TECHNICAL UNIVERSITY OF MOMBASA
SCHOOL OF BUSINESS
DEPARTMENT OF ACCOUNTING AND FINANCE
UNIVERSITY EXAMINATION FOR:
BACHELOR OF COMMMERCE FOURTH YEAR

BFI 4410: ISSUES IN FINANCIAL MANAGEMENT
MAIN EXAM FOR END OF SEMESTER

SERIES: AUGUST 2024 **TIME:** 2 HOURS

INSTRUCTION: ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS.

QUESTION ONE (COMPULSORY)

In Utopia, a very restrictive investment market exists. Investors are able to invest in four types of security (in any combination): A, B, C and X. Securities A, B and C are all risky investments; their current market-derived expected (period) returns E(r)and the standard deviation of these returns (∂) are given below:

Security	E(r)	∂(standard deviation)
A	0.10	0.02
B	0.15	0.04
C	0.20	0.07

All are perfectly positively correlated with each other. Security X is a risk free investment which yields a period return of 8%. Investors can also borrow unlimited amounts of cash at an interest rate of 8% per period. There is no taxation in Utopia.

REQUIRED:

i. Draw to scale of the area of possible risky portfolios. Draw the capital market line and identify the market portfolio. (3marks)

ii. Calculate the market price of risk and explain what it represents. (3marks)

iii. State briefly what conclusions you draw from your answer to (a) about the current state of the market for risky asset in Utopia (3 marks)

iv. An investor in Utopia wishes to hold an efficient portfolio yielding a 10% expected period return. How would this portfolio be composed and what would its risk be? (3 marks)

v. Show how an investor in Utopia might construct an efficient portfolio yielding a 20% expected period return. (3 marks)

vi. State the main assumptions underlying portfolio theory and indicate briefly why its conclusions may be of importance for investment decision making within individual companies. (3 marks)

b)

i. Why is project financing used for financing infrastructure projects? (2 marks)

ii. Explain BOOT, BOO and BLT financing arrangements in project financing. (2 marks)

iii. How is risk allocated in project financing? (2 marks)

c)

Lisboa Ltd issued some convertible bonds with a coupon rate of 6%. Each bond has a sh. 100 nominal value and is redeemable at par in three years 'time or convertible into 40 shares.

The company's current share price is sh.2.10 and similar risk-debt securities are expected to produce a 14% redemption yield.

REQUIRED:

Calculate:

i. The value of the bond as straight debt; (3marks)

ii. The minimum value of the convertible bond (3marks)

(Total =30marks)

Question Two

The government of TRINKA is considering how to protect its domestic cement industry. There is one cement manufacturer in the country-Cemenco Ltd-which is coming in for severe competion from imported cement. Currently the government is considering banning import of cement and –because that would leave Cemenco Ltd with a monopoly-imposing government controls` on the price of cement.

In this respect the government wish to be able to compare the systematic riskiness of Cemenco with that of its overseas competitors, with this knowledge, the government hopes to be able to determine a fair return for the company's shareholders and hence, the price that should be set for cement.

As a result, you have been called in by the government to try to estimate the company's beta value. Trinka has an active stock exchange and Cemenco is one of the quoted companies. The government has provided you with the following information:

Cemenco ltd **Trinka stock exchange**

	Average	**Dividend**	**Average**	**Average**	**Return on**

	Share price	Yield	TSR index	Dividend yield	government stock
	Sh.	%			
Current year	16.42	10%	1983	16%	15%
1 year ago	15.50	12%	1665	16%	16%
2 year ago	12.10	8%	1789	10%	14%
3 years ago	9.50	10%	1490	18%	15%

Required:

a) Estimate the beta value of Cemenco Ltd (16marks)

b) Comment on what effect you think that the government's action might have on the riskiness of Cemenco Ltd. (4 marks)

Question THREE

The first step for a company (or an entrepreneur) proposing a new venture in obtaining venture capital is to prepare a business plan for the consideration of venture capitalist.

Required:

a) Define a" business plan." (5marks)

b) What are the elements of business plan? (10 marks)

c) What does a venture capitalist look for in a venture? (5 marks)

(Total =20marks)

QUESTION FOUR

As the finance manager of Holiday Ltd, you are investigating the possible acquisition of Leisure Ltd. You have the following basic data:

	Holiday	Leisure
Earnings per share (expected next year)	sh. 5	sh. 1.50
Dividends per share (expected next year)	sh.3	sh.0.80
Number of shares	1 million	0.6 million
Share price	sh.90	sh.20

You estimate that Investors currently expect a steady growth of about 6% in Leisure's earnings and dividends. Under new management, this growth rate would be increased to 8% per year, without any additional capital investment required.

Required:

a) What is the gain from acquisition? (5marks)

b) What is the cost of acquisition if Holiday Ltd pay sh.25in cash for each leisure share? Should it go ahead? (5mark)

c) What is the cost of the acquisition if Holiday ltd offer one of its own share for every 3 shares of Leisure ltd? Should it go ahead? (5marks)

d) How would the cost of cash offer and the share offer alter if the expected growth rate of Leisure ltd were not changed by the takeover? Does it affect the decision? (5marks)

(Total 20marks)

QUESTION FIVE

a) Identify and explain the most important assumptions of the Capital Asset Pricing Model. (14marks)

b) Distinguish CAPM from Arbitrage Pricing Theory (APT) (6 marks)

(Total 20 marks)