

HBF 2404;
CONTEMPORARY FINANCIAL MANAGEMENT



MURANG'A UNIVERSITY COLLEGE

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

MAIN CAMPUS

SPECIAL/SUPPLEMENTARY UNIVERSITY EXAMINATIONS

2015/2016 ACADEMIC YEAR

THIRD YEAR FIRST SEMESTER EXAMINATIONS

FOR THE DEGREE

OF

BACHELOR OF COMMERCE

COURSE CODE: HBF 2404;

**COURSE TITLE: CONTEMPORARY FINANCIAL
MANAGEMENT**

DATE:TIME.....

INSTRUCTIONS TO CANDIDATES

Question ONE (1) is compulsory
Answer ANY other TWO (2) questions

MRUC observes ZERO tolerance to examination irregularities

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QUESTION ONE

- a) Highlight factors to be considered when making a capital structure decision. (6 Marks)
- b) Discuss the assumptions of capital assets pricing model. (5 Marks)
- c) Explain how weak companies protect themselves from predating companies.(5 Marks)
- d) An investor has two securities, K and L, with the following return characteristics:

State of economy	Probability	Returns Security K (%)	Returns Security L (%)
Recession	0.2	18	10.8
Stable	0.5	22.5	13.5
Boom	0.3	15	9

Required:

- (i) Compute the expected returns of K and L (3marks)
- (ii) Compute the standard deviation of the individual securities (3marks)
- (iii) Compute the correlation coefficient between the two securities returns and comment (3marks)
- (iv) Compute portfolio expected return for portfolio consisting of 75% of K and the rest being of L (3marks)
- (v) Assess the riskiness of securities K and L (2marks)

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[Total: 30 marks]

QUESTION TWO

- a) Determine any **six** factors to be considered when making a Dividend Policy decision. (4Marks)
- b) Discuss the Pecking order theory. (4Marks)
- c) ABC Ltd. is considering acquiring XYZ Ltd. The selected financial data for the two companies for the year ended December 31, 2015, are as follows:

	Maxi. ltd	Mini. ltd
Annual sales sh. million	750	90
Net income (sh. million)	60	7.50
Ordinary shares outstanding (million)	15	3
Earnings per share (EPS) (sh)	4	2.50
Market price per share (sh)	44	20

Both companies are in the 30% tax bracket.

Required:

- a) Calculate the maximum ratios ABC Ltd. should agree if it expects no dilution in earning per share. (3 marks)
- b) How much premium would the shareholders of XYZ Ltd receive at this exchange ratio? (2 marks)
- c) Calculate maxi Ltd.'s post-merger EPS if the two companies settle on a price of sh.24.20. (2 marks)
- d) Calculate Maxi Ltd.'s EPS of XYZ Ltd.'s shareholders accept one sh.6 convertible preference share (stated value sh.100) for every 5 ordinary shares they own. (2 marks)

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- e) Calculate ABC Ltd.'s EPS if every 50 shares of XYZ Ltd are exchanged for one 8% debenture at par value. sh 1,000 (3 marks)

[Total 20marks]

QUESTION THREE

- a) Differentiate between Yield to maturity and Yield to Call (2 Marks)
- b) A10% 10-year bond with the par value being Sh.1,000, is redeemable in six (6) years at a call price of Sh.1,050. The bond is currently selling for Sh 960.

Required;

- Determine the yield to call (4 Marks)
- c) Company XYZ Ltd has 500,000 shares currently trading at Sh.150 each in the Nairobi Securities Exchange. The expected dividend to be received in the year 2017 will be Sh.3 per share. The company intends to invest Sh.25, 000,000 in an investment opportunity that is intended to boost the Shareholders' wealth. The company's current year's profit is sh.15, 000,000 and its cost of capital is 10%.

Required;

- i. The share price in the year 2017 if the company;
- I. Pays dividend. (2 Marks)
 - II. Does not pay dividend. (2 Marks)
- ii. The number of new shares to be floated if the company;
- I. Pays dividend (4 Marks)
 - II. Does not pay dividend. (4 Marks)
- iii. Show that the payment of dividends does not affect the value of the firm. (2 Marks)

(Total; 20mks)

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QUESTION FOUR

- a) Discuss the “Term Structure of the Interest Rates” . (5 marks)
- b) Explain factors that affect Bond yield. (5 marks)
- c) Discuss the various dividend irrelevancy theories. (5 marks)
- d) Highlight the contemporary issues related to Financial Management. (5 marks)

(Total 20 marks)