CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

RESITS/SPECIAL

EXAMINATIONS FOR AWARD OF DEGREE OF BACHELOR OF PROCUREMENT AND LOGISTICS MANAGEMENT AND BACHELOR OF PURCHASING AND SUPPLIES MANAGEMENT

BPLM 321 / BPSM 402: FINANCIAL MANAGEMENT

STREAMS: BPLM/BPSM **TIME: 2 HOURS**

DAY/DATE: MONDAY 01/02/2021 **8.30 A.M. – 10.30 A.M.**

INSTRUCTIONS: ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE

a) ABC ltd intends to acquire a new asset to replace the existing one. The new asset will cost sh 120000 and it will require an installation cost of sh 3500. The new asset has an economic life of 8 years and a salvage value of sh 20500. The old asset has a net book value of 20000 and the market value of the machine is sh 15000. The company uses straight line method of depreciation. As a result of this replacement, sales will increase from 190000 to 218500. In addition it will reduce cost from sh 170000 to sh 161000. The company tax rate is 30%. Required: advise the company whether it should replace the asset if the cost of capital is 11% (11 marks)

b) Discuss the managerial functions of the finance managers (6 marks)

c) Agency problem exists when agents pursues their own interests rather than the interest of their principles. Discuss the causes of conflicts between creditors and shareholders and solutions to these conflicts (6 marks)

d) A company has a net operating income of sh 100,000, it has 15% 300,000 bond, the equity capitalization rate is 10%.

i) Calculate the value of the firm and the overall capitalization rate using the net income approach (4 marks)

ii) What will be the effect on the value of the firm and the overall capitalization rate if bond is increased to sh 500,000 (3 marks)

QUESTION TWO

a) ABC limited is considering whether it should purchase a new machine to increase its production and sales. The machine costs sh 800000 and has an expected life of 5 years. The machine will be sold at the end of 5 years with a scrap value expected to be 5% of the initial cost. For each of the 5 years of usage the machine is expected to increase both sales revenue and operating costs by 1000000 and 600000. Depreciation is on straight line method and the tax rate is 30%.if the cost of capital is 10%. Determine the NPV of the project and by what percentage change is required in the cost of machine and sales revenue for the project to be rejected. (8 marks)

b) Differentiate between the following terms

i. Impact analysis and Break even analysis (3 marks)

ii. Expected utility of wealth and Utility of expected wealth (3 marks)

c) A company whose cost of capital is 12% and the cost of the project is 5,320,000 is considering investing in a project that has the following information.

Years	Cashflow (000)	Abandonment value (000)
1	1800	1500
2	1750	1800
3	1600	1700
4	800	500

Required: advise on the optimal time to abandon the project (7 marks)

QUESTION THREE

a) The following information has been extracted from the books of Bimbo limited

Earnings after tax	10 million
Number of outstanding shares	800000
Total dividends paid	4 million
Internal rate of return	10%
Cost of equity	15%

Required:

i) Calculate the value of the firm using Walters model (4 marks)

ii) Explain the factors affecting dividend payment of a firm (6 marks)

b) Highlight the steps involved in financial planning (6 marks)

c) Assume a project costing sh 35,000 yields the following uncertain cash flows with the corresponding certainty equivalent coefficients. Determine the net present value if the cost of capital is 12% (4 marks)

Years	Cash flows	Certainity coefficient
1	28000	0.9
2	16000	0.6
3	14000	0.8
4	15000	0.5

QUESTION FOUR

a) Discuss the determinants of working capital needs of a firm (5 marks)

b) A company requires 12,500 units of a component in its manufacturing process which costs sh 200 each. The items are available locally and the lead time is 3 weeks. Each order costs sh 250 and the holding cost is sh 100 to prepare. The company considers giving a quantity discount of 20% if a minimum of 500units are ordered advise whether the quantity discount should be given. (7 marks)

c) Suppose a new firm is being formed. The management is expecting a before tax rate of return of 50% on the estimated total investment of sh 8million. The alternative plans available are:

i) Raising the entire funds by issuing 800,000 ordinary shares at sh 10 per share

ii) Raising sh4,000,000 by issuing 400,000 ordinary shares at sh 10 pers share and borrow sh 4,000,000 10% debt

iii) Tax rate is 30%

Required:

i) Show the effect of each alternative plan on earnings per share and return on equity (6 marks)

ii) Calculate the gain from financial leverage (2 marks)
