the relationship between the coupon rate and the required return? (3 Marks)

QUESTION 3

a) Define capital budgeting and discuss typical capital budgeting decisions that managers make in allocating firm resources. (9 Marks)

b) "The value of an asset is the price that a willing and able buyer pays to a willing and able seller." In this context, list and discuss three kinds of value. (6 Marks)

QUESTION 4

a) United Company just paid a dividend of Ksh. 3.40 per share on its stock. The dividends are expected to grow at a constant rate of 6% per year indefinitely. If investors require a 14% return on the stock.

i) What is the current price of the stock? (3 Marks)

ii) What will be the price in 3 years? (3 Marks)

iii) What will be the price in 15 years? (3 Marks)

b) An investor is considering an investment of Ksh. 500,000 in a security with an interest rate of 9% which matures in 5 years. The options of interest payments are: annually, semiannually; quarterly? Calculate the terminal value of each of the three options and advise the investor on which option to undertake. (6 Marks)

QUESTION 5:

a) Discuss the role of the Nairobi Securities Exchange and the Capital Markets Authority in the Kenyan economy. (8 Marks)

b) Why is finding a solution to the Agency Conflict key to the successful running of an organization? (7 Marks)

QUESTION 6:

A Company is considering the two machines which are expected to save labour on an existing project. The estimated data for the two machines available in the market are as follows:

	Machine A	Machine B
Initial Cost	2,400,000	2,600,000
Residual Value	200,000	300,000
Shipping & Installation	25,000	15,000
Increase in Working Capital	50,000	-
Annual Labour Cost Savings		
Year 1	550,000	580,000
Year 2	525,000	565,000
Year 3	600,000	615,000
Year 4	650,000	700,000
Year 5	700,000	500,000

Depreciation is straight line and tax rate is 40%. Cost of Capital is 12%.

Required:

a) Calculate Payback Period, Net Present Value (NPV) and Internal Rate of Return (IRR). (10 Marks)

b) Which machine is acceptable if the two are mutually exclusive? (5 Marks)