**BUST FINANCIAL MANAGEMENT**

**ATTEMPT ALL QUESTIONS IN SECTION A, AND ONE QUESTION IN SECTION B**

**SECTION A**

1.

a. Suppose you want to buy a share of Swiss Farms, S.A., a dairy products company.

The recent dividend payouts by the firm are as follows.

|  |  |
| --- | --- |
| YEAR | DIVIDEND PER SHARE (KSH) |
| 2005 | 1.20 |
| 2006 | 1.25 |
| 2007 | 1.45 |
| 2008 | 1.60 |
| 2009 | 1.85 |
| 2010 (CURRENT YEAR) | 2.00 |

Your opportunity cost is 12%. What is this stock worth to you? (8 MKS)

b.A 9%, 10-year bond with a face value of Ksh.1000 sells at Ksh.920. What is its yield to maturity? (For simplicity, assume interest is payable only once per year at Ksh. 90 per bond per year). (7.5 mks)

c. Discuss the internal rate of return as a method of evaluating investments, highlighting its advantages and disadvantages. (8 mks)

1. Assume that Stock A had an average return over a 5 year period of 11.3, with a standard deviation of 20.79. Stock B had an average return of 11.3, with a standard deviation of 20.78. The correlation between the returns of the 2 stocks is 0.88.   
     
   If you formed a portfolio consisting of 50% Stock A and 50% Stock B, calculate
2. The average return and (4 mks)
3. The standard deviation for the portfolio (8 mks).
4. The covariance between stock A and stock B. (4 mks)
5. If you are a risk averse investor, would you prefer to invest all in Stock A, all in Stock B, or in the portfolio? Why? (4 mks)
6. Briefly discuss the shortcoming of CAPM that led to the development of the arbitrage pricing model as a multifactor model of capital asset pricing. (3.5 mks)
7. A company is weighing whether to invest in a tea leaves picking machine to replace the current manual labor it employs. The machine would cost Ksh. 4,500,000.00. The machine is estimated to have a useful life of 8 years with no salvage value. During its life, it is expected that the company will save Ksh. 800,000.00 per year in labor expenses. The cost of capital for the company is 12%. REQUIRED
   1. The cash flow per year expected from the machine. (6 mks)
   2. The net Present value of the benefits to be generated by the machine. (6 mks)
   3. The payback period of the machine (in years) (4 mks)
   4. Discuss the advantages and disadvantages of
      1. The net present value method of evaluating investments. (4 mks)
      2. The payback period method of evaluating investments. (3.5 mks)

**SECTION B**

4.

a. Write short notes on the following bond terminology.

* 1. Coupon rate (2 mks)
  2. Notes (2 mks)
  3. Par value (2 mks)
  4. Maturity (2 mks)
  5. Indenture (2 mks)
  6. Debt ratings (2 mks)

1. Briefly discuss 5 objectives of financial management, citing relevant examples. (11.5 mks)

5.

* 1. ‘Profit maximization objective has been criticized on many grounds’. Discuss the criticism of the profit maximization as an objective of financial management (8.5 mks)
  2. Discuss wealth maximization as an alternative objective of a finance manager, highlighting its strengths and weaknesses. (15 mks)