2906/306
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FINANCIAL MANAGEMENT
July 2018
Time: 3 hours

THE KENYA NATIONAL EXAMINATIONS COUNCIL

DIPLOMA IN INVESTMENT MANAGEMENT
DIPLOMA IN BUSINESS MANAGEMENT
DIPLOMA IN HUMAN RESOURCE MANAGEMENT

MODULE III

FINANCIAL MANAGEMENT

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of **SEVEN** questions.*
*Answer any **FIVE** questions in the answer booklet provided.*
All questions carry equal marks.
Candidates should answer the questions in English.

This paper consists of 5 printed pages.

Candidates should check the question paper to ascertain that all the pages are printed as indicated and that no questions are missing.

1. (a) Highlight **four** differences between commercial banks and non-banking financial institutions. (8 marks)

(b) Mambo Limited intends to invest in either project K or project L. The initial capital outlay of the project is Ksh 2,000,000. The estimated cash inflows from the projects are as follows:

Year	**Project K**	**Project L**
	Ksh	**Ksh**
1	(120,000)	520,000
2	400,000	72,000
3	500,000	530,000
4	1,300,000	1,600,000
5	1,900,000	1,650,000

The company's cost of capital is 14%.

(i) Calculate the profitability index (P.I) for each of the projects.
(ii) Advise the management on the project to invest in. (12 marks)

2. (a) Explain **four** factors which may affect the working capital cycle of the firm. (8 marks)

(b) I The following information relates to Weba Limited and Mambale Limited for the year ended 31 December 2016.

	Weba Limited Ksh '000'	**Mambale Limited Ksh '000'**
Sales	48,000	76,000
Cost of sales	26,000	44,000
	22,000	32,000
Less Operating expenses	9,600	15,600
Profit before tax	12,400	16,400
Less corporate tax	3,720	4,920
Profit after tax	8,680	11,480

II The issued share capital of each company is as follows:

Weba Limited	Ksh
400,000 ordinary shares of Ksh 20 each	8,000,000
400,000 8% preference shares of Ksh 15 each	6,000,000
	14,000,000

Mambale Limited	
6,00,000 ordinary shares of Ksh 15 each	9,000,000
400,000 12% preference shares of Ksh 10 each	4,000,000
	13,000,000

III Ordinary divided of Weba Limited is 15% while that of Mambale Limited is 10%. The market price of an ordinary share in Weba Limited is Ksh 50 while that of Mambale Limited is Ksh 55.

(i) For each of the companies, calculate the:

I. retention ratio;
II. dividend cover for ordinary shares;
III. earnings per share;
IV. dividend per ordinary shares;
V. price earnings ratio.

(ii) Kamau is considering investing in either of the companies. Using the price Earning Ratio (PER) computed in (i)(v) above, advice him on the company to invest in. (12 marks)

3. (a) Explain **five** functions of the Capital Markets Authority in Kenya. (10 marks)

(b) Maroko Limited intends to rise Ksh 24 million during the forthcoming year as follows:

	Ksh million
1,000,000 fully paid up ordinary shares	10
Retained earnings	4
8% 200,000 preference shares	4
6% 40,000 Debentures	6

Additional Information

- The company's ordinary shares are currently selling at Ksh 24.50 per share.
- The expected dividend of an ordinary shares is Ksh 2.40 per share.

- The average growth rate in earnings and dividends has been 10% and is expected to be sustained.
- Preference shares are currently selling at Ksh 25 per share.
- The company's debentures have a face value of Ksh 100 and are currently selling at par.
- The corporation tax rate is 30%.

Using market values, calculate the company's Weighted Average Cost of Capital (WACC). (10 marks)

4. (a) Highlight **five** negative effects of high gearing in a company. (10 marks)

(b) Explain **five** differences between factoring and invoice discounting as methods of raising finance. (10 marks)

5. (a) Explain **four** challenges that a finance manager may face in an effort to improve the liquidity position of a firm. (8 marks)

(b) The following estimates relate to Mandera Limited for the year 2018.

Month	**Wages Incurred Ksh'000**	**Materials Purchased Ksh'000**	**Overheads Ksh'000**	**Sales Ksh'000**
April	40,000	100,000	64,000	240,000
May	36,000	148,000	56,000	100,000
June	48,000	120,000	72,000	280,000
July	40,000	100,000	64,000	240,000
August	36,000	100,000	56,000	200,000
September	36,000	120,000	56,000	200,000

Additional information:

(i) The expected cash balance on 31 May will be Ksh 188,000,000.
(ii) Wages will be paid in the month they are incurred.
(iii) Creditors will be paid two months after receipt of goods.
(iv) Debtors will pay one month after sale.
(v) Overheads will be paid one month after they are incurred.
(vi) 10% of the monthly sales will be in cash while 90% will be collected one after sale.
(vii) A loan of Ksh 50,000,000 will be paid on 30 June, 2018.

Prepare a cash budget for the months of June, July and August 2018. (12 marks)

6. (a) Langat intends to buy a machine that will cost Ksh 7,000,000 at the end of year 5. To finance this project, he plans to deposit the following amounts in a savings account at the beginning of each year.

Year	Amount (Ksh)
1	1,000,000
2	1,500,000
3	1,000,000
4	800,000

The bank pays a 6% annual interest, compounded quarterly.
Determine the amount of money that he should deposit at the beginning of year 5 to enable him buy the machine. (10 marks)

(b) Outline **five** differences between domestic financial management and international financial management. (10 marks)

7. (a) Explain **four** factors which may influence the capital structure of a company. (8 marks)

(b) The following are the projected returns from security A and security B under different states of nature:

		Returns	%
State	Probability	Security A	Security B
I	0.30	5	6
II	0.50	8	7
III	0.20	3	2

(i) For each of the securities, calculate:

I. the expected return;
II. standard deviation.

(ii) Advise an investor who is conservative on the security to invest in. (12 marks)

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