

CHUKA



UNIVERSITY

UNIVERSITY EXAMINATIONS

CHUKA, CHOGORIA AND EMBU CAMPUSES

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF EDUCATION
ARTS

BCOM 337: FINANCIAL MANAGEMENT

STREAMS: B.ED Y4S1

TIME: 2 HOURS

DAY/DATE: THURSDAY 19/12/2024

2.30 P.M – 4.30 P.M.

INSTRUCTIONS:

- ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS.

QUESTION ONE

- a) A project with an initial outlay of sh 500,000 promises the following Profit before depreciation and tax.

Years	Profits before depreciation and tax
1	180,000
2	160,000
3	150,000
4	140,000
5	120,000

Depreciation is on straight-line method, tax rate is 30%, scrap value is 50,000 and the cost of capital is 10%. Determine the NPV, PI and IRR. (11 marks)

- b) Agency problem exists when agents pursues their own interests rather than the interest of their principles. Discuss the causes of conflicts that occurs when shareholders pursues their own interest rather than the interest of creditors and the solutions to the conflicts.

(6 marks)

- c) Discuss the functions of the finance manager.

(5 marks)

d) A company whose cost of capital is 11% and the cost of the project is 40,000 is considering investing in a project that has the following information

Years	Cash Flows	Abandonment Value
1	10,000	12,000
2	12,000	10,000
3	14,000	8,000
4	20,000	5,000

Required: advise on the optimal time to abandon the project (8 marks)

QUESTION TWO

a) The following is the capital structure of Shirandula company

	Sh (000)
Ordinary shares (sh 30 par)	9,000
12% Preference shares (sh 15 par)	6,000
10% Debentures (sh 100 par)	4,000
15% Medium Term Loan	5,000
Retained Earnings	<u>4,000</u>
	<u>30000</u>

Additional information

- i) The company expects to pay a dividend of sh 15 per share which is expected to grow at 10%. The current market price of the ordinary shares is sh 75 including sh 15 as floatation cost
- ii) The 12% preference shares will mature in 100 years and currently sell for sh25
- iii) The 10% debentures currently sell for sh 150 and will mature in 20 years
- iv) The medium term loan currently sell at sh 4,000,000
- v) The tax rate is 30%

Required calculate the Weighted average cost of capital (WACC) (12 marks)

b) Describe the factors that affect the cost of finance. (8 marks)

QUESTION THREE

a) The following data is available for a certain firm

Units sold	200,000 units
Selling price per unit	Sh 150
Variable cost per unit	Sh 80

Fixed cost	Sh 4,000,000
20% Bond	Sh 10,000,000
Tax rate	30%
Number of outstanding shares	1,400,000

Required:

- i) Determine the degree of operating, financial, and combined leverage and interpret its meanings. (10 marks)
 - ii) Differentiate between operating and financial leverage. (3 marks)
- b) Assume that a project has the following cash flows. The cost of capital is 14%. Determine the projects expected net present value using a decision tree and advise whether the investment is financially viable if the cost of the project is sh 20,000 (7 marks)

YEAR ONE		YEAR TWO	
Cash flow	Probability	Cash flow	Probability
10,000	0.6	12,000	0.3
		15,000	0.4
		20,000	0.3
15,000	0.4	14,000	0.2
		16,000	0.3
		18,000	0.5

QUESTION FOUR

- a) A Company is considering investing in a project that promises profit before depreciation and tax of sh 80,000 each year for 4 years. The cost of the project was sh 250,000 with sh 50,000 as the salvage value. Depreciation is on straight-line method and the tax rate is 40%. Required: calculate the Accounting rate of return for the project. (6 marks)
- b) A company currently pays a dividend of 20 per share. The dividend is expected to grow at 8% for 3 years, 10% for 3 years and 15% for 2 years after which it will fall to a constant rate of 11%. Calculate the intrinsic value of the share if the required rate of return is 15% (10 marks)
- c) State the reasons for valuation of securities. (4 marks)

