CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF MASTER OF BUSINESS ADMINISTRATION

MBAD 831: FINANCIAL MANAGEMENT

STREAMS: MBAD **TIME: 3 HOURS**

DAY/DATE: MONDAY 05/07/2021 **11.30 A.M. – 2.30 P.M.**

INSTRUCTIONS:
- **Answer ALL questions.**
- **Do not write anything on the question paper.**

QUESTION ONE

Millennium Investment Ltd. wishes to raise funds amounting to Sh. 10 million to finance a project in the following manner.

Sh. 6 million from debt
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. 4,000,000.
3. 200,000, 10% preference shares of Sh. 20 each.
4. 400,000, 6% long-term debentures of sh. 150 each.

The current market value of the company's ordinary shares is Sh. 60 per share. The expected ordinary share dividends in a year's time 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 to the foreseeable future.

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

Required

(a) Compute the components cost of, ordinary share capital, debt capital and preference share capital. (5 marks)

(b) Compute the company's weighted average cost of capital. (10 marks)

(c) Compute the company's marginal cost of capital if it raised the additional Sh. 10 million as envisaged. Assume a tax rate of 30%. (5 marks)

(d) Discuss the importance of corporate governance. (10 marks)

QUESTION TWO

A manufacturing firm intends to procure an industrial plant for its operations. The firm has obtained four quotations. An analysis of the quotations, show that cash flows generated by the plant will differ depending on the quality, grade of labour and the output produced by the industrial plant supplied. The following details indicate the cash flow position of the four quotations.

Year	Quotation 1	Quotation 2	Quotation 3	Quotation 4
0	-10,000,000	-10,000,000	-3,000,000	-3,000,000
1	6,000,000	2,000,000	1,000,000	0
2	2,000,000	2,000,000	1,000,000	0
3	2,000,000	6,000,000	1,000,000	3,000,000
4	1,000,000	1,000,000	6,000,000	6,000,000

Required

(a) Calculate the payback period for each quotation. (4 marks)

(b) If he firms uses a standard payback period of 3 years, which quotation would be chosen? Would your answer change if the standard payback period were 2 years? (8 marks)

(c) If the cost of capital was 10 percent, compute the NPV of each quotation. Which quotation would you recommend? (8 marks)

QUESTION THREE

A company has a policy of distributing 40% of its earnings as dividends every year. In the year ended 30th June 2014, its total earnings after tax and preferences dividends were Sh. 4,000,000. The company has 200,000 outstanding, ordinary shares. The company's rate of return on investments is 12% and earnings are projected to grow at the rate of 5% per annum in the foreseeable future.

Required

(i) Calculate the earnings per share at 30th June 2014. (5 marks)

(ii) Calculate the retention ratio. (5 marks)

(iii) Calculate the market value of the share as at 30th June 2014. (5 marks)

(iv) Price earnings ratio. (5 marks)

QUESTION FOUR

(a) Explain the importance of using cash flows in investment appraisal instead of accounting profits. (4 marks)

(b) A foreign investor wishes to construct a factory in Kenya. He estimates that the factory will generate after tax profits of Sh. 10,000,000 in the first through the third year and later increase by 5% to the fifth year. What is the maximum amount of money that the investor would spend in laying the investment today assuming an interest rate of 10% (6 marks)

(c) Discuss at least five sources of financing. (10 marks)
