

**HBF 2302; ADVANCED FINANCIAL MANAGEMENT**



**MURANG'A UNIVERSITY COLLEGE**

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

**MAINCAMPUS**

**ORDINARY UNIVERSITY EXAMINATIONS**

**2015/2016 ACADEMIC YEAR**

**THIRD YEAR FIRST SEMESTER EXAMINATIONS**

**FOR THE DEGREE**

**OF**

**BACHELOR OF COMMERCE**

**COURSE CODE: HBF 2302;**

**COURSE TITLE: ADVANCED FINANCIAL MANAGEMENT**

**DATE: 15<sup>TH</sup> DECEMBER, 2015**

**TIME 2 HOURS**

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**INSTRUCTIONS TO CANDIDATES**

Question ONE (1) is compulsory

Answer THREE (3) questions

Marks are indicated alongside the questions



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### QUESTION ONE

- (a) Explain the causes of conflict between shareholders and the Directors (4mks)
- (b) Differentiate between;
- (i) Weighted average cost of capital and marginal cost of capital. (2mks)
- (ii) Hard rationing and soft rationing. (2mks)
- (iii) Mutually exclusive projects and Independent projects (2mks)
- (c) Discuss the theories of Dividends. (4mks)
- (d) Impala Limited is considering the launch of the new product 'UTZ' for which an investment of Sh.9 million in plant and machineries will be required. The production of 'UTZ' is expected to last for five years after which the plant and machineries would be sold for Sh. 3.3 million

#### Additional Information:

- 'UTZ' would be sold at sh720 per unit with a variable cost of sh450 per annum.
- Fixed production cost [including depreciation] would amount to sh580,000 per annum.
- The company applies the straight line method of depreciation.
- The cost of capital is 12% per annum.
- The number of units of 'UTZ' 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	10,000
2	6,000
3	7,500
4	9,000
5	11,000

- The corporation tax rate is 30%.

#### Required

Advise the management of Impara Ltd on the appropriate course of action using;

- [i] The net present value [NPV] approach [8mks]
- [ii] The initial rate of return [IRR] approach [8mks]

**[Total: 30 marks]**

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### QUESTION TWO

- a) Discuss factors to be considered when making a Dividend decision (6mks)
- b) Explain the following theories of Capital structure. (3mks)
- (i) Pecking order theory.
- (ii) Arbitrage(3mks)
- c) ABC ltd has the following capital structure as at 30<sup>th</sup>April 2015.

Sh. "Million"	
9 Million fully paid Ordinary shares	90
Retained earnings	60
2.5 Million 5% preference share capital	40
600,000 10% Long-Term debentures	<u>60</u>
	<u>250</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 30%.

#### Required:

- (i)The weighted average cost of capital [WACC] of the firm as at 30<sup>th</sup>April 2015. (5marks)
- (ii) The marginal cost of capital (3marks)

[Total 20marks]

### QUESTION THREE

- a) Differentiate between Financial leverage and Financial risk (4mks)
- b) ABC Ltd undertook project 'P' with the following cash flow over its useful life of 4 years. The cost of capital for the project is 15%. The abandonment values of the project have been given below:-

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

### Required

Advice the management of ABC ltd, on when to abandon the project 'P'. (8mks)

- c) The data below relate to the financial performance of PQR Limited for the year ended 31 August 2015;  
Sh "000"

Earnings before interest and tax	4,480
Interest	3,200
Fixed cost	2,800

### Required:

- (i) Contribution (1 mark)
- (ii) Degree of Financial leverage (2marks)
- (iii) Degree of operating leverage (1mark)
- (iv) Degree of combined leverage (2marks)
- (v) Percentage change in sales if earnings per share increase by 25% (3marks)

[Total 20mks]

## QUESTION FOUR

- a) Explain the position of Modigliani-Miller (MM) on the issue of capital structure, ignoring the corporate income taxes. (5marks)

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- b) PKL Company is currently paying a dividend of sh. 2.00 per share. The dividend is expected to grow at a rate of 15% per annum for three years, then at 10% rate for the next 3 years, after which it is expected to grow at a 5% rate forever.

What is the present value of the share if the rate of return is 9% (15mrks)

**(Total; 20mks)**