



**MURANG'A UNIVERSITY COLLEGE (MRUC)**  
(A Constituent College of Jomo Kenyatta university of Agriculture & Technology)

**SCHOOL OF BUSINESS AND ECONOMICS**  
**DEPARTMENT OF COMMERCE**  
**SPECIAL/SUPPLEMENTARY EXAMS**  
**HBF 2302; ADVANCED FINANCIAL MANAGEMENT**  
**MAIN CAMPUS**

**YEAR 3, SEMESTER I, (BCom,)**

**2014/2015 ACADEMIC YEAR**

**DATE: 5<sup>TH</sup> AUGUST 2015**

**TIME: 2.00-4.00PM**

**INSTRUCTIONS**

Answer Question *ONE* and any *OTHER TWO* Questions.

**COMPULSORY QUESTION (30 MARKS)**

**QUESTION ONE**

- (a) Discuss the methods that can be used by a company to resolve agency conflicts between managers and shareholders (7 Marks)
- (b) Differentiate between;
- i) External and internal capital rating (2 Marks)
  - ii) Divisible and indivisible projects (2 Marks)
- (c) ABC LTD has the following proposed independent projects for the year ending December 31/2013

	Project Net Investment	Present value of future
	Outlay	Net cash flow
	sh '000'	sh '000'
A	500	1000
B	1,000	2,500
C	400	300
D	300	400
E	200	300

### Required

- i) Assuming that there is no capital rationing indicate which project should be selected (3 Marks)
  - ii) Total net present value (NPV) of the selected projects (3Marks)
  - iii) Assuming a single period internal capital constraints of sh. 1,700,000 is imposed indicate which projects should be selected based on NPV and profitability index(PI) respectively (4 Marks)
  - iv) Which of the two techniques is to be preferred. Justify your choice (2 Marks)
- (d) Outline the role of a finance manager in contemporary setup (7 Marks)

**(TOTAL: 30 MARKS)**

### QUESTION TWO

- (a) KK Ltd and PK Ltd are in the same business risk class each with operating profits of sh. 4million. However, they differ in their capital structure since PK Ltd has 8% sh10 million debt. The corporate tax rate is 30% and the cost of equity of KK Ltd is 14%
- Required
- i. Compute the market value of each firm (4 Marks)
  - ii. Compute the market value of equity of PK Ltd (4 Marks)
  - iii. Compute the cost of equity of PK Ltd(5Marks)
- (b) Discuss the pecking order theory of capital structure by Masilluf (7 Marks)

**(TOTAL: 20 MARKS)**

### QUESTION THREE

Kilimo Ltd is a newly incorporated firm which wants to raise shs.10million to finance an acquisition of machinery. Three financing plans have been suggested earnings before interest and tax (EBIT) is sh 1,500,000 p.a

1. Issue 1,000,000 ordinary shares at sh10mps
2. Issue 500,000 ordinary shares at sh10mps and a 10% sh 5 million debenture
3. Issue 300,000 ordinary shares at sh10 mps and a 10 % shs 7 million debenture

## Required

- a. Dividend paid and Dps (4 Marks)
  - b. The cost of equity (3 Marks)
  - c. The cost of debt (3 Marks)
  - d. The Mps (3 Marks)
  - e. WACC (4Marks)
  - f. Total market value of the firm (3 Marks)
- (TOTAL:20 MARKS)**

## QUESTION FOUR

- (a) Discuss the effect of the following concepts on the firms dividend policy
- i) Clientele effect (4 Marks)
  - ii) A bird in the hand (4 Marks)
  - iii) "Home-made" dividend (3 Marks)
- (b) Bright ltd undertook project x with the following cash flow over its useful life of 3 years.

The cost of capital for the project have been shown below

Year	cash flow	Abandonment value
	Sh '000'	sh'000'
0	(9,600)	9600
1	4000	6000
2	3750	3800
3	3500	0

## Required

Advice the management of Bright ltd when the abandon project 'X'

(9 Marks)

**(TOTAL: 20 MARKS)**

## QUESTION FIVE

- (a) Karatina industries wishes to expand its output by purchasing a new machine worth 170 million and installation cost are estimated. In the 4<sup>th</sup> year, this machine will require an overhaul cost of sh 80 million. Its expected inflows are:

Year	sh (Million)
1	60
2	72.65
3	35.720
4	48.570
5	91.630
6	83.715

This contemporary can raise finance to purchase machine at 12% interest rate. Complete NPV and advise management accordingly

(10 Marks)

- (b) For the year ended JP Ltd reported profits after tax amounting to sh. 8,800,000. The firm has 1,100,000 shares outstanding and usually adopts a residential dividend policy whereby 60% of the profits are transferred to reserve for investments purposes and the remainder is paid out as dividends. The cost of equity of the firm is 15%. The intrinsic value of a share can be estimated under the following three conditions

- i. No growth in dividends due to possible economic decline
- ii. The DPs and other earning will increase by 10% p.a incase of economic recovery
- iii. If there is economic prosperity the EPS and DPS will grow by 10% for the first 2 years, 12% for the next 3 years and 5% thereafter

### **Required**

Determine the intrinsic value under each of the above economic situation

(10 marks)

**(TOTAL: 20 MARKS)**