**DBM19: INTRODUCTION TO FINANCIAL MANAGEMENT**

**EXAM 2021**

**QUESTION ONE**

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

i. The payback period

ii. The average rate of return

iii. The net present value

iv. Profitability index

Which project should be accepted? Why (20 marks)

**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 value  Retained earnings  10% preference share capital Sh.20 par value  12% debenture Sh.100 par value | Shs.M  400  200  100  200  900 |

**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**

a) Determine the WACC of the firm. (10 Marks)

b) Explain why market values and not book values are used to determine the weights. (4 marks)

c) 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)