

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF BACHELOR OF PROCUREMENT AND LOGISTICS MANAGEMENT, COOPERATIVE MANAGEMENT AND AGRIBUSINESS MANAGEMENT

BPLM 321: FINANCIAL MANAGEMENT

STREAMS: Y3S1

TIME: 2 HOURS

DAY/DATE: WEDNESDAY 4/12/2019

8.30 A.M – 10.30 A.M

INSTRUCTIONS

Answer question one and any other two questions

1. (a) Agency conflict exists when agents pursue their own interest rather than the interest of the principals. From this context discuss the causes of conflicts between shareholders and managers and their solution . [8 marks]

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

Earnings after tax	12,000,000
Number of outstanding shares	1,500,000
Internal rate of return is	20%
Dividend payout ratio	60%
Market price of a share	100

Calculate the cost of equity . [4 marks]

- (c) A company is evaluating new equipment for its production . The equipment has 2 years and costs ksh 250,000. In the first year the equipment ha an equal chance of producing high cash flows of ksh 155,000 and average cash flows of 130,000 respectively. If it generates high cash flow the second year cash flow will be 120,000, 140,000 and 180,000 with associated probabilities of 0.5,0.2 and 0.3 respectively. If they generate average cash flows the second year cash flows will be 200,000. 240,000 and 260,000 with associated probability of 0.4, 0.3 and 0.3

respectively. Required a decision tree depicting this information and the expected net present value. [7 marks]

(e) state two advantages of decision tree technique. [2 marks]

(f) Assume a company has 2 assets i and j . Asset i has a probability of 40% of generating a return of ksh 20 and 60% chance of generating a return of ksh 10. Asset j has a probability of 20% of generating a return of ksh 18 and 80% of generating a return of ksh 15.

Required :

Calculate the expected utility of wealth of each asset and advise on which asset to invest in . [5 marks]

(g) Distinguish between capital budgeting decision and liquidity decisions. [4 marks]

QUESTION TWO

(a) Bimbo limited is considering investing in six projects whose information is provided below.

Projects	Initial cost(000)	Annual cashflows (000)	Useful life
A	18	7	6
B	25	8	3
C	17	5	5
D	15	2.5	10
E	7	3	8
F	10	4	12

Additional information

(i) Project B and E are mutually exclusive
 (ii) Cost of capital is 10% and the company has a limit of 50,000. Determine the optimal allocation of 50,000 among the projects if the projects are divisible. [7 marks]

(b) Describe the factors affecting the capital structure decisions. [6 marks]

(c) A company expects a net operating income of ksh 60,000. The overall cost of capital is 5% and it has 6% ksh 300,000 bond.

Required :

- (i) Calculate the equity capitalization rate and the value of the firm under the net operating income approach. [4 marks]
- (ii) Highlight the assumptions of net operating income approach. [3 marks]

QUESTION THREE

- (a) Explain the factors affecting dividend payment of a firm. [5 marks]
- (b) The following information has been extracted from the books of Bimbo limited.

Earnings after tax	30,000,000
Number of outstanding shares	3,000,000
Dividend payout ratio	70%
Cost of capital	10%
Internal rate of return	12%

Required :

- Calculate the value of the company using walters model. [4 marks]
- (c) Explain the various components of financial planning model. [4 marks]
- (d) The management of ABC limited wants to establish the amount of financial needs for three years.

	Ksh ‘000’
<u>Fixed assets</u>	
Land	10,000
Plant and machinery	70,000
Equipment	50,000
<u>Current assets</u>	
Stock	50,000
Debtors	30,000
Cash	<u>10,000</u>
	220,000
	=====
Financed by:	
Ordinary share capital	90,000
Retained earnings	50,000
10% bond	25,000
Trade creditors	40,000
Accrued expense	<u>15,000</u>
	220,000
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Additional information:

- (i) Sales amounted to 250 million in 31st Dec 2006. The firms projected that sales will increase by 15% in 2007 ,10% in 2008 and 20% in 2009.
- (ii) The after tax return on sales has been 12%
- (iii) Dividend payout ratio is 70%

Required :

Determine the amount of external finance needed for three years . [7 marks]

QUESTION FOUR

- (a) Assume the following information

	2018	2019
Sales volume(units)	100,000	120,000
Selling price per unit	60	80
Variable cost per unit	25	35
Fixed cost	1,000,000	1,400,000
10% ksh 5,000,000 debentures		
Tax rate	30%	30%

Required :

Degree of operating financial and combined leverage. [8 marks]

- (b) Highlight the strategies that the firm employs in managing its cash. [3 marks]

- (c) A company has set the minimum cash balance to be equal to ksh 20,000. The variance of the daily cash flow is 4,000,000 and the interest rate on marketable securities is 25% per annum. The transaction cost is ksh 50.

Required : Target cash balance, average cash balance and the spread. [6 marks]

- (d) Using examples differentiate between credit terms and collection policy. [3 marks]