CHUKA **UNIVERSITY**

UNIVERSITY EXAMINATIONS
RESIT/SPECIAL EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF PURCHASING AND SUPPLIES MANAGEMENT

BPLM 321/BPSM 402: FINANCIAL MANAGEMENT

STREAMS: **TIME: 2 HOURS**

DAY/DATE: THURSDAY 26/07/2018 **8.30 A.M– 10.30 A.M**

INSTRUCTION:

- **Answer question one and any other two questions**

1. (a) ABC ltd intends to acquire a new asset to replace the existing one. The new asset will cost ksh 6,000,000 and it will require an installation cost of ksh 400,000. The new asset has an economic life of 10 years and a salvage value of ksh 800,000. The old asset has a net book value of 600,000 and the market value of the machine is ksh 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 1,200,000 to 1,800,000. In addition it will increase cost from ksh 600,000 to ksh 720,000 and commitment of 5 million in raw materials, 1.5 million in debtors and 4.5 million in creditors. The company tax rate is 30% and the cost of capital is 12%. Required: advise the company whether it should replace the asset. [9marks]

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

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

(d) Assume a project costing ksh 40,000 yields the following uncertain cash flows with the corresponding certainty equivalent coefficients. Determine the net present value if the cost of capital is 12%. [4marks]

Years	Cash flows	Certainty coefficient
1	20000	0.9
2	15000	0.8
3	10000	0.6
4	8000	0.4

(e) Discuss the factors affecting the capital structure decisions of a firm. [5marks]

2. (a) ABC limited is considering whether it should purchase a new machine to increase its production and sales. The machine costs ksh 800,000 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 increase 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 1,000,000 and 600,000. 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. [8marks]

(b) Assume the project has the following cash flows. The cost of capital is 10%. Determine the projects expected net present value using a decision tree and advise whether the investment is financially viable if the cost of capital is ksh 50,000.

[6marks]

Year 1		Year 2	
Cash flows	Probability	Cash flow	Probability
16000	0.4	30000	0.2
		40000	0.6
		50000	0.2
24000	0.6	40000	0.3
		60000	0.5
		80000	0.2

(c) Explain the factors affecting the reverage decisions of a firm. [6marks]

3. (a) Highlight the steps involved in financial planning. [7marks]

(b) The following is the balance sheet of Bindo limited as at 31st December 2014

	Ksh (000)
Fixed assets	
Land	5000
Machinery	4000
Equipment	3000
Current assets	
Cash	500
Debtors	3000
Stock	4500
	20000
Financed by :	
Ordinary share capital	8500
Retained earnings	3500
15% long term loan	2500
Creditors	3500
Accrued expenses	2000
	20000

Additional information

The sales for the year ended 31st December 2014 amounted to 30 million. The sales will increase by 10% in 2015 and 20% in 2016.

The after tax profit on sales is 15%

The company's divided payout ratio is 60%

Any external financing will be affected through the use of commercial paper.

Required :

(i) Determine the amount of external financial requirements for the year 2015 and 2016 . [7marks]

(ii) Prepare a proforma balance sheet as at 31st December 2016. [6marks]

4. (a) Briefly discuss the determinants of working capital needs of a firm. [6marks]

(b) The following information relates to XYZ limited.

Sales volume	12000 units
Variable cost per unit	ksh 100
Selling price per unit	ksh 150
Fixed cost	ksh 120,000
15% debenture	ksh 150,000

Determine the degree of operating, degree of financial and degree of combined leverage.

[6marks]

(c) A company has a net operating income of ksh 100,000, it has 15% 300,000 bond, the equity capitalization rate is 10%. Calculate the value of the firm and the overall capitalization rate using the net income approach. [4marks]

(d) Explain the different dividend policies that a company may adopt. [4marks]
