TECHNICAL UNIVERSITY OF MOMBASA

Faculty of Business & Social Studies

DEPARTMENT OF BUSINESS STUDIES

DIPLOMA IN LOGISTISTCS AND TRANSPORT MANAGEMENT
DIPLOMA IN ACCOUNTANCY

BAC 2212: FINANCIAL MANAGEMENT

SPECIAL/SUPPLEMENTARY EXAMINATIONS

SERIES: FEBRUARY 2015

TIME: 2 HOURS

INSTRUCTIONS:

- This paper consists of **FIVE** questions.
- Answer question **ONE (Compulsory)** and any other **TWO** questions.
- Do not write on the question paper.

This paper consists of Three Four printed pages.

QUESTION 1 (Compulsory)

a) A project costs shs. 80,000 and a scrap value of Kshs. 20,000. Its stream of cashflows before depreciation and taxation during the 1st year to the 5th year is Ksh. 16,000, shs. 18,000, shs. 20,000, shs. 21,000 and shs. 30,000. Assume 40% tax rate and depreciation is given shs. 12,000 on a straight line basis. Interest rate is 10%.

Required:

i) Compute the NPV (Net Present Value). **(7 marks)**

ii) Compute the internal rate of return of the project and advice the management accordingly. **(8 marks)**

b) PEMA holdings has identified three different projects. The estimates of probability of success and associated additional profits in each of the three projects are provided below:

	Project I		**Project II**		**Project III**	
	Profit (£)	**Probability**	**Profit (£)**	**Probability**	**Profit (£)**	**Probability**
Normal	10,000	0.4	5,000	0.2	16,000	0.5
Excellent	18,000	0.5	8,000	0.6	20,000	0.3
Fair	25,000	0.1	12,000	0.2	25,000	0.2

Rank the **THREE** projects according to their riskiness using the coefficient of variation. **(10 marks)**

c) List **FIVE** factors that finance managers should analyze before making a dividend decision. **(5 marks)**

QUESTION 2

a) Trade credit is a 'cost free" source of funds. Explain. **(10 marks)**

b) What role is the Capital Markets Authority expected to play in Kenya. **(10 marks)**

QUESTION 3

a) Explain what is meant by "marginal cost of capital". (3 marks)

b) Samco properties are planning to build a business complex along Uhuru Highway, Nairobi. The project will cost shs. 180 million. Samco's current capital structure which is considered optimal is as follows:

	Shs. '000'
Debt	384,000
Ordinary shares (par value shs. 10)	480,000
Retained profits	96,000
	960,000

The following information is also available:

i) New debt will be privately placed via a debenture issue with a large insurance company at an interest rate of 15% No floatation costs will be incurred.
ii) Ordinary shares – current market price is shs. 30 per share with a dividend of shs. 5 per share and an expected growth rate of 5 percent, floatation costs amount to 4 percent.
iii) The marginal tax rate is 40%.

Required:

a. Determine how much of the shs. 180 million is to be raised by equity capital if the capital structure is to remain unchanged. **(3 marks)**
b. Determine how much of the capital must come from retained earnings. **(3 marks)**
c. Determine how many new ordinary shares have to be floated to raise the required portion of equity capital. **(3 marks)**
d. Calculate the investment's marginal cost of capital. **(8 marks)**

QUESTION 4

The following one independent party have approached you with a view to obtaining professional advice on how they could raise funds needed in their business.

The Managing Director of a bank which has been in business for the last few years has made the following information available to you:

- The authorized, issued and paid up capital of the bank is shs. 12 million
- Deposits from account holders and depositors amount to shs. 40 million
- Advances to customers are shs. 30 million.
- Deposits with the Central Bank and other commercial banks add upto shs. 20 million.
- Other assets amount to shs. 2 million.

Required:

a) Advise the parties concerned on the possible sources of long and short term finance. **(10 marks)**

b) Give the advantages and disadvantages of each source of finance in (a) above. **(10 marks)**

QUESTION 5

a) Explain the theories of dividend payout. **(10 marks)**

b) Describe the factors to consider when making a financing decision. **(10 marks)**