



MUEO

MOI UNIVERSITY

OFFICE OF THE DEPUTY VICE CHANCELLOR
ACADEMIC AFFAIRS, RESEARCH AND EXTENSION

UNIVERSITY EXAMINATIONS

2013/2014 ACADEMIC YEAR

FOURTH YEAR END OF SEMESTER II EXAMINATIONS

FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: BBM 410

EXAM TITLE: FINANCIAL MANAGEMENT

DATE: 30TH SEPTEMBER, 2013 TIME: 9.00 A.M. – 12.00 NOON

INSTRUCTION TO CANDIDATES

- ATTEMPT ANY FOUR QUESTIONS

INSTRUCTIONS TO THE CANDIDATES; ANSWER QUESTION ONE AND ANY OTHER THREE QUESTIONS.

QUESTION 1.

- a) (i) What is CAPITAL RATIONING (ii) Distinguish SOFT CAPITAL RATIONING from HARD CAPITAL RATIONING and highlight some influences to capital rationing indicating whether each of them is soft or hard capital rationing? (8 Marks)
- b) JUBILEE HOLDINGS LTD. Intends to undertake the following 4 independent projects.

PROJECT	INITIAL CASH OUTLAY K£ (YEAR 0)	YEAR 1 K£	YEAR 2 K£
A	10,000,000	7,000,000	6,000,000
B	20,000,000	15,000,000	15,000,000
C	30,000,000	20,000,000	15,000,000
D	40,000,000	25,000,000	20,000,000

The company's opportunity cost of capital is 10% p.a The company has imposed a capital expenditure ceiling of K£ 70,000,000 in year 0.

- i) Determine the Net Present Value of each project. (8 Marks)
- ii) Allocate the K£ 70,000,000 available in year 0 to the projects that promise to bring maximum value to the firm. (8 Marks)
- iii) What will be the effect on the value of the firm after undertaking the selected projects? (2 Marks)
- c) Discuss the following cash management models meant to determine optimal cash balances for a public corporation. (i) BAMOUL MODEL(7 Marks) (ii) MILLER-ORR MODEL (7 Marks)

Question 2.

CORD CORPORATION purchased a brand new tractor 5 years ago at K£1,800,000. The machine had 15 years economic life and being depreciated on straight line. The book value after 5 years was K£1,200,000. It had zero scrap value at the time of the purchase. The managing director has done some feasibility study and found that with K£ 2,880,000 a brand new machine can be bought whose scrap value after its 10 years of service will be K£ 480,000. The old machine can fetch K£240,000 in the market today. The opportunity cost of capital of the company is estimated at 10% p.a. The company is in the 40% tax bracket. Advice on the replacement decision. (20 Marks)

Question 3.

KAMATUSA CORPORATION wishes to invest in a project whose initial cash outlay is estimated at K£5,000,000. Its expected net cashflows K£600,000 p.a for the 6 years economic life. The average market return over the period is averaged at 15% p.a .The yield on Government Treasury bills is

stabilized at 10% and is expected to remain so for the period in question. The systematic risk of the project is estimated at 1.2

- a) Determine the viability of the project under RISKY CONDITIONS. (5 Marks)
- b) Determine viability of the project under CERTAINTY EQUIVALENT. (15 Marks)

Question 4.

Firms A and B are similar in all respects except that firm A is UNGEARED while firm B is GEARED with a K£ 500,000 debt at 10% and K£500,000 equity. Both firms have investments in total assets worth K£1,000,000 each. Both firms are in the 40% tax bracket and the cost of capital of the ungeared firm is 12%. Net Operating profits for both firms is K£200,000.

Required :

- i) Proof of all MM propositions using the above data. (16 Marks)
- ii) Highlight the main conclusions that can be drawn from the MM hypothesis on COST OF CAPITAL and VALUATION, CAPITAL STRUCTURE and COST OF CAPITAL. (4 Marks)

Question 5.

Write short notes on the following:

- a) OPERATING LEASE (5 Marks)
- b) FULL PAYOUT LEASE (5 Marks)
- c) SALE AND LEASEBACK TRANSACTION (3 Marks)
- d) AGENCY THEORY IN FINANCE (3 Marks)
- e) CORPORATE GOVERNANCE and SOCIAL RESPONSIBILITY (4 Marks)

Question 6.

- a) Concisely, describe the Relevance of Dividend Policy school of thought under the following headings:
 - i) GORDON'S MODEL (4 Marks)
 - ii) WALTER'S MODEL (4 Marks)
 - iii) THE BIRD-IN-HAND VIEW (4 Marks)
- b) Highlight on the practical considerations when formulating a credible dividend policy. (4 Marks)
- c) A firm's dividend policy is 50% payout. Its EPS=Ksh. 30. The rate of return on internal investment is 20%. Shareholders require a 15% return on their share capital investment. Determine the current market price per share under:
 - i) GORDON'S MODEL (2 Marks)
 - ii) WALTER'S MODEL (2 Marks)

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TABLE A-2

Present value of \$1 to be received after r periods = $1/(1+r)^t$

Period	Interest Rate									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	0.9803	0.9612	0.9426	0.9246	0.9070	0.8900	0.8734	0.8573	0.8417	0.8264
3	0.9706	0.9423	0.9151	0.8890	0.8638	0.8396	0.8163	0.7938	0.7722	0.7513
4	0.9610	0.9238	0.8885	0.8548	0.8227	0.7921	0.7629	0.7350	0.7084	0.6830
5	0.9515	0.9057	0.8626	0.8219	0.7835	0.7473	0.7130	0.6806	0.6499	0.6209
6	0.9420	0.8880	0.8375	0.7903	0.7462	0.7050	0.6663	0.6302	0.5963	0.5645
7	0.9327	0.8706	0.8131	0.7599	0.7107	0.6651	0.6227	0.5835	0.5470	0.5132
8	0.9235	0.8535	0.7894	0.7307	0.6768	0.6274	0.5820	0.5403	0.5019	0.4665
9	0.9143	0.8388	0.7684	0.7026	0.6446	0.5919	0.5439	0.5002	0.4604	0.4241
10	0.9053	0.8203	0.7441	0.6756	0.6139	0.5584	0.5083	0.4632	0.4224	0.3855
11	0.8963	0.8043	0.7224	0.6496	0.5847	0.5268	0.4751	0.4289	0.3875	0.3505
12	0.8874	0.7885	0.7014	0.6246	0.5568	0.4970	0.4440	0.3971	0.3555	0.3186
13	0.8787	0.7730	0.6810	0.6006	0.5303	0.4688	0.4150	0.3677	0.3262	0.2892
14	0.8700	0.7579	0.6611	0.5775	0.5051	0.4423	0.3878	0.3405	0.2992	0.2633
15	0.8613	0.7430	0.6419	0.5553	0.4810	0.4173	0.3624	0.3152	0.2745	0.2394
16	0.8528	0.7284	0.6232	0.5339	0.4581	0.3936	0.3387	0.2919	0.2519	0.2176
17	0.8444	0.7142	0.6050	0.5134	0.4363	0.3714	0.3166	0.2703	0.2311	0.1978
18	0.8360	0.7002	0.5874	0.4936	0.4155	0.3503	0.2955	0.2502	0.2120	0.1799
19	0.8277	0.6864	0.5703	0.4746	0.3957	0.3305	0.2757	0.2317	0.1945	0.1635
20	0.8195	0.6730	0.5537	0.4564	0.3769	0.3118	0.2584	0.2145	0.1784	0.1486
21	0.8114	0.6598	0.5375	0.4388	0.3589	0.2942	0.2415	0.1987	0.1637	0.1351
22	0.8034	0.6468	0.5219	0.4220	0.3418	0.2775	0.2257	0.1839	0.1502	0.1228
23	0.7954	0.6342	0.5067	0.4057	0.3256	0.2618	0.2109	0.1703	0.1378	0.1117
24	0.7876	0.6217	0.4919	0.3901	0.3101	0.2470	0.1971	0.1577	0.1264	0.1015
25	0.7798	0.6095	0.4776	0.3751	0.2953	0.2330	0.1842	0.1460	0.1160	0.0923
30	0.7419	0.5521	0.4120	0.3083	0.2314	0.1741	0.1314	0.0994	0.0754	0.0573
40	0.6717	0.4529	0.3066	0.2083	0.1420	0.0972	0.0668	0.0460	0.0318	0.0221
50	0.6080	0.3715	0.2281	0.1407	0.0872	0.0543	0.0339	0.0213	0.0134	0.0085

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The factor is zero to four decimal places.

Present value of an annuity of \$1 per period for t periods = $\frac{1 - 1/(1 + r)^t}{r}$

Number of Periods	Interest Rate									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4868
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684
8	7.6517	7.3555	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	6.0021	5.7750
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1466
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8889	7.4987	7.1390	6.8052	6.4951
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137
13	12.1337	11.3484	10.6350	9.9856	9.3956	8.8527	8.3577	7.9038	7.4889	7.1034
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014
19	17.2280	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136
21	18.8570	17.0112	15.4150	14.0292	12.8212	11.7641	10.8355	10.0168	9.2922	8.6487
22	19.6604	17.6580	15.9369	14.4511	13.1630	12.0416	11.0612	10.2007	9.4424	8.7715
23	20.4553	18.2922	16.4436	14.8568	13.4886	12.3034	11.2722	10.3741	9.5802	8.8832
24	21.2434	18.9139	16.9355	15.2470	13.7986	12.5504	11.4693	10.5288	9.7066	8.9847
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148

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Number of Periods	Interest Rate										
	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	0.9091	0.8928	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576	0.7353
2	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315	1.2760
3	2.4868	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663	1.6735
4	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5867	2.4043	2.2410	2.0957	1.9658
5	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452	2.1807
6	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342	2.3388
7	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775	2.4550
8	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860	2.5404
9	5.7590	5.3282	4.9454	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681	2.6033
10	6.1466	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304	2.6495
11	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776	2.6634
12	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133	2.7084
13	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5227	3.9124	3.4272	3.0404	2.7268
14	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609	2.7403
15	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6765	4.0013	3.4834	3.0764	2.7502
16	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882	2.7675
17	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971	2.7829
18	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039	2.7868
19	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090	2.7897
20	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129	2.7718
21	8.6487	7.5620	6.6870	6.3125	5.9731	5.3837	4.8913	4.1212	3.5514	3.1158	2.7734
22	8.7715	7.6446	6.7429	6.3587	6.0113	5.4099	4.9094	4.1300	3.5558	3.1180	2.7746
23	8.8832	7.7184	6.7921	6.3988	6.0442	5.4321	4.9245	4.1371	3.5592	3.1197	2.7754
24	8.9847	7.7843	6.8351	6.4338	6.0726	5.4509	4.9371	4.1428	3.5619	3.1210	2.7760
25	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220	2.7765
30	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242	2.7775
40	9.7791	8.2438	7.1050	6.5418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250	2.7778
50	9.9148	8.3045	7.1327	6.5605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250	2.7778