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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2018/2019 ACADEMIC YEAR TWO**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DIPLOMA IN BUSINESS MANAGEMENT**

**COURSE CODE: DBM 19**

**COURSE TITLE: INTRODUCTION TO FINANCIAL MANAGEMENT**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 23/08/2021 TIME: 12.00-2.00 PM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of THREE (3) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. Nuriye limited wishes to expand its output by purchasing a new machine worth 170,000 and installation costs are estimated at 40,000/=. In the 4th year, this machine will call for an overhaul to cost 80,000/=. Its expected inflows are:

 Shs.

 Year 1 60,000

 Year 2 72,650

 Year 3 35,720

 Year 4 48,510

 Year 5 91,630

 Year 6 83,715

This company can raise finance to purchase machine at 12% interest rate. Compute NPV and advise management accordingly. (8 marks)

1. State the disadvantages of using NPV in assessing the viability of a project (2marks)
2. The finance manager spends most of his time making managerial finance decisions as opposed to routine functions". Discuss. (20 marks)

**QUESTION TWO**

A company is considering two mutually exclusive projects requiring an initial cash outlay of Sh 10,000 each and with a useful life of 5 years. The company required rate of return is 10% and the appropriate corporate tax rate is 50%. The projects will be depreciated on a straight line basis. The before depreciation and taxes cash flows expected to be generated by the projects are as follows.

***YEAR year 1 2 3 4 5***

 Project A Shs 4,000 4,000 4,000 4,000 4,000

 Project B Shs 6,000 3,000 2,000 5,000 5,000

**Required:**

Calculate for each project (20 marks)

1. The payback period
2. The average rate of return
3. The net present value
4. Profitability index
5. Which project should be accepted? Why

**QUESTION THREE**

1. Explain the reasons why firms in the same industry with equal earnings and share capital would pay different amount of dividends? (5 marks)
2. Explain any theories on dividends (15 marks)

**QUESTION FOUR**

The following is the capital structure of XYZ Ltd as at 31/12/2002.

|  |  |
| --- | --- |
| Ordinary share capital Sh.10 par valueRetained earnings10% preference share capital Sh.20 par value12% debenture Sh.100 par value | Shs.M400200100200900 |

**Additional information**

1. Corporate tax rate is 30%

2. Preference shares were issued 10 years ago and are still selling at par value MPS = Par value

3. The debenture has a 10 year maturity period. It is currently selling at Sh.90 in the market.

4. Currently the firm has been paying dividend per share of Sh.5. The DPS is expected to grow at 5% p.a. in future. The current MPS is Sh.40.

**Required**

1. Determine the WACC of the firm. (10 Marks)
2. Explain why market values and not book values are used to determine the weights. (4 marks)
3. What are the weaknesses associated with WACC when used as the discounting rate, in project? (6 marks)

**QUESTION FIVE**

1. Explain the reasons why firms in the same industry with equal earnings and share capital would pay different amount of dividends? (5 marks)
2. Explain any theories on dividends (15 marks)