CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

FOURTH YEAR EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF PURCHASING AND SUPPLIES MANAGEMENT AND COOPERATIVE MANAGEMENT

BPSM 402: FINANCIAL MANAGEMENT

STREAMS: BPSM (Y4S1) TIME: 2 HOURS

DAY/DATE: TUESDAY 05/12/2017 11.30 A.M. – 1.30 P.M.

INSTRUCTIONS: ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE

(a) Discuss the functions that affect the value of the firm. [6marks]

(b) A company intends to acquire a new asset to replace an existing one. The asset will costs 1, 500, 000 and an installationcost of sh. 300,000. The new assets has an economic life of 5 years and a salvage value of sh. 500,000. The old asset has a net book value of 800,000 and a market value of sh. 300,000 with a zero salvage value. The company uses straight line method of depreciation. As a result of this replacement, sales will increase from sh. 1,000,000 to 1, 400,000. In addition it will decrease the costs from 800,000 to 600,000. Tax rate is 30% and the cost of capital is 12%. Required advise the company whether it should replace the asset or not. [9 marks]

(c) A company is considering whether it should purchase a new machine to increase its production. The equipment cost sh. 500,000 and has expected life of 3 years with a scrap value of sh 80,000 sales production is expected to be 60,000 units per year. Each unit can be sold for sh. 10 per units and will incur a variable cost of sh 5 per unit. Fixed costs will be sh 90,000 per year. The costs of capital is 10% and the tax rate is 30%.

Required: the NPV of the project and by what percentage change is required in the cost ofmachine and sales revenue for the project to be undesirable. [8 marks]

(d) A company is considering investing in a project whose cost is sh. 40,000

Years	Cash flow	Certainty coefficient
1	20,000	0.9
2	17,000	0.7
3	23,000	0.8
4	12, 000	0.6

Risk free rate is 8% should the project undertaken. [4 marks]

(e) State the causes of conflicts between shareholders and auditors. [3 marks]

QUESTION TWO

(a) A company expects a net operating income of sh. 80,000. It has sh. 200,000 8% debentures and the equity capitalization rate is 10%.

(i) Calculate the value of the firm and the overall capitalization rate according to the net income approach. [3 marks]

(ii) If the debentures is increased to sh. 300,000 what will be effect on the value of the firm. [3 marks]

(b) ABC limited is evaluating new equipment for its production. The equipment has 2 years and it costs sh. 50,000. Its impact is subject to risk. In the first year management estimates that there is an equal chance that the technology will produce high returns or average returns of sh. 50,000 and sh. 30,000 second year Cashflows will be sh. 60,000 and sh. 70,000 with probabilities of 0.3 and 0.7 respectively. If they provide average returns then second year Cashflows will be 30,000 and 65,000 with probabilities of 0.6 and 0.4 respectively.

Required:

A decision tree and the expected NPV if the cost of capital is 12%. [7 marks]

(c) Discuss the components of financial planning model [4 marks]

(d) Explain any three forms of dividend. [3 marks]

QUESTION THREE

(a) XYZ currently has 5,000 outstanding shares selling at sh. 100 each. The dividend for the financial year is sh. 6 per share. The company expects a net income of sh. 50,000 and has a proposal of making new investment of sh. 100,000 show that under mm hypothesis payment of dividends does not affect the value of the firm if the equity capitalization rate is10%. [6 marks]

(b) Briefly describe the factors affecting capital structure decisions. [4 marks]

(c) The management of Bimbo limited wants to establish the amount of financial needs for two years

	Sh '000'
Fixed assets	120,000
Current assets	
Stock	40,000
Debtors	35,000
Cash	15,000
	210,000
Financed by:	
Ordinary share capital	75,000
Retained earnings	50,000
10% bond	30,000
Trade creditors	40,000
Accrued expenses	15,000
	210,000

Additional information:

(i) Sales amounted to 200 million in 31st Dec 2006. The firms projected that sales will increase by 15% in 2007 and 10% in 2008.

(ii) The after tax return on sales has been 10%

(iii) Dividend payout ratio is 75%

Required:

Determined the amount of external finance needed for two years and prepare a profoma balance sheet as at 31st Dec 2008. [10 marks]

QUESTION FOUR

(a) Explain the determinants of working capital needs of a firm.[6 marks]

(b) A company is considering relaxing its credit standards. The firms current credit terms in nest 45 but the average collection period is 75 days. Current annual sales amount to sh. 6, 000, 000, the firm wants to extend the period to 120 days. With that sales will increase by 25% and bad debts will increase from 2% to 2.4% of annual credit sales. Collection cost will increase by 80,000. The return on investment in debtors is 12% selling price per unit is 100 and the variable cost per unit is sh. 70. Assume a year has 360 days. Required should the term change the credit policy. [9 marks]

(c) A company has the following

Equity share capital	Sh.
10% preference share capital	100,000
8% debentures	125,000
Earnings before interest and tax	50,000
Tax	50%

Calculate the degree of financial leverage and give its financial interpretation. [5 marks]
