



kasneb

ATD LEVEL II

FUNDAMENTALS OF FINANCE

TUESDAY: 21 May 2019.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Explain the following terms as used in finance:

- (i) Financial intermediaries. (2 marks)
- (ii) Risk-return trade off. (2 marks)
- (iii) Stakeholder management. (2 marks)

(b) Describe three motives of holding inventory. (6 marks)

(c) Zeltex Ltd.'s shares cost Sh.120 each and pay no dividends. The possible prices that the company's shares might sell for at the end of the year with the respective probabilities are provided below:

Price Sh.	Probability
115	0.10
120	0.10
125	0.20
130	0.30
135	0.20
140	0.10

Required:

- (i) The expected return of the company's shares. (4 marks)
- (ii) The standard deviation of return. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Firms strive to achieve objectives which at times overlap with each other and in some cases conflict with each other.

With reference to the above statement, discuss four overlaps that could arise in the course of a firm's effort to achieve its objectives. (8 marks)

(b) Umbo Ltd. is evaluating two mutually exclusive projects, A and B. Both projects are expected to cost Sh.8 million. However, an additional Sh.1 million investment in working capital will be required if the firm were to invest in project A and Sh.1.5 million for Project B.

Project A has an estimated useful life of five years while Project B has an estimated useful life of 4 years. Estimated net operating cash flows (NOCF) from each investment in each year are given as follows:

Year	PROJECT	
	A Sh."000"	B Sh."000"
1	2,500	3,500
2	3,000	3,500
3	3,500	3,500
4	2,800	3,500
5	2,000	-

Additional information:

1. The resale values for Project A and Project B at the end of their useful life are estimated at Sh.200,000 and Sh.300,000 respectively.
2. Cost of capital is projected at 14%.

Required:

- (i) Net present value (NPV) for Project A and Project B. (10 marks)
 - (ii) Advise the company on which project to undertake. (2 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Describe four forms of dividend payments that a company could utilise to pay its shareholders. (8 marks)
- (b) Mazeras Ltd. is considering an investment of Sh.20,000 that will generate a perpetual after tax annual cash flow of Sh.2,000. The required rate of return is 8%.

Required:

- (i) The investment's profitability Index (PI). (3 marks)
 - (ii) Advise the company whether to undertake the investment, based on the profitability index obtained in (b) (i) above. (2 marks)
- (c) Explain two advantages of using private placement when issuing long-term debt. (4 marks)
 - (d) John Malech deposits the following amounts at the end of each year in a savings account paying an annual interest rate of 4% compounded semi annually:

Year	End of year deposits (Sh.)
1	4,000
2	8,000
3	7,000
4	10,000

Required:

- The value of the account at the end of year 4. (3 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) In relation to financial markets, outline four benefits that could accrue to investors from using the Central Depository System in securities trading. (4 marks)
- (b) Kingstone Omondi plans to make a constant deposit into his savings account at the start of each year over a period of four years.

He expects the sum deposited to earn interest at the rate of 8% each year compounded annually. Omondi expects to raise Sh.1,500,000 after four years in order to finance a capital investment.

Required:

- The annual deposit into his savings account. (4 marks)
- (c) Ushindi Ltd.'s capital structure which is considered optimal, is as follows:

	Sh."000"
Ordinary share capital (Sh.10 Par value)	40,000
Reserves	20,000
12% Debenture (Sh.100 Par value)	<u>40,000</u>
	<u>100,000</u>

The firm's management are considering raising an additional Sh.20 million to finance an expansion programme. The company expects to generate Sh.2 million from internal sources.

Additional information:

1. The firm will issue new ordinary shares at Sh.25 each to raise desired external equity. A flotation cost of Sh.2 per share will be incurred.
2. The company will issue new 14% redeemable debentures to raise desired debt capital. The issue price will be at Sh.90 subject to a flotation cost of Sh.10 per unit issued. The debentures will mature after 10 years. Par value of each unit is Sh.100.
3. Corporation tax rate applicable is 30%.
4. The most recent ordinary dividend paid is Sh.3.0 per share, while future dividends shall grow at the rate of 5% each year in perpetuity.

Required:

- (i) The cost of retained profit. (2 marks)
 - (ii) The cost of new ordinary share capital. (2 marks)
 - (iii) The cost of new 14% redeemable debt. (3 marks)
 - (iv) The firm's weighted marginal cost of capital (WMCC). (5 marks)
- (Total: 20 marks)**

QUESTION FIVE

(a) Explain the following principles of Islamic Banking and Finance:

- (i) Paying or charging an interest (Riba). (2 marks)
- (ii) Investing in businesses involved in prohibited activities (Haram). (2 marks)
- (iii) Speculation (Maisir). (2 marks)
- (iv) Uncertainty and risk (Gharar). (2 marks)

(b) Summarise four roles of the Capital Markets Authority (CMA) or similar authority in your country. (4 marks)

(c) Baraka Ltd. has provided the following forecasted financial information for the year ending 30 June 2019:

	Sh. "000"
Sales – (all credit)	7,200
Average trade receivables	612
Finished goods	400
Work-in-progress (WIP)	700
Raw materials (balance held)	300
Trade payables	260

The gross profit margin is 25% on sales. Raw materials are 80% of the cost of sales. All purchases are also made on credit.

Assume that the calendar year has 365 days and that inventory levels are constant throughout the year.

Required:

Calculate the following:

- (i) Raw material holding period. (2 marks)
 - (ii) Trade payable days. (1 mark)
 - (iii) Work-in-progress (WIP) period. (1 mark)
 - (iv) Finished goods holding period. (1 mark)
 - (v) Trade receivables collection period. (1 mark)
 - (vi) Cash operating cycle (2 marks)
- (Total: 20 marks)**

