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**FINANCIAL MANAGEMENT**

November 2018

Time: 3 hours

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**THE KENYA NATIONAL EXAMINATIONS COUNCIL**

**DIPLOMA IN BUSINESS MANAGEMENT  
DIPLOMA IN INVESTMENT 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.*

*Candidates should answer the questions in English.*

**This paper consists of 6 printed pages.**

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

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**Turn over**

1. (a) Explain **four** factors that should be considered by the management of a public limited company when designing its capital structure. (8 marks)

The following information relates to Ketami Limited for the year ended 31 December 2017:

	Ksh.
Credit sales	1,700,000
Credit purchases	720,000
Accounts receivable	480,000
Accounts payable	350,000
Cost of sales	1,840,000
Inventory (1 January 2017)	600,000
Inventory (31 December 2017)	380,000

Take one year to be 365 days.

Determine the working capital cycle of the company.

(12 marks)

2. (a) Explain **four** ways in which capping of interest rates in an economy may affect the operations of commercial banks. (8 marks)

- (b) The following capital structure relates to Zama Limited as at 31 December, 2017:

	Ksh.
2,000,000 ordinary shares of Ksh. 18 each	36,000,000
12% debentures of Ksh. 1,000 each	4,000,000
1,000,000, 10% preference shares of Ksh. 6 each	6,000,000
14% bank loan	10,000,000

The market price of an ordinary share is Ksh. 30.

The ordinary shareholders have just received a dividend of Ksh. 2 per share and it is expected to grow at 5% per annum.

Corporation tax rate is 30%.

Determine:

- (i) the cost of each component of capital;  
 (ii) the weighted average cost of capital (WACC).

(12 marks)

3. (a) Explain **four** limitations of the profit maximization goal of a firm. (8 marks)

(b) Janet intends to save an amount of money in bank X, bank Y or bank Z. She deposits Ksh. 1,200,000 at the beginning of the first year and Ksh. 800,000 at the beginning of the second year.

The following information relates to the banks:

Bank	Interest rate per annum	Terms
X	6%	Compounded quarterly
Y	8%	Simple interest
Z	7%	Compounded <u>semi-annually</u>

(i) Determine the amount of money Janet expects to receive at the end of the two years from each of the banks X, Y and Z.

(ii) Advise Janet on the bank to save in.

(12 marks)

4. (a) Explain **four** differences between ordinary shares and preference shares. (8 marks)

(b) Zango Limited intends to invest Ksh. 4,800,000 in either Project Alpha or Project Beta. The expected net cash inflows from each of the projects is as follows:

Year	Alpha Ksh.	Beta Ksh.
1	2,100,000	2,300,000
2	1,700,000	1,800,000
3	1,200,000	1,000,000
4	900,000	800,000

The company's cost of capital is 14%.

(i) Determine the Net Present Value (NPV) for each project.

(ii) Advise the management on the project to invest in.

(12 marks)

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5. (a) Explain five ways in which a multinational firm may manage foreign exchange risks. (10 marks)

(b) The following balances were extracted from the statement of financial position of Kotam Limited as at 31 December, 2017.

	Ksh.
Accounts receivable	1,200,000
Inventory (31 December 2017)	850,000
Bank	1,300,000
Creditors	700,000
Ordinary shares of Ksh. 50 each	10,000,000

Additional information:

- The net profit after tax for the year ended 31 December 2017 was Ksh. 1,500,000.
- The firm's dividend payout ratio is 40%.
- The current market price per ordinary share is Ksh. 45.

Determine:

- (i) Return on Equity (ROE);
- (ii) Dividend per share (DPS);
- (iii) Earnings per share (EPS);
- (iv) Acid Test Ratio;
- (v) Price Earnings Ratio (PIE).

(10 marks)

6. (a) Explain four ways that a firm may use to manage its book debts. ✓ (8 marks) easytvet.com

x (b) Menso Limited intends to invest Ksh. 2,000,000 in project PQ. The following are the expected net cash inflows and associated probabilities from the project under different states of economy.

State of Economy	Probability	Year 1	Year 2
		Ksh.	Ksh.
I	0.5	3,000,000	2,500,000
II	0.2	2,000,000	2,000,000
III	0.3	1,000,000	1,500,000

The company's cost of capital is 8%.

(i) Determine:

- (I) the expected net cash inflows.
- (II) the expected net present value.

(ii) Advise the management whether to invest in the project or not.

(12 marks)

7. (a) Explain five factors that should be considered when undertaking financial forecasting in a firm. (10 marks)

(b) Betah Limited intends to Purchase Four machines A, B, C and D. The company has a maximum of Ksh. 4,000,000 available for the investment. The following details relate to the machines:

Consider  
Budget

	Machine			
	A	B	C	D
	Ksh.	Ksh.	Ksh.	Ksh.
Initial cost	1,500,000	1,300,000	900,000	1,200,000
Net Present Value (NPV)	144,300	98,200	123,450	-10,500

- (i) Determine the profitability index (PI) for each machine.
- (ii) Rank the machines based on the profitability index in (i) above.

(10 marks)

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**Table A**  
Present Value of \$1 Received at the End of n Periods:  
 $PV/F, r_n = 1/(1 + r)^n$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8085	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7895	.7761	.7632	.7482	.7344	.7085	.6804	.6576	.6353
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.7050	.6875	.6707	.6508	.6326	.6057	.5766	.5536	.5307
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.6281	.6078	.5882	.5653	.5443	.5164	.4864	.4634	.4405
5	.9515	.9057	.8625	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5594	.5359	.5136	.4887	.4657	.4368	.4058	.3828	.3600
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4956	.4705	.4465	.4205	.3965	.3666	.3346	.3116	.2897
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.4398	.4136	.3885	.3615	.3365	.3056	.2726	.2496	.2287
8	.9235	.8535	.7894	.7307	.6788	.6274	.5820	.5403	.5019	.4665	.4039	.3905	.3635	.3375	.3095	.2845	.2526	.2196	.1966	.1757
9	.9143	.8368	.7664	.7026	.6446	.5819	.5439	.5002	.4604	.4241	.3605	.3471	.3201	.2941	.2651	.2391	.2072	.1742	.1512	.1303
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2997	.2727	.2467	.2177	.1917	.1608	.1278	.1048	.0839
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2658	.2389	.2130	.1840	.1580	.1281	.0951	.0721	.0532
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2376	.2107	.1848	.1558	.1308	.1019	.0689	.0459	.0310
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.2121	.1852	.1582	.1292	.1042	.0753	.0423	.0193	.0084
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1897	.1627	.1357	.1067	.0817	.0528	.0198	.0068	.0019
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1701	.1431	.1161	.0871	.0621	.0332	.0002	.0000	.0000
16	.8528	.7284	.6232	.5329	.4581	.3936	.3387	.2919	.2519	.2179	.1631	.1529	.1259	.0989	.0700	.0450	.0161	.0001	.0000	.0000
17	.8444	.7142	.6050	.5114	.4363	.3714	.3166	.2703	.2311	.1978	.1455	.1378	.1108	.0838	.0549	.0299	.0100	.0000	.0000	.0000
18	.8360	.7002	.5874	.4896	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.1246	.0976	.0706	.0417	.0167	.0007	.0000	.0000	.0000
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.1129	.0859	.0589	.0290	.0040	.0000	.0000	.0000	.0000
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	.1037	.1029	.0759	.0489	.0190	.0000	.0000	.0000	.0000	.0000
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0688	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0018	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	.0001	.0001
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	.0001	.0001	.0001	.0001
60	.5504	.3048	.1897	.0951	.0535	.0303	.0173	.0099	.0057	.0032	.0011	.0004	.0002	.0001	.0001	.0001	.0001	.0001	.0001	.0001

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