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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2022/2023 ACADEMIC YEAR
THIRD YEAR, FIRST SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 28th July, 2022
Time: 11.30am –1.30pm

KFI 302 - INVESTMENT ANALYSIS 1

INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS

QUESTION ONE (30 MARKS)

- a) Using appropriate examples outline three classifications of investments. (6 marks)
- b) Riley Securities Ltd. is a securities advisory firm consulted by Mr Isaac. They advised him to invest in Regal Ltd.'s shares, a **recently listed and promising tech company**, which they believe will fit his investment requirements. **This is in line with a recent July 2022 article of the Business Daily that showed that the NSE is one the most promising financial markets in Africa with the technologies industry leading the pack. Accordingly,** Riley Securities forecast that Regal's dividends will grow at a constant rate of 8% per year, while the latest **financial** reports indicate the firm will pay a dividend of Ksh. 18 per share. Their current market share price is Ksh. 195. Investors' minimum required rate of return in this market is 15%?

Required:

- i) In your opinion, do you think Regal Ltd.'s stock is over- or under-priced? (Show your workings) (3 marks)
- ii) Should Mr. Isaac buy the stock if the company decides to pay a constant dividend per share of Ksh. 22 in perpetuity without any growth? (3 marks)
- iii) Outline the assumptions of Gordon's model as an asset pricing model. (3 marks)
- c) Investor behaviour is characterised by various factors including risk tolerance. Outline the different risk attitudes of investors in financial markets. (6 marks)
- d) Akai Ltd. has preference shares with a face value of Ksh. 140 and pays 6% dividends. If the required rate of return of a rational investor is 10%, what is the value of the preference share? (3 marks)
- e) Highlight the anomalies that violate the concept of perfection and efficiency of capital markets, giving examples in each. (6 marks)

QUESTION TWO (20 MARKS)

- a) Bonds are financial instruments used by firms to raise funds to finance their usually long-term investment projects. Describe the traits identifiable with the Kenyan bond market. (8 marks)
- b) KWUST Ltd. Has 900,000 shares outstanding at the current market price of Ksh. 130 per share. The company wishes to raise Ksh. 22.5 million to finance a number of proposed projects. The Board has decided to conduct a rights issue to raise these funds where the subscription price per share has been set at Ksh. 75.
Required;
- i) How many shares are required to purchase one new right? (3 marks)
 - ii) Determine the theoretical value of one right. (3 marks)
 - iii) Determine the theoretical ex-right price of the share. (3 marks)
- c) In your own opinion, explain why the rate of return on a treasury bill is lower than a commercial paper, yet they both belong to the same classification of short-term investment instruments. (3 marks)

QUESTION THREE (20 MARKS)

- a) Financial literacy has been highlighted as one of the key skills required by an investor. In order to make wise investment decisions, an investor is advised to follow an outlined order of activities. Describe the steps involved in the decision making process. (10 marks)
- b) Grace is an avid investor in the Kenyan bond market where she has been investing in various types of bonds over the years. She recently came across a firm issuing two bonds with different terms; Bond A has a face value of Ksh. 2,000,000, coupon rate of 12% and matures in 5 years. Bond B on the other hand has a face value of Ksh. 2,500,000, coupon rate of 10% and matures in 3 years. Showing your workings, determine the profit she stands to make from each bond and advise her on the appropriate bond to invest in considering Bond A pays its coupon annually, while Bond B pays semi-annually, and the yield to maturity for both bonds is 14%. (8 marks)
- c) Justify why an investor would prefer a bond whose coupon rate of return is lower than his or her minimum required rate of return. (2 marks)

QUESTION FOUR (20 MARKS)

- a) The Efficient Market Hypothesis states that asset prices reflect all available information regarding that asset, and that any new information is instantaneously reflected in the price. However, for this theory to hold true, it relies on agreed upon assumptions. Discuss the assumptions of this hypothesis. (10 marks)
- b) Lewamu Enterprises is a plastics manufacturer that intends to expand their operations by raising additional finance. They are torn between issuing preference share capital and ordinary share capital. As an investment analyst, relying on the differences between ordinary and preference shares, justify why Lewamu should issue ordinary shares.

QUESTION FIVE (20 MARKS)

- a) Firms can raise additional equity capital through a number of ways in secondary financial markets. However, for an existing shareholder, the decision to invest in more of a firm's stock is influenced by various factors including whether their wealth/shareholding will increase or decrease. Discuss three methods that firms use to issue additional shares and their effect on shareholders' wealth. (9 marks)
- b) Maureen is considering investing in the stock market and has identified two potential stocks in different stock markets that she believes are ideal for her, and has approached you to help her determine which stock she should choose.

	Asset G	Asset Y
Asset Beta	0.8	1.2
91-day treasury bill	10.2%	9.8%
Expected market return	15%	13%

Required:

Using the Capital Asset Pricing Model, advise on the best choice of asset that Maureen should undertake if her minimum required rate of return is 14%. (7 marks)

- c) Bonds can be defined based on different factors and conditions as specified in their covenants. Elucidate on two different types of bond covenants. (4 marks)