



(Knowledge for Development)

KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS
2020/2021 ACADEMIC YEAR
SECOND YEAR FIRST SEMESTER
MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCF 211

COURSE TITLE: FINANCIAL MANAGEMENT

DATE: 20-5-21 TIME: 9-11 AM

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

SECTION A (COMPULSORY)

QUESTION ONE (30MARKS)

- a) Define the term agency relationship as used in corporate management and explain what you would consider to be the cause of conflict of interest between shareholders and debt holders (6 marks)
- b) Explain how the objective of wealth maximization differs from that of profit maximization for a company listed at the securities exchange (6 marks)
- c) Explain factors that should be taken into account by a business person in making the choice between financing by short-term and long-term source (6 marks)
- d) Alpha Ltd requires a return on investment of 24 % on proposed investment projects whose total cost is sh. 5,000,000. In order to finance these investment projects, the company is considering two options.

Option A

Issue 500,000 ordinary shares at par value of sh.10 each.

Option B

Issue 250,000 ordinary shares at par value of sh.10 each and obtain the balance through a bank loan at an interest of 15% per annum.

The corporation tax rate is 30%.

Required:

Determine the effect of the two financing options on the earnings available to shareholders and advice the company on the best financing option (6marks)

- e) ABC Ltd had the following pattern of earnings per share (EPS) over the last five years;

Year	2013	2014	2015	2016	2017
Earnings per share	Sh.4.00	Sh.4.20	Sh.4.41	Sh. 4.63	Sh. 4.86

The company maintained a constant dividend payout ratio of 40 %. The company's required rate of return is 13%.

Required:

The company's theoretical value of the share (6 marks)

SECTION B

ANSWER ANY TWO QUESTIONS

QUESTION TWO

- a) Explain Four factors that may influence the value of market value of bonds (8 marks)
- b) Bungoma Processors Ltd, a company quoted on the Securities Exchange had the following capital structure as at 31 December 2017.

	Sh.(000)
Ordinary share capital sh.20 per value	10,000
Retained earnings	12,000
12% preferred share capital sh.10 per value	4,800
10% debentures (sh. 1,000)	7,200
Total	34,000

Additional information:

- 1) The current market price per ordinary share, preference share and debenture is sh. 50, sh. 24 and sh.1, 200 respectively.
- 2) For the year ended 31 December 2017, the company had paid an ordinary dividend of sh.6.00 per share. A financial analyst estimates that the company's earnings and dividends will grow at an annual rate of 15 % indefinitely.
- 3) The corporation tax rate is 30 percent.

Required:

The company's market weighted average cost of capital (12 marks)

QUESTION THREE

- a) Explain five features of an ideal investment appraisal method (6 marks)
- b) XYZ Ltd is evaluating an investment project which requires the importation of a new machine at a cost of sh.2, 700,000. The machine has a useful life of six years.
 - i) The following additional costs would be incurred in relation to the machine.

	Sh.
Freight	225,000
Installation and preproduction Testing	375,000
Import duty	375,000
Total	900,000

- ii) The machine is expected to increase the company annual cash flows before tax as shown

Year	1	2	3	4	5	6
Cash flow (sh.)	1,760,000	1,360,000	1,050,000	900,000	840,000	750,000

- iii) The machine is to be fully depreciated over its useful life using the straight line method.
 iv) The cost of capital is 12% and the corporation tax is 30%
 v) The maximum acceptable payback period to the company for all projects is four years.

Required :

- i) Payback period for the machine (4marks)
 ii) Net present value of the machine (7 marks)
 iii) Advise the company on whether to import the machine based on your results in (ii) and (iii) above (3 marks)

QUESTION FOUR

- a) Distinguish between compounding and discounting of cash flows (5 marks)
 b) Mjenzi Ltd has constructed a commercial building at Kibabii Township. The management of the company intends to sell the building at sh. 8,400,000. However, Mzee Mali has decided to rent the building for student's accommodation for a period of 8 years at a fixed annual rent of sh. 160,000. At the end of the period, the building will be sold.

An estate adviser estimates that the price of the building will increase by 3% per annum. The company cost of capital is 5%.

Required :

- Advise the company on whether to sell or rent out the building (9 marks)
 c) An investor is considering two projects; N and M for investment. The probabilities and returns for either project are as shown.

Probability	Returns of N	Returns of M
0.3	12%	10%
0.2	14%	11%
0.1	18%	13%

0.4	11%	9%
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Required:

- i) Expected returns (3 marks)
- ii) Standard deviation (4 marks)
- iii) Coefficient of variation (2 marks)
- iv) From your computations, recommend the type of project one can choose for investment (2 marks)

QUESTION FIVE

- a) Explain three approaches that could be used to finance the working capital needs of a company (6 marks)
- b) Enumerate four ways in which the dividends decision affects the wealth maximization goal of a company quoted in the Security Exchange (8 marks)
- c) Mambo Ltd has provided the following financial statement for the year ended 31 December 2016.

Item	Amount at start (sh.)	Amount at end (sh.)
Inventory	17,340,000	15,960,000
Accounts payable	42,240,000	37,250,000
Accounts payable	35,510,000	27,370,000
Net sales		120,000,000
Cost of sales		92,000,000

Required:

The operating and conversion cycles assuming that the year has 360 days (6 marks)