



# **MURANG'A UNIVERSITY COLLEGE**

(A constituent College of Jomo Kenyatta University of Agriculture & Technology)

**MAINCAMPUS**

**ORDINARY UNIVERSITY EXAMINATIONS**

**2015/2016 ACADEMIC YEAR**

**THIRD YEAR SECOND SEMESTER EXAMINATIONS**

**FOR THE DEGREE**

**OF**

**BACHELOR OF COMMERCE**

**COURSE CODE: HBF 2302;**

**COURSE TITLE: ADVANCED FINANCIAL MANAGEMENT**

**DATE: 21<sup>ST</sup> APRIL 2016**

**TIME: 2 HOURS**

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## **INSTRUCTIONS TO CANDIDATES**

Question ONE (1) is compulsory  
Answer ANY other TWO (2) questions  
Marks are indicated alongside the questions

MRUC observes ZERO tolerance to examination irregularities

This Paper Consists of 5 Printed Pages. Please Turn Over. ►

## QUESTION ONE

- (a) Discuss the importance of the concept of “Time value of money”. (4mks)
- (b) Differentiate between;
- (i) Profit after tax and cash flow. (2mks)
  - (ii) Hard rationing and soft rationing. (2mks)
  - (iii) Mutually exclusive projects and Independent projects (2mks)
  - (iv) The Net present value and the Profitability Index. (2mks)
  - (v) Financial leverage and operating leverage. (2mks)
- (c) Discuss any four factors that a company should consider when choosing between equity and debt as a source of finance. (4mks)
- (d) Explain factors that affect the cost of :  
(i) A Bond. (3mks)  
(ii) Externally sourced equities. (3mks)
- (e) XYZ Ltd undertook project ‘Q’ with the following cash flow over its useful life of 5 years. The cost of capital for the project is 12%. The abandonment values of the project have been given below:-

Year	cash flow Sh000’	Abandonment values Sh000’
0	(14,400)	14,400
1	7,500	11,600
2	6,000	9,000
3	5,625	5,700
4	5,250	3,400
5	4,500	0

### Required

- Advice the management of XYZ limited on when to abandon the project ‘Q’. (6mks)

**[Total: 30 marks]**

## QUESTION TWO

- a) Discuss the role of a Financial Manager in any organization. (5mks)
- b) UBER Company is currently paying a dividend of sh. 2.00 per share. The following are the expected annual growth rates for the dividend.

Year	Dividend growth rate(%)
1-3	25
4-6	20
7-9	15
10 and thereafter indefinitely	9

The rate of return is 14%

### Required

The intrinsic value of the share (15mrks)

[Total 20marks]

## QUESTION THREE

- (a) (i) Define “financial innovation”. (2 Marks)
- (ii) Discuss three factors that lead to financial innovation in the economy of your country.(3 Marks)
- (b) ABC ltd had the following capital structure as at 31<sup>th</sup> December 2015.

	Ksh.”Million”
8 Million fully paid Ordinary shares	80
Retained earnings	20
2.5 Million 7.5% preference share capital	40
600,000 10% Long-Term debentures	<u>60</u>
	<u>200</u>

The company intends to raise additional finance as follows;

- (i) Sh60 Million from issuing 6% debentures. The debentures of the company have a face value of sh.100 each with a market value of sh.125.

- (ii) Sh45 Million from selling new ordinary shares at a floating cost of Sh. 1.5per share.
- (iii) The current market value of each ordinary share is Sh.50.The shareholders expect a dividend of Sh.4 per share next year. The dividend grows at the rate of 12% per annum into perpetuity
- (iv) The company's tax rate is 35%.

**Required:**

- (i) The weighted average cost of capital [WACC] of the firm as at 30<sup>th</sup> April 2015. (8marks)
- (ii) The marginal cost of capital (7marks)

**[Total 20marks]**

**QUESTION FOUR**

- (a) Explain the relationship between;
  - (i) Risk and return. (2 Marks)
  - (ii) Cost of capital and the Net Present Value (2 Marks)

(b) Kizingitini Limited is considering the launch of the new product `NAZII` for which an investment of Sh.9 million in plant and machineries will be required. The production of `NAZII` is expected to last for five years after which the plant and machineries would be sold for Sh. 3.3 million

**Additional Information:**

1. `NAZII` would be sold at sh720 per unit with a variable cost of sh450 per unit.
2. Fixed production cost [excluding depreciation] would amount to sh280,000 per annum.
3. The company applies the straight line method of depreciation.
4. The cost of capital is 10% per annum.
5. The number of units of `NAZII` expected to be produced and sold per annum for the next five years is shown below:-

Year	Units expected to be produced and sold
1	11,000
2	10,000
3	9,000
4	7,500
5	6,000

6. The corporation tax rate is 35%.

**Required**

- (i) Compute the Net Present Value(NPV) of the project and advise the management of Kizingitini ltd on the appropriate course of action. [8mks]
- (ii) Determine the internal rate of return [IRR] of the project and advise the management of Kizingitini ltd on the appropriate course of action. [8mks]

**(Total; 20mks)**