(*Knowledge for Development)*

**KIBABII UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**2021/2022 ACADEMIC YEAR**

**FIRST YEAR SECOND SEMESTER**

**MAIN EXAMINATION**

**FOR THE DEGREE OF MASTERS IN BUSINESS ADMINISTRATION**

**COURSE CODE: MBA 808**

**COURSE TITLE**: FINANCIAL MANAGEMENT

**DATE:30TH NOVEMBER,2021** **TIME: 9.00AM – 12NOON**

**INSTRUCTIONS TO CANDIDATES**

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 3 Hours

KIBU observes ZERO tolerance to examination cheating

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

## SECTION A

## QUESTION ONE

a) A company has 10% perpetual debt of Ksh. 100,000. The tax rate is 35%. Determine the cost of capital (before tax as well as after tax) assuming the debt is issued at

i) Par (2mkks)

ii) 10% discount (2mks)

iii) 10% premium (2mks)

b) You won ksh. 7M from betting. Being unemployed you wish to have a regular income over the next ten years. You have been approached by a life insurance company that sells annuity contracts and will pay you a fixed amount annually for ten years. Your opportunity cost of funds is 12%. How much annual income will you be receiving? (6 mks)

c) ABC. Plc. Share had been found to be 1.25 reflecting the fact that its excess return varies more than proportionately in relation to the excess return in the market. The directors believe that this relationship will continue into the future. If the market index return is 15% and the return of treasury bills is 12% calculate the cost of equity of ABC. Plc (4mks)

d) The capital structure of a concern depends upon a large number of factors. Discuss atleast seven factors affecting an organization (14mks)

## SECTION B

## QUESTION TWO

Calculate the following ratios from the following accounts of a manufacturer of products for the construction industry and comment on the ratios.

| | **2010** | **2009** |
|---|---|---|
| Sales revenue | 2,065.0 | 1,788.7 |
| Cost of sales | (1,478.6) | (1,304.0) |
| **Gross profit** | **586.4** | **484.7** |

| | | |
|---|---|---|
| | 2010 | 2011 |
| **Current Assets** | | |
| Inventories | 119.0 | 109.0 |
| Accounts Receivables | 400.9 | 347.4 |
| Short term investments | 4.2 | 18.8 |
| Cash at bank and in hand | 48.2 | 48.0 |
| **Total current assets** | **572.3** | **523.2** |
| **Current liabilities** | | |
| Loans and overdrafts | 49.1 | 35.3 |
| Corporation taxes | 62.0 | 46.7 |
| Dividend | 19.2 | 14.3 |
| Accounts payable | 370.7 | 324.0 |
| Net current assets | 71.3 | 102.9 |
| | **572.3** | **523.2** |

**Notes:**

| | 2010 | 2009 |
|---|---|---|
| 1) Trade accounts | 329.8 | 285.4 |
| 2) Trade accounts payable | 236.2 | 210.8 |

**Required:**

i. Current Ratio (3mks)
ii. Quick ratio (3mks)
iii. Accounts receivable turnover (3mks)
iv. Inventory turnover period (3mks)
v. Accounts payable turnover period (3mks)

## QUESTION THREE

a) Alpha company is contemplating conversion of 500 14% convertible bonds of Ksh. 1,000 each. Market price of bond is Ksh. 1,080. Bond indenture provides that one bond will be exchanged for 10 share. Price earnings ratio before redemption is 20:1 and anticipated price earnings ratio after redemption is 25:1. Number of shares outstanding prior to redemption are 10,000. EBIT amounts to Ksh. 200,000. The company is in the 35% tax bracket. Should the company convert bonds into share? Give reasons. (8mks)

b) While ratios are very important tools of financial analysis, they have some limitations. State and explain such limitations (7mks)

## QUESTION FOUR

a) Alhaji invested in the sum of Ks. 80,000 in a poultry project. He estimated that the project will yield the following after tax returns annually for the next five years, Ks. 20,000, Ks. 40,000, Ks. 60,000 Ks. 80,000 and Ks. 120,000 respectively. The poultry house is expected to be depreciated on a straight line basis.

**Required;**

Provide the accounting rate of return of the project. (10mks)

b) State and explain atleast five importance of Working Capital management (5mks)

## QUESTION FIVE

XYZ Ltd has 900,000 shares outstanding at current market price of Sh 130 per share. The company needs Sh 22,500,000 to finance its proposed expansion. The board of directors has decided to issue rights for raising the required funds. The subscription price has been fixed at Sh 75 per share.

**Required:**

(a) How many rights are required to purchase one new share? (5mks)

(b) What is the price of one share after the rights issue (Ex-right price)? (3 mks)

(c) Compute the theoretical value of each right (2mks)

(d) Consider the effect of the rights issue on the shareholders' wealth under the three options available to the shareholders (Assume he owns 3 shares and has Sh 75 cash on hand). (5mks)