



REFORMED CHURCH UNIVERSITY

FACULTY OF COMMERCE

**Bachelor of Commerce Honours Degree in Human Resources, Industrial
and Labour Relations Management**

Financial Management

HHRM 112/HPAD 216 206

Part 1 Semester 2 Examination

Total Marks [100]

Date: June 2020

Time: 3 Hours

INSTRUCTIONS

1. This paper has *six (6)* questions
2. Answer question *one (1)* and *any* other **three (3)**
3. Each question carries **25 marks**
4. Start each question on a new page

1. Explain the following:
 - (a) The **five** ways in which financial markets can be classified. (10)
 - (b) The **three** forms of market efficiency according to the Efficient Market Hypothesis. (15)

2. (a) Hay Ltd has 1000 bonds with a nominal value of \$1000.00 and a coupon rate of 9%. The bonds have 8 years remaining to maturity and they are currently trading at \$980.00 in the market. The company also has 100 000 ordinary shares in issue with a par value of \$10.00 per share and it has just paid a dividend of \$5.00 per share on these ordinary shares which is expected to increase at an annual rate of 4% forever. On issue the company was charged 2% by the investment bank for its role. It also has 50 000, 10% preferences as part of its capital. The company wants to make an investment and hence wants to know the minimum return they should expect from any investment considering that the corporate tax rate is 35%. Advise the company. (20)
- (b) Explain the Relevance theory of Capital structure. (5)

3. (a) Giving practical examples, distinguish between degree of operating leverage and financial leverage. (6)
- (b) Explain combined leverage. (3)
- (c) Consider the following information for XYZ

Sales	\$2430
Less variable cost	\$ 610
Less fixed cost	\$ 700
EBIT	\$1120
Less interest	\$ 800
Profit Before Tax	\$ 320
- (d) Calculate the percentage change in Earnings per Share (EPS) if sales increase by 6% in the company. (10)

(e) Explain **any three** components of market interest rates. (6)

4. (a) Examine **any five** factors that affect dividend decision in an organisation. (20)

(b) Explain the Bird in Hand Theory of dividends. (5)

5. The following are data relates of two securities on the market:

STATE OF THE ECONOMY	PROBABILITY	RETURN OF ASSET A	RETURN OF ASSET B
Recession	30%	45%	-5%
Normal	20%	30%	15%
Boom	15%	15%	40%
Superboom	35%	5%	55%

a) Calculate the expected return and standard deviation of each asset.

(14)

b) Assume it's a two asset portfolio with a weight of 50% of Asset A, what is the expected return of this portfolio and the portfolio standard deviation if the covariance between the two assets is 0.078. (6)

c) Assume you have the option to select one asset which one would you select using the mean variance rule. (5)

6. (a) A debenture has a face value of \$1 000 and a coupon rate of 18% which is paid semi-annually. It has 10 years to maturity and is priced to yield 20%. What is the fair value of this debenture? (5)

(b) Suppose you invest \$30 000 into an account that pays 14% per annum compounded quarterly and after 3 years 9 months you withdrew \$33 000 and invest this amount in another account which is paying 13,5% per annum compounded monthly. What will be the total of both investments at the end of the 6th year? (10)

- (c) ABC Ltd has shares with a Beta of 0.74, the return on the market is 15% and the return on its shares is 8%. The return on the Treasury bill in the economy is 7%. What is the cost of equity of ABC Ltd. (4)
- (d) Explain any **three** defences to unwanted takeovers. (6)

End of paper