



MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

SECOND YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 204: BUSINESS FINANCE II

DATE: 15/8/2019

TIME: 2.00-4.00 PM

INSTRUCTIONS:

ANSWER QUESTIONS ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE

- (a) What is capital budgeting and what are its significance to the firm? (3 marks)
- (b) A project is in the consideration of a firm. The initial outlay of the project is ksh. 10000/= and is expected to generate cash inflows of ksh.4000/=, ksh.3000/=, ksh.5000/= and ksh.2000/= in the four years to follow. Assuming a 10% rate of discount, calculate the net present value (NPV) and the profitability index (PI) and comment on your results. (8 marks)
- (c) BXM LTD, unprepared to invest more than ksh. 500 million in the current year, but has the following projects available to it:

Project.	Initial investment in ksh.Millions	NPV in Ksh. Millions
A	100	15
B	150	29
C	140	31
D	210	22
E	180	36

- Which of these projects should the company invest in? (8 marks)
- (d) X Company Ltd has 100,000 shares outstanding; the current market price of the share is Ksh.15 each. The company expects the net profit of Ksh.200, 000/= during the year and it belongs to a rich class for which the appropriate capitalization rate has been estimated to be 20%. The company is considering a dividend of Ksh. 2.50/= per share.

Required: What will be the price of the share at the end of the year if:

- (i) Dividend is paid
 - (ii) Dividend is not paid (8 marks)
- (e) “The sum of the current assets is the working capital of the business” In the light of this statement, state and explain the three primary components of working capital. (3 marks)

QUESTION TWO

Zee Company Ltd is evaluating the following seven investment proposals. The company has capital expenditure ceiling of Ksh. 2000, 000/= and therefore can accept just enough proposals. Cost of capital is 12%:

Project	Cash outlay Ksh. “000”	NPV Ksh.
O	100	18
P	500	80
Q	200	40
S	600	36
T	1000	250
U	800	180
V	400	40

You are required:

- (a) To rank the proposals according to profitability index (PI) and indicate the group of proposals to be accepted (10 marks)
- (b) If projects T and U were mutually exclusive would this change your answer to (a) above? If yes indicate which projects would be accepted. If no, why? (10 marks)

QUESTION THREE

- (a) What are the benefits of MIRR over IRR? (3 marks)
- (b) Engineering Company is currently contemplating four projects: A, B, C, and D, which requires an initial investment of Ksh. 36,000,000/=. The projected cash flows for each project are as shown in the table below:

Year	Cash inflows Ksh. “000)			
	A	B	C	D
1	18000	2000	24000	16000
2	6000	16000	6000	20000
3	12000	0	12000	2000
4	4000	0	0	2000

Required:

- i. Calculate the payback period for each project (12 marks)
- ii. If the minimum standard payback period is two years which projects, you recommend? (8 marks)

QUESTION FOUR

- (a) For each of the following companies described below, state whether and why you would expect to have high or dividends out ratio:
 - (i) A company with a large proportion of inside ownership, all of whom are high income individuals (2 marks)
 - (ii) A growth company with an abundance of good investment opportunities (2 marks)
 - (iii) A company experiencing ordinary growth that has high liquidity and unused borrowing capacity (2 marks)
 - (iv) A dividend paying company that experience an unexpected drop in earnings from trend (2 marks)
 - (v) A company with volatile earnings and high business risk (2 marks)
- (b) State and explain the major determinants of capital structure of a company (10 marks)

QUESTION FIVE:

- (a) Explain the following dividend theories:
 - i. Dividend Irrelevance Theory
 - ii. Bird in Hand Theory
 - iii. Tax Preference Theory
 - iv. Clientele Effect
 - v. Information Content Hypothesis (10 marks)
- (b) A firm has in its books the following amounts and specific costs of each type of capital:

Type of capital	Book value in Ksh.	Market value in Ksh.	Specific cost %
Debt	400,000	380,000	5
Preference	100,000	110,000	8
Equity	600,000	900,000	15
Retained earnings	200,000	300,000	13
Total	1300,000	1690,000	

Required: Determine the weighted average cost of capital (WACC) using:

- i. Book value weights
- ii. Market value weights (10 marks)