BACHELOR OF FINANCIAL SERVICES

END OF SEMESTER EXAMINATION

BFS 2202: FINANCIAL MANAGEMENT II

Date: Monday, 17th January 2022 **Time:** 2 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE

a) Read the **Case extract on Marriott Corporation** below and answer the questions that follow

The Marriott Corporation began as an A&W Root Beer stand in 1927, two years before the Great Depression. In 1937, the firm began providing in-flight catering at Hoover Field, an airfield in Arlington, VA, which is now the site of the Pentagon. Marriott went public with a share price of $10.53 in 1953 and opened its first "motor lodge" hotel in 1957. By the late 1950s, the Marriott Corporation was at the forefront of both airline food and the motel industry. By 1979, the firm had grown substantially and was diversified into Hotels (35% of sales), Contract Food Services (32% of sales), Restaurants (25% of sales), and Theme Parks and Cruise Ships (8% of sales); the firm's total sales topped $1.5 billion.

Corporate governance

The firm remained family controlled (holding 6.5 million of the approximately 36.2 million shares outstanding), and family members occupied four of the eight seats on the board of directors. At a time when there were few women or minorities on boards, the firm was also proud to be one of the few Fortune 500 firms with a woman on its board—Mom.

Policy changes

In the late 1970s, Marriott implemented a major policy change in their product market operations. Marriott went from owning their hotel properties to managing them. That is, Marriott formerly had built, owned, and operated their hotels. Now, Marriott built their hotels and then sold them to investors, while maintaining a contract to operate the facility as a Marriott hotel. As explained in Marriott's 1980 Annual Report: "This enables Marriott's hotel business to expand 25% annually without commensurate capital requirements thereby releasing investment capacity to fund additional corporate growth".

Capital structure

Around the same time, Gary Wilson, Marriott's CFO, was considering changing the firm's capital structure by issuing debt and using the proceeds to retire equity. When Gary Wilson took over as CFO of Marriott, he proposed a series of financial policies for the firm that the Board of Directors approved. These policies stated that:

I. Debt should be maintained between 40% and 45%
II. The Moody's commercial paper rating should be at P-1 or better (this is roughly equivalent to a bond rating of A or above)
III. The principal source of financing should be domestic, unsecured, long-term, fixed-rate bonds.
IV. In addition, although not formally a guideline, Marriott started paying a cash dividend in January 1978 (they had in the past paid a stock dividend).

Required

Discuss the implications for the above policies (**8 marks**)

b) Graphically illustrate the working capital finance policies
   i. Matching approach (**4 marks**)
   ii. Conservative approach (**4 marks**)
   iii. Aggressive approach (**4 marks**)

c) Teamworks Ltd. earned Kshs. 6 per share and paid Kshs.3.48 per share as dividend in the previous year. Its earnings and dividends are expected to grow at 15% for 6 years and then at a rate of 8% indefinitely. The capitalization rate is 18%.

Required:

What is the price of the share today?

(**10 marks**)

Total: 30 marks

QUESTION TWO

a) The various statements below relate the quizzes done on e-learning. Explain why the statements are TRUE/FALSE for marks allocation (**Each 2 marks**)

i. The pecking order theory is important because it signals that if a company finances itself through issuing new stock, it is normally a negative signal, as the company this its stock is overvalued and seeks to make money prior to its share price falling (**True/False**)

ii. A company's investment decisions for new projects should always generate a return that is lower than the firm's cost of the capital used to finance the project. Otherwise, the project will not generate a return for investors. (**True/False**)

iii. A country has a comparative advantage in producing a good if its opportunity cost of producing that good is less than that of its trading partner while a country has an absolute advantage in producing a good (or service) if it is able to produce that good at a lower cost or use fewer resources in its production than its trading partner (**True/False)**.

iv. An exchange rate is the value of a country's currency vs. that of another country or economic zone **(True/False**).

v. The COP26 conference and the 12th WTO Ministerial conference are some of the key moments in 2021 sustainable trade agenda (**True/False**).

b) Multiple choice questions: Each 2 marks (Marks allocated to questions showing the workings)

i. Nelson a portfolio manager is considering the purchase of a bond with a 5.5% coupon rate that pays interest annually and matures in three years. If the required rate of return on the bond is 5%, the price of the bond per Kshs.100 of par value is closest to:

a. Kshs.98.65

b. Kshs.101.36

c. Kshs.106.43

ii. Which of the following examples has been placed correctly with its international business method:

a. Franchising - Starbucks and Barnes & Noble

b. Licensing – Microsoft office

c. Strategic Alliances - McDonalds

iii. Financial markets continue to evolve, grow globally and exchange rates keep playing an increasingly large role in day-to-day global investment transactions. Which of the currency pairs below indicate one of the "Major pairs"?

a. AUD/USD - Aussie

b. USD/CHF - Swissie

c. USD/CAD - Loonie

iv. The following are post-offer takeover defense mechanisms EXCEPT?:

i. Golden Parachutes

ii. Pac-Man

iii. Greenmail

v. The Balance of payments (BOP) is composed of the current account that measures:

i. Transfers of capital

ii. Flow of goods and services

iii. Records investment flows

Total: 20 marks

QUESTION THREE

The following information is available for Jamii Ltd and Umoja Ltd to enable them to estimate their working capital.

	Jamii Ltd (Kshs.)	Umoja Ltd (Kshs.)
Material cost:		
Raw material consumed	248,000	248,000
Less: By product	68,800	68,800
Net material cost	179,200	179,200
Manufacturing cost		
Labor	171,200	171,200
Maintenance	160,000	160,000
Power and fuel	57,600	57,600
Factory overheads	240,000	240,000
Depreciation	160,000	320,000
Total manufacturing cost	788,800	948,800
Total product cost	968,000	1,128,000
Annual credit sales	1,448,000	1,448,000
PBIT	**480,000**	**320,000**
Investment	1,600,000	3,200,000
Period	1 Year	1 Year
Plant life	10 years	10 years
PBDIT	640,000	640,000
ROI/(PBIT/Investment-depreciation)	33.3%	11.1%

Assumptions regarding current assets holding period method in estimating working capital are:

Method	Assumption
Current assets holding period	Inventory: one month's supply of each of raw material, semi-finished goods and finished material. Debtors: one month's sales. Operating cash: one month's total cost-

Required

i. Estimate the working capital needs for both firms using the current assets holding period method (**15 marks**)

ii. For the method is (a) above estimate the rate of return for both firms. (**5 marks**)

Total: 20 marks

QUESTION FOUR

a) Ulinzi Ltd is evaluating two mutually exclusive projects. Project X will cost Kshs.10,000 now and will generate cash flows of Kshs.5000 each year over its life of four years. Project Y will cost Kshs.2500 and will generate cash flows of Kshs.3000 each year over its life of three years. Which project would you select assuming a risk-free cost of capital of 10 per cent? Use the annual equivalent value (AEV) method (**10 marks**)

b) Given the following statements, explain why they are TRUE/FALSE for marks allocation (**Each 2 marks**)

   i. A multinational corporation, is an international corporation that derives at least a quarter of its revenues outside its home country (**True/False**)

   ii. Cost of capital is significant in appraising the financial performance of top management and designing the debt policy of the company (**True/False)**

   iii. Working capital is a measure of a company's liquidity, operational efficiency and its short-term financial health. (**True/False**)

   iv. From the presentations on corporate restructuring: Joint Ventures vs Strategic Alliances are terms related but also very different. Starbucks and Barnes&Nobles are an example of a Joint Venture while BMW and Brilliance auto group are an example of a Strategic Alliance (**True/False**).

   v. A tender offer is an informal offer to purchase a given number of a company’s shares at a specific price and its viewed as a means for a hostile takeover when negotiations take place with the management of the target company (**True/False**)

Total: 20 marks

QUESTION FIVE

You have been requested to write a report on your video presentation, virtual tour of the Central Bank of Kenya (CBK) and e-learning discussions. The report should give a brief description on the CBK and NSE group company, guided by the following questions:

i. Chart the coupon rates of the Treasury bonds issued by the Central bank of Kenya between September 2021 – November 2021. Comment of the bond's performance in the primary market **(6 marks)**

ii. Chart the average share prices of your NSE Company (September 2021 – November 2021) and comment on the value of the company **(8 marks)**

iii. Comment on the Dividend policy of your NSE Company **(6 marks)**

Total: 20 marks