**CHUKA UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**FOURTH YEAR EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF AGRIBUSINESS MANAGEMENT**

**AGBM 413: FINANCIAL MANAGEMENT**

**STREAMS: B. AGBM Y4S1** **TIME: 2 HOURS**

**DAY/DATE: THURSDAY 7/12/2017** **11.30 A.M - 1.30 P.M.**

**INSTRUCTIONS:**
- **Question ONE is and any other TWO Questions l**
- **Do not write on the question paper**
- **Present Tables are attached at work of the back of the question paper**

**QUESTION ONE**

Explain the following sources of funds that can be used by agricultural business.

(i) Trade Credit [2 Marks]
(ii) Leasing [2 Marks]
(iii)Bank overdraft [2 Marks]

(b) ABC Ltd is considering investing in a new cooling system with the following characteristics:
- Initial investment of Kshs.7.63 million with no scrap value
- Expected Economic life of 5 years
- Sales volume of 1.12 million Litres per annum
- Selling price of Ksh.15 per Litre
- Variable cost of Kshs.11 per Litre
- Fixed cost excluding depreciation of Kshs.1.628 million per annum

The Company's hurdle rate is 15% and it uses straight line method of depreciation.
The corporate tax rate is 40%.

**Required:**

(i) Calculate the NPV of the project. [8 Marks]

(ii) Perform the sensitivity analysis (Breakeven analysis) of the project assuming that characteristics (iii) and (i) above varies adversely by 10% at different times. [10 Marks]

(c) Differentiate between the following;
- (i) Degree of financial leverage and degree of operating leverage. [2 Marks]
- (ii) Constant amount of dividend policy and constant payout ratio policy. [2 Marks]
- (iii)Allocative efficiency and operational efficiency. [2 Marks]

## QUESTION TWO

(a) The earnings yield of Excel Ltd is 20% and the current market price per ordinary share is Kshs.100. Each share has a par value of Ksh.50. The dividend for the current year is expressed as 10% of the par value of a share.

**Required: Calculate;**
- (i) Earnings per share [2 Marks]
- (ii) Dividend Cover [2 Marks]
- (iii)Dividend Yield [2 Marks]
- (iv)Prices Earnings Ratio [2 Marks]

(b) Explain the limitations of financial ratio as a tool for financial statement analysis. [4 Marks]

(c) XYZ Ltd has an average selling price of Kshs.10 per unit, variable cost of Kshs.7 per unit and total fixed cost of Khs.170,000. It finances all its assets by equity funds. It pay 35% tax on its income. ABC Ltd is identified to XYZ Ltd except in the pattern of financing. The later finances its assets by 50% debt, the interest on which amounts to Kshs.20,000. The sales are Kshs.700,000 for each firm.

**Required:**

(i) Determine the operating leverage for each firm and interpret the results. [3 Marks]
(ii) Degree of financial leverage for each firm and interpret the results. [3 Marks]
(iii)Degree if combined leverage. [2 Marks]

## QUESTION THREE

(a) Explain the following dividend theories;
- (i) Modigilian and Miller dividend Theory. [3 Marks]
- (ii) Signaling Theory [3 Marks]
- (iii)Clientele effect theory [3 Marks]

(b) ABC Ltd belongs to a risk class for which the appropriate capitalization rate is 10%. It currently has outstanding 5000 shares selling at Kshs.100 each. The firm is contemplating declaration of a dividend of Khs.6 per share at the end of the current financial year. The company expects to have a net income of Kshs.50,000 and has a proposal of making a new investment of Kshs.100,000

**Required:**

Show under MM hypothesis that payment of dividend does not affect the value of the firm.

[5 Marks]

(c) Explain why two different companies with the same capital base and same profit after tax would pay different amount of dividend per share. [4 Marks]

(d) What is the difference between Beta of a security and standard deviation of a security's return. [2 Marks]

**QUESTION FOUR**

(a) Mr. Kamau is considering investing in a project which costs Kshs.40,000. The expected returns during the life of the project are as follows:

**Year I**

| **Event** | **Cash inflow** | **Probability** |
|---|---|---|
| i | Kshs.16000 | 0.3 |
| ii | Kshs.24000 | 0.5 |
| iii | Kshs.20000 | 0.2 |

**Year 2**

| **Year 1 Cash Inflows (Kshs.)** | **16,000** | | **24,000** | | **20,000** | |
|---|---|---|---|---|---|---|
| **Year 2 Cash Inflows (Kshs.)** | **Cash Inflows** | **Prob** | **Cash Inflows** | **Prob** | **Cash Inflows** | **Prob** |
| i | 30,000 | 0.2 | 40 000 | 0.1 | 5000 | 0.2 |
| ii | 40,000 | 0.6 | 60 000 | 0.8 | 8000 | 0.5 |
| iii | 50,000 | 0.2 | 80 000 | 0.1 | 12000 | 0.3 |

Assuming the cost of capital is 10%, advice about the acceptability of the investment proposal. What is the probability of getting a negative NPV? [11 Marks]

(b) Explain the following forms of market efficiency
- (i) Weak-form [3 Marks]
- (ii) Strong-form [3 Marks]
- (iii)Semi strong form [3Marks]

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