JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

MAIN CAMPUS

UNIVERSITY EXAMINATIONS 2013/2014

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

ABA406: MANAGEMENT OF FINANCIAL SERVICES

Instructions: This question paper caries FIVE questions. Answer THREE questions. Question ONE is compulsory.

QUESTION ONE.

a) Distinguish between operating and financial leases.Under financial loses methods what are the advantage of tax- oriented, leveraged and sale and back lease? **(10mks)**

b) XYZ Company intends to purchase a new computer server which costs Ksh 240,000/=.Its estimated life span is three years. The company has the option to borrow the money at 10% or to lease the machine. Under the lease option the payments will be Kshs. 90,000/= per year, payable at the end of each of next three years. The company uses straight line method as its depreciation policy. The corporation tax rate is at 34%.
Required: - should the company buy or lease the asset? Why? Show your computation **(10mks)**

c) For accounting purposes, what constitutes a financial and is it reported? **(10mks)**

QUESTION TWO

a) Define venture capital and its characteristics **(5mks)**

b) What are the steps involved in venture capital investment processes? **(5mks)**

c) Explain the strategic role of venture capital in developing entrepreneurship in a country**(10mks)**

QUESTION THREE

a) State the basic procedures in selling a new issue. **(5mks)**

b) What is the difference between a rights offer and a cash offer? **(5mks)**

c) What are the possible reasons that the price of stock drops on the announcement of a new equity issue? **(5mks)**

d) Oswago Company Ltd has proposed a rights offering. The stock currently sells at Kshs. 40/= per share. Under the terms of the offer, stock holders will be allowed to buy one new share for every five that they own at a price of Khs. 25/= per share. What is the value of the right? What is the ex-rights price? **(5mks)**

QUESTION FOUR

a) How does one distinguish between an off-balance sheet asset and off-balance sheet liability?

b) A security analyst calculates the following ratios for two banks. How should the analyst evaluate the financial health of the two banks? **(5mks)**

	BankA	**Bank B**
Return on equity	22%	24%
Return on assets	2%	1.5%

Equity Multiplier	11x	16x
Profit Margin	15%	14%
Asset utilization	13%	11%
Spread	3%	3%
Interest expense ratio	35%	40%
Provision for loan loss ratio	1%	4%

c) Characterize the risk exposure (s) of the following financial (F1) transactions by chosing one or more of the following:-

i. Credit risk
ii. Interest rate risk
iii. Off balance sheet risk
iv. Foreign exchange risk
v. Sovereign risk
vi. Technology risk

1) A bank finances a Kshs. 100 million, six-years, fixed rate commercial loan by selling one year certificates of deposit.
2) An insurance company invests in policy premiums in a long-term municipal bond portfolio.
3) A French bank sells two year fixed rate notes to finance a two year fixed rate loan to a British entrepreneur.
4) A Japanese bank acquires an Australian bank to facilitate closing operations.
5) A mutual fund completely hedges its interest rate risk exposure using forward contingent contracts.
6) A bond dealer uses his own equity to buy Mexican debt on a developing country bond market.
7) A securities firm sells a package of mortgage loans as mortgage backed securities. **(10mks)**

QUESTION FIVE

a) What is a merger? How does a merger differ from other acquisition firms? **(5mks)**
b) State the relevant incremental cash flows for a merger. **(5mks)**
c) Consider the following information for two all equity firms a and B

	Firm A	firm B
Total earnings	1000/=	400/=
Share Outstanding	100	80
Price per share	80/=	25/=

Firm A is acquiring Firm B by exchanging 25 of its shares for all the shares in B. what is the cost if the merged firm is worth Kshs. 11,000/=? What is the impact on Firm A's EPS and P/E ratio?

(10mks)