MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS

2023/2024 ACADEMIC YEAR

*THIRD*YEAR *FIRST*SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS

BACHELOR OF COMMERCE & BSc. PROJECT PLANNING & Mgt.

COURSE CODE: BCM 3113-1

COURSE TITLE: BUSINESS FINANCE

DATE: December 2023 **TIME: 2HRS**

INSTRUCTIONS TO CANDIDATES

Answer Question **ONE** and any other **THREE** Questions

*This paper consists of **5**printed pages. Please turn over.*

Question One

a) Western Corporation was formed 5 years ago through a public subscription of ordinary shares. Douglas Wekesa who owns 15% of ordinary shares is the current chairman of Western Corporation. The company has been successful, but is currently experiencing a shortage of funds. On 10 June 2017, Wekesa approached Salama Bank requesting for a 24 – month extension on two sh. 35 million notes, which were due on 30June 2017 and 30 September 2017. Another note of sh. 6 million was due on 31 March 2018, but he expects no difficulty in paying this note on its due date. Wekesa explained that Western Corporation's cash flow problems were due primarily to the company's desire to finance a sh. 300 million plant extension over the next two financial years through internally generated funds. The commercial loan offer of Salama Bank obtained the following financial reports of the company for the last two financial years:

Western Corporation
Statement of Financial Position as at 31 March

Assets	**2017**	**2016**
	Sh. "000"	**Sh. "000"**
Cash	18,200	12,500
Notes received	148, 000	132, 000
Accounts receivable (net)	131,800	125,500
Inventories (at cost)	105,500	50,000
Plant and equipment	1,449,000	1,420,500
Total assets	**1,852,000**	**1,740,500**
Liabilities and stockholders' equity:		
Accounts payable	79,000	91,000
Notes payable	76,000	61,500
Accrued liabilities	9,000	6,000
Ordinary shares (130 million shares, sh. 10 par)	1,300,000	1,300,000
Retained earnings	388,000	388,000
	1,852,000	**1,740,500**

Western Corporation
Income statement
For the financial year ended 31 March

	2017	**2016**

	Sh. "000"	Sh. "000"
Sales revenue	3,000,000	2,700,000
Cost of goods sold	(1,530,000)	(1,425,000)
Gross profit margin	1,470,000	1,275,000
Operating expenses	(860,000)	(780,000)
Income before tax	610,000	495,000
Income taxes	(244,000)	(198,000)
Net income	**366,000**	**297,000**

Additional information:

1. Cash dividends were paid at the rate of sh. 1 per share in the financial year 2016 and sh. 2 per share in the financial year 2017.
2. Depreciation charges in the plant and equipment of sh. 100 million and sh. 102.5 million for the financial years ended 31 March 2016 and 31 March 2017 respectively are included in the cost of goods sold.

Compute:

i. Current ratio for financial year 2016 and 2017. **(3 Marks)**

ii. Acid-test (quick) ratio for the financial year 2016 and 2017. **(3 Marks)**

iii. Inventory turnover for the financial year 2017. **(3 Marks)**

iv. Return on Assets (ROA) for the financial year 2016 and 2017 (assume total assets were sh. 1,688,500,000 as at 31 March 2015). **(3 Marks)**

v. Percentage change in sales, cost of goods sold, gross profit margin and net income after taxes from financial year 2016 to 2017. **(3 Marks)**

b) Discuss five factors that a finance manager considers when choosing a source of finance to finance a business. **(5 Marks)**

Question Two

a) Mr. Mauzo is considering a project whose capital outlay is sh. 1,000,000. Assume that the cash flows to be generate from the project are as follows:

Period	Cash flows (Ksh.)
1	100,000
2	200,000
3	150,000
4	175,000

5	230,000
6	210,000
7	210,000

Using a 12% cost of capital, advice Mr. Mauzo on whether to invest in the project using the following project appraisal techniques:

i. Net Present Value (NPV). **(4 Marks)**
ii. Payback Period. **(3 Marks)**

b) Assume you are a finance manager advising the Chief Executive Officer of Mali Mingi Ltd. Company on the merits of using Net Present Value (NPV) to appraise projects. Discuss the content of your talk. **(3 Marks)**

Question Three

a) Lengo Ltd. Company has raised preference shares capital for perpetuity of sh. 1,000,000 by issuing 12% preference shares of sh. 10 each. The company is in the 35% tax bracket. Calculate the cost of preference capital when they are issued at:

i. Par **(2 Marks)**
ii. 10% discount **(2 Marks)**
iii. 10 % premium **(2 Marks)**

b) Wazito Ltd. Intends to install a new production machine after 7 years. The company plans to deposit sh. 2 million at the end of each year into a saving plan that pays a fixed rate of interest of 13% p.a. Calculate the maturity value after 7 years. **(4 Marks)**

Question Four

a) Ole Menye is evaluating Narok water company, a publicly traded water utility. Analysis was conducted in early 2021. The net income growth during the past 5 years has been 6% in line with the long-term growth rate of nominal Kenya GDP. During the past five years, Narok water company return on equity average 9% with relatively little variation, slightly below the 10% level target by some faster growing peer companies. Narok water company appears to have a policy of small annual increases in the dividend rate, maintaining a dividend payout ratio of at least 80%. Narok water company per share dividends for 2020 were sh. 0.68. Ole Menye forecasts a long-term earnings growth rate of 6% per year, somewhat below the 8% consensus three-to-five-year earnings growth rate forecast reported by Zack's investment research. Narok water company raw beta and adjusted beta are, respectively 0.717 and 0.811 based on 60 monthly returns. The R^2 associated with beta, however is under 10%. Ole Menye estimates that Narok water company pre-tax cost of debt is 6.9%, he also estimates required return on equity as 9.25%. Narok water company current market price is sh. 18.39.

Required:

i) Calculate the Gordon growth model estimate of value for Narok water company using Ole Menye's required return on equity estimate. **(2 Marks)**

ii) State whether Narok water company appears to be overvalued, fairly valued or undervalued. **(2 Marks)**

iii) Justify the selection of the Gordon growth model for valuing MSEX. **(3 Marks)**

iv) Calculate Capital Asset Pricing Model (CAPM) estimate of the required return on equity for Narok water company under the assumption that beta regresses to the mean. (Assume an equity risk premium of 4.5% and a risk-free rate of 5% as of the price quotation date). **(3 Marks)**

Question Five

a) Discuss **five** functions of a finance manager in a company. **(5 Marks)**

b) Analyze **five** external sources of finance to a company. **(5 Marks)**

//end///