

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 337: FINANCIAL MANAGEMENT

STREAMS:

TIME: 2 HOURS

DAY/DATE: THURSDAY 13/04/2023

11.30 A.M. – 1.30 P.M.

INSTRUCTIONS

- Answer QUESTION ONE and any other TWO

QUESTION ONE

- a) A car hire company has six projects to implement but its faced with a shortage of capital. The amount of capital available for investment is Sh. 100,000,000 only. Luckily, the projects are divisible i.e. part of the project can be undertaken profitable.

Project	Outlay Sh.	NPV Sh.
A	20,000,000	8,000,000
B	40,000,000	28,000,000
C	35,000,000	37,500,000
D	50,000,000	31,500,000
E	15,000,000	3,500,000
F	45,000,000	-5,000,000

Which project (s) should be chosen?

(10 marks)

- b) In January 2021, an investor is considering investing in a project in North Eastern Kenya. He estimates that the project will cost Sh. 40,000,000. Random Researchers have given the following figures to the investor relating to the expected cash flows.

End Year	Cash flows
2021	10,000,000
2022	20,000,000
2023	30,000,000
2024	20,500,000
2025	30,000,000

Mr. Daniel Mworira a famous statistical analyst, who have worked for long in the North Eastern Kenya, advises the investor to attach some certainty equivalent to the cash flows as follows

(10 marks)

c) Is the concept of agency theory applicable to the public sector? Explain

(10 marks)

QUESTION TWO

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 costs 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, degree of operating leverage and degree of combined leverage for this company. (10 marks)

b) Discuss the reasons motivating the increasing interest in Corporate governance (10 marks)

QUESTION THREE

a) State three uses to which the Weighted Average Cost of Capital (WACC) can be put.

(3 marks)

b) State three difficulties associated with the use of the Weighted Average Cost of Capital (WACC) (3 marks)

c) Upendo Limited has provided the following balance sheet at 20 June 2007.

	Sh.		Sh.
Cash	200,000	Accounts payable	400,000
Debtors	400,000	12% preference shares	400,000
Stocks	600,000	Long-term debt	800,000
Fixed assets	<u>3,600,000</u>	Ordinary share capital	<u>3,200,000</u>
	<u>4,800,000</u>		<u>4,800,000</u>

The cost of equity is 18% and the interest on debt is 12 per cent. Calculate Upendo's After tax Weighted Average Cost of Capital assuming that taxation amount to 30%. (8 marks)

- d) A company is in a risky industry with a beta coefficient of 1.45. Treasury bills are currently paying 11% interest per annum and the market rate of return is 14%. The tax rate applicable to all the companies is 30%. Estimate the cost of equity for this company using the capital Asset pricing Model (CAPM) (6 marks)

QUESTION FOUR

Sunny Ltd. is evaluating whether to replace an old printing machine with a new one. The following information relate to the two machines.

	Old machine	New machine
Original cost Sh.	825,000	1,100,00
Estimated life years	10	5
Estimated salvage value Sh.	55,000	110,000
Depreciation method	Straight line	Straight line
Book value Sh.	385,000	
Market value Sh.	165,000	
Savings in production Sh.		143, 000 per annum

The company's marginal tax rate is 40% and the cost of capital is 14%.

Required

Using the NPV method, analyze the replacement decision and state whether or not the old machine should be replaced. (20 marks)
