MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING, FINANCE AND BANKING

FIRST YEAR SECOND SEMESTER EXAMINATION FOR

MASTER OF BUSINESS ADMINSTRATION

BAC 815: FINANCIAL MANAGEMENT

DATE: 23/5/2019 **TIME: 9.00-12.00 PM**

INSTRUCTIONS

- ***Answer Any FOUR Questions***
- ***All Questions Have Equal Marks***

QUESTION ONE (25 MARKS)

SME company is considering two projects: A _ a kitchen project that requires an initial investment of Kshs 50,000 and will produce FCFs of Kshs. 20,000 for five years. Assume the required cost of capital is 15%. Project B_ also requires capital outlay of Kshs. 50,000 and whose cash flows are Year 1-18,000; Year 2- 22,000; Year 3-25, 000; Year 4- 30,000 and Year 5- 32,000. Assume the required cost of capital is 18%. Both projects have issued shares of 1000.

Required

a) Calculate the NPV for each project and decide which project the company should implement if only Kshs, 60,000 are available. (6 marks)

b) Calculate the IRR for each project. Which project should the company invest in if only Kshs,60,000 are available (8 marks)

c) Calculate the wealth increase brought about by implementing each project (*Hint: NPV represents wealth increase).* Which project should the company accept based on wealth maximization principle? (9 marks)

d) Which decision should the company accept if (a), (b) or (c) differ? (2 marks)

QUESTION TWO (25 MARKS)

KANZIKU Engineering Ltd has the following capital structure, which is considered optimal.

Debt	25%
Preferred shares	15%
Ordinary shares	60%
	100

KANZIKU expected Net income this year is Kshs. 34,285, its established dividend payout ratio is 30 Percent; while its tax rate is 40%. Investors expect earnings and dividend to grow at a constant Rate of 9% in the future. KANZIKU paid dividends of Kshs. 3.6 per share last year and its shares currently sell at a price of Kshs. 54. KANZIKU can obtain new capital in the following ways:

1. Preferred shares with a dividend of Kshs. 11 sold to the public at a price of Kshs. 95 per share.
2. Debt; which can be obtained at a cost of 12%

Required

a) Determine the cost of each capital structure component (3 marks)

b) Calculate the weighted average cost of capital (7 marks)

c) KANZIKU has the following investment opportunities that have the same average risk.

Project	**Cost @ t=0**	**Rate of Return**
A	Kshs. 10,000	17.4%
B	20,000	16.0
C	10,000	14.2
D	30,000	13.7
E	10,000	12.0

Which investment should KANZIKU accept and Why? (10 marks)

e) Finance theory states, "the value of a business is equal to its expected future cash flows discounted to present value at WACC". Using the DCF method valuation is always a function of three (3) fundamental factors; identify these factors. (5 marks)

QUESTION THREE (25 MARKS)

a) "The Modigliani and Miller capital structure propositions produced two competing theories that explain how managers make financing decisions". Examine these theories and state in your view the theory that explains how SMEs finance their businesses (10 marks)

b) Conglomerate mergers and corporate diversification are both forms of mergers and /or acquisitions and have proven to be failures- comment. Explain what form you think is represented by Current NIC and CBA bank merger? Why do managers pursue these objectives? (15 marks)

QUESTION FOUR (25 MARKS)

a) NGOZI products is concerned about managing its operating assets and liabilities efficiently. Inventory have an average age of 110 days, and acct receivables have an average age of 50 days. Account payables are paid approxi. 40 days after they arise. The firm has annual sales of Kshs. 36 million, and its cost of sales represents 75% of sales, and its purchases represent 70% of cost of goods sold. Assume a 365-day year.

Required:

i. Compute the firm's operating cycle (3 marks)

ii. Calculate the firm's cash conversion cycle (CCC) (5 marks)

iii. Calculate the amount of total resources the firm has invested in cash conversion cycle (CCC) (7 marks)

b) Explain the difference between Money and Capital markets. If you were awarded a tender to construct a Dam under the Youth Empowerment Programme and you did not have the Kshs. 30 million required to finance the project; which market would you use to the raise the money from, and how would you do it. (10 marks)

QUESTION FIVE (25 MARKS)

a) "Finance literature is not clear as to what investors and shareholders prefer- to receive their earnings in dividends or defer the earnings for reinvestment in the business." Discuss the arguments for and against the decision- to pay or not to pay dividends (*Hint: Support your arguments using dividend theories).* (9 marks)

b) A new division of a company will increase revenues by Kshs.50, 000 and operating expenses by Kshs. 30,000 per year. It will be depreciated over 3 years at Kshs. 10,000 per year at straight line method. Your firm's marginal tax rate is 35%. Capital expenditures will be Kshs. 3,000 annually and additional working capital to the level of Kshs. 3,500 will be needed.

Required:

i. Calculate the yearly free cash flow (4 marks)

ii. Calculate the PV of the FCFs over the three years (3 marks)

iii. Advise the CEO which values between FCFs and PVs are suitable in a borrowing decision for the CAPEX (3 marks)

c) Write short notes on the following:

i. Agency theory (3 marks)

ii. Firm theory (3 marks)