TECHNICAL UNIVERSITY OF MOMBASA

School of Business

DEPARTMENT OF ACCOUNTING AND FINANCE

UNIVERSITY EXAMINATIONS FOR DEGREE IN
BACHELOR OF COMMERCE

BFI 4301: FINANCIAL MANAGEMENT

SPECIAL/ SUPPLIMENTARY EXAMINATIONS
SERIES: 2019
TIME: 2 HOURS

INSTRUCTIONS:
Answer Question **ONE (Compulsory)** and any other **TWO** questions
This paper consists of Six printed pages

QUESTION 1 (Compulsory)

a) Capit SA is a large firm listed on the Nairobi Securities Exchange. It has the following capital structure:

Long Term Capital	Sh. in millions
5yrs Debenture; 8%	25
Preferred Shares – 5% coupon + nominal value of 100	15
Common Equity (nominal value ksh. 10/share)	10
Retained Earnings	23

The current dividend for the company is ksh. 50/share and is expected to grow at 3% per year in the foreseeable future. The equity shares trade at ksh. 450/share. The preferred shares trade at PLN 104/share. The convertible debt has a conversion privilege of 2 shares per 1,000 ksh. face value at maturity. The debt currently trades at ksh. 950. The firm's income tax rate is 30%

Required:

i. Calculate the firm's weighted average cost of capital (WACC): (10 marks)

ii. Discuss the firm's dividend payout policy and whether it has an impact on share price? (6 marks)

iii. Explain why the different sources of capital have different levels of risk and return. (6 marks)

b) Kojos ltd. wants to establish the position of financial manager. They have approached you to explain to them why this position should be created. Concisely explain to them why they should establish the position. (8 marks)

QUESTION TWO

a) The shareholders' equity of LINU co. Ltd included the following items;

Equity structure	kshs.(in millions).
Ordinary shares	100
Premium on ord. Shares	980
8% preference shares	200
Premium on preference shares	555.

The board of directors declared cash dividends of sh. 8 millions, 20 million and 150 million for the first threes of operations respectively.

Required:

Determine the amount of dividends paid to both preference and ordinary shareholders' in each year (10 marks)

b) Ordinary shares is a major source of capital to established firms despite the Uncertainties attached to them. Briefly explain why they are popular. (5 marks)

c) WACC is always used as the discounting factor when evaluating business projects. Briefly explain the weaknesses of using WACC as the discounting factor. (5 marks)

QUESTION THREE

a) From the following information, ascertain which project should be selected on the basis of standard deviation.

	Project X		**Project Y**	
	Cash inflow	**Probability**	**Cash inflow**	**Probability**
Period	**sh.**		**sh.**	
1	3,200	0.2	32,000	0.1
2	5,500	0.3	5,500	0.4
3	7,400	0.3	7,400	0.4
4	8,900	0.2	8,900	0 .1

(10 Marks)

b) Briefly explain any five factors which may influence capital structure decisions. (10 marks)

QUESTION FOUR

a) Briefly explain any 4 dividend theories, justifying the existence of the theory. (10 marks)

b) A company's net profit after tax is 6 million and the Company has a dividend payout policy of 60%. It has a share capital of 7.2 million at a nominal value of sh.10. The shares have appreciated by 20%.

Required:

(i) Dividends yield (5 marks)

(ii) Earnings per share (5 marks)

QUESTION FIVE

a) ABC Ltd. needs sh. 3,000,000 for the installation of a new factory. The new factory expects to yield annual earnings before interest and tax (EBIT) of sh.500,000. In choosing a financial plan, ABC Ltd., has an objective of maximizing earnings per share (EPS). The company proposes to issue ordinary shares and raising debit of sh. 300,000 and sh.1, 000,000 of sh. 1,500,000. The current market price per share is sh. 25 and the number of shares on issue are 200,000. The tax rate is 30%. Funds can be raised at the following rates.

- up to sh. 300,000 at 8%
- over sh. 300,000 to sh 1,500,000 at 10%
- over sh. 1,500,000 at 15%

Assuming a tax rate of 50%

Required:

Advise the company on which financing structure to use. (10 marks)

b) The following information was extracted from ABC Company Ltd books:

	Sh.
10.000, Sh.20 ordinary share capital	200,000
10,000, Shs.10 8% preference share capital	100,000
5,000, Shs.100 12% debentures	500,000

The above debentures are due for conversion:

Additional information;

i. The company has been paying dividends at the rate of 15% with a growth of 10%, and this is expected to continue**.**

ii. The shares are currently trading at the stock market at sh. sh. 30 per share.

iii. The preference shares are currently trading at sh. 9 each.

iv. Debentures are trading at per.

v. The corporate tax is 30%

Required

i) Compute the market weighted cost of capital. (5 marks)

ii) Briefly explain any five reasons why leases may be preferred to outright purchase. (5 marks)