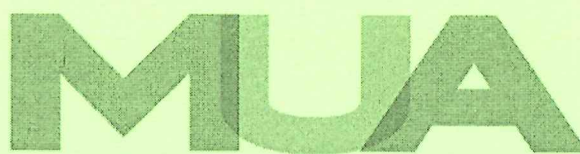


The
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UNDERGRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF BACHELOR OF COMMERCE

FIN 421: SECURITY ANALYSIS AND SECURITIZATION

DATE: 29th March 2022

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

QUESTION ONE

Summarised below are financial data in respect of Kevinko Ltd:

Profit and loss Accounts for the years ended

	2014 Sh.'000'	2015 Sh.'000'	2016 Sh.'000'
Turnover	<u>89,410</u>	<u>102,300</u>	<u>76,270</u>
Taxable income	12,260	14,190	10,140
Taxation	<u>4,291</u>	<u>4,966</u>	<u>3,549</u>
Net profit	7,969	9,224	6,591
Dividends	<u>2,557</u>	<u>2,800</u>	<u>2,335</u>
	5,412	6,424	4,256
	=====	=====	=====

Balance Sheet as at 31 March	
Fixed Assets	54,200
Current Assets	39,500
Current Liabilities	<u>(26,200)</u>
	67,500
	=====
Ordinary shares (Sh.5 par value)	20,000
Reserves	32,500
10% Debentures (due 2000) par Sh.100	<u>15,000</u>
	67,500
	=====

As a result of recent capital expansion, market analysts expect pre-tax earnings to increase at the rate of 25% for the next two years before reverting to the company's existing growth rate. The company's overall beta is 0.763 while the beta for debt is 0.20. The risk-free rate is 12% and the market return is 17%. Currently, the shares of the company are selling at Sh.21.70 on the stock exchange cum 2016 dividend. The debentures are selling at Sh.89.50 ex-interest. The corporate tax is 35%.

Required:

- i) Using the dividend growth model, estimate what a fundamental analyst might consider to be the intrinsic value of Kevinko's shares. Comment on this value.
(12 Marks)
- ii) If interest rates were to go up by 5% what would be the effect of this increase on the company's share price?
(7 Marks)
- iii) What is the difference between fundamental analysis and technical analysis in the valuation of shares?
(6 Marks)

QUESTION TWO

- a) Explain what you understand by the term Market efficiency. (1 Mark)
- b) Discuss the implications of the theory of market efficiency to the finance manager. (8 Marks)
- c) Discuss three forms of Market efficiency. (6 Marks)

QUESTION THREE

- a) Explore the steps involved in securitization process (10 Marks)
- b) Examine the two forms of random walk (5 Marks)

QUESTION FOUR

- a) Discuss any five advantages of securitization (10 Marks)
- b) Evaluate any five factors that to consider in the purchase of ordinary shares of a company. (5Marks)

QUESTION FIVE

- a) Company XYZ pays a dividend of 10% on its Sh.60 par value ordinary shares. This company uses a discount rate of 15%. (6 Marks)

- i. Assuming no growth, compute the value of its ordinary share
 - ii. if there's growth of 5%, what would be the value of this company's ordinary shares.
- b) Company XYZ Ltd has sold 10,000 ordinary shares of Shs.30 (partly called up) plus 20,000 Shs.45 preference shares, which are convertible. Compute the total number of ordinary shares after conversion. **(9 Marks)**

QUESTION SIX

- a) XYZ Ltd is expected to pay a DPS of Sh.6 in one year's time. The dividend payout ratio is 60% and the Return on Equity is 15%. Determine whether the share is overvalued if the MPS is Sh.40. **(5 Marks)**
- b) Evaluate the significance of valuation of securities. **(5 Marks)**
- c) ABC Ltd has issued a 5-year zero coupon rate bond with maturity value of Sh.100,000. The bond is issued at a discount of 32%. Determine the rate of return of the bond. **(5 Marks)**