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(*University of Choice*)

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY

(MMUST)

MAIN, BUNGOMA, MUMIAS, BUSIA, NAIROBI, WEBUYE CAMPUS

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

FIRST YEAR SEMESTER TWO EXAMINATION

FOR DIPLOMA

IN

BUSINESS MANAGEMENT

COURSE CODE: DAF 106

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: TUESDAY 19TH APRIL 2022 **TIME: 12-2PM**

INSTRUCTIONS TO CANDIDATES

Answer QUESTION ONE and any OTHER TWO questions

TIME: 2 Hours

MMUST observes ZERO tolerance to examination cheating

QUESTION ONE (30 MARKS)

I. Briefly discuss four decisions involved in financial management (4 Marks)

II. Discuss three reasons for time preference of money. (3 Marks)

III. Discuss three reasons why Net Present Value (NPV) is considered the most superior investment proposal evaluation technique. (3 Marks)

IV. What is agency theory? Discuss three agency relationships (5 Marks)

V. Explain three features of a bond (3 Marks)

VI. John wants to borrow a loan of Ksh. 10,000 from KCB at an annual interest of 10% p.a. Loan will be repaid over a period of 3 years and installments are made on annual basis. Prepare a loan amortization schedule. (6Marks)

VII. Juma has invested Ksh. 600,000 in stock A and Ksh. 400,000 in stock B. The expected rate of return for assets A and B are 6% and 8% respectively. The returns of stock A and B have previously shown volatility of 6% and 2% respectively as measured by standard deviation. The two stocks returns have a correlation coefficient of 0.50.

a) Juma's portfolio expected return (2 Marks)

b) Risk of Juma's portfolio (4 Marks)

QUESTION TWO (20 MARKS)

a) Thika ltd wishes to raise funds amounting to KShs. 10 million to finance a project in the following manner:

Sh. 6million from debt and Sh. 4 million from floating new ordinary shares

The present capital structure of the company is made up as follows:

1. 600,000 fully paid ordinary shares of sh. 10 each

2. retained earnings of sh. 4 million

3. 200,000, 10% preferences shares of sh. 20 each

4. 40,000 6 % long term debenture of sh. 150 each

The current market value of the company's ordinary shares is sh. 60 per share. The expected ordinary share dividend in a year's is sh. 2.40 per share. The average growth rate in both dividends and earnings has been 10% over the past ten years and this growth rate is expected to be maintained in the foreseeable future.

The company's long term debentures currently change hands for sh. 100 each. The debentures currently change for sh. 100 each. The debentures will mature in 100 years. The preference shares were issued four years ago and still change hands at face value.

Required;

i. Compute the component cost of: ordinary share capital, debt capital, preference share capital. (6 Marks)

ii. Compute the company's current weighted average cost of capital (4 Marks)

iii. Compute the company's marginal cost of capital if it raised the additional sh. 10 million as envisaged (assume a tax rate of 30%) (4 Marks)

b) A corporate bond is currently trading at Ksh 1,000 at the NSE. The bond has 5 years remaining to maturity and has a face value of Ksh 950 and coupon of 10% p.a. (Paid annually). Determine the bond's yield to maturity (YTM) (6 Marks)

QUESTION THREE (20 MARKS)

a) Consider the following two investment proposals;

	A	B
Initial outlay	Sh. 100,000	Sh. 100,000
Cashflows		
Year 1	35,000	30,000
Year 2	35,000	40,000
Year 3	35,000	35,000
Year 4	35,000	40,000
Year 5	35,000	50,000

The opportunity cost of capital is 10% p.a.

Required: Using NPV select the better investment proposal (8 Marks)

b) Two securities have the following returns under different states of economy and probability

State of economy	Probability	Returns of x	Return of y
A	0.2	-6	12

B	0.4	10	-4
C	0.2	8	6
D	0.1	5	15
E	0.1	-4	20

Required

I) Expected return of the portifolio x and y (3 marks)

ii) Covariance of the portifolio and correlation coefficient (6 marks)

iii) Calculate the standard deviation of the 2 assets assuming that weight of security x and y is 0.6 and 0.4 respectively (3 marks)

QUESTION FOUR (20 MARKS)

a) The shares of ABC Ltd are currently retailing at a price of Sh 140. The firm paid dividends of Sh 5 per share last year. The future dividends are expected to grow at a rate of 7% p.a into perpetuity. The required rate of return is 10% p.a. You are required to estimate the stock's intrinsic value and advise whether the stock could be a good buy. (6 Marks)

a) List and explain the factors accompany should consider before paying dividends (5 marks)

b) Firms can pay out their dividends to shareholders by use of cash and other three ways. List and explain the other methods of dividend payment. (3marks)

c) XYZ ltd made plans for the next year. It is estimated that the company will employ total assets of kshs 800,000. 50% of the assets are being financed by borrowed capital at an interest of 8% per year. The direct costs for the year are estimated at kshs 480,000 and other operating expenses are estimated 600,000.Tax is assumed to be at 50%.

Required

(i) Net profit margin (3marks)

(ii) Return on assets (3marks)