



MASENO UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

**THIRD YEAR FIRST SEMESTER EXAMINATIONS FOR THE
DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH
INFORMATION TECHNOLOGY**

HOMA-BAY CAMPUS – SCHOOL BASED

ABA 303: FINANCIAL MANAGEMENT

Date: 27th July, 2017

Time: 9.00 - 12.00 noon

INSTRUCTIONS:

- Answer question ONE and any other THREE questions.

Q1a) For the past five years, the market price per share (MPS) and the dividend per share (DPS) for Salama company Ltd were as follows.

	2012	2013	2014	2015	2016
	ksh	ksh	ksh	ksh	ksh
MPS as at 31 st , Dec.	40	45	53	50	52
DPS for the year.		3	4	3	

Required:

Determine the estimated cost of equity (shareholders' percentage yield) for each of the years involved. (10 marks)

b) Explain the agency problems that may be experienced as a result of the agency relationship between the shareholders and debenture holders and hence, generate the possible remedies to these problems. (10 marks)

c) A certain project proposal has a cost of capital of 12% and requires an initial cash outlay of Ksh 100,000. The project promises the following cashflows from year 1 to year 4 consecutively: Ksh 25,000, 40,000, 40,000 and 50,000.

Required:

Calculate the benefit- cost ratio for this project and advise whether to accept or reject the project. (5 marks)

Q2 a) Two projects X and Y have the following cash flows for 4 years each.

	Project X	Project Y
Initial Investment	Ksh 110,000	Ksh 110,000
Year 1	31,000	71,000
Year 2	40,000	40,000
Year 3	50,000	40,000
Year 4	70,000	20,000

Required:

Calculate the two projects' Modified Net Present Value (MNPV) using re-investment rate of 14% at 12% cost of capital. (8 marks)

b) Outline the factors that determine the capital structure of a firm. (7 marks)

3 a) Sony Sugar company ltd requires 2000 units of a component in its manufacturing process in the coming year which costs sh 50 each. The items are available locally and the lead time is one week. Each order costs sh 50 to prepare and process, while the holding cost is sh 15 per unit per year for storage. The opportunity cost of capital is 10%.

Required:

Use the Economic Order Quantity Model (EOQ) model to determine:

- i) The number of units that should be ordered each time an order is placed to minimize inventory costs (2 marks)
- ii) The re-order level (2 marks)
- iii) The number of orders to be placed per year (2 marks)

iv) The total relevant costs (2 marks)

b) Sukari industry makes cash payments of sh 10,000 per week. The interest rate on marketable securities is 12% and every time the company sells marketable securities, it incurs a cost of sh 20.

Required:

Using Baumol's model of setting optimal cash balance:

- i) Determine the optimal amount of marketable securities to be converted into cash every time the company makes the transfer. (2 marks)
- ii) Determine the total number of transfers from marketable securities to cash per year. (2 marks)
- iii) Determine the total cost of maintaining the cash balance per year. (2 marks)
- iv) Determine the firm's average cash balance. (1 mark)

Q4 a) KenGen ltd intends to undertake a geothermal electricity generating project with a cost of ksh 80 million. The project is expected to have a life of five years and nil residual value. The expected earnings before depreciation and taxes are: ksh 20 million, 24 million, 28 million, 32 million and 40 million from year one to year five respectively. Corporate tax rate is 40% and depreciation is on a straight line basis.

Required;

- i) Compute the project's accounting rate of return (5mks)
- b) Security X has a covariance of return of 2 % with the market return. If the risk free rate is 8% and the expected rate of return is 14 %. The standard deviation of the market return is 2 %.

Required:

What is the required rate of return on security X? (5mks)

c) Discuss the limitations of Capital Asset Pricing Model (CAPM). (5mks)

Q5 a) The following is an extract from the financial statement of Kirengo traders ltd.

	SH
Issued 150,000 ordinary shares of sh 10 each fully paid.	1,500,000
10 % Loan stock	2,000,000
Preference share capital	1,500,000
Reserves	7,000,000
Capital Employed	12,000,000

Additional information

- i) The profits after 30 % tax is sh 600,000. However, interest charge has not been deducted.
- ii) Ordinary dividend pay-out ratio is 40 %.
- iii) The current market value of ordinary share is sh 36.

Required

Calculate the following:

- | | | |
|------|-----------------------------------|--------|
| i) | Return on capital employed (ROCE) | (2mks) |
| ii) | Earnings per share (EPS) | (2mks) |
| iii) | Price earningsratio (P/E) | (2mks) |
| iv) | Book value per share (BVPS) | (2mks) |
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b) Explain the first seven principles of corporate governance as given by the Common Wealth Association of Corporate Governance (CACG) and the Private Sector Corporate Governance Trust (PSCGT) in 1999. (7mks)

Q6. XYZ ltd wants to raise new capital to finance a new project.

The firm will issue 200,000 ordinary shares with sh.10 per value at sh.16 per share.

The floatation cost per share is sh 1.

Issue 75,000 12% preference shares with sh.20 per value at sh.18 with sh.150,000 total floatation costs.

Issue 50,000 18% debentures with sh.100 per value at sh.80 and to raise a sh.5,000,000 from 18% loan paying total floatation costs of 200,000.

Assume a 30% corporate tax rate.

The company paid 28% ordinary dividends which is expected to grow at 4%p.a.

Required;

- Determine the total capital to raise net of floatation cost. (6mks)
 - Compute the marginal cost of the capital. (9mks)
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