CHUKA **UNIVERSITY**

UNIVERSITY EXAMINATIONS
RESIT/SPECIAL EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 335/BUST 412/BCOM 337: FINANCIAL MANAGEMENT

STREAMS: **TIME: 2 HOURS**

DAY/DATE: WEDNESDAY 12/09/2018 **2.30 P.M – 4.30 P.M**

INSTRUCTIONS:

- **Answer Question ONE and any other TWO questions.**
- **Do not write on the question paper.**

QUESTION ONE

(a) Explain any four major functions of a finance manager in a large organization. [4 Marks]

(b) The following information is provided for Project A that the management of Company XYZ Ltd intends to invest in. Depreciation for the project is done on straight line basis.

Initial Cash Outlay Kshs.100,000
Estimated Economic Life 5 Years
Scrap Value Kshs.10,000 Profit after tax:
End of year 1 Kshs.6000
2 Kshs.14000
3 Kshs.24000
4 Kshs.16000
5 NIL **Required: Calculate**

(i)NPV of the project and advise the management. [8 Marks] (ii)Payback period of the project. [2 Marks]

(c)Explain the following sources of funds;

Trade credit [2 Marks]

Invoice discounting. [2 Marks]

Mortgage Finance [2 Marks]

(d) Explain the agency problem between shareholders and managers and show how such conflict can be resolved. [6 Marks]

(e) Why do we value Financial Assets? [4 Marks]

QUESTION TWO:

XYZ Company Ltd has a current dividend of Kshs.2 per share and dividend is expected to grow at a rate of 5% p.a for the next 5 years and then at 8% p.a thereafter into perpetuity. The opportunity cost of capital is 10%.

Required:

Determine the intrinsic value of the company's share [6 Marks]

(a) Discuss the wealth maximization goal of affirm. [5 Marks]

(b) Mary deposits Kshs.100,000 at the beginning of each year for 10 years. If she decides to withdraw the amount after 10 years, how much will she withdraw all together if the interest rate is 10% p.a. [3 Marks]

(c) What is the significance of the overall cost of capital in a firm? [4 Marks]

(d) What is a financial asset? [2 Marks]

QUESTION THREE:

(a) The earnings yield of Excell Ltd is 20% and the current market price per ordinary share is sh.100. Each share has a par value of sh. 50. The dividend for the current year is expressed as 10% of the par value.

Required:

Compute the following financial ratios

(i) Earnings per share [2 marks]

(ii) Dividend cover [2 marks]

(iii) Price earnings ratio [2 marks]

(b) The following information related to Juba Ltd a company quoted on the securities exchange

- The dividend per share for the year ended 31 December 2007 was sh. 2.50
- The dividend is expected to increase at a rate of 15% per annum for the next two years after which the growth rate would stabilize at 5% per annum. - The required rate of return is 10%

Required:

Calculate the theoretical value of the share. [6 marks]

(c) Suppose a new firm, bright ways ltd is being formed, the management of the firm is expecting a before tax rate of return of 30% on the estimated total investment of sh.1,000,000. The firm is considering two alternative finance plans as follows:

(i) To raise the entire funds by issuing 100,000 shares at sh.10 per share or

(ii) To raise sh.250,000 by issuing 25000 ordinary shares at sh.10 per share and borrow the balance at 15% rate of interest.

The tax rate is 40%

Required:

(i) Show the effect of alternative financial plans on EPS and ROE. [6 marks]

(ii) When does a firm have a positive financial leverage. [2 marks]

QUESTION FOUR:

(a)Betty Muyes has invested 75% of her funds in shares of Company X and 25% in shares of Company Y. The following probability distribution relates to the shares of the two companies.

State of economy Probability Return on Company X Return on

		Shares (%)	Company Y Shares (%)
Boom	0.2	24	5
Steady growth	0.6	12	30
slump	0.4	0	-5

Required:

(i) Expected returns on the shares of Companies X and Y. [2 marks]

(ii) Standard deviation of returns on shares of Companies X and Y. [2 marks]

(b)Distinguish between weighted average cost of capital and marginal cost of capital. [4 marks]

(c)The following was the Capital structure of Fahari Ltd as at 31 October 2007:

	Sh.
Ordinary share capital (Sh.10 par)	10.0 million
12% preference share capital (Sh.20 par)	4.8 million
10% debentures (Sh.1000 par)	3.6 million

Additional information:

1. The market prices per ordinary share, preference share and debenture were Sh.45, Sh.30 and Sh.1200 respectively on 31 October 2007.

2. The dividend per ordinary share for the year ended 31 October 2006 was Sh.8.00. Dividends are expected to grow at an annual rate of 12%.

3. The rate of corporation tax is 30 percent.

Required:

(i) The Weighted Average Cost of Capital. [10 marks]

(ii) The relevance of the WACC in decision making by Fahari Ltd. [2 marks]
