

**SCHOOL OF BUSINESS AND ECONOMICS**

**DEPARTMENT OF COMMERCE**

**MASTER OF BUSINESS ADMINISTRATION**

**MAY – JULY 2018 FINAL SEMESTER EXAMINATION**

**CODE: FIN 611X UNIT: FINANCIAL MANAGEMENT & CONTROL**

INSTRUCTIONS: Answer question **ONE** and any other **TWO** questions TIME: 3 HOURS

**Question One:**

Myria Company is a public listed company in the Nairobi Securities Exchange but it is located in Uganda. Myria Company chose the Kenyan Exchange because it normally reflects all current prices and all publicly available information, including such things as annual reports and news items. Any time there are announcements of dividends and management change, the market is always anticipating. The Capital Market has also been on the look out to make sure that no certain investor influences the Exchange alone. In addition, the Finance Directors and Auditors of all these companies listed in the NSE must be affiliated with the Institute Certified Public Accountants of Kenya. This is because of transparency and effectiveness in management that is pertinent to CMA’s goal of the Kenyan Exchange. It is also a way of curbing any unethical practices/behavior.

Myria Company’s core business is in manufacturing and delivering photocopiers. For the last ten years, it has been making profits but the cashflows have been affected drastically. However, recently, the company went outsourcing for a supplier who would be willing to produce the photocopiers on their behalf while using their materials. The following is a particular supplier’s quotation that the CFO wants you to analyse if it is a viable one. The cost of the materials will be Kshs. 3,500,000 and the expected life of these materials will be 4 years with a working capital requirement of Kshs. 200,000 that will be increased to Kshs. 350,000 by end of the third year. The earnings before tax are as follows: Year 1 – Kshs. 1,500,000; Year 2 – Kshs. 1,800,000; Year 3 – Kshs. 2,100,000 and Year 4 – Kshs. 2,500,000. The operating costs will be: Year 1: Kshs. 800,000; Year 2: Kshs.1, 000,000; Year 3: Kshs. 1,200,000 and Year 4: Kshs. 1,500,000. All of the above estimates have been prepared in terms of present day costs and prices. Therefore, the revenues and operating costs are expected to rise by Kshs. 100,000. By the end of the four years, the working capital will be fully recovered. Depreciation is straight line over the life of the materials and it is expected to have a salvage value of Kshs. 300, 000 at the end of year 4. Depreciation costs will need to be included as they were excluded in the operating costs. Myria Company’s uses a discount rate that it would require to assess the NPV at 14% and 30% tax rate is paid in one year in arrears.

**Required:**

1. Explain some of the corporate governance considerations Kenyan Exchange has emphasized on **(4 Marks)**
2. From the case study, discuss ***five reasons*** that the Chief Finance Director would want to outsource part of the Company’s unit? **(6 Marks)**
3. The CFO wants you to write a *draft letter* explaining the difference between a cash flow and profits **(10 Marks)**
4. Prepare the Myria Company’s Supplier incremental cash flow report and *advice* the CFO if it is viable or not **(20 Marks)**

**Question Two:**

1. There is cash payments and instalments payments when dealing with long term investments. Suppose you want to buy a piece of land for Kshs. 1,200,000 cash. The owner would allow you to pay for it in six annual installments of Kshs. 230,000 each, the first one right now. Which method is cheaper for you if the time value of money is 12%? **(5 Marks)**
2. Kinyangariko has won a million Shillings in the Heri lottery and wants the company to pay him in installments. They both agree that Heri Lottery will pay him Kshs. 50,000 annually in 20 annual installments. He will get the first installment right now. Using a discount rate of 10% per year, find the present value of all these payments later at the end of the period. **(6 Marks)**
3. Explain the reasons behind “A shillings received today is better than a shilling received sometime later” **(5 Marks)**
4. Suppose the price of a house that you are interested in buying today is Kshs. 10,000,000 and you have your savings up to Kshs. 1,500,000 that can be used as a down payment. The bank will loan you the remaining funds at 8% annual interest for a 2-year term paid semiannually. Prepare a loan amortization Schedule **(10 Marks)**
5. Suppose a banker offers you a loan at an annual nominal interest rate of 12% compounded quarterly. What is the effective annual interest is the bank charging you?

**(4 Marks)**

**Question Three:**

1. Explain the two types of risk in modern finance and give two examples of each **(6 Marks)**
2. A portfolio consisting of two assets has a correlation coefficient of 0.8. Another two asset portfolio has a correlation coefficient of -0.8. In the absence of any other

information, which portfolio should you invest in? Justify your reasoning. **(6 Marks)**

1. Suppose your company encounters a challenge in attracting a strategic investor, as a Finance Manager, how would you advice your company in going about to attract investors? **(5 Marks)**
2. Explain the three major long term source of finance. If you were to choose one source during a boom economy, which one would you use? **(9 Marks)**
3. “Dividends are key great returns of a company that are given to the shareholders”. At what point does a company decide to give bonus dividends and cash dividends

**(4 Marks)**

**Question Four:**

1. Kipenzi Ltd has the following capital structure:

400,000 Ordinary shares @10 Kshs. 4,000,000

200,000 12% Preference shares @10 Kshs. 2,000,000

50,000 8% Bonds @100 Kshs. 5,000,000

The market prices are sh150, sh50 and sh110 for ordinary shares, preference shares and bonds respectively. An ordinary share is expected to pay a dividend of sh8 one year from now and the dividends are expected to grow at 4% p.a. indefinitely. Tax rate is given as 30%.

**You are required:**

1. Determine the component costs of capital **(8 Marks)**
2. Calculate the market value weights and book value weights.  **(5 Marks)**
3. Calculate the WACC using Market Value weights only **(9 Marks)**

2. Discuss ***four*** of the dividend policies that you know of that a firm can apply **(8 Marks)**