Ser. No. MBA 214/18

GARISSA UNIVERSITY

UNIVERSITY EXAMINATION 2017/2018 ACADEMIC YEAR ONE SECOND SEMESTER EXAMINATION

SCHOOL OF BUSINESS AND ECONOMICS

FOR THE DEGREE OF MASTER OF BUSINESS ADMINISRATION

COURSE CODE: MBA 811

COURSE TITLE: FINANCIAL MANAGEMENT

EXAMINATION DURATION: 3 HOURS

DATE: 13/04/18 **TIME: 09.00-12.00 PM**

INSTRUCTION TO CANDIDATES

- **The examination has FIVE (6) questions**
- **Question ONE (1) is COMPULSORY**
- **Choose any other THREE (3) 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 FOUR (4) printed pages ***please turn over***

QUESTION ONE (COMPULSORY)

(a) A company issues 10,000 equity shares of Kshs. 100 each at a premium of 10%. The company has been paying 25% dividend to equity shareholders for the past five years and expects to maintain the same in the future also.

Compute the cost of equity capital. **[3 marks]**

Will it make any difference if the market price of equity share is Kshs. 175? **[3 marks]**

(b) Critically evaluate the assumptions that underlie Miller-Modigliani's dividend mode [**3 marks]**

(c) An investor deposits Kshs10,000. Ten years later it is worth Kshs17,910. What rate of return did the investor earn on the investment? **[3 marks]**

(d) You invest Kshs10,000. During the first year the investment earned 20% for the year. During the second year, you earned only 4% for that year. How much is your original deposit worth at the end of the two years? **[3 marks]**

QUESTION TWO

(a) Describe waltrers dividend policy model pointing out its major assumptions **[3 marks]**

(b) From the following information supplied to you, ascertain whether the firm is following an optional dividend policy as per Walter's Model?

Total Earnings Kshs. 2,00,000

No. of equity shares (of Kshs. 100 each 20,000)

Dividend paid Kshs. 1,00,000

P/E Ratio 10

Return Investment 15%

i. The firm is expected to maintain its rate on return on fresh investments. Also, find out what should be the E/P ratio at which the dividend policy will have no effect on the value of the share. Will your decision change if the P/E ratio is 7.25 and interest of 10% **[12 marks]**

QUESTION THREE

From the following balance sheet of Mr. Arvind Industries Ltd., as 31st March 2007.

Liabilities	**Kshs**	**Assets**	**Kshs**
Equity share capital	10,000	Fixed Assets less depreciation (Kshs 10,00)	26,000
7% preference Share capital	2,000	Current Assets	
Reserve and Surplus	8,000	cash	1,000
6% Mortgage Debentures	14,000	Investments (10%)	3,000
Current Liabilities		Sundry Debtors	4,000
creditors	1,200	Stock	6,000
Bill payable	2,000		
Outstanding expenses	200		
Tax provision	2,600		
	40,000		**40,000**

Other information:

1. Net sales Kshs 60,000

2. Cost of goods sold Kshs. 51,600

3. Net income before tax Kshs. 4,000

4. Net income after tax Kshs. 2,000

Calculate the following ratios.

i. Liquidity ratio **[3 marks]**
ii. Interest coverage ratio **[3 marks]**
iii. Stock turnover ratio **[3 marks]**
iv. Working capital turnover ratio **[3 marks]**
v. Return of investment ratio **[3 marks]**

QUESTION FOUR

(a) Explain any three methods/techniques of financial statement analysis **[6 marks]**

(b) There are two firms 'A' and 'B' which are exactly identical except that A does not use any debt in its financing, while B has Rs. 2,50,000 , 6% Debentures in its financing. Both the firms have earnings before interest and tax of Rs. 75,000 and the equity capitalization rate is 10%. Assuming the corporation tax is 50%, calculate the value of the firm. **[9 marks]**

QUESTION FIVE

(a) The following information is provided:

Cash outflow Kshs. 1,00,000

Annual cash inflow Kshs 25,000

(After tax before depreciation)

Estimate Life 6 years

Compute;

i. Payback period **[3 marks]**
ii. Post pay-back profitability **[3 marks]**
iii. Post pay-back profitability index. **[3 marks]**

(b) Write short notes on the following theories

i. The pecking order theory **[3 marks]**

ii. The trade-off theory **[3 marks]**