INTERNATIONAL UNIVERSITY OF EAST AFRICA
'Learning to Succeed'

FACULTY OF BUSINESS MANAGEMENT

END OF SEMESTER EXAMINATIONS - APRIL 2025

PROGRAMME: BBA
YEAR/SEM: YEAR 3/SEMESTER 1
COURSE CODE: FIN 3203
NAME: INVESTMENT APPRAISAL AND PORTFOLIO

DATE:
TIME:

INSTRUCTIONS TO CANDIDATES:

SECTION A

Section A is Compulsory

Question 1:

KENT Limited is considering to invest in machine in order reduce their operating costs. The Machine will Costs 140 million and its expected to have a useful life of six years only. At the end of six years, it will have a value of sh. 5 million as salvage value. Operating costs over the six years are expected to be 10 millions per year and expected revenue of shs. 50 million is to be realized each year. The tax is 30% . Depreciation is to be calculated by straight line method. The discount rate is 8%. Note, the desired PBP is 4 years, IRR is 9% and a greater than 1 Profitability Index.

Required:

i) Prepare a financial Plan, clearly showing the Accounting profits and the Net cash flows. *(25 marks)*

ii) Evaluate the feasibility of the investment in the Machine using: Pay Back Period Profitability Index and IRR method. ***(15 marks)***

Question 2:

Mr. Tony Kendo is a local investor who is considering either setting up a Ravage Treatment plant (RTP) or a Risky waste transportation company, (RWTC) Whichever maximizes return and minimizes risk. The plan is to have the company operate in the Western where Uganda has discovered oil and gas reserves. Mr. Kendo has contracted you as a financial management expert to help him with issues of risk and return assessment. He has separately intimated to you that he is desirous to have his new company listed on the Uganda Securities Exchange (USE) in less than three years from now. He

thinks this approach will enable him generate more funds for expansion. Mr. Kendo has also provided you with the following information obtained from his investment advisor:

State of the economy Possible returns (Shs '000')

	Probability	RTP	RWTC
Strong	0.20	200	500
Moderate	0.30	150	400
Weak	0.50	100	200

Required:

(a) Calculate the risk and return for both RTP and RWTC **(20 marks)**

(b) Explain to Mr. Kendo the:

(i) different types of risks that may affect the realization of returns. **(10 marks)**

(ii) procedures for listing on Uganda Securities Exchange. **(10 marks)**

Question 3:

Anob Limited is considering to invest in one of the latest machines in order reduce their operating costs. This Machine is Model XX2003 and Costs 150 million, its expected to have a useful life of three years only at the end of which it will have no salvage value. Operating costs over the three years are expected to be 20 millions per year and expected revenue of shs. 220 million are to be realized each year. The tax is 30% . Depreciation is to be calculated by straight line method. The discount rate is 10%.

Required.

a) Using Profitability Index as a method investment appraisal , Advise Anob Limited whether its feasible to invest in the machine. ***[15 marks]***

b) Assume the expected revenue from the Machine declines by 30%, what would be the Profitability Index and should the investment in the machine continue? ***[5 marks]***

SECTION B

Attempt any Three Questions From Section B

Question 1:

a) Explain the concept of cost of capital and the various categories of cost of capital (8 mks)

b) Mabati Uganda Limited (MUL) deals in manufacture and supply of iron sheets in Uganda. At its recently concluded Board meeting, it was resolved that the company expands its operations to include production of roofing tiles effective 1st January 2023. The Board however directed that the company's Managing Director should assess the viability of the proposed investment prior to committing funds. It was also resolved that since the project will be financed by both debt and equity, a weighted average cost of capital should be determined and be applied in evaluating the project's viability. MUL has hired you as a financial consultant to help in determining the cost of capital suitable for evaluating the proposed investment. The company currently has a total capital of 24.5Million composed of:

	UGX Million
25% Long term bank loan	6.7
20% preference shares	5.5
Common stock	7.8
Retained profit	4.5

Additional information

1. MUL anticipates that the dividends on ordinary shares will be UShs. 10,000 per share and the market value of the share is UShs 32,000 per share.

2. The dividends are expected to grow at a rate 8% per year with a tax bracket of 30%.

Required:

i) Compute individual cost of capital
[2 marks]

ii) The weights of each source of capital
[4 marks]

Weighted cost of capital using the book value weights and explain the significance of your answer on the company's financial decisions
[6 marks]

Question 2:

a) Define Future Value in relation to time value of money. ***[3 marks]***

b) AO Limited is an investor and they have got shs. 10 million to invest today at an interest rate of 10% per year for a period of five [5] years. If they interest is compounded annually, what would be the future value after five years? ***[7 marks]***

c) Define "Perpetual Annuities" in relation to time value of money. ***[2 marks]***

d) Suppose Anob limited is interested in buying shares from Capital investment Limited which promises to pay an annual dividend of shs. 200,000 per year. Assume a market rate of interest is 10%, how much would you be willing to pay per share? ***[8 marks]***

Question 3:

a) You have a choice of accepting either a five year uniform cash flow streams or lump sum amounts discounted for five years. The cash flows for the lump sum at time zero is $2,825 and the uniform cash flow is as indicated below.

End of yr.	
1	$700
2	700
3.	700
4.	700
5.	700

Assuming a 11% discount factor, which cash flow alternative would you accept? ***[10 marks]***

b) John Kazimoto places $ 800 in a saving account paying 6% interest compounded annually. He wants to know how much money will be in the account at the end of 5 years. Advise him. ***[5 marks]***

c) Give reasons why organizations should maintain relative amount of cash within their operations and state causes of cash flow shortage. How can the organization solve cash flow problems ***[5 marks]***

Question 4:

a) What are financial Markets and who are the players in that market? ***[5 marks]***

b) Using relevant examples, define financial instruments. ***[5 marks]***

c) Give five factors that make financial instruments attractive to any investor. ***[5 marks]***

d) List the types of Instruments found in "Non-Securities Segment" of Financial markets. ***[5 marks]***

Question 5:

a) "An Investment Bank is an intermediary between the capital markets and corporations or borrowers. They offer strategic advice and performs financial analysis". State and explain the other objectives of an Investment Bank. ***[8 marks]***

b) State and explain the various Financial Activities and services offered by investment banks in the region. ***[7 marks]***

c) What is Initial Public Offering [IPO] and how do investment banks support IPO? ***[5 marks]***

Question 6:

a) State and explain reasons for growing Microfinance Institutions despite the existence of development Banks. **[8 marks]**

b) "Sound financial activities based on best practices play a decisive role in providing the majority of clients with access to financial services that propel investment, however, there has been more failures than success". What are the credit risks faced by Microfinance Institutions? ***[7 marks]***

c) Write short notes about the following; ***[1 mark @]***

i) Credit Institutions
ii) Formal banks
iii) Micro-Deposit Taking Institutions
iv) Non-Deposit Taking Institutions
v) SACCOs and Money Lenders

Question 7:

a) When organizations are facing financial distress and they are unable to facilitate their loan repayment, their financiers encourage them to restructure their operations. Clearly define Corporate restructuring as used in Investment banking. **[5 marks]**

b) State and explain four different techniques applied by businesses carrying out Restructuring. **[5 marks]**

c) Explain the term Merger as used in Business combinations and give three conditions that may make Merging firms successful. **[5 marks]**

d) Discuss five reasons for business combinations and show how each of them can promote investment. **[5 marks]**

Question 8:

a) AO Limited is an investor and they have got shs. 10 million to invest today at an interest rate of 10% per year for a period of five [5] years. If their interest is compounded annually, what would be the future value after five years? *[8 marks]*

b) Define "Perpetual Annuities" in relation to time value of money. *[5 marks]*

c) Suppose Anob limited is interested in buying shares from Capital investment Limited which promises to pay an annual dividend of shs. 200,000 per year. Assume a market rate of interest is 10%, how much would you be willing to pay per share? *[7 marks]*

Question 9:

a) You are a financial manager in charge of appraising loan applications. A customer has applied for a six months loan of UGX. 6,000,000/= payable in equal monthly installments. The loan is at interest rate of 12% p. a compounded monthly, payment being due at the end of each

month.

Required;

Calculate the monthly installment payment necessary to fully amortize the loan in six months and draw up a loan amortization schedule. *[10 marks]*

b) Explain the nature of the important decisions in finance showing the likely impact on the organization if each decision was not correctly made. *[10 mark]*

Question 10:

a) (i) Define the term "Specific cost of Capital" as used in financial management. *[4 marks]*

(ii) Given that the tax rate is 30% and the interest rate is 10%, compute the cost of debt for

the company. *[6 Marks]*

b) GMT Limited has got the overall capital structure of UGX. 200 million. The capital structure has got a break down as follows;

Long term debt	sh. 60 million
Preference share capital	sh. 20 million
Equity share capital	sh. 120 million

Specific cost of capital after tax is as follows;

Long term debt	7.2%

Equity share capital	11.2%
Preference share capital	10%

Required:

The Directors of GMT Limited company want to make further borrowings to expand the operations of the company but they are not sure of the current cost of capital. As the Finance Manager, Advise them on the current Weighted Average Cost of Capital since its necessary for the above decision. *[10 marks]*

Question 11:

CAPITAL STRUCTURE OF X COY:

ORDINARY SHARE CAPITAL	**400,000**
RESERVES	240,000
8% PREF. SHARE CAPITAL	100,000
10% DEBENTURES	60,000

Ordinary Shareholders expect Dividend Per Share of $15 and the Market Price per share is $100 which reflects a 15% rate of return, Growth in Equity is 5% p.a. and the Tax rate is 40%.

Determine the weighted cost of capital (WACC) [20 marks]

Question 12:

Total Debt	$273
Total Equity	$250
Total Debt & Owners Equity	$523
Interest rate is	25%
Tax rate is	30%

Required:

a) Compute the Weights of sources of funds (10 marks)

b) Determine the after tax cost of sources of funds (10 marks)