CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION AND MASTER OF PROCUREMENT & LOGISTICS MANAGEMENT

MBAD 831: FINANCIAL MANAGEMENT

STREAMS: MBAD /MPLM **TIME: 3 HOURS**

DAY/DATE: TUESDAY 06/04/2021 **8.30 A.M. – 11.30 A.M.**

INSTRUCTIONS: ANSWER ALL QUESTIONS

QUESTION ONE

(a) State and discuss five functions of financial management [10 marks]

(b) Discuss the nature and purpose of capital budgeting [5 marks]

(c) Rosy Bakeries specializes in the making of cakes and other pastries. The company is considering purchase of a new machine for putting icing and other toppings on pastries. Currently these processes are done manually. The machine costs sh. 465,000. Installation costs are estimated at sh. 15,000. The machine will have an economic life of 6 years but would require an overhaul at the end of the fourth year. The overhaul will cost sh. 37, 500. After six years, the machine could be sold for sh. 30,000. The company uses the straight line method of providing for depreciation and is in the 30% income tax bracket.

The bakery estimates that it will cost sh. 70,000 per year to operate the new machine. The present manual method of putting pastries cost sh. 175,000 per year. In addition to reducing operating costs, the new machine will allow the bakery to increase its margin of sh. 30 per package and requires a 16% return on all investments in equipment.

Using the NPV criteria, advise the company if it will be viable to acquire the new machine.

[15 marks]

QUESTION TWO

Com-Tech company ltd., is in the Telecommunications industry. The company's balance sheet as at 31st March 2014 is a below:

Liability and owners' equity	Sh. 000	Assets	Sh. 000
Current liabilities	12,500	Current assets	32,500
18% debentures (sh. 1,000 par)	16,000	Fixed assets	42,875
10% preference shares	6,250		
Ordinary shares (sh. 10 par)	12,500		
Retained earnings	28,125		
	75,375		75,375

Additional information:

1. The debentures are now selling at sh. 950 in the market and will be redeemed 10 years from now
2. By the end of the last financial period, the company had declared and paid sh. 5.00 as dividend per share. The dividends are expected to grow at an annual rate of 10% into the foreseeable future. Currently, the company's shares are trading at sh. 38 per shae at the local stock exchange.
3. The preference shares were floated in 2009 and their prices have remained constant.
4. Most banks are lending money at an interest rate of 22% per annum.
5. The corporation tax rate is 40% per annum.

Required:

(i) Calculate the market weighted average cost of capital for this firm [15 marks]

(ii) Discuss the need of having a stable dividend policy [5 marks]

QUESTION THREE

(a) A company that produces a single product has the following details

(i) The selling price for the product is sh. 1,200

(ii) The variable cost per unit is sh.800

(iii) Total fixed cost amount to sh. 12,500, 000 for a sales level of 100,000 units

(iv) The company has employed debt finance to the extent of sh. 20,000,000 at an annual interest rate of 12%.

You are required to calculate the Degree of Financial Leverage for this company. [4 marks]

(b) Explain the follow approaches to capital structure planning

(i) Cash flow approach [4 marks]

(ii) Pecking Order Hypothesis [4 marks]

(c) List and briefly explain factors variables or factors that may affect the composition and the amount of funds in the capital structure of a business enterprise. [8 marks]

QUESTION FOUR

P ltd has an expected return of 22 per cent and a standard deviation of 40 per cent. Q ltd has an expected return of 24 per cent and standard deviation of 38 per cent. P has a beta of 0.86 and Q 1.24

Required:

(a) Is investing in P better than investing in Q? [3 marks]

(b) If you invest 30% in Q and 70% in P, what will be the expected rate of return of the portfolio? [3 marks]

(c) What is the market portfolios expected rate of return and how much is the risk free rate? [10 marks]

(d) What is the beta of the portfolio if P's weight is 70% and Q is 30%? [4 marks]
