PAN AFRICA CHRISTIAN UNIVERSITY

MASTERS OF BUSINESS ADMINISTRATION

END OF TERM EXAMINATION

DEPARTMENT: BUSINESS

COURSE CODE: MBA 506

COURSE TITLE: FINANCIAL MANAGEMENT

EXAM DATE: FRIDAY; JULY 31st, 2015

TIME: 1730HRS – 2030HRS

INSTRUCTIONS

- Read all questions carefully before attempting.
- Answer ANY FIVE questions
- Write your **student number** on the answer booklet provided.

QUESTION 1

a) What do you understand by flotation costs? **(2mrks)**

b) Explain how flotation costs affect the cost of capital **(6mrks).**

c) A company is evaluating its cost of capital under two alternative financing arrangements shown below. In consultation with investment bankers, the company expects to issue new debt securities with a coupon rate of 10% and to issue new preferred stock at Kshs 25 per share that pays an annual dividend of Kshs 4.00 per share. The common stock of the firm is currently selling for Kshs 20.00 a share and the firm expects to pay a dividend of Kshs 2.50 per share next year. The analysts have forecasted a growth in dividends at a rate of 5% per year. The firm's marginal tax rate is 40%.

Financing plan	Proportion of Debt	Proportion of Preferred stock	Proportion of Common stock
1	20%	30%	50%
2	50%	30%	20%

Determine the cost of capital for the firm under each financing arrangement and advice the management on which is the best plan **(12mrks).**

QUESTION 2

a) Discuss the three main sources of capital available to a corporate entity clearly articulating the advantages and disadvantages of each

(15mrks)

a. Briefly discuss **three types** of decisions made by a finance manager of a firm

(5mrks)

QUESTION 3

a) Distinguish between Coupon rate and Yield in the context of valuation of debt securities **(4mrks)**

b) Determine the current market value of a straight coupon bond that pays interest semi-annually and with the following additional features:
Maturity value = Kshs 1,000,000
Coupon rate per year = 12%
Yield to maturity = 10%

Remaining period to maturity = 10 years
Assume no withholding taxes **(10 mrks)**

c) If your required rate of return per year in the above circumstance rose to 12%, determine the maximum price you would be willing to pay for the bond **(6mrks)**

QUESTION 4

a) XYZ Company Ltd has 1,000,000 shares of common stock outstanding. The company paid total dividends of Kshs 6,000,000 on common stock this year. Dividends are expected to grow at a rate of 4% per year and the investor's required rate of return on common stock is 7%. Using the dividend valuation model (DVM), determine the value of a share of common stock **(6mrks)**

b) Explain the scope and the role of financial management in a corporate entity

(10mrks)

c) Explain briefly why cash today is preferable than the same amount of cash receivable in future **(4mrks)**

QUESTION 5

a) Write brief notes on the following terms within the context of corporate financial management:

i. Required rate of return **(3mrks)**
ii. Preference shares **(2mrks)**
iii. Annuity cash flow **(2mrks)**

b) Okal is considering an investment project whose cash flows are projected as below:

End of Period	**Cash flow (Kshs)**
1	400,000
2	300,000
3	450,000
4	500,000
5	700,000

Okal considers a required rate of return of 12% P.a sufficient after taking into account the expected inflation and the risk of the project's cash flows.

Determine the present value of the expected cash flows **(8mrks)**

c) If in the above situation (part b) Okal estimates that the project will generate a constant cash flow of Kshs 800,000 per year over the five years, determine the present value of the project's cash flows. **(5mrks)**

QUESTION 6

a) Determine the future value of Kshs 10,000 deposited in a bank account at the end of every year for the next 7 years if the bank pays a compound interest at a rate of 12% per year **(6mrks)**

b) Martin is planning to start a poultry project 10 years from now. He expects to raise Kshs 2 million as capital for the project. Towards this end, he has approached the bank manager who has advised him to open a savings account with the bank and start depositing money every end of the month. The bank Manager has offered to pay martin a compound interest on deposits at a rate of 12% p.a. as long as Martin does not make any withdrawals in the intermediate period. Martin doesn't know how much he should be depositing every year in order for him to accumulate the required amount by end of the 10^{th} year. He has approached you for an advice. Using the knowledge you have on time value of money and cash flow valuations, advice Martin **(8mrks)**

c) Determine the Number of years that a deposit of Kshs 100,000 is expected to remain in an account earning interest at a rate of 12% p.a. if the owner of the account expects to withdraw Kshs 300,000 at the end (assume no withdrawals are made) **(6mrks).**